EXECUTIVE SUMMARY

The market for India-based IT services continues to grow quickly. The Indian providers that pioneered this market — HCL, Infosys, Satyam, TCS, and Wipro — have become mainstream global service providers and now compete head to head with the likes of Accenture and IBM. Unfortunately, this success and accompanying maturity have caused erosion of some of the key benefits these providers used to deliver, primarily flexibility and client responsiveness. Today, clients that want influence and flexibility in addition to quality and efficiency, without spending $100 million per year, are looking at the increasingly impressive array of midtier providers. To help understand the field of smaller, yet reputable, midtier global providers, Forrester plans to highlight several of them over the coming months. Hexaware, Syntel, and US Technology are three that provide high quality, low cost IT services as well as the flexibility and client service many Indian provider clients grew to expect and now sometimes miss.

TIER ONE PROVIDERS EXPERIENCE DRAMATIC GROWTH

The top Indian providers have grown dramatically almost since their inception. Earlier this year, several of India’s tier one providers announced their fiscal year 2007 revenues, and their growth rates are out of sight, a good news/bad news story (see Figure 1). The good news is that these providers have matured dramatically, moving up the value chain to compete with traditional IT consulting providers and outsourcers.

The Growth Has A Downside

The bad news is that with that growth comes some degradation in the service that clients are used to receiving from their Indian partners. This is manifesting itself in several ways:

• **Costs are going up.** Although rates are not inflating as rapidly as wages, they are increasing because supply exceeds demand for many skill categories. In addition, Indian provider overhead is increasing as real estate costs escalate, training requirements become more important, and the Indian rupee continues to appreciate against US and European currencies. Larger providers tend to have larger overhead because of the additional benefits they are able (and required) to deliver.

• **Providers are more rigid.** To accommodate this rapid growth, providers must establish and adhere to more rigid processes. In the past these providers were inclined to have staff work overtime to satisfy a client requirement or deadline. Today, they are much less willing to do so without agreements from the client related to overtime pay or complementary scope decrease. Another
example is related to provider staff evaluation. In the past, providers typically allowed clients
to interview staff or review staff résumés. Today, some top tier Indian providers simply will not
allow this, albeit for some very good reasons. Still, this can make clients that are less mature in
their outsourcing approach uncomfortable. Also, providers are having a hard time delivering
incremental staff to clients in a short time frame. The fastest growing providers simply don’t
have the bench or the ability to quickly hire the way they used to.

- **Clients do not have the degree of influence they used to.** Unless they’re spending a
tremendous amount of money ($20 to $100 million per year), some clients do not have the
influence they used to have with the top tier providers. These providers are increasingly willing
to walk away from business rather than make concessions or alterations that don’t suit them.

- **Client service shortfalls.** One Forrester financial services client (that spends approximately
$22 million per year with a tier one Indian provider) has had a difficult time getting the new
account manager and head of the financial services group to return calls. The client wanted to
discuss contract terms and provisions, as its contract is about to expire. The client’s original
account manager (who was both client service focused and intimate with the client) had left the
company. The client finally asked Forrester to make some inquiries in order to get the providers’
attention. We found this behavior surprising, given the quality, prestige, spend, and potential
spend of the client as well as the quality, prestige, and reputation of the provider. Clearly, the
providers are growing at such a rate that they can barely keep up with their most lucrative
clients, never mind their second tier clients.

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**Figure 1 The Top Three Indian Providers Experience Dramatic Growth**

![Chart showing export revenues for financial years 2004 and 2007](chart.png)

- **Export revenues for financial year 2004**
  - Top three providers ($3.5 billion) 26%
  - Other firms ($9.9 billion) 74%

- **Export revenues for financial year 2007**
  - Top three providers ($9.5 billion) 41%
  - Other firms ($13.5 billion) 59%

**Base: Indian IT services firms**

*The Indian financial year ends on March 31.*

Source: Forrester, Nasscom, and company reports

Source: Forrester Research, Inc.
SMALLER PROVIDERS OFFER AN ALTERNATIVE, BUT ARE NOT ALWAYS A SOLUTION

A comparatively small number of offshore players in India, in particular, the top three, are performing exceedingly well, but there are more than 500 small and medium-size firms that might not be as stable or as well-qualified as clients might expect. Forrester has found that the rapid growth of larger firms is proving detrimental to many small to mid-size providers. As many of these smaller players are incapable of differentiating their offerings, they are, by and large, beaten by the scale and volume pricing of the top Indian firms.

