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The Effects of Outsourcing Industry Growth on BPO firms in India- A Study from Financial Perspective

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ABSTRACT

The growth of outsourcing industry across the globe is magnificent and has been continuously shooting up with double digit growth every financial year. It is like a fashion going on across the world of outsourcing. Due to its ever expected growth rate many firms have entered into outsourcing business in India too. But there is a dilemma among the entrepreneurs whether they will achieve the same pace of growth in outsourcing business or not? Whether they will have positive impact of outsourcing industry growth on their financial performance? Is there any relation between industry growth and firm's individual growth? To answer these questions the current study has been taken over with two BPO firms as sample and finds relation with outsourcing industry growth. The study has taken 10 years financial data of BPO firms and 10 years revenue data of outsourcing industry for analysis. The research finds impact of industry growth on financial performance of sampled firms and studying relation between these two variables. With help of important financial ratios, t-test & pearson's correlation study analyzed the data and achieved research objectives. The result indicates that there is a positive relation between the studied variables. Firms' financial performance has been increased during the 10 years duration with an increase in industry revenue.

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Introduction

Growing complexity in business operations and global market scenario has brought organizations putting themselves into safe mode through finding best alternative available to achieve competitiveness. Firms need extra pace and accelerator for meeting business objectives and fulfilling market expectation while increasing market share, increasing revenue and achieving global footprints. In this highly competitive world outsourcing has been identified as best strategic decision to remain competitive. Outsourcing became a strategic move for the companies to reduce cost of production and be competitive at global market but on the other side it was difficult to handle distribution of works among various companies. The potential distribution of work across geographic and temporal boundaries requires careful delineation of the economic ramifications of alternative distribution models in order to elicit the optimal benefits from the outsourced model. Hence, firms keep hold of in-house activities and externalize other non core activities from best supplier (Aoki, Gustafsson, and Williamson, 1990; Williamson, 1995).

The current research would find whether this positive scenario of outsourcing across the globe offering financial benefits to the service providing firms in equal proportionate of not? Outsourcing provides competitiveness to the sourcing firms and helps them in saving cost and increasing profit, does it do so for outsourcing providing firms too? Whether the growth of outsourcing industry positively affects the growth of service providing firms? Is there any relation between outsourcing market and financial performance of individual firms?

The above research questions are answered with help of analyzing financial statements of two popular BPO firms taken as sample viz. eClerx Services Ltd. & Firstsource Solutions Ltd. The analysis of financial statements is done with the help of ratio analysis because financial ratios are the best determinants of determining financial health of a firm. The analysis is done in two steps to study financial impact over these firms. First, study liquidity of the firm with the help of *liquidity ratio* which comprises three important ratios viz. current ratio, cash ratio & acid test ratio. Second, study profitability of the firm with the help of *profitability ratio* which comprises three important ratios viz. gross profit margin ratio, return on asset ratio & return on equity ratio. The study also worked out at finding relationship between outsourcing industry growth and financial performance of outsourcing service providing firms i.e. BPO firms.

1.1 Outsourcing Phenomenon

Outsourcing is a fastest emerging phenomenon. Over the last two decades outsourcing has become the norm rather than the exception. Outsourcing was started in 1970s but it grew rapidly after 1990s (Hatonen and Eriksson 2009). The global outsourcing market was estimated about \$232 billion which in the year 2008 was amounted up to \$443 billion (Newton-Taylor 2010). Outsourcing as a strategic business move growing rapidly worldwide. Every organization is fighting to be competitive in the market for their long run sustenance and customer retention. The outsourcing technique is outcome of 'David Ricardo' theory of 'Comparative Advantage' where Ricardo (1817) suggested that a country should produce the goods in which it has comparative advantage compare to other producing country. This theory explains the advantage earn by country due its expertise, thus resources can be best utilized at

lowest cost. Today, companies are following the same pattern of business operation where they like to source services, material, semi-processed item etc. from the other manufacturing company who has got economies of scale in such production. Multinational companies are the best example of outsourcing, such companies concentrate on their core business activity where as associated assembly parts are being outsourced. Outsourcing is a management practice since over 200 years but it has achieved significant attention in the recent decades as the volume of world trade has grown rapidly. According to Defond, M.L., and Park, C.W. (1997) outsourcing facilitates multi-facet benefits to the firms like business effect, functional effect, financial effect and cost effect Outsourcing provide opportunity to the firm to get intellectual capital which otherwise may not be available to them to become best in business operation.

