

## Innovation in Outsourcing - Concept of the 6<sup>th</sup> Vertical



### **Abstract**

*The growth in offshoring of IT services started to spurt in the late Eighties. The industry spawned market valuations, investor wealth and employment in India, at a pace and scale, unparalleled in the Indian economy. IT professionals enjoy perks and salaries significantly above other wage earners with similar qualifications, even other engineering degrees. This anomaly is now normalizing, the reasons given ranging from the weak dollar to the influx of the larger MNC's who have set up shop in India with access to the same skill base. Customer satisfaction surveys frequently indicate that service levels from providers are either mediocre or just about acceptable, and in some cases, there appears to be a fairly large gap that is growing between what is expected and what is offered, and more so in what is delivered. The answer does not seem to be in simply improving traditional parameters of service, but perhaps indicates that a new segment of clients are now seeking to embrace offshore benefits and their requirements are to be met quite differently from the carefully designed and well documented processes that govern present delivery models. This group of clients seems to have service level requirements bound by their genre and not by their industry vertical. So much so, there is almost something elusive, almost surreal, in the expression and satisfaction of their needs. This community is therefore termed as the 'Sixth Vertical' and this article seeks to prove their growing widespread presence, increasing economic power, and what they almost uniformly want from their service providers.*

## **Introduction**

Traditionally, service offerings are vertical based with a separation of business units by industry. A grid allows technical skills across horizontals to service each vertical that in turn services the external client who is classified by the business he is in. Banking and financial services, followed by telecom and health care are the significant consumers of these services from India. Typically, routine services that administer these industries are transferred to India; the work includes development and maintenance of technical solutions as well as back office functions, and in some cases, data and call centers.

While cost savings that prompted this migration have been realized, there are now some questions about the sustainability of the model, in part due to rising costs in India coupled with decreasing customer satisfaction levels. This may well be because the elements that are to be outsourced are not as well understood as we would like them to be. It is not just about lack of clarity in the requirements gathering phase, but something more complex in that the subjective parts of the relationship, have now started to more profoundly influence the payback these relationships are required to offer. Requirements are solicited by analysts, quantified and clearly articulated within development projects and service level agreements are drafted to quantify the level of service in terms of measurable units that a vendor is to provide. The difficulty lies in the fact that the target is now a perpetually moving one, and the requirements are defined on the fly by a community of influencers that are often not in direct contact with the provider. The users are often a community removed and increasingly more powerful. Attempts to harness their power by translating their voice into the offering in real time have not met with consistent success.

## **User Power**

Vertical expertise in the traditional sense is no longer a rare commodity. Unfortunately, for those who have toiled long and hard to acquire it, vertical expertise becomes legacy faster and faster. Often, experience amongst the practitioners within an industry leads to rigidity, becoming a handicap, as it contorts into a barrier to thought, even preventing the use of current tools that homogenize erstwhile disparate industries. The user, even a relatively inexperienced user, now has unprecedented power to shape the object that he uses, be it in design or in functionality. The Internet is the great leveler. The progressive enterprise has started to relinquish power over its offering, becoming a vehicle that is driven by the user, evaluated frequently by the user, and in many cases just acting as the medium of expression of the user's perception of value. Terms like Web 2.0 express this concept that has extended beyond the Web in guiding the core of a business to becoming what its customers want it to be.

## Emergence of the 6th Vertical

The products in the marketplace that enable technology to satisfy the needs of business, with increasing flexibility, are seeking to allow a business to retain their differentiators. However, the service providers themselves have become less flexible, even somewhat rigid in determining how a customer should use their industry specific offerings.

In the late nineties and in the first part of this decade, large enterprises successfully offshored worldwide, the replicable parts of their business processes. Assembly lines were built overseas, to take advantage of labor costs and efficiencies that could be realized by a modernized assembly line, where cost per KLOC was reduced and defect density was monitored and improved. While this objective was realized, particularly in support, a vague dissatisfaction started to assert itself.

