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EXLSERVICE: BUSINESS PROCESS OUTSOURCING IN INDIA

Every morning in Africa, a gazelle wakes up.
It knows it must run faster than the fastest lion or it will be killed.
Every morning a lion wakes up.
It knows it must outrun the slowest gazelle or it will starve to death.
It doesn't matter whether you are a lion or a gazelle.
When the sun comes up, you better start running.

—African proverb, translated into Mandarin and posted on the floor of a Chinese factory, then translated into English and printed in *The World Is Flat*, by Thomas Friedman

At the dawn of 2003, ExlService founders Rohit Kapoor and Vikram Talwar were back in control of the Indian outsourcing company that they had founded four years earlier. Compared to struggling under the impending bankruptcy of their former parent company, it seemed that managing ExlService now should be easy: They had sufficient capital, top-tier investors, and a battle-tested workforce. Nevertheless, the partners had to face difficult strategic decisions about replacing the declining business from the company's erstwhile parent. While their employees had stayed with the company through some very dark days, they all had opportunities with other Indian firms as the competition for well-trained employees heated up on the subcontinent. Kapoor and Talwar had to run faster than ever, conserving the momentum from the firm's spinout, if they wanted to preserve their chief asset, their workforce.

Joshua Spitzer prepared this case under the supervision of John Morgridge, Lecturer in Business, and Charles A. Holloway, Kleiner Perkins Caufield & Byers Professor of Management, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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EXLSERVICE IN 2003

Defining Business Process Outsourcing

While there were over 400 Indian outsourcing service providers in India in 2003, ExlService was one of a handful that could provide true business process outsourcing. (For more background on the history of Indian outsourcing, see **Exhibit 1**.) Outsourcing consultant Maurice Greaver II defines a "business process" as linked activities that "create an output for the customers' benefit"; business processes are "how the products or services actually flow through the organization."[1] Touching the companies' products and customers, business process outsourcing (BPO) often comes close to companies' core value propositions.

In 1998, insurance companies could outsource arcane computer coding jobs that most consumers did not necessarily know even existed. In 2001, the same companies could outsource certain basic call-center functions connected to non-core services. By the mid-2000s, companies could outsource the complete processing of insurance claims, a service that came very close to customers' understanding of what an insurance company does.

That evolution changed the relationships between companies and their outsourcing providers. First, the cost of mistakes increased. When outsourcing a process moves knowledge and experience out of the company and into a third party, errors can not only drive customers away, but they can leave the company without the capacity to fix the problems. Accordingly, the relationship between companies and providers must be based on a high degree of trust, given the significant risk associated with the arrangement. In a true BPO arrangement, the provider takes on increased responsibility and independence to make the solution work well.

By 2003, ExlService had specialized in the financial services and insurance sectors, and the company could handle complex processes for clients in those industry verticals. The company offered insurance companies a range of offshore solutions that included new-business processing, claims processing, and premium administration. With ExlService managing those business processes, the insurance companies could focus on structuring new products, initiating new business, and other core competencies. In the banking and financial services vertical, ExlService worked with consumer finance companies, credit card companies, and mortgage lenders. It offered those clients services that ranged from customer service provision to loan verification to financial analysis. It also had the capacity to provide a range of accounting functions (from general accounting to transaction processing), and accounts receivable and collection services.

Value Proposition

Depending on the complexity of the process, ExlService could offer its clients savings of 25 to 60 percent over their existing in-house processing. While most of the cost savings were achieved through labor arbitrage (the practice of moving a job from a highly paid employee to a lower-

[1] Maurice F. Greaver II *Strategic Outsourcing: A Structured Approach to Outsourcing Decisions and Initiatives* (New York: American Management Association Publications, 1999) 6.

paid individual), ExlService deployed a rigorous process improvement regime, which would often reduce costs by an additional 10 to 15 percent. To drive process improvement and efficiency, the company invested heavily in Six Sigma methodology and training. It also developed proprietary enterprise software called ProMPT (Process Management Performance and Tracking) to help manage internal performance and offer real-time reporting to clients.