1.2 Financial Inclusion of Outsourcing

As the demand grew after 1990s outsourcing business achieved tremendous growth in revenue generation by service providing firms. It is like a new industry started up for entrepreneurs who are efficient and has expertise into any business function. They started enmeshing their expertise by offering services to less competitive business bodies. Global demand for various services offered outsourcing services providing firms double digit growth in every financial year. Tata Consultancy Services reported strong growth in revenue and profit in the fourth quarter, taking advantage of an improvement in key markets for offshore services like the U.S. and Europe. According to International Financial Reporting Standards, the revenue generated by Indian outsourcers was 17 percent more than the last year of same quarter. This phenomenal increase in revenue made outsourcing a blessed industry. If this growth converts into rupee term the percentage of growth was 50 percent due to rupee weaken against US dollars.

Till 2007 business research outsourcing in India had achieved significant growth in revenue and provide strong financial performance. That time industry was full with desired profit, better margins and high return on investment. It attracted new investors too and gets existing stakeholders calm and satisfied. Research analyst (Value Notes, a research firm) estimated 47 percent CAGR growth of outsourcing industry during 2007-12. This has not only appreciated wealth of business but also led service providing firms to strong their financial health.

2 Literature Review

Entrepreneurs have learnt strategic advantages of outsourcing over a period of time and accepted it with open heart and mind. They took business outsourcing as a means of achieving competitiveness in this highly curious market. Outsourcing is being used by many firms in different industries as well as sectors. Services like operations, labor management, logistics, packaging, IT solution, SCM etc. are very common type of services that are being outsourced from last so many years. But over some years BPO & ITeS outsourcing has declared phenomenal growth in outsourcing business. The concept of outsourcing sourced from underperformance of industries and firms in various business tasks. Firms have come to know that all business functions cannot be carried out efficiently by themselves. Therefore, they feel like performing essential task/core function themselves and non core functions to be outsourced from an efficient supplier (Peters and Waterman, 1982). Hence, from

then it is continuously going on and growing with unpredictable pace.

The fashion of outsourcing opened new vistas for new ventures and entrepreneurs who had expertise in specific business function. The revenue growth of outsourcing industry has significantly grown with double digit numbers. India's information technology and outsourcing business are set to cross \$100 billion revenue. This phenomenal growth in industry revenue has blessed company's financial performances that are into the business of service providing (outsourcing business). As per the NASSCOM (2007) report and various industry experts the revenue can be predicted around \$225 billion by 2020. One of the prime factors of this growth is incremental growth in technology spending worldwide. Transforming global trading system has brought new avenues of outsourcing services to service providers. Due to the attractiveness of industry many new players are entering into different types of services.

According to Malhotra (1995), factors that affect IT outsourcing decisions are reduction in operating costs, cost predictability due to fixed contract, sharing risk on technology investments, access to specialized expertise, political reasons that hinder internal IS (Information system) efficiencies, and perception of efficiency of internal IS function. Another potential cause of IT outsourcing is IT cost structure. It carries huge investment over IT infrastructure, skilled employees and timely maintenance. Therefore, literatures revealed that IT outsourcing is found to be positively correlated to business and IT cost structure, and negatively related to the performance of the existing IT infrastructure (Loh & Venkatraman 1992).

Service providing firms are getting revenue advantages from outsourcing business because organizations believes that outsourcing offers innumerable benefits to them which otherwise not possible. According to Narayan (2009) outsourcing offers various advantages to the firm among all four major advantages are scalable output, improved revenue and cash flow, better control and improve overall business functions. Such strategic advantages ensure the existence and survival of outsourcing firms in today's global outsourcing market. Another factor that has direct influence on demand for outsourcing services is consumers' expectation for high quality products and services at reasonable price. This is forcing firms to get high quality services and acquire global talent at very competitive rates to make themselves competitive. Such business moves enlarge the scope for firms offering outsourcing services (Gupta, 2009).