Despite these caveats, Forrester has found that firms that specialize can win in this competitive market. What's more, these firms provide a super valuable option for clients frustrated by diminished or even absent client service from the larger players. Although not all are a safe bet, midtier players with clearly specialized offerings and a disciplined approach to vertical solutions can provide a valid alternative for services clients.

One Solution: Find A Slightly Smaller, But Highly Qualified Provider

There are many smaller, reputable providers that can deliver the cost and quality benefits as well as the flexibility and client service benefits buyers have come to expect. Some midtier providers specialize in certain vertical or horizontal areas in order to differentiate and better compete. Others are more full service players that emphasize their client intimacy and price competitiveness. The three providers profiled here are strong, midtier providers that are willing to go the extra mile to accommodate their clients. In addition, each of the three firms profiled reported attrition rates below the industry average of 20%. Large companies that work with these providers sometimes view them as “virtual captives.” The level of control and provider flexibility make the client feel as though it's dealing with an internal IT arm. The following three midtier providers offer strong options for clients.

THREE MIDTIER FIRMS USE SPECIALIZATION AND CLIENT SERVICE TO COMPETE AND WIN

Hexaware

Founded in India in 1990, Hexaware began operations in both North America and Europe in 1995. Initially, the firm offered a broad array of application maintenance and development skills, but by the late 1990s had established a significant PeopleSoft practice. In fact, Hexaware did product development and support for PeopleSoft. After acquiring PeopleSoft, Oracle decided to acquire Hexaware’s PeopleSoft development and support center. Although many of its PeopleSoft resources left Hexaware at this point, the company still has deep HR expertise and a strong PeopleSoft bench as a souvenir. Although small (approximately $200 million and 6,000 employees), Hexaware has strong global capabilities, and works with clients across North America, APAC, and EMEA.

While the bulk of its work is delivered from India, Hexaware also has a newly acquired nearshore development center in Monterrey, Mexico. To bolster its independent testing offering, Hexaware recently acquired FocusFrame, a small, California-based firm specializing in automated testing of
ERP and custom applications. Upon acquisition, FocusFrame had around 75 engineers working in the center. Hexaware plans to add another 200 headcount by year-end.

Hexaware's vertical expertise is strongest in the financial services areas, but it has a blue chip list of transportation and leasing clients as well. About 45% of the firm's revenue is from the banking, financial services, and insurance sector. Hexaware's major clients: Air Canada, Alliance Capital, Northwest Airlines, and Princeton University.

Hexaware is distinguished by the following capabilities:

- **Proficiency and focus concerning PeopleSoft.** About 45% of Hexaware's revenues come from its ERP services practice. Hexaware is, at present, a market leader in terms of its PeopleSoft expertise. Even in the wake of the Oracle-PeopleSoft acquisition, the firm has managed to hold onto this aspect of its business through a deep partner relationship with Oracle.

- **Strong HR capabilities.** Hexaware not only has strong capabilities in terms of its HRIT offerings, but also caters to HR BPO. Hexaware offers product-based services (Authoria, PeopleSoft, SAP, etc.) as well as payroll solutions, portals, and learning systems. Hexaware's HR BPO practice involves all aspects of the HR life cycle: recruitment, payroll, benefits, learning, and records management.

- **Capabilities/vertical expertise in the transportation/airlines industries.** Hexaware has since its inception built strong domain expertise in what the firm considers an underserved niche, the transportation and hospitality industry. Eight of the top 10 global airlines are clients of Hexaware. The company's vertical structure helps maintain a strong focus on this particular niche market.

- **Ability to partner with large technology and services firms.** Because it is reputable and reliable, despite not being a tier one Indian provider, Hexaware is a favorite partner for global vendors that don't have sufficient offshore bandwidth internally. Major partners include: IBM, Microsoft, Oracle, SAP, and Unisys.

**Syntel**

Michigan-based, publicly traded Syntel was founded in 1980 by the husband-wife team of Bharat Desai and Neerja Sethi. Syntel, like US Technology and Cognizant, operates a hybrid model featuring US-based ownership and operation with a significant offshore presence and workforce. Finishing 2006 with $270 million in revenue, Syntel is today a top alternative for companies seeking a more nimble but experienced offshore outsourcing firm. Syntel is by no means flashy, but its conservative, consistent approach is particularly appealing to clients in this hyper-growth environment.
Initially a staff augmentation provider, Syntel has made the transition to a higher value IT services and outsourcing firm. It has a strong applications development and outsourcing offering (about 70% of Syntel’s revenue is derived from this practice) in addition to packaged solutions services that include CRM, BI, and Web technologies as well as “integrated” business process outsourcing (BPO).