These rumblings that 'all was not well', took the following shapes. Firstly, customer satisfaction ratings, never really evidenced a glowing satisfaction, in fact the vast majority ranked their experiences as "somewhat satisfied". Secondly, increasing costs incurred by service providers, due to competition for resources, and the lower net realization due to currency exchange rates, were not compensated. Consequently, sales prices uniformly remained at the same level, despite various attempts by service providers to go up the value chain and charge premiums on consulting services. The high-end business solicited by the large offshore providers, never really took off and even today, accounts for a small fraction of overall revenues, and in itself, in many cases has yet to demonstrate profitability. Thirdly, and perhaps most damaging, was the fact that a variety of less structured buyers, and not just the SMB community, found the offshore experience quite disruptive and unable to fit in with their internal teams, technical or business, that were required to work closely.

This group is willing to pay the premium on higher, intimate service levels when compared to the assembly line offering. The structure required to service such a group is emerging fairly clearly.

The characteristics of this group, the 6<sup>th</sup> Vertical, that is growing by the day, and will continue to grow as service levels rise across the world, are evidenced by a variety of distinct symptoms displayed by the group, when exposed to the solutions offered by traditional service providers. These symptoms may include most or all of the following

- Indifference and lack of excitement
- Price discussions early and frequently with value received or provided unrecognized
- A disquieting realization by the client that this relationship is not sufficient to guarantee business longevity
- Supplier versus partner mentality, glimpses of mutual profiteering

- Unwillingness to share plans
- Slippages, lack of accountability and two way suggestions to improve

It is interesting to see that the 6<sup>th</sup> Vertical co-exists within other verticals, thereby increasing its own size. Large multinationals that require assembly line production units also require more sensitive offshore partners to work with, for their other needs. While the larger vendors set up industry based Business Units, built to service a 'Vertical' in the traditional sense, they often find their bulk production systems do not lend themselves to think fast or change fast enough to cater to those sub-sets within the larger enterprise that seek a more agile offering.

The offshore provider, who caters to this community, has a potentially larger customer base than ever before. If from the ground up, he creates a platform with this target in mind, in terms of human skills, attitude, and technical skills, he has an unprecedented opportunity to profit and grow, on a larger scale than his predecessors who built their service platforms to cater to one or more of the traditional verticals.

Their requirements are addressed by a variety of measures common to this group. The financial results of doing so from offshore are impressive. Quite naturally, the group is seeking to purchase something more, for less, when compared to the price of customer centric service within their native habitats that is extremely expensive, if at all available in terms of a 24 x7 implementation, on the scale they demand it.

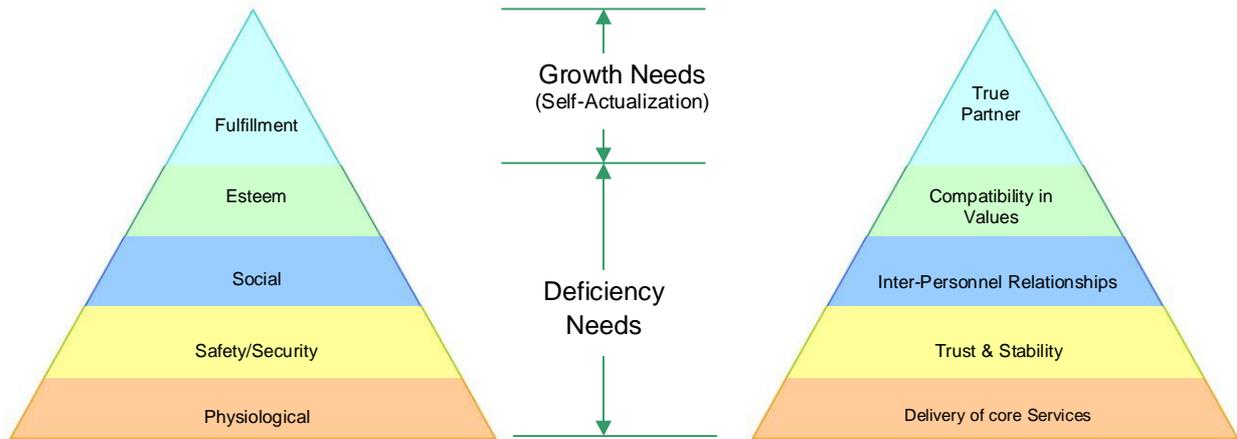
## **Maslow and the hierarchy of needs as expressed in software services**

Abraham Maslow, an eminent American psychologist in the middle of the last century, best known for his work on human motivation that guides behavior and consequently influences buying patterns, conceptualized the pyramid of needs of the individual.