Another biggest factor which has sound reason to push demand for outsourcing business globally is implementation of globalization and economic integration of different economies. This has introduced offshore outsourcing requirement among the organizations working abroad (Ramaswamy, K. V. 2003). Since, India is recognized as best strategic location for doing business in and around Asia pulled MNCs in India. As a result MNCs are primarily depending on and getting offshore outsourcing from Indian outsourcing firms. This offshore outsourcing trend has brought great demand for outsourcing services in India and acknowledges bright future for outsourcing firms. These are some potential reasons which may cause for astonishing growth in industry revenue as well as firms financial performance.

3 Methodology

3.1 Research Problem 1: Does firms' liquidity position affect with an increase and decrease in BPO industry revenue?

H₀₁: There is no significant impact of industry growth on BPO firm's liquidity position.

Research Problem 2: Does firms' profitability position affect with an increase and decrease in BPO industry revenue?

H₀₂: There is no significant impact of industry growth on BPO firm's profitability position.

Research Problem 3: Is there any relationship between BPO sector growth and outsourcing industry growth.

H₀₃: There is no significant relationship between BPO sector growth and outsourcing industry growth.

3.2 Sample for study: Two firms have been taken as sample to study the research problem.

Sample Firms	
eClerx Services Ltd.	Firstsource Solutions Ltd.

4 Objectives of the Study

- To study the trend of revenue growth of BPO industry in India.
- To study the impact of revenue growth of BPO industry on liquidity position of firms.
- To study the impact of revenue growth of BPO industry on profitability position of firms.
- To determine and analyze the relationship between BPO sector growth and industry growth.

The above discussed research problem is carried out with an objective to study relationship between BPO firms' revenue and overall industry revenue as well as individual impact on each BPO firm taken as sample. The study is based on 10 years financial data of specific BPO firms and overall industry. Analysis is done in two ways first identify the correlation directly among BPO sector growth and outsourcing industry growth and second impact on individual BPO firm's financial performance. For this Pearson's correlation statistical tool and Paired t-test is used with the help of SPSS. To study the relation and impact research used financial statements of sampled firms. To measure the financial impact of outsourcing

industry growth on firm's financial performance the research studied 'Liquidity Position with the help of liquidity ratio & Profitability position with the help of profitability ratio. Further, three important ratios viz. cash, current & acid test ratio (refer to exhibit 1) for both the firms were studied to predict liquidity position of the firm whereas, gross profit margin, return on asset & return on equity (refer to exhibit 2) for both the firms has been studied to predict profitability position of the sampled firms.

5 Result Analyses

5.1

H₀₁: There is no significant impact of industry growth on BPO firm's liquidity position.

The test is found significant at 5% level significance as the sig. value is found $0.00 < 0.05$.

The null hypothesis found rejected, hence, the study concludes that there is a significant impact of industry revenue growth on liquidity position of eClerx. With the help of this result current research also acknowledge the positive relationship among industry revenue and financial performance of sampled firm.

The test is found significant at 5% level significance as the sig. value is found $0.00 < 0.05$.

The null hypothesis found rejected, hence, the study concludes that there is a significant impact of industry revenue growth on liquidity position of Firstsource. With the help of this result current research also acknowledge the positive relationship among industry revenue and financial performance of sampled firm.

5.2H₀₂: There is no significant impact of industry growth on BPO firm's profitability position.

The test is found significant at 5% level significance as the sig. value is found $0.01 < 0.05$. The result revealed that there is a significant impact of industry revenue growth on profitability position of eClerx. With the help of this result current research also acknowledge the positive relationship among industry revenue and financial performance of sampled firm.