ExlService would begin a business relationship by identifying a company's opportunities for profitable outsourcing. It would establish a strategy around the outsourcing opportunity, and then it would develop action plans that would eventually have ExlService managing and improving the migrated processes. Process migration (from the client to ExlService's offshore employees) would begin with a careful audit of existing processes, during which ExlService would map exactly what the client does and would evaluate how well it performs those functions. ExlService would train its own employees to manage any specialized aspects of that process. It then would begin performing the process (modified as necessary) in India, first on a trial basis before ramping up to full off-shore processing. Ultimately, the company would monitor performance and begin process improvements.

Managing Human Resources in India

Compensating Indian employees was significantly different from compensating American workers with similar qualifications. Indian employees tended to value current cash compensation over deferred or equity compensation. In general, performance-based compensation tended to be a lower portion of employees' total compensation package than it would have been in a U.S. employee's situation. Furthermore, few Indian companies had offered their employees equity compensation, and many workers did not necessarily understand or value it. Instead, Indian employees tended to value personal development though experience and exposure to key clients. Establishing career paths that would include prestigious promotions and titles could also be important enough in some cases to replace incremental increases in cash compensation. Many Indian workers sought brand-name companies that would signal job stability and would be recognizable on their resumes. (See **Exhibit 2** for a summary comparison of American and Indian employee compensation.)

While it was clearly less expensive to hire an Indian employee to perform ExlService's processing work, high employee turnover became one of the greatest challenges facing Indian outsourcing firms. In 2003, according to Kapoor, the industry benchmark for annual turnover in Indian outsourcing firms ranged from 50 to 100 percent. The dramatic growth in the outsourcing industry contributed to the high turnover rates, giving employees an ever-increasing number of potential employers.

ExlService had invested significantly to keep its employees. Attracting and retaining entry-level associates presented different challenges from retaining managerial talent. Associates particularly were motivated by current cash compensation. ExlService had to increase its wages to keep pace with the market, but the large supply of well-educated college graduates kept the wage increases to about 7 percent total since the company's founding. Nevertheless, ExlService incurred other significant costs to maintain its associates. It offered a range of perks including free door-to-door transportation and free meals to all employees. The company encouraged associates to take pride in their company and recreate together, and it provided pool tables, gymnasiums, and other such facilities. Kapoor reported that such perks added as much as 25 to 30 percent to the cost of employing associates (beyond their wages and benefits). All told, ExlService paid about $0.67 in benefits and perks for each $1 in wages. The firm also retained associates by continually training them to handle more complex work while also offering an attractive career path. A promotion to team leader from associate would bring both prestige and a significant pay raise. Promising employees could expect 10 to 15 percent annual pay raises and promotions into supervisory roles.

Retaining managers was a somewhat different challenge that could be met with different tools. (See **Exhibit 3** for an organization chart of ExlService's senior management.) Replacing a manager at any level was a much more costly proposition than replacing an associate. Not only were talented managerial candidates much rarer than associate candidates, but ExlService's managers also built significant firm-specific knowledge. While some managers did have a bias toward current cash compensation, many were more comfortable with equity compensation, which figured significantly in ExlService's approach to retaining them. From its earliest days as a startup, the company had established a generous options pool for managers in India, and it made sure that such compensation was significant, especially by Indian standards. ExlService ensured that promising managers had clear and swift career paths ahead of them. The founders were careful to communicate frequently and with complete honesty. They established trust and loyalty in their management team and required the managers to do the same through the ranks. These measures helped to keep managerial turnover low—even though they were among the scarcest workers in India.

Training employees was a significant part of ExlService's human resource management challenge. All employees attended accent neutralization and culture training, which would prepare them to engage western clients on terms that would make the clients comfortable. This sort of training was ubiquitous throughout the Indian outsourcing industry, and it had become something of a science. Nevertheless, Kapoor reported, subtle cultural habits and differences persisted—and occasionally caused problems in BPO. For example, Indian employees tended not to be assertive when dealing with clients, so a pushy client could sometimes talk an ExlService account team into problematic situations. Kapoor reported that Indian employees often would apparently agree to a client's request with a statement that the employee took to mean "I will try my best," and the client took to mean "I commit to delivering on your request." The company went to great lengths to explain this cultural difference to both employees and clients; nevertheless, the problem persisted.

