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vCUSTOMER: ESTABLISHING A GLOBAL FOOTPRINT

Sanjay Kumar settled into a chair in the utilitarian conference area of his offices in Kirkland, a suburb of Seattle, Washington. He began talking energetically about his company, vCustomer, and the options for becoming a global player in the fast-changing IT offshoring industry. He had to decide the future strategic direction of vCustomer, the company he founded in October 1999. Six months ago, the company faced an expansion question, whether to move into heath-care services. But that was already old news. This fast-moving company had already expanded beyond being a primarily a call center outsourcer to managing two businesses: a CRM (customer relations management) practice, and a BPO (business process outsourcing) practice.

The offices of vCustomer may have looked unremarkable, but the company's track record was quite impressive. Since its founding, vCustomer had combined aggressive growth with close to 100% customer retention. *Inc.* magazine ranked it as the fastest growing private company in the Information Technology Enabled Services (ITES) industry in 2004. In 2006, *Business Week* magazine ranked the company among the Top-5 pure-play call centers, and *Fortune* Magazine ranked vCustomer as one of the world's top BPO companies. More recently, Data Quest ranked it 12th among the Top 20 BPO companies in India. The company had 20 marquee clients, many of whom were large, diversified global leaders in the computer/networking/ peripherals manufacturing industry. At the end of 2006, the company employed 4,500 people, 300 of whom were in the BPO business and the rest in CRM. It had offices in multiple cities in India, in addition to its Seattle-area headquarters.

The Offshore-Outsourcing Phenomenon

From Manufacturing to Services

Outsourcing is a generic business practice in which firms decide to buy inputs or services from external sources rather than produce them in-house. Although over 85% of outsourcing activity is domestic, there has been tremendous growth of "offshore outsourcing" or simply "off-shoring," which involves sourcing from business organizations in foreign countries. The adoption of offshore outsourcing by manufacturers started in the late 1980s and early 1990s. As transportation and communications costs fell and logistics technology improved, U.S. manufacturers of automobiles and consumer electronics began moving production to cheaper nearby countries like Mexico. By the late 1990s, China had emerged as a major destination for the offshoring of manufacturing.[1]

In the words of Alan Blinder, a well-respected Princeton University economist:

[1] "Men and machines." *The Economist*, November 11, 2004.

This case was written by Suresh Kotha, Oleson/Battelle Endowed Chaired Professor, and Debra Glassman, Senior Lecturer, both from the University of Washington Business School, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The case is based on publicly available information at the time of writing.

> At any point in time, the available technology – especially in transportation and communications – largely determines what can be traded internationally and what cannot. ... Traditionally, any item that could be put in a box and shipped (roughly, manufactured goods) was considered tradable, and anything that could not be put in a box (such as services) … was thought of as nontradable. But because technology is always improving and transportation is becoming cheaper and easier, the boundary between what is tradable and what is not is constantly shifting … with more and more items becoming tradable. The old assumption that if you cannot put it in a box, you cannot trade it is thus hopelessly obsolete. Because packets of digitized information play the role that boxes used to play, many more services are now tradable and many more will surely become so. In the future, and to a great extent already, the key distinction will no longer be between things that can be put in a box and things that cannot. Rather, it will be between services that can be delivered electronically and those that cannot.[2]

As telecommunications costs continued to fall, U.S. firms started moving their business services abroad. Countries like India, where skilled labor could be accessed at relatively low costs, became attractive destinations for IT services.

Indian IT companies got their first big boost with the "Y2K problem" at the turn of the millennium, as they still had programmers who could read old computer code such as COBOL. Meanwhile, U.S. corporations were struggling to cope with the growing complexity of managing their own IT systems. Since different sorts of computer systems had been acquired at different times, IT departments of major corporations were spending a large portion of their time maintaining legacy systems and adapting them to changing needs. Such U.S. companies started looking to outsource their IT work. Standardization of network protocols allowed for easy routing of voice and data traffic through global networks, so offshoring was a logical choice.

Business Process Outsourcing

After IT offshoring gained momentum, U.S. companies recognized that other IT-related service jobs, especially those not requiring highly qualified computer programmers and engineers, could be outsourced. Routine telephone inquiries were bundled together into call centers outside the United States. Call centers are in the category of Customer Relationship Management (CRM) services. Companies also began digitalizing and telecommunicating paper-based back office functions around the world. Such operations are collectively called Business Process Outsourcing (BPO) and include sales and marketing, human resources, finance and administration, and logistics activities (see **Exhibit 1**). Both CRM and BPO activities fall under the general category of ITES.[3]

India's BPO industry started with foreign "captives," or subsidiary organizations that handled the respective parents' in-house work. Pioneers in BPO operations like American Express, British Airways, and GE arrived in India in the late 1990s. For instance, GE's Indian subsidiary, GECIS, handled administrative processing work for the parent firm's financial businesses. Soon call center operators such as 24x7, EXL, Spectramind, Daksh, and vCustomer joined them in setting up operations in India.

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[2] Alan S. Blinder, "Offshoring: The Next Industrial Revolution?" *Foreign Affairs*, March/April 2006, Vol. 85, Issue 2, p.113.

[3] Some analysts define the term BPO more broadly to include call centers and other CRM activities, as in **Exhibit 1**.

Indian BPO firms faced competition from specialist U.S.-based call center companies, which had been adjusting to competition from Indian companies by locating their operations in India. Among the more successful of these firms were Convergys, the world's largest call center operator with a staff of 60,000, and the Sutherland Group, a U.S.-based company with over 6,000 employees (see the **Appendix** for a partial list of ITES firms operating in India in 2006).

