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# OFFSHORE Opportunities

While global outsourcing practices have engendered political controversy, the companies that make offshoring possible are enjoying dramatic growth

BY JOHN FILAR ATWOOD

With the U.S. unemployment rate hovering at 5.5 percent, the public is in no mood to hear that companies are sending more jobs offshore, but they are. Forrester Research projects that 830,000 IT service jobs will be moved to lower-cost countries by the end of 2005, representing a sharp 40 percent revision upward from an earlier estimate. By 2015, Forrester forecasts that 3.4 million services jobs will be going offshore.

"Companies are careful about how they discuss their offshore initiatives so as not to upset shareholders, customers and employees, but they are clearly moving ahead with it," says Forrester's William Martorelli. "Despite the growing controversy, North American companies simply cannot ignore the cost and quality benefits it makes possible."

Regardless of public opinion, the rise of outsourcing will help drive 6 percent compound annual growth in the IT services industry over the next five years. The market will expand from $184 billion in 2003 to $241 billion in 2008, according to Forrester.

At the core of the rapid acceptance of outsourced labor models is the simple fact that companies need to cut costs to deliver product that can compete on a basis of both cost and quality. "Offshore outsourcing is a way for companies to do more with the same IT dollars," says Martorelli. "Indian service providers are extremely adept at process-oriented software development, so they tend to deliver a product that has very few defects compared to what can be developed internally or by a domestic vendor."

The cost and quality benefits have driven companies to outsource overseas, and the success is now feeding on itself. As offshore outsourcing becomes increasingly accepted as a normal business strategy, more companies — even conservative ones — are willing to experiment with the model in order to stay competitive, Martorelli says.

## INDIA'S INFLUENCE

The expansion of services offered by foreign vendors, especially in India, is further accelerating the process. "Leading Indian suppliers such as Wipro (WIT) and Infosys (INFY) are offering broader services, affecting a wider workforce back in the U.S.," explains Martorelli. "The downside is that the language barrier means the vendor can sometimes miss the requirements if they do not fully understand a customer's specifications."

Indian providers are moving beyond application maintenance into business process outsourcing, packaged application implementation and administration of infrastructure, he says. This, in turn, enables these firms to capture a greater percentage of global IT services spending and expand their own revenue streams.

In the June quarter, INFY's revenues surged 44 percent year-over-year to $335 million; based on continued momentum in the industry, management projects 40 percent revenue growth and 33 percent earnings growth in 2005. WIT's revenues were $385 million in the quarter, up 51 percent jump over the previous year. The growth came from all product lines and customers, with orders from European clients up 20 percent in the quarter.

## "STATESIDE" RESPONSE

Martorelli says the Indian market for IT services will grow at least 30 percent this year, but U.S. companies are taking steps to compete more effectively with India's leading outsourcing firms. Providers like

Electronic Data Systems (EDS), IBM (IBM), Accenture (ACN) and Computer Sciences (CSC) are increasing their footprint in India and other global low-cost centers.

Accenture currently has the largest foreign presence, with 15 percent of its staff overseas, compared to an average of 9 percent for its primary competitors, but the balance is shifting. IBM plans to move 3,000 U.S. jobs offshore in 2004, while EDS expects to increase its international workforce to 20,000, including 3,500 employees in India. CSC intends to increase its headcount in India to between 4,000 and 5,000 over the next three years.

"U.S. firms are also relying less on partnerships and establishing more wholly-owned captive offshore centers," says Martorelli. "That gives them greater control over operations and over sensitive issues like data security."

The move toward operating overseas should make it easier for U.S. service providers to keep customers who want the benefits of offshore outsourcing, but would still prefer to remain with an established vendor relationship.

Meanwhile, moving labor overseas is just one of two primary ways to make a company more efficient, says Todd Pietri, co-founder and general partner of Milestone Venture Partners. The other is to deploy more advanced technology to make sure clients get maximum value out of every billable hour.

In particular, Pietri likes the prospects of certain technology-focused services companies that develop their own software to serve their customers' specific objectives. "If you develop software to address a particular need, then year after year make that software better, you've created a powerful barrier to entry against the competition," he says. "You've also created a barrier to exit for your customers."

## NICHE PROVIDERS

Pietri believes there is a huge opportunity for companies that develop targeted software for the pharmaceutical industry, including privately held Medi-

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data Solutions, which offers electronic data capture services for information generated in clinical trials. In his opinion, the company's system is more efficient and generates results faster than the current process. "We think this is a low penetration, high growth area," he says. "It's a multi-billion-dollar opportunity where the spoils will go the nimblest competitor with the best software, and we think that's Medidata."

Another Pietri favorite is Octagon Research Solutions, a privately held provider of electronic submission services for companies seeking FDA approval. "The process is now very paper-intensive," he says. "Contract research organizations such as Covance (CVD) have provided these services for decades without innovation. They just pushed the paper themselves."

"It's another high-growth area where technology is needed to improve the process," he says. "We think niche providers are the future."

In other areas of the business services industry, such as consulting, niche providers are already conquering the present. Aside from giants like IBM and ACN, many consulting firms offer extremely specialized services.

For example, InteGreyted International delivers environmental, health and safety solutions exclusively to the private sector. "We do not compete with business and management consultants like ACN and IBM," says the privately held company's president and CEO, Brian Jacot. "Our competitors primarily are private architectural and engineering firms."

He says that regulatory issues such as Superfund drove the market for InteGreyted's services in the mid-1980s and early 1990s, when his business expanded 30 percent to 40 percent per year. As those issues ran their course and the market flattened out, the company's top line now grows about 5 percent annually.

"The recent downturn in the economy also hurt the environmental consulting industry," Jacot says. "Companies cut back on their discretionary spending and that impacted our business."

Conditions improved in 2003 and 2004 will be even better, he says, while longer-term trends like globalization, the growth of health and safety services and the outsourcing of environmental services leave him optimistic about the future of the industry at large.

## THE ENDLESS OPPORTUNITY

The need to comply with Section 404 of the Sarbanes-Oxley Act is also increasing the business of niche service providers that enable audits of business processes and documentation to support companies' internal controls.

The consulting team at tax technology services provider Vertex is very busy with Sarbanes-Oxley engagements, according to Joseph Bongiovi, the private company's international compliance product manager. David Leifer, Vertex director of emerging tax compliance, says that Section 404 will require technology to take over some manual processes while companies adopt tools with strong documentation capabilities and standardize their systems on one enterprise resource platform.

Because the clock is ticking for companies to certify full compliance with Section 404, some industry observers have likened the market opportunity to that of the Y2K problem, which consumed corporate resources in the months leading up to the deadline and then saw demand fall off a cliff. Leifer disagrees. "There is always going to be an emphasis on corporate governance," he says. "This opportunity is timeless."