At present, Syntel has about 8,650 employees and continues to grow. It has an aggressive hiring practice, with plans to add between 3,500 and 4,000 employees in 2007. It expects to recruit 75% of its new hires from Indian campuses. The firm also has made big investments in its infrastructure, recently adding an impressive 77-acre campus in Pune. The company intends to invest $30 to $40 million in facilities, new services, and people in 2007.

Syntel has vertical expertise in the financial services, insurance, and healthcare sectors. It also has automotive expertise; its first clients in 1980 in Troy, Mich., were, not surprisingly, in this vertical. Syntel’s rapidly growing BPO practice (growth in this area of business exceeded 200% through 2006) leverages the company’s strength in the above verticals to offer an integrated vertical approach for clients looking for custom BPO solutions, as opposed to low value transaction processing and call center BPO solutions.

Other features that distinguish Syntel include:

- **Outstanding client loyalty engendered by top line client service.** About 95% of Syntel’s business each year comes from repeat clients and referrals. The firm achieves this through strong, stable relationship management and, of course, delivery excellence. Syntel is on the “preferred partner” list at 81 different Global 2000 companies. To achieve the growth of some its tier one competitors, Syntel will need to focus on new client acquisition at some point, but today its focus seems to be more on delighting its existing client base.

- **Understanding how to map resources to the client’s need.** Perhaps learned from its staff augmentation heritage, Syntel understands the importance of using the right resource for the right job. Not wanting to use Ph.D.s to do production support or programmers to do testing, Syntel has created career paths for staff in less sexy roles (application maintenance and testing, for example) so that it does not have to use those roles as a training ground. This gives the company more stability and consistency in its service offerings. This not only helps with client satisfaction (staff are not constantly turning over as they graduate to different jobs), but also improves employee satisfaction and reduces attrition.

- **A “comfortable” approach to offshore.** Syntel’s hybrid approach offers clients new to the outsourcing game a way to “get their feet wet.” They can start with more resources onsite and eventually transition to a more offshore-centric model. Syntel’s strong processes and knowledge transfer approach, called IntelliTransfer, ease this transition. Syntel frequently discusses its
“small enough to listen, big enough to deliver” differentiator. Syntel clearly has the maturity, the processes, and the experience with blue chip clients, without the baggage that comes from 50% year-on-year growth.

**US Technology**

US Technology, based in Aliso Viejo, Calif., was established in 1999. Today it has nearly 5,000 employees and a global footprint that encompasses the United States, Europe, the UK, and Asia-Pacific. US Technology is part of the Comcraft Group, a $6 billion conglomerate with operations in more than 50 countries. US Technology likes to call its service model a hybrid. Ideally, lower priced resources in India and Malaysia are teamed with locally based architects, analysts, and project managers. US Technology also works with clients in a completely offshore model if and when required. The interesting twist here is that US Technology’s Indian headquarters is in Trivandrum in Kerala, a smaller Indian city that is thus far exempt from the traffic, over-crowding, and attrition that plague tier one Indian cities like Bangalore and Mumbai. Sourcing and vendor management executives familiar with the infrastructure and aesthetic limitations of tier one Indian cities will be particularly pleased by the region’s unspoiled beaches, palm trees, and quiet streets. The almost 100% literacy rate also differentiates Kerala from other Indian states.

US Technology offers both end-to-end IT services and BPO solutions. The firm is committed to delivery of high competency, high quality services through four well-focused centers of excellence (CoEs). US Technology’s major enterprise service offerings are: enterprise consulting, technology (Java, MS, etc.), systems (ERP, CRM, etc.), and infrastructure. The firm also offers BPO services including a strong offering for mortgage BPO.

US Technology hasn’t focused on becoming a vertical specialist provider, but given its client distribution it has expertise in the healthcare, retail, financial services, manufacturing, automotive, and transportation and logistics industries. Major clients include: Cisco Systems, DHL, General Electric, and Nokia. The firm aims to grow its business and achieve $1 billion plus status by 2010.