Changes in the Industry

The nature of the outsourcing industry in India was changing in 2007. Some large IT companies were entering this space and recognizing potential synergies that could be achieved with their existing businesses. In mid-2004 IBM acquired one of vCustomer's rivals, Daksh Services, in a deal worth about $170 million. More recently, in 2006, Fujitsu's U.S.-based consulting arm acquired Rapidigm, EDS launched the $380 million takeover of MphaiS BFL, and CapGemini made a $1.25 billion takeover bid for Kanbay International. In addition, Indian IT firms such as Wipro and others were making acquisitions to meet the challenge of multinationals entering their home turf.[4] The top six Indian firms controlled 42% of the Indian IT Market in 2006 (see **Exhibit 2**). According to Wachovia Equity Research:

> The Tier 1 providers [e.g., IBM Global Services, Cognizant, and Infosys] – those that are larger, have well-established delivery centers and recruiting capabilities, as well as strong new businesses capabilities – have for some time been able to command premium pricing. Given that we are now in a period of "mature" growth, we expect it will be more difficult for the Tier II [e.g., Syntel, and vCustomer] providers to consistently grow rapidly without meaningfully affecting operating margins.[5]

Along with falling operating margins, a report by Pacific Crest Securities warned that client demands were also changing:

> The offshore model for outsourcing services is evolving as clients express a preference for companies with a global presence, local knowledge, and locations physically close to their customers – known as "near shoring." We believe that the Indian companies are still not sufficiently globalized, though we are beginning to see signs of change as they build their offshore capabilities at low-cost locations outside India. … Indian IT services companies are beginning to build a truly global operating model for themselves, whether organically or inorganically, in emerging countries such as China, the Philippines and Eastern Europe, where labor is cheap. They are also pursuing acquisitions in the West targeted at building their onshore operations to facilitate gaining local clients, specifically in Europe.[6]

A recent report by NASSCOM made a similar point[7]:

> Eastern Europe, in fact, is expected to emerge as an outsourcing hotspot, with the rest of the continent looking to offshore its non-core activities to nations in this region. Offshore outsourcing in

[4] Wipro had already acquired Spectramind, India's largest call center firm, and NerveWire, a Massachusetts-based IT consultancy. Infosys had established a BPO subsidiary called Progeon, and acquired Expert, an Australian IT firm. TCS had purchased Phoenix, a Bangalore-based subsidiary of an American insurance and asset management firm.

[5] Wachovia Equity Research, Global Delivery of IT/BPO Outsourcing, November 16, 2006.

[6] Pacific Crest Securities, "Industry Overview," February 27, 2007.

[7] NASSCOM is the National Association of Software and Service Companies, the trade association for India's IT software and services industry, www.nasscom.in.

> Eastern Europe is estimated to triple between 2005 and 2008, according to business intelligence major, McKinsey and Co. The firm estimates that the BPO industry will support 130,000 jobs in the region by 2008.
>
> By the look of things, Indian BPOs will also be focusing on Eastern Europe as an investment destination on account of the region's low wage levels, slow wage inflation (that will keep the geography economically competitive for at least 15 years), relatively low-risk nature of the investments due to the availability of reliable infrastructure and its geographical and cultural proximity to Western Europe, making the process of setting up offices much easier. There are also fewer language barriers compared to elsewhere, with German and French both being widely spoken.[8]

According to a 2005 study, the total addressable market for global offshoring exceeds $300 billion, of which $110 billion was forecasted to be offshored by 2010 (see **Exhibit 3** for details of Indian IT revenues by sector and **Exhibit 4** for Indian IT services offshore penetration figures). This report noted:

> India has the potential to capture more than 50 per cent of this opportunity and generate export revenues of approximately $60 billion by growing at 25 per cent year-on-year till 2010. Inherent advantages like abundant talent supply, strong cost- and leadership-oriented companies, regulatory support, scaleable high-quality infrastructure, and a growing domestic market have been instrumental in driving the growth of this sector.[9]

The report continued:

> While the addressable market for the global offshore IT and BPO industries is quite large, industry evolution will largely be shaped by the interplay of three major forces: (1) supply (the capacity and quality of offshore locations); (2) demand ramp-up (realistic adoption of offshoring by companies); and (3) industry conduct (the actions taken by industry players). The global offshore IT and BPO industries are subject to different constraints. The offshore IT industry is more likely to be demand-constrained, that is, market growth will largely be driven by the adoption rate of companies in "sending/source geographies". On the other hand, the BPO industry is more likely to be supply-constrained due to potential talent shortfalls within the "receiving/service geographies."

Analysts from Wachovia noted:

> Early adopters were concentrated in the banking and telecom markets. This may reflect favorable experience during the Year 2000 (Y2K) remediation period for these information intensive verticals. Recent reports indicated that retail, manufacturing, health care, and pharmaceutical companies are also starting to meaningfully embrace the use of offshore for IT development and maintenance, as well as transaction-based BPO. This comes at a time of improved spending by financial services and telecom services sectors.[10]

NASSCOM estimated that, in 2006, financial services accounted for about 38% percent of the Indian IT and ITES export services market. This was followed by high technology and telecom at 19.8% and manufacturing at 17%. Health care accounted for about 5%. (See **Exhibits 5** and **6** for market data by industry vertical.)

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[8] BPO Newsline, NASSCOM, Issue #63, January 2007.
[9] NASSCOM-McKinsey Study 2005.
[10] Wachovia Equity Research, Global Delivery of IT/BPO Outsourcing, November 16, 2006.

Sanjay Kumar left India for the U.S. at age 17 for undergraduate studies at Carnegie Mellon University, after which he moved to the University of Pennsylvania to earn a doctorate in Computer Science. Upon completion in 1991, he went to Seattle for an interview with the aerospace giant, Boeing. However, based on conversations with friends, he instead accepted a job at Microsoft.

At Microsoft, Sanjay worked in areas related to networking, broadband and telephony using the Windows platform. Within a few years, he was promoted to lead a group of around 200 people. He, and most of his subordinates, benefited from Microsoft's explosive growth during that period and ended up financial wealthy by cashing in on Microsoft's stock options.

In the late 1990s, Sanjay left Microsoft to join Teledesic Corporation, a satellite communications services start-up, which was funded by numerous prominent Seattle billionaire investors, including Bill Gates, Craig McCaw, and the Boeing Company. The goal was to build a global high-speed service network using 800 satellites. Unfortunately, Teledesic's projects were severely delayed (and ultimately the firm folded in 2002). Sanjay began toying with the idea of starting his own company. As part of his work, he had made numerous trips to India, and he was particularly struck by one such visit:

> While my first transition to Teledesic had been very smooth, I was now wondering what I would do once I left this organization. In 1998, it was the visit to the facility of a big customer, GE, in Gurgaon[11] that opened my eyes to the potential of the BPO industry in India. It took GE, a U.S.-based company, to figure out that potential in the early days. They were the pioneers.