It may be interesting to explore a parallel, substituting “the business” for the individual, and extend his theory to the present context.

Maslow stated: *“Deficiency needs must be met first. Once these are met, seeking to satisfy growth needs drives personal (business) growth. The higher needs in this hierarchy only come into focus when the lower needs in the pyramid are satisfied. Once an individual (business) has moved upwards to the next level, needs in the lower level will no longer be prioritized. However, if a lower set of needs is no longer being met, the individual will temporarily re-prioritize those needs by focusing attention on the unfulfilled needs”.*

In the case of the business, the *deficiency needs* are similar to those articulated by Maslow in 1943 with reference to humans; oxygen, food and water, termed as “the bread and butter” or the basics of a business model - the ability to produce somewhat efficiently and keep “churning it out”. The first step up the pyramid would be the need for security and safety. That too is in line with business goals, once the basic model is seen to function. Rapidly, we move to the need of a business to reach “self actualization” as do humans, strikingly characterized by the very same elements, a desire to contribute, morality or the desire to do the right thing, lack of prejudice and an awareness of facts. Current business trends and growing corporate awareness, in many cases, enforced by law, demonstrate that businesses, their employees and their customers are increasingly preoccupied in satisfying these so called higher needs, as the deficiency needs are satisfied by the efficiencies of the production line. Al Gore and others occupied with sustainability, be it in the corporate model or in preservation of the world as we know it, are louder voices that are being taken seriously. Al Gore recently joined Kleiner Perkins Caufield and Byers (a prestigious VC firm in Silicon Valley) as the partner heading up their climate change solutions group. Gore is hoping to translate his standing as the top evangelist on climate change to push businesses worldwide to increase their investments in renewable energy and other projects to reduce greenhouse gas emissions (source: [www.sfgate.com](http://www.sfgate.com))



Compatibility, in values, and the administration of human resources, in the client and provider environment, takes greater meaning and is no longer just a desirable trait, but a necessary one. A genuine sharing of ideology is required, with a common recognition of the joint enterprise's changing role as they together serve a very demanding market. A service provider therefore becomes a partner, in the fuller sense of the word, almost intuitive in his understanding of his client, and modifying his ability proactively, before receiving firm directives from his client, that may often be too late to save the relationship. The service provider must be privy to his client's thoughts and plans early in the game.

The delivery is not contained or restricted to providing a feel good factor, it must include the real understanding and delivery of the lower level needs, the so called *deficiency needs*, together with the higher ones, for as Maslow pointed out seventy years ago, the lower needs have to be continuously satisfied or regression will occur. The higher needs here should not be confused with providing business consulting which is a different service and perhaps a complementary one. The needs that are to be satisfied refer to the more complete expression of the requirement within the delivery of the functionality that is contracted. The recognition of the perceived contract that may be quite different from the written one, the gradual move towards acknowledging, even nourishing mutual dependency, and developing a hard-earned and durable intimacy.

The offshore provider, who has built the assembly line to cater to *deficiency needs*, may find himself in the position of a start up, for he is now required to identify, acknowledge and create the environment required by this community. There are difficulties in retro-fitting the distinct and increasingly clearer articulation of dissatisfaction into the mold that was never designed for flexibility.

Reusable flexible molds can be constructed, ground up, and scale can be realized, while preserving the elements required. The ability to serve a large number of seemingly

disparate individuals is made easier by identifying the common traits at the top of the pyramid to which this community belongs and creating a cost effective structure to serve them. Offshore, India and China, with its vast labor force does not have to automate beyond a level where such automation erodes the custom-made look and feel of the solution. Preparing the resources to serve the growing market represented by the 6<sup>th</sup> Vertical requires discipline and training not unlike the rigor of serving the other verticals, but with the focus on different elements catering to more evolved needs and consequently yielding much higher benefits in terms of return on investment.