Other features that distinguish US Technology include:

- **“Client University” program.** US Technology employs an innovative, cutting edge process and tool called the “Client University.” The Client University started life as a knowledge acquisition tool to help optimize transition from the client to the provider environment. It is an ongoing program that begins, pre-engagement, to ramp up provider staff for new projects. By day one of an engagement, the team is 75% conversant with the client’s needs and domain, and by the 60 to 90 day mark, the entire team is 100% conversant with the client’s applications, technology, and processes. The team builds reusable libraries and tools in order to enable new staff to assimilate as quickly as possible. In one case, the process was so successful that the client has begun to use its client university to train new internal hires.
• **Investment in people.** US Technology’s attrition rate is less than 10%, far below the industry average of around 20%. The investments it has made in its people (for training and acculturation US Technology focuses on three key values: humility, humanity, and integrity) and in Six Sigma and PCMM Level 5 to create and maintain its HR policies, are partially responsible for the low attrition. Another key factor, however, is US Technology’s location. Cities like Trivandaum, in which there are not as many opportunities for programmers as there are in cities like Bangalore, do not face the same attrition rates as tier one cities, at least not yet.

• **“Quality versus quantity” client focus.** In terms of client relationship management, US Technology’s motto seems to be “less is more.” The company maintains a small but impressive client base, with approximately 40 “tier one” clients. The goal is to eventually grow the business between 90 and 100 accounts, maintaining focus on strategic, long-term, accounts.

**RECOMMENDATIONS**

**DETERMINE YOUR NEEDS AND MAP THEM TO THE RIGHT PROVIDER**

Clients considering using smaller Indian providers should:

• **Expand for appropriate reasons.** Clients that rely exclusively on tier one Indian providers should consider diversifying their global provider portfolio to include reputable tier two providers if they are looking for more intimacy, more control, more flexibility, or specialist skills. Moving to midtier firms strictly for cost reasons often will not generate the desired effect.

• **Take the time for significant due diligence.** All midtier offshore providers are not equal. Clients must do their homework and ensure that their prospective providers are stable and credible. Financial due diligence will help clients determine stability.

• **Develop strategies for exit or transition as mid-sized providers get acquired.** Midtier providers are hot acquisition targets for global multinational IT services providers that don’t have sufficient offshore capability. Clients must make sure that they are prepared for any change of ownership that could occur during the life of their contracts.

**SUPPLEMENTAL MATERIAL**

Companies Interviewed For This Document

Hexaware

Syntel

US Technology
ENDNOTES

1 When overused differentiators like low cost and quality have become hygiene factors, smaller firms need to go beyond the age-old “India story” and build vertically aligned solutions that solve specific business pains like dealer management in auto or deploying RFID- and GPS-based logistics. Focusing on a clearly defined niche like HR processes and apps or engineering services for automotive will enable firms to win over business from volume players like Infosys or TCS. Firms following this route — for example, Hexaware, iFlex, and Tech Mahindra — continue to be successful in their niches, despite fierce competition. This will be a challenge for firms that want to take any engagement that comes along, but the market has proven that lots of small engagements in many areas eventually hurt rather than help providers. See the March 15, 2007, “The Polarization Of Indian Offshore Providers Accelerates” report.

2 PeopleSoft had entered into a build-operate-transfer (BOT) arrangement with Hexaware. Hexaware built a facility for PeopleSoft, hired and trained developers in PeopleSoft technology, and charged PeopleSoft for the services it delivered to it through this model. PeopleSoft had the option to buy this operation from Hexaware after a specified period of time. When Oracle acquired PeopleSoft, Oracle decided that it wanted this staff to be internal staff as opposed to external third-party staff. See the June 25, 2004, “PeopleSoft Support From India: Hexaware Is A Top Choice” report.

3 For Q1, 2007, Syntel reported revenue broken out by verticals as follows: financial services (46%), insurance (19%), healthcare (16%), automotive (9%), retail (3%), other (8%), http://www.syntelinc.com/uploadedFiles/SYNT_Q107_FACTS.pdf.

4 Tier two cities in India are gaining in importance as tier one cities like Mumbai, Bangalore, and Chennai grow beyond their capacity. For more information about the strained Indian infrastructure, see the March 30, 2005, “India's Infrastructure Can't Keep Up With The IT Industry's Rapid Growth” report.

5 National Association of Software and Services Companies of India (Nasscom) is a premier industry association.