Sanjay considered riding this wave, because of his expertise in communications technology, his experiences in dealing with the FCC and other regulatory bodies at Teledesic, and his tenure at Microsoft, a company that often outsourced many of its non-essential activities. Although colleagues were skeptical about outsourcing as a business opportunity, he felt that his venture was likely to secure funding.

He wrote a business plan and assembled an impressive team of financial backers using his personal contacts. They included Scott Oki, who had built up Microsoft's international division, and the noted venture capital firm Warburg Pincus. His early investors put in about $20 million, a level of venture funding rare for a start-up intending to enter the outsourcing business in 1999. Sanjay recalled: "There was an unfulfilled demand for critical support that already existed. We were not banking on some kind of futuristic technology, hoping and praying that it worked and someone bought it."

Flush with capital, Sanjay launched vCustomer in June 1999. He elaborated on the company's financial position since:

> The fact that Scott agreed to sit on our board was a great help. When we needed more funding for investments in voice infrastructure, we raised $11 million from Warburg Pincus, WestRiver Capital, and Oki again. From then on, it has been my single-minded focus not to raise capital ever again to

[11] Gurgaon is a suburb of New Delhi, the capital city of India.

> meet our growth requirements. As a company, we achieved that goal by turning cash flow positive in the last quarter of 2001.

Early Growth

Sanjay's early vision for the company was to develop technical support as its core competency. The venture provided off-line technical support to clients through e-mail. These services required relatively low infrastructure, and the employees manning the help lines needed few social skills. The context was thus tailor-made for using Indian employees, and ten people were initially hired at a facility in Gurgaon. In 2000, vCustomer acquired its first client, the data storage company Iomega Corp, which needed support for the FAQs on its portal.

The year 2000 proved to be a remarkable one for the young firm in terms of increasing its scope of services. During that year, the company moved to "real-time" technical support using instant messaging. Then, later that year, Sanjay spotted another emerging opportunity, this time in telephony services, as the Voice-Over-Internet-Protocol (VoIP) technology became operational and scalable. He noted the significance of that decision:

> We made a bit of a technological gamble at that point, betting the company's voice services on the untested VoIP rather than the traditional Time Division Multiplexing (TDM) standard, which required a large amount of equipment to be installed at the delivery side. A key reason for choosing the VoIP network was the ease of integrating business applications, resulting in significant cost savings. We felt that we would reap maximum benefits from this technology without worrying about interoperability with classic TDM based systems.

Soon, vCustomer was using a combination of communication media (voice, chat, and e-mail) to provide hardware and software product support for its clients. Sanjay highlighted the role of advances in communications:

> My whole business plan when I started the company revolved around the fact that the cost of communications would drop dramatically. In 1999, a 2 megabyte link to India cost me $40,000 a month. Today it costs me about $7,000. The availability is unlimited. I could ask for a 10 gigabyte line, and I would get it. So that's the big difference. When you look at the whole reason for having call centers, it's basically built on the fact that you couldn't sit at home and do this work.

Sanjay had a "hands-on" attitude towards attending to operational problems and decisions, which kept the company tuned to customer needs. He spent five or six hours a day talking to customers, a practice which he retained even when the company grew bigger. In this he was aided by technology — he had one phone number that clients could contact him at, irrespective of whether he was at home, at his Kirkland office, or anywhere in India. Hence, his primarily U.S.-based customers were assured that the vendor's senior personnel were relatively close by and therefore accessible. A large portion of his remaining time was spent talking to department heads in New Delhi and trying to solve their operational problems.

At the same time, Sanjay recognized that he would have to inculcate customer quality at vCustomer through more formal mechanisms. Moreover, the company needed to provide a greater breadth of services to a client, which would also help in building switching costs and thus enable the company to retain clients.

Assembling the Management Team

As the company's customer base grew, many managers were recruited either through a formal hiring process that aimed to get the best available talent in this fledgling business, or were personally persuaded by Sanjay to join the firm. Within a few years, some senior-level managers were also hired in India so that Sanjay and the U.S. team could focus on broader strategic issues and cut down on travel between Seattle and India. Additionally, the number of operating employees increased exponentially when the company started expanded its call centers in Delhi and opened new centers in Pune, Maharashtra. (See the vCustomer website, www.vcustomer.com, for milestones in the company's growth and **Exhibit 7** for a description of the company's management team in March 2007.)

Nearly 50% of the original executives were engineers. To strengthen his management team, Sanjay recruited MBAs from the top Indian business schools. This helped vCustomer to expand its BPO side:

> Look at us a year ago and today. We used to be a call center outsourcer; today we are running two practices. We are running a CRM practice and a BPO practice. This means that when we go to clients we are no longer talking about having them just outsource to us. We are actually going to them and saying: how do we improve your process? Whether it is in-house, whether you are outsourcing to somebody else, whether you're doing a back-office process, we can improve any kind of process in your company. The sales pitch has significantly changed.

vCustomer's Strategy

The Value Proposition

vCustomer offered its clients significant cost savings and a quality of service that was comparable to, or even better than, what the client could accomplish in-house. Clients could also increase revenues significantly without corresponding expenditure on infrastructure and scale. Sanjay described how this worked for call centers:

> To achieve these objectives for every client, we put together dedicated teams trained extensively in the respective businesses. These teams acted like the *de facto* employees of the client, except that they were operating out of our offices. Each associate went live only after rigorous training in computer skills, accent and modulation, language, culture, listening and comprehension, tele-etiquette, not to mention industry and process-specific issues.

To upgrade employee skills, vCustomer frequently brought in teachers from the U.S. to impart "soft skills" to the employees, such as conversing without a strong Indian accent. These procedures and systems increased the costs of servicing a contract, but they contributed substantially to building quality and trust, thereby helping to retain existing customers and to attract new ones.

The abundance of educated workers in India allowed vCustomer to build a strong multilingual capacity. For example, the Indian call centers could provide services in the major European languages. vCustomer had about 70 people in India providing support in Spanish, and they could serve a wide range of Spanish-speaking countries.