THE FOUNDERS

ExlService was founded by three Indian nationals, two of whom remained at the helm of the company in 2003. Rohit Kapoor and Vikram Talwar both earned MBAs at Indian Institute of Management, but they did not actually meet and become friends until both were working for Bank of America in India. Like many of their company's executives and managers, Kapoor and Talwar were educated in India but spent much of their professional lives working in multinational companies both in India and abroad.

In the early 1990s, Kapoor was transferred to New York to set up a new business unit for Bank of America. Soon after, he and Talwar began entertaining entrepreneurial ideas, starting with a plan to establish an Indian financial services firm that could loan capital to small and medium-sized enterprises in India. The pair produced a business plan but could not get it funded. With a better sense of the capital markets and the Indian regulatory environment, Kapoor and Talwar recast their plans and proposed to start a private bank in India. When the private bank plan fell apart, Kapoor reported, “We gave it up for a little while.”[2]

Before they could restart their entrepreneurial planning, Talwar resigned after a 26-year career at Bank of America, and he joined Ernst & Young, India, where he held positions of CEO and Managing Director. Kapoor also left Bank of America, moving to Deutsche Bank, where he managed international investments for clients all over the world. He reported:

> I was investing a lot of that capital into companies based in India, and they were basically providing software services. I began to learn about the leverage and the power of this industry. [For example,] I made an investment of $10 million on behalf of one of my clients in January of 1997, and by October, I think we came out with $80 million. It was phenomenal, and at that point in time, all of the IT-services companies used to trade at very low multiples. . . . These Indian companies had earnings, but they were being valued at ridiculously low levels.

Kapoor was well-positioned in the late 1990s to see the capital markets begin to appreciate Indian technology firms and to see funds flowing into that sector. Talwar also observed the phenomenon. He quit his job at Ernst & Young and approached Kapoor with a business plan to establish one of these emerging Indian IT-services companies. In short order, Kapoor quit his job to join Talwar and a third partner to co-found ExlService in 1999.

EXLSERVICE: VERSION 1.0

Getting Started

Kapoor and Talwar’s original business model was predicated on managing e-mail communication between dot-com businesses and their customers. Kapoor explained the business model:

> We had a very simple theory. The cost of processing an e-mail in the U.S. was around $3 per e-mail, and in India we figured we could do that at $1 per e-mail. We said we would charge our clients $2 per e-mail, so they’d save and we’d make a ton of money, and that was the business model. So it didn’t require much technology. It didn’t require much infrastructure. It was just trying to take care of the labor arbitrage. And because of the dot-com boom, we felt there would be a huge market opportunity for it.

Talwar’s business plan projected that the start-up would need $1.5 million in capital. The pair decided to seek $2 million (“to be on the safe side”) and eventually raised $3 million.

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[2] Interviews with Rohit Kapoor. Subsequent quotations are from the author’s interviews unless otherwise noted.

The partners had received their first investment commitments when Gary Wendt, the recently retired chief executive of General Electric Capital Services, contacted them about investing in ExlService as an angel. At GE Capital, Wendt had had some experience in India, and he was keen to invest in the emerging technology sector. The partners met Wendt at a restaurant, where he conducted fairly unconventional negotiations. Kapoor recalled the conversation:

> He threw away the business plan, of course, because he didn't look at it at all. He said, "This stuff has no meaning to me. I'm going to put in $1.5 million of my own money, and I want so much of an equity stake." And we said, "That's outlandish! We're not going to work for you!" He just picked up a paper napkin, wrote on it his terms, and said, "I'm going to the restroom. By the time I come back, you've either accepted it, or I'm walking off."

Kapoor concluded with a laugh, "So we accepted it. We really didn't have any choice. And that's how we got started."

Wendt became the Chairman of ExlService and quickly became engaged in the company's operations. He helped the partners raise the rest of the round, and then he helped them win their first two clients, 1-800-FLOWERS and Live Help (a company that provided customer service and technical assistances via text-based internet chat).

The Realities of Outsourcing

In spite of ExlService's success with its early accounts and Wendt's extensive connections, building a customer base proved to be difficult, and the partners learned their first hard lesson of outsourcing. When the partners entered the business, they expected to win clients on the basis of price alone. Accordingly, ExlService attempted to conserve capital and reduce risk by selling contracts first and then building the capacity to service the clients