

Towards value creation

Aspire Systems says companies can take a leaf from manufacturing, for outsourcing product development.

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The Chennai-based Aspire Systems focuses on 'helping software companies create innovative products,' as its home page, www.aspiresys.com, states. "Why should product companies build their own products? Shouldn't they be able to tap specialists who can build their products for them?" argues Aspire, as its *raison d'être*.

And its work has recently earned it a place in 'Deloitte Technology Fast 50 India 2006', as one of the fastest growing technology companies in the country. Here, Gowri Shankar Subramanian, CEO, Aspire Systems, takes on a few questions from eWorld.

To many, IT = software = service. Isn't there a confusion?

Very much, and a fundamental one. Because, if you were to ask, 'What business are you in?' many IT companies are likely to say, "We are in the software services business." But the reality is different. In truth, most of our IT (information technology) companies are in the 'cost arbitrage business', typified in BPO (business process outsourcing).

Why is it important to know what business one is in, as long as it earns revenue?

As the booming US railroad businesses of the early 1900s can easily tell us, it is extremely vital to understand what business one is in. How so? If only the railroad barons had defined themselves as being in the 'transportation business' and not in the 'railroad business', they would have responded much faster to competition from several new alternative modes of transportation (trucks, airplanes, cars). In that process, they would have saved themselves from dozens of crippling bankruptcies.

Do you see a threat in the flawed perception that IT companies may

entertain?

Like all history lessons, the railroad story holds a simple moral. That it is important to honestly appraise what business one is in. Defining most Indian IT companies (leaders and small companies) as being in the cost arbitrage business helps us understand our number one threat – becoming more expensive. And all signs today point to a continuing decline of cost arbitrage.

What are the signs, the redflags, as you see them?

Take, for example, wage trends in India and the US. Salary increases for the IT industry are in the range of 15-25 per cent year-on-year. Comparatively higher than that of other countries in the region. The cost of labour in India will continue to rise, and this is likely to accelerate with increase in demand. In sum, therefore, although IT employees in the US continue to earn considerably more than their counterparts in India, the cost differential is expected to decline significantly by 2007.

Can't we sustain the cost advantage? And, what happens when one loses the cost advantage?

A close look at the IT industry trends in India will reveal that cost advantage will not be sustainable. The skilled manpower strength is growing with the industry at a rapid pace and as history would reveal, once trained and experienced, manpower does not stay low-cost very long. Sooner or later, costs will come close enough to the US, which is when it won't be viable any longer to move work to India just for the cost advantage.

Customers who have come in search of cost arbitrage will constantly migrate in pursuit of the same. Today, it is India. Tomorrow, it could be Malaysia, Indonesia or China. A whole lot of offshore businesses will vanish if companies don't move away from selling cost as their primary advantage.



Illustration by V.S. Wasson

Sounds perilous. What is your prescription?

The time has come for Indian IT companies to focus on 'value creation'. India can counter the eroding competitive advantage (i.e. a combination of low cost and high skill) by moving up the value chain. Interestingly, we have parallels from manufacturing.

Such as?

Unable to sustain profits because of high labour costs, the manufacturing industry in

the US witnessed nearly 2 million jobs being shifted to countries with lower labour costs. Mexico, with its proximity to the US and low costs, was the most viable option then. However, as demand soared, costs went up significantly in Mexico, forcing jobs to move to China.

What are the takeaways for the IT industry from the manufacturing example?

What is striking is that the exodus of jobs to China happened within a decade. Since 2000, government estimates in Mexico

point out a whopping 2,50,000 job losses. Even more striking is the fact that if capital-intensive manufacturing can move so easily, IT jobs, undoubtedly, can shift even more quickly.

Value creation, moving up the value chain. But how?

A case in point is the niche area of OPD or 'outsourced product development'. Indian companies addressing this market are seeking to achieve a paradigm shift in the thought process of software product companies worldwide by getting them to think whether product development is their forte, or if they are better off outsourcing it to a specialist.

The key driver in OPD isn't cost?

The fundamental proposition behind OPD is not just cost, but the ability to build products better and faster to keep up with rapid changes in technology and market demand for innovative features. The implausible combination of technology, expertise, flexibility and costing has been an alluring proposition for most software product companies preparing to outsource to India. However, catering to such requirements calls for more sophisticated technical design and architectural capabilities than in the past.

A leaf from manufacturing, again?

True, this phenomenon is certainly not new. The pharmaceuticals, automobiles, and consumer electronics industries are replete with outsourcing trends that are so complete. BMW outsources the entire product development and manufacturing to Steyr – Daimler Puch Fahrzeugtechnik (SFT). SFT also undertakes manufacturing for Daimler Chrysler in Europe. There is no reason why this manufacturing trend cannot be repeated in software product development.

How much is the potential?

Taking a cue from the potential of nearly \$8-11 billion in the products and technology services market as projected by Nasscom-McKinsey, Indian companies focused on outsourced product development are well-positioned to capitalise on the market, move up the value creation chain, and of course, move away from cost arbitrage.