Emphasizing Quality and Security

Sanjay's faith in the superior value provided by vCustomer stemmed from the confidence that it had developed certain distinctive, technology-based capabilities derived from timely investments in advanced technology infrastructure. The VC funding obtained earlier provided cash reserves to execute its plans. Sanjay recalled those plans as follows:

> Using the money raised, we equipped the delivery centers with cutting-edge hardware and software, self-generated power facilities, and secure back-up recovery capabilities. For communicating between the U.S. and India we used one of the world's largest Wide Area Networks that utilized four pathways between the two countries and spanned both oceans. We also formed a beneficial working relationship with Sprint in 2002 to acquire private line circuits exclusively for our client base. These investments gave us the reliability and scalability to provide real-time services.

Additionally, he also built more formal quality systems early on by instituting processes such as ISO 9001 and Six Sigma, groundbreaking steps for a company engaged in outsourcing at that time. Such certification formed the foundation for creating the company's service delivery methodology. Resources were invested at all levels to ensure that desired quality levels were sustained. For instance, the company had one quality supervisor for every 16 agents as compared to the industry norm of one supervisor for every 35 agents.

Sanjay's experience in dealing with regulatory agencies helped him to work effectively with relevant Indian governmental agencies. For instance, to ensure uptime of the network that was critical to the voice and chat services that the company offered, he made intensive efforts early on to strike up cooperative relations with the Videsh Sanchar Nigam Ltd. (VSNL), India's leading provider of international long distance services.[12] Sanjay got VSNL's managers to subscribe to his vision and subsequently make authorization decisions more quickly.

As the business grew, vCustomer could also afford to get selective about its future clients. The company's management became less inclined to sign on clients like Wal-Mart or Dell, who merely emphasized cost savings. They believed that the "superior" value that vCustomer provided could not be offered at the prices that these firms demanded.

Creating Barriers

Through investments in technology and scale, the company was able to offer some distinctive benefits to clients vis-à-vis rivals. Sanjay described how this was possible:

> Early on, I noticed that many players in this business were building a similar set of competencies. So I wanted to differentiate vCustomer from the competition. The idea was that even in an industry thought to have "zero" intellectual property, it would take a while for competitors to duplicate our approach if we focused on developing solutions through advanced technology and more rigorous process management.

Sanjay's overall vision kept the company focused on its core competency of technology support, even while branching out into other BPO activities. This focus paid off handsomely when billing rates charged for services plummeted due to intense competition and price wars in the

[12] At that time, VSNL was government-owned. A process of privatization began in 2002.

BPO space. vCustomer, however, could still maintain billing rates of $10-$16 hour for tech support.[13] At the same time, Sanjay differentiated vCustomer from Indian rivals by focusing exclusively on inbound call center operations and shunning telemarketing altogether. As he explained:

> Typically, our contracts last between one to three years, whereas in telemarketing this can be just one to three months. There is no comparison between the two services, because if there has been no impact for a client from a telemarketing campaign, people will look back at the value of the contract and say it amounted to a zero benefit.

Willingness to Take Risks

The investments made in promoting quality and technology infrastructure represented Sanjay's differing approach to risk vis-à-vis his competitors. He was willing to invest up-front in building distinctive competencies through process management techniques. As long as an initiative was consistent with the values of the company, it was not considered too risky. Noted Sanjay:

> Of the eight Indian start-up firms in 2000 with call center operations, only two, 24x7 and EXL, remained owned by their original founders in 2004. Many of the others exited the market by selling out at good prices to larger corporations, probably because the founders lacked the appetite for greater risk and were quite happy with where they had gotten so far. My approach to bearing risk was to go ahead with a risky initiative provided the potential adverse impact to the core business was low and that the timeline one had for turning things around was long (say, by using equity/internal accruals for investments as against debt).

Moving Beyond Call Centers

Over time vCustomer expanded into the emerging BPO business services segment. By 2002, vCustomer had signed up clients interested in back-office processing operations, such as business documentation management. Today the CRM practice generates about 85% of the company's revenue, and BPO accounts for the other 15%, but the latter is growing faster.

Enhancing seat utilization, a key driver of business success in the industry, was the primary motivation towards moving into greater back-office work for existing and new clients. vCustomer's current seat utilization went up to around 1.2-1.3 (one workstation was being utilized for a little more than a shift of eight hours), but the objective was to push it higher.

vCustomer also began to advise customers on improving their processes. Sanjay elaborated:

> Today, we don't position ourselves as a low-cost provider anymore, but as somebody who has learned how to improve business processes. Regardless of where your call center is and what changes you are looking for – we can implement those changes. One of the biggest values we project is our ability to develop customized technology solutions.

Sanjay envisioned much of this being done by online automation:

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[13]"vCustomer to set up more facilities," *Financial Times*, August 16, 2003.
[16] Pacific Crest Securities, "Industry Overview," February 27, 2007.

> Automation shows our value. A lot of client interaction can be online. We don't need lots of consultant travel. The client can just fill out templates online. That software can easily be multilingual. We can build a website in three major European languages very quickly in India.

Serving New Industries

By 2006, the company also began to provide services to a wider range of sectors. In Sanjay's words:

> With the move to BPO came diversification into services to other sectors or "verticals," like retail, hospitality and utilities. Our moves were somewhat serendipitous as they resulted from casual enquiries made by prominent players in each of these sectors. The addition of a new sector required a dramatically non-linear effort from the company to execute successfully, since the complexities of the new business had to be effectively understood by the operating personnel.

Given its expanded capabilities, vCustomer had started serving the health-care sector. Health-care offshoring was slowly gaining traction, as U.S. companies recognized that a variety of activities could potentially be outsourced (see **Exhibit 8** for outsourcing trends in health-care). According to Pacific Crest Securities:

> Industries such as health care, retail, transportation and logistics are now beginning to adopt offshore services. We believe that continued spending by the financial services vertical and the adoption of offshore services by hitherto under-penetrated verticals will be the main drivers of future growth of the Indian IT services export market.[16]

The primary reasons why health-care firms were looking to outsource specifically to offshore destinations included: reducing operating costs, focusing on the core business, reducing the need to invest, overcoming inability to staff appropriately, and upgrading current service levels.[17] Sanjay recognized the challenges inherent in entering this new sector:

> Moving into a new vertical such as health-care is extremely challenging. It is almost like starting over. It is difficult to convince potential customers that they should be our first client in this new vertical. Health-care has its own significant challenges in terms of core competencies and service platforms that we would have to create to show that we understand the business.
>
> In health-care, we'll do both the technology and the services. If you don't have your own platform, you're just paid labor on the client's platform. But platform-only businesses mostly just scan documents. The health-care transaction is not necessarily scripted, so training and quality processes matter a lot.