Table A .T Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Industryrevenue - Liquidityeclerx	7.01970E1	33.82386	10.69604	46.00087	94.39313	6.563	9	.000

Table B.Paired Samples Test

		Paired Differences					T	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Industryrevenue - Liquidityfirstsource	7.00900E1	34.95407	11.05345	45.08536	95.09464	6.341	9	.000

Table C.Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Industryrevenue - Profitabilityeclerx	-1.04450E1	251.17584	79.42878	-190.12537	169.23537	-.132	9	.01

Table D.Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Industryrevenue - Proffirstsource	7.13160E1	33.92261	10.72727	47.04923	95.58277	6.648	9	.000

Exhibit 1

eClerx SERVICES LTD. (INR Crore)

FIRSTSOURCE SOLUTIONS LTD. (INR Crore)

LIQUIDITY RATIO

LIQUIDITY RATIO

Years	Current Ratio		Cash Ratio		Acid Test Ratio		Years	Current Ratio		Cash Ratio		Acid Test Ratio	
	CR= CA/CL	Value	Cash R= Cash/CL	Value	ATR= (CA-Inventory.)/CL	Value		CR= CA/CL	Value	Cash R= Cash/CL	Value	ATR= (CA-Inventory.)/CL	Value
2014	376.98	1.995	222.49	1.177	376.98	1.995	2014	23.75	0.091	28.78	0.110	23.75	0.091
	188.95		188.95		188.95			260.86		260.86		260.86	
2013	228.58	1.541	169.50	1.143	228.58	1.541	2013	-104.58	-0.394	25.33	0.095	-104.58	-0.394
	148.29		148.29		148.29			265.58		265.58		265.58	
2012	283.16	2.540	161.29	1.447	283.16	2.540	2012	-572.38	-0.410	556.33	0.398	-572.38	-0.410
	111.48		111.48		111.48			1397.73		1397.73		1397.73	
2011	192.89	1.704	149.27	1.319	192.89	1.704	2011	914.09	3.860	147.56	0.623	914.09	3.860
	113.18		113.18		113.18			236.78		236.78		236.78	
2010	164.17	3.451	45.33	0.953	164.17	3.451	2010	1011.85	10.905	11.84	0.128	1011.85	10.905
	47.56		47.56		47.56			92.78		92.78		92.78	
2009	131.31	2.744	18.92	0.395	131.31	2.744	2009	253.35	1.864	15.31	0.113	253.35	1.864
	47.86		47.86		47.86			135.94		135.94		135.94	
2008	104.50	4.146	12.45	0.494	104.50	4.146	2008	-175.47	-0.347	31.18	0.062	-175.47	-0.347
	25.21		25.21		25.21			505.33		505.33		505.33	
2007	21.66	3.495	7.35	1.186	21.66	3.495	2007	548.75	7.129	241.06	3.132	548.75	7.129
	6.20		6.20		6.20			76.97		76.97		76.97	
2006	4.66	0.345	5.90	0.437	4.66	0.345	2006	92.07	1.378	1.92	0.029	92.07	1.378
	13.50		13.50		13.50			66.80		66.80		66.80	
2005	3.16	0.954	1.85	0.559	3.16	0.954	2005	84.68	2.328	5.68	0.156	84.68	2.328
	3.32		3.32		3.32			36.38		36.38		36.38	
Average -		2.292		0.911		2.292	Average -		2.641		0.485		2.641

Exhibit 2

eClerx SERVICES LTD. (INR Crore)

FIRSTSOURCE SOLUTIONS LTD. (INR Crore)