## The profile of the service provider

The growth of a provider, who identifies and creates a platform to cater to the 6<sup>th</sup> vertical, is accelerated and stabilized when a large user, who has access to traditional sources of supply, finds value in this service offering. Companies who have satisfied their primary needs and seek leadership positions through a more intuitive understanding of their existing or new customer segments, often are the first to accept and utilize this offering, since it allows them to bridge a gap they see within themselves, irrespective of their own resources.

A new breed of service providers must develop to fill this need of the 6<sup>th</sup> vertical. They will not be limited or successful purely by virtue of geography, market maturity, and technology or domain expertise. Also, one needs to take cognizance of the fact that the concept is not confined to developing the so called soft skills; however empathy, and the ability to develop and nurture it across the company, could well be the differentiator, determining the success of those who choose to enter. Empathy can be created, and there is a cost and investment in doing so. The selection criteria may have to weed out closed thinking individuals, followed by training of skills across broader areas, in relation to domain and technology. Particularly, an ability to cross industry verticals and seeking to understand service deficiencies that stem from communication gaps, with a greater focus on cultural differences besides mere language skills. Almost all such service providers would require a domestic native front-end, coupled with an offshore back-end that embodies the discipline and willingness to perform repeatedly mundane tasks.

The back-end must preferably be located in one of the skill-set supermarkets such as those that exist in India or China, where a wide range of technical skills can be sourced on-demand. Such flexibility is now mandatory but the decreasing profitability forbids a large bench. How well a company bridges these conflicts and remains agile, while fostering a successful retention policy for high performers, is perhaps the barometer of longevity in the race that will be run. For example, a company that has a development base in one of the Tier 1 cities where such wide skills are available could operate support centers in Tier 2 or Tier 3 cities. In these units, the company could create a link between the city's social well-being and the company, so employees in such cities are seen by the community as those that communicate to a larger cause, and therefore fulfill in themselves a higher need that is not met purely by financial compensation, and therefore are more resistant to change.

## **Summary and a glimpse of the future landscape of the offshoring industry**

The decreasing disparity in living standards and costs between the consumers and offshore providers of a service has started to force a change in the model and type of services that can be profitably provided. The decrease in the gap between supply and demand of virtually all consumer goods and the increasing difficulty in product differentiation as seen for example in the telecom industry provokes focus almost exclusively towards differentiation within the service element. Banking and financial services, including insurance are other such domains. These so called 'verticals' are therefore in some sense becoming governed by horizontals, with service related technical and non-technical assets, spread across their business implementation, determining the sustainability of the enterprise. The power of the user, faced with the widest choice in economic history, available to him at the speed of the internet, across hitherto disparate boundaries, spells life or death even quicker than ever before. The evolution of his needs, extending beyond the basic elements of functional well-being, now require a platform to deliberately identify and promote the growth of an infrastructure of people, facilities and community who will be chosen to service such higher level needs. In many cases, such a structure cannot be created by modifying an existing model that was built for a different purpose and we may see the rise of a new genre of enterprises built ground up to satisfy the new generation of business providers who in turn require a new generation of service providers that identify closer than ever before with their changing marketplace. The rewards of doing so will be reaped at Internet speed, as the channels of providing such service are no longer constrained.

These hybrid models of the future that could well be a composite created from India, China and the West, that blends the recognition of these needs as articulated by the Sixth Vertical, together with their realization in one seamless pyramid, will secure the future of the offshoring industry. They will coexist with the traditional providers of vertical expertise, who with optimization and tightening of the belt may continue to serve their client base. It may be difficult for the traditional providers who have built fairly rigid assembly lines based on vertical or solely industry specific knowledge domains to make the shift to the Sixth Vertical as their legacy would burden their flexibility. However with the help of radical surgery, they could mutate themselves to adapt and carve a place as they fundamentally reinvent themselves from the ground up. All in all, it will be an extremely interesting battle ground, with Goliaths battling Davids, better equipped than ever before with user molded slingshots.