Challenges Going Forward

In 2007 vCustomer was a mid-sized BPO company and faced a new set of challenges. During 2004, the company recorded revenues of $33 million, nearly twice the levels 2003.[18] By the end of fiscal 2006, vCustomer had projected revenues to be over $50 million (being a privately-held company, vCustomer did not disclose its revenues or profits). Further, Sanjay had accumulated

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[17] Report by Ravi Shah of NewHorizons Consulting
[18] "vCustomer set to double revenue." *Rediff.com*, June 16, 2004.

a war chest of over $25 million that could be used for acquisitions if the "right" opportunity came along.

However, Sanjay and his management team felt that, in order to grow, they needed to scout for low-cost destinations in other parts of the world. In India, rising wages, the growing scarcity of experienced talent, employee turnover, and increased competition from leading players in the industry (e.g., Infosys, Wipro, and IBM Global Services) could potentially hurt profit margins.

Broader Service Offerings and the Need for a Global Footprint

Potential new clients were looking for new services to outsource and for vendors who had a broad set of capabilities. Currently, a typical client maintained outsourcing relationships with several vendors, a pattern of behavior that had emerged not only because outsourcing companies had built up core competencies in different areas over time, but also because clients sought to avoid excessive dependence on any one vendor. This pattern was expected to change in the future.

Many multinational clients were now demanding multinational solutions from their vendors – that is, services delivered to a variety of countries in a variety of languages. While U.S. companies were the earliest adopters of the offshoring model, European companies had been slow to embrace this business model. This was due to a variety of factors, including cultural, political, and linguistic barriers. However, recently, European companies have begun to realize the potential cost saving that result from offshoring. Not surprisingly, European clients demanded multilingual CRM and BPO services. These developments were forcing Indian and other ITES providers to expand their geographic scope of operations. (See the **Appendix** for details regarding the operating locations of the various ITES firms. **Exhibits 9** and **10** provide geographic breakdowns of export markets for Indian firms.)

vCustomer's clients were generating multilingual demand in a variety of ways. For example, some U.S. firms wanted to offer Spanish-language services for their Hispanic customers. Some clients asked for call centers located in the Philippines, because they had concerns about the accents of Indian employees. As another example, vCustomer currently was supporting the U.S. business of Japanese companies, and Sanjay wanted to offer to serve their Japanese customers. Sanjay surveyed the opportunities:

> There are all sorts of things to consider. For example, companies that are earning money in the Philippines have to realize that costs have risen, but that has been hidden by the devaluing currency. … Japan is a high value opportunity, but it is hard to enter a relationship with Japanese firms. You could go to China to provide Japanese. Lots of Japanese call centers are located there. In China, a partnering strategy would be hard. We don't have anyone in the company who understands the culture and who could pick a partner and do a deal. We might have to build a business by ourselves in China.
>
> The European customer pays a premium. They are just discovering customer service. Where are people looking? They are looking at Poland (although wages are rising fast), the Czech Republic, Slovakia, Hungary. More recently, Bulgaria, and Estonia. Estonia is high quality but has high wages. Bulgaria is a stretch in terms of infrastructure – only Sofia has it. We think that Russia, the Ukraine and Belarus may be too difficult now.

> We've got a partnership in Sofia, Bulgaria with a company that does tech support in 4 languages for the EU market. Bulgarian wages are comparable to India. Currently we provide Spanish language service from India, but we may be able to provide it more cheaply from Bulgaria. We can serve French Canada out of Bulgaria. We think that Bulgaria now is where Poland was five years ago. Five years from now, Bulgaria may not be viable any more.
>
> Any client could come to us tomorrow and say: "I'll give you 200 heads in Spanish if you set up in Latin America." If so, I would have fly to Latin America and find a partner. Firms in Mexico, and Argentina have already contacted me. We already have some contacts and pricing information for these countries. So it wouldn't take much too much of stretch to set up operations in Latin America.
>
> Our immediate goal when we bid on contracts is to convince our clients we have the ability to deliver a multinational solution to address their needs. In order to do so, we are asking ourselves how we can support any presence that our clients might have in various locations.

However, Sanjay noted:

> The biggest challenge for us is the training of employees in a multilingual capacity. For every single language we would have to have an expert in-house. We can't possibly do that if we are supposed to support 30 languages, I can't have 30 in-house experts to verify that the quality is there and the training material is appropriate, etc. So that's our biggest challenge today. It's a huge overhead for us to find experts who will be able to evaluate our agents.
>
> Another challenge is recruiting. If I am recruiting, say, native Hungarian speakers, they would have to know English before I could hire them. So we are stuck with having to hire everyone who is multilingual, which raises our cost. We need to develop some kind of a global recruiting network, which would help us do the recruiting so that we can bring in people who are native language speakers and don't necessarily know English.

vCustomer was looking to partner with existing players, and at the same time they were open to acquisition possibilities in these markets. Observed Sanjay:

> One of the largest players that has put together a structure of European language offshoring is a French company called WebHelp. They are in Algeria for French, and they are in Eastern Europe for other European languages. So we've been having discussions with them. They would be a great example of a merger that would make a lot of sense. They have a strong client base in Europe, we have a strong client base in the U.S., and we have the same exact model. That would be an example of a merger. We are also open to possibility of opening our own facilities in one of these countries.

Expanding the Scope of the Business

Besides the larger incumbents and new entrants, there were over 1000 firms involved in BPO offerings, though quite a few of these were little more than fly-by-night operators. Margins were falling and contracts were becoming more short-term as clients were increasingly looking for new vendors to associate with. Therefore, it was becoming clear that the company could not maintain its rate of growth by remaining focused only on its current businesses.