PROFITABILITY RATIO

PROFITABILITY RATIO

Years	Gross Profit Margin		Return on Asset		Return on Equity		Years	Gross Profit Margin		Return on Asset		Return on Equity	
	GPM= (Sales-Cost of goods sold)/Sales	Value	ROA= Net Income/Total Asset	Value	ROE= Net Income/Shareholder's equity	Value		GPM= (Sales-Cost of goods sold)/Sales	Value	ROA= Net Income/Total Asset	Value	ROE= Net Income/Shareholder's equity	Value
2014	246.51	0.346	729.15	1.006	729.15	24.162	2014	134.47	0.141	987.41	0.571	987.41	1.497
	713.38		724.50		30.18			954.17		1728.48		659.74	
2013	155.92	0.273	579.84	1.040	579.84	19.409	2013	117.39	0.129	1055.46	0.668	1055.46	1.605
	570.92		557.70		29.88			910.64		1579.73		657.67	
2012	157.33	0.333	494.79	1.098	494.79	17.028	2012	45.36	0.060	961.65	0.418	961.65	2.232
	472.47		450.47		29.06			754.26		2298.09		430.78	
2011	118.56	0.347	366.00	1.049	366.00	12.685	2011	66.29	0.094	769.63	0.314	769.63	1.787
	341.91		348.90		28.85			702.97		2449.28		430.64	
2010	72.59	0.282	262.45	1.065	262.45	13.791	2010	67.33	0.102	833.88	0.352	833.88	1.943
	257.02		246.37		19.03			661.72		2371.47		429.21	
2009	60.64	0.308	201.96	0.951	201.96	10.670	2009	15.11	0.027	837.74	0.334	837.74	1.956
	197.09		212.39		18.93			566.04		2511.26		428.19	
2008	43.91	0.375	123.46	0.766	123.46	6.543	2008	57.64	0.117	516.44	0.231	516.44	1.209
	116.98		161.25		18.87			493.91		2239.44		427.31	
2007	39.67	0.461	86.23	2.426	86.23	85.127	2007	74.28	0.172	445.98	0.379	445.98	1.049
	86.12		35.55		1.01			432.68		1178.05		425.08	
2006	24.46	0.518	47.69	1.816	47.69	47.098	2006	15.77	0.048	330.92	0.546	330.92	1.639
	47.20		26.26		1.01			327.14		605.82		201.88	
2005	11.22	0.423	26.64	2.734	26.64	2220	2005	9.04	0.036	256.81	0.486	256.81	1.279
	26.53		9.75		0.01			253.54		528.72		200.75	
Average -		0.367		1.395		245.660	Average -		0.092		0.430		1.620

The test is found significant at 5% level significance as the sig. value is found $0.00 < 0.05$. The result revealed that there is a significant impact of industry revenue growth on profitability position of Firstsource. With the help of this result current research also acknowledge the positive relationship among industry revenue and financial performance of sampled firm.

5.3 H₀₃: There is no significant relationship between BPO sector growth and outsourcing industry growth.

Table E. Correlations

		Industry growth	BPO growth
Industry growth	Pearson Correlation	1	.909**
	Sig. (2-tailed)		.000
	N	10	10
BPO growth	Pearson Correlation	.909**	1
	Sig. (2-tailed)	.000	
	N	10	10

** . Correlation is significant at the 0.01 level (2-tailed).

Here, the null hypothesis H₀₃ stands rejected as the sig. value is found $0.00 < 0.01$ (standard sig. value) which reveals significant relation between the two variables.

The test result is found significant at the 0.01 level of significance or 99 percent of level of confidence.

Correlation result in table E reflects a positive (close) relationship among the studied variables viz. Industry growth and BPO growth. The value is found 0.909 for BPO sector growth with respect to outsourcing industry growth i.e. 1. The relationship can statistically prove as the degree of influence of industry growth over BPO sector growth as 1:0.909. This high value of ratio indicate that there is a strong positive relation between industry growth and BPO growth, it also means that if industry revenue changes with one unit there would be a positive change in BPO revenue by 0.909 unit.

6. Conclusions

Based on the deep investigation of financial statements of selected firms to understand the relationship among outsourcing industry and BPO sector and impact of one on another the present research reached at the conclusion that two variables are highly connected and responsible for growth of each other. Research concludes that outsourcing industry growth has significant relation with BPO sector growth since it is a part/cash cow of outsourcing industry. Results also revealed that firms involved in BPO outsourcing business are achieving double digit growth in every financial year. Overall outcome of the current research comes in the form of empirical evidences which establish proofs of financial stability of the firms through profitability and liquidity position. Thus, the research contributes to the truth that Indian Outsourcing industry has tremendous pace to grow in revenue as well as market coverage. It has become an outstanding place for offshore and onshore outsourcing business. Under the umbrella of outsourcing BPO sector has come up as the most flourished sector.

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