In the face of growing competition, Sanjay recognized that vCustomer had to diversify into value-added services that offered a great potential for growth. This move could increase vCustomer's scale of operations resulting and could potentially reduce the threat posed by larger companies. Currently, a typical BPO-based relationship fetched revenues of $50,000-$200,000 a month for vCustomer and was assigned 50-100 dedicated personnel (workstations). The goal was to sign up clients for transactions of higher value, say $200,000-$1,000,000 a month. Higher value transactions would make vCustomer more important to its clients and they would be more reluctant to switch to other vendors in future. However, to make the transition to bigger deals, the company needed a broader base of delivery capabilities so that clients would consider it a "one-stop-shop" for all their outsourcing needs.

Sanjay saw technology-driven opportunities to expand service offerings:

> Our objective really is to drive more and more of our revenue through the delivery of automation, and delivery of more BPO-type solutions. Automation won't give us a whole lot of revenue, but it is something that will potentially open the door for us to provide more business process services. Most clients are trying to figure out how they can eliminate the human factor altogether. Our pitch is: if you look at most back-office practices today, they are paper-based. The most compelling increase in productivity would be to help clients move away from paper and towards an online mechanism. So I tell my folks: let's focus on improvement services rather than just outsourcing. We don't ever want to give up outsourcing [call centers]; it's our bread and butter. But I look at all these other things and say: wow, we can do this.
>
> All our customers today have databases, and they have front-ends for their agents to interact with the clients. We actually go through and help our clients understand how to streamline the client interaction, how to host the client interaction, how to assimilate all the data and come up with some conclusions about how to work with this client either better or more effectively in terms of revenue. Then we take the data from all the calls they've received or all the emails received and provide some kind of analysis as to what needs to change in the company.
>
> We now have some very specific examples where we demonstrate to clients what we have done in the past. For example, returns processes – we did a very simple survey of all of our existing clients and said, "How effective is your return process?" We found all kinds of very common problems across all these clients, so we made a list of best practices for returns and we sent them to all our clients. We said, "If you want, we can help you implement them or you can just do it yourself." It made clients see that we understand their business, and that gives us a lot more credibility.

Sanjay Kumar concluded,

> Obviously we have a lot of directions that we could go, and we can't go in all of them at once. There's no question that we are going to grow. The question is: where do we expand? And how does the geography interact with our choices about what services to provide and what verticals to serve? … We have really struggled with this. Every day we seem to be pulled in a different direction. If we just looked at the immediate future, there would be an opportunity everywhere. I think that a 3-year horizon for a growth strategy would create more clarity.
>
> This is a good moment to have a consulting group come in and take a big-picture look at vCustomer and our growth opportunities.

Exhibit 1: **Scope of BPO Services**

Function	Human Resources	Payment Services	Manufacturing, Distribution, Logistics	Finance and Administration	Sales, Marketing, Customer Care
Activities	Payroll/ Benefits Processing Training and Development Hiring/ Staffing Employee Benefits Management 401K	Loan Administration Credit/ Debit Card Services Check Processing	Inventory and Warehousing Industry Management Order Fulfillment/ Procurement Transportation and Distribution	Document Management Billings Claims Processing Accounts Receivable Accounts Payable General Ledger Accounting Services Shareholder Services	Customer Service Customer Analysis Call Centers Consumer Information Services
Share of Revenues	14%	9%	59%	11%	7%

Source: Gartner Dataquest

Exhibit 2: **Revenue for the Top 6 Indian IT Companies ($ Millions)**

	2002	2003	2004	2005	2006
TCS (Tata Consultancy Services)	$916.7	1140.3	1544.5	2170.6	2996.1
Infosys	545.1	753.8	1062.6	1592.3	2151.8
Wipro*	476.6	625.2	943.3	1353.6	1815.0
Satyam	414.5	459.2	566.4	793.6	1096.3
Cognizant	180.9	257.1	413.5	648.6	989.6
HCL Technologies	333.2	399.0	508.9	711.1	919.4

* Wipro revenue is for IT services and BPO only.
Source: Pacific Crest Securities, "Industry Overview," February 27, 2007

Exhibit 3: **Indian IT Industry – Revenues by Sector ($ Billions)**

	2004	2005	2006	2007 Estimated
IT Services	**10.4**	**13.5**	**17.8**	**23.7**
-Exports	7.3	10.0	13.3	18.1
-Domestic	3.1	3.5	4.5	5.6
ITES-BPO	**3.4**	**5.2**	**7.2**	**9.5**
-Exports	3.1	4.6	6.3	8.3
-Domestic	0.3	0.6	0.9	1.2
Engineering Services and R&D, Software Products	**2.9**	**3.9**	**5.3**	**6.5**
-Exports	2.5	3.1	4.0	4.9
-Domestic	0.4	0.8	1.3	1.6
Total Software and Services Revenues	**16.7**	**22.6**	**30.3**	**39.7**
Of which, exports are	12.9	17.7	23.6	31.3
Hardware	**5.0**	**5.9**	**7.0**	**8.2**
Total IT Industry (including Hardware)	**21.6**	**28.4**	**37.4**	**47.8**

Source: NASSCOM, January 2007

Exhibit 4: **Indian IT Services Offshore Penetration – Current and Forecast** ($ Billions)

	ADM*	**System integration**	**Infrastructure outsourcing**	**IT Consulting**	**R&D Services**	**Total market**
Addressable market	$30-36	$30-36	$70-85	$3-4	$14-17	**$150-$180**
Current offshore penetration	31%	5%	2%	10%	30%	**11%**
India's penetration (2005)	$6.6	$1.1	$1.0	$0.2	$3.1	**$12.0**
Forecast of India's penetration (2010)	$13.7	$4.8	$9.0	$0.7	$6.6	**$34.8**

*Application Development, and Maintenance.

Source: Pacific Crest Securities, "Industry Overview," February 27, 2007 (based on NASSCOM-McKinsey Study 2005)

Exhibit 5: **Market Size and Offshore BPO Penetration by Industry Vertical ($ Billions)**

	Insurance	*Retail Banking*	*Travel & hospitality*	*Auto manufacturing*	*Telecom*	*Pharmaceutical*	*Others*
Addressable market	$25-$35	$35-$40	$10-$12	$10-$12	$8-$10	$4-$5	$20-$25
Offshore penetration (FY 2005)	6%	9%	3%	9%	9%	8%	9%
India's penetration (FY 2005)	$0.80	$1.60	$0.20	$0.50	$0.40	$0.20	$0.60

Source: Pacific Crest Securities "Industry Overview," February 27, 2007; based on NASSCOM-McKinsey Study 2005

Exhibit 6: **Revenue by Industry Vertical for Top Five Indian ITES Firms (FY 2006)**

	Tata Consultancy Services	*Infosys Technologies*	*Wipro Technologies*	*Cognizant Technology Solutions*	*Satyam Computer Services*
Banking, financial services and insurance	41.2%	36.0%	21.1%	49.2%	27.3%
Manufacturing	17.2%	13.9%	10.7%		28.6%
Health-care	4.6%		1.7%	20.5%	6.1%
Telecommunications, media and entertainment	15.0%	16.5%	5.7%		18.4%
Retail	6.6%	10.2%	9.7%		
Other	15.4%	23.5%	51.1%	30.2%	19.6%

Source: Pacific Crest Securities "Industry Overview," February 27, 2007

Exhibit 7: **vCustomer's Top Management Team in March 2007**

Sanjay Kumar, CEO

Sanjay founded vCustomer in Seattle in 1999 with a mission to create a data driven customer-focused BPO and contact center provider whose value was driven by demonstrably higher quality and lower cost. Over the years, Sanjay has grown vCustomer into a global, multi-center, multi-solution, organization that is a dominant player in the technical support space. Before founding vCustomer, Sanjay worked with Teledesic and was responsible for the design and successful approvals for global ground connectivity at the International Telecommunication Union (ITU), the United States Federal Communications Commission (FCC) and other national regulatory bodies. Over the years, he has chaired a number of technical groups in the area of broadband and Internet standards at the ITU, the ATM Forum, and U.S. based T1S1 committees.

Prior to Teledesic, Sanjay worked at Microsoft where he developed his leadership skills bringing the industry together behind key protocols to establish more open industry standards in networking communications technology. Sanjay was instrumental in developing Broadband and Telephony capabilities across all versions of the Windows Platform. He substantively drove the creation of the Quality of Service (QOS) capability in Windows by driving standards through the Winsock Forum. Additionally, Sanjay led the team that added Asynchronous Transfer Mode (ATM) support to the Windows NT platform. Sanjay has also served as Director on the Board of the Washington Software Alliance. He received a baccalaureate in Computer Engineering and Mathematics from Carnegie Mellon University in Pittsburgh, Pennsylvania and then received his Master's in Engineering and his Ph.D. in Computer Science from the University of Pennsylvania in Philadelphia, Pennsylvania.

Bill Holder, Vice President – Business Development

Bill Holder is responsible for new business development, sales and marketing. This includes the development of partner, alliance and channel sales programs. Bill has more than 20 years of international business development, marketing and sales management experience in the technology, healthcare and service domains. Prior to joining vCustomer, Bill had executive roles in leading outsourcing and management consulting organizations. This includes experience as Business Development Executive for Deloitte & Touche. He is also recognized as a pioneer in the field of IT asset management and software license management with extensive knowledge in marketing information services. Previously, Bill has developed partnerships and major account relationships with several Fortune 100 companies including IBM, United Health Group, Microsoft, EDS Corporation and Dell Inc. He is a graduate of the University of Washington's Business School with specialization in Finance and Marketing.

David Warren, Vice President - Sales

David Warren is vCustomer's Vice President of Sales. He is responsible for sales process, strategies and brand positioning. Prior to joining vCustomer, David served as VP of Sales at Mixx, Inc., where he developed and executed a sales plan that increased sales by 65%. David has held national and regional management positions in sales and merchandising at Nike, Helly Hansen, Timberland, Frederick & Nelson and Nordstrom. In every case, David has successfully developed sales strategies that have resulted in substantial revenue growth. David has a Communications degree from Washington State University.

Lori Inuzuka, Vice President - Client Services Operations

Lori Inuzuka is vCustomer's Vice President-Client Service Operations. She oversees global client service delivery, which includes operations, HR and IT. She is responsible for ensuring service satisfaction to our mainstream clients. Lori comes with 10 years of call center experience in Operations, Add-on-Sales, Capacity Planning and Outsourcing Management. The breadth of her experience and management skill results in informed client advocacy backed with focused project management, which drives service level performance. Her experience in facilitating large multi-million dollar system/process transformations has resulted in numerous clients expanding their offshoring efforts. The end result has been win-win partnerships resulting in increased savings for clients.

Prior to joining vCustomer, Lori managed call centers for well-known branded companies including Eddie Bauer in the retail sector and Blue Cross in the insurance sector, with up to 1,200 employees. She also managed multi-site and multi-function outsourcers. Lori has a business degree from the University of Southern California.

Source: vCustomer website, accessed on March 27, 2007.

Exhibit 8: **Outsourcing Trends in Health-care Sector in 2005**

Issues facing Health-care players:

- Managing increasing medical costs and balancing customer satisfaction
- Reducing operating back-office costs
- Complying with the standards and requirements of the Health Insurance Portability and Accountability Act
- Upgrading IT infrastructure and moving to the web to provide real time connectivity
- Focusing on survival and developing strategies to differentiate products from competitors

Organizations most likely to pursue an offshore initiative:

- Health plans
- Health-care payers
- Third party health benefit administrators
- Independent software vendors
- Application service and BPO service providers

Activities being outsourced offshore:

- Enrollment services (enrollment of new members, eligibility verification)
- Claims adjudication (claims data entry, reference to policy, managing billing and Explanation of Benefit forms, claims re-pricing)
- Customer service (call center handling, email/web support)
- Imaging and data digitization (mailroom services, scanning of documents, converting text into electronic data)
- Premium administration (application of money received to individual accounts, end of day balancing of suspense accounts)
- Policy administration (maturities, policy changes, beneficiaries)
- Underwriting (risk assessment, pre-existing condition evaluation)

Emerging models in Health-care offshore BPO:

- Managed services outsourcing (outsourcing of low value and non-strategic activities that are transactional in nature, e.g., imaging and data digitization)
- Business function outsourcing (outsourcing of complete business functions and processes, e.g., claims adjudication, policy administration)
- Enterprise operations outsourcing (outsourcing of complete back-office operations in one package to specialized vendor)

Source: Report by NewHorizons Consulting, 2005.

Exhibit 9: **Geographic Breakdown of Indian IT Exports**

	2003	2004	2005	2006
Americas	69.1%	69.4%	68.3%	67.2%
Europe	22.2%	22.6%	23.1%	25.1%
Rest of the World	8.7%	8.0%	8.6%	7.7%

Exhibit 10: **Geographic Breakdown for Top 6 Indian ITES Firms (calendar year 2006)**

	Tata Consultancy Services	Infosys Technologies	Wipro Technologies	Cognizant Technology Solutions	Satyam Computer Services	HCL Technologies
North America	56.9%	63.9%	62.2%	86.3%	64.2%	58.5%
Europe	27.4%	26.1%	32.7%	12.8%	18.8%	28.2%
India	9.5%	1.7%			4.6%	
Rest of world	6.2%	8.3%	5.1%	0.9%	12.4%	13.3%

Source: Pacific Crest Securities "Industry Overview," February 27, 2007

Appendix
Tier 1 and Tier II Players in the Indian ITES Industry (2006)
(source: Wachovia Equity Research, Global Delivery of IT/BPO Outsourcing, November 16, 2006.)

Major Players in Outsourcing

Company and Headquarters	Specialty	Low-Cost Locations	Offshore Revenue Range
Accenture (US)	Software Development, Network Support, Finance & Accounting (F&A) Human Resources (HR) Procurement, Insurance Operations, General Banking	India, Philippines, Spain, China, Czech Republic, Slovakia, Brazil, Australia	Over $5 B
ACS (US)	F&A, HR, Payroll, Procurement. Telecom, Transportation, Healthcare Operations; General Banking, Mortgage Processing	India, China, Dominican Republic, Ghana, Guatemala, Jamaica, Malaysia, Mexico, Spain	$1-5 B
Capgemini (France)	Software Development	Canada, Mexico, Spain, Poland, India, Australia	$1-5 B
ClientLogic (US)	Call Centers	India, Philippines, Poland	$100-500 MM
Cognizant Technology Solutions (US)	Software Development, Network Support	India, China, and Canada	$500-999 MM
Convergys (US)	Call Centers	"India, China, Indonesia, Malaysia, Philippines, Sri Lanka, Taiwan, Thailand, Argentina, Brazil, Colombia, Mexico, Australia, Canada	Over $1 B
CSC (US)	Software Development, Insurance Operations, Demand Management	Canada, Bulgaria, Ireland, India, Mexico, Malaysia, South Africa, Spain	Over $5 B
EDS (US)	Software Development, Network Support; F&A, HR, Payroll, Demand Management, Procurement, Insurance, General Banking, Telecom, Transportation, Health Care Operations	Canada, Mexico, Brazil, Argentina, India, Australia, South Africa, Spain, Hungary	Over $5 B
eTelecare International, Inc. (US)	Customer Service	Philippines	Below $100 MM
ExlService Holdings, Inc. (India)	Insurance, Transportation Operations	India	Below $100 MM
HCL Technologies (India)	Software Development, Network Support, R&D/Engineering, Financial Services	India	$500-999 MM
Hewitt Associates (US)	HR, Payroll, Procurement	India, China, Philippines, Thailand, Malaysia, Czech Republic, Poland, Hungary, Brazil, Mexico, Argentina, Chile	Over $5 B
Hewlett-Packard (US)	F&A, Payroll, Procurement	India	Over $5 B
IBM (US)	Software Development, Network Support, F&A, HR, Payroll, Procurement, Insurance Operations	India, Brazil, China, Mexico, Belarus, Philippines, South Africa, Romania, and Argentina	Over $5 B
ICICI OneSource (India)	Call centers	India	Below $100 MM
ICT Group (US)	Call centers	Philippines	$100-500 MM
Infosys Technologies (India)	Software Development, Network Support, Banking, Mortgage Processing	India, Czech Republic, China, Australia	$1-5 B
Mphasis Corp. (India)	Financial Services	India, China, Australia	Under $100 MM

Appendix: Tier 1 and Tier II Players in the Indian ITES Industry (2006) (Continued)

Major Players in Outsourcing - ***Continued***

Company and Headquarters	Specialty	Low-Cost Locations	Offshore Revenue Range
OfficeTiger (US)	F&A, Financial Services, Transaction Processing	India, Sri Lanka	Under $100 MM
Patni Computer Systems (India)	Software Development, Network Support, R&D/Engineering	India	$500-999 MM
Sapient (US)	Software Development	India	$100-500 MM
Satyam (India)	Software Development, Network Support, R&D/Engineering	India, China, Hungary, Brazil, Australia	$500-999 MM
SITEL (US)	Call Centers	India, Philippines, Brazil, Spain, Mexico, Panama	$500-999 MM
Softtek (Mexico)	Software Development	Mexico, Spain, and Brazil.	$100-500 MM
SR.Teleperformance (France)	Call Centers	Philippines, Indonesia, Mexico, Brazil, Argentina, Spain	Over $1 B
Stream (US)	Call Centers	India, Tunisia, Dominican Republic, Poland	$100-500 MM
Sykes Enterprises (US)	Call Centers	India, Philippines, China	$100-500 MM
Syntel (US)	Software Development	India	$100-500 MM
Tata Consultancy Services (India)	Software Development, R&D/Engineering, F&A, Telecom, Transportation, Hospitality Operations	India, Hungary, Brazil, Uruguay, Chile, China	$1-5 B
TeleTech (US)	Call Centers	India, Philippines, Malaysia, China, Northern Ireland; Spain, Mexico, Argentina, Brazil	Over $1 B
vCustomer Corp. (US)	Call Centers	India	Below $100 MM
West Corp. (US)	Call Centers	India, Philippines, Mexico, Canada, Jamaica	$500-999 MM
Wipro (India)	Software Development, R&D/Engineering, Demand Management, Mortgage Processing, Transportation Operations, Healthcare Operations, Banking, Mortgage Processing	India, Canada	$1-5 B
WNS Global Services (India)	Transportation Operations, Healthcare Operations, Banking, Mortgage Processing	India, Sri Lanka	Below $100 MM
24/7 Customer (India)	Customer Service	India, Philippines	Below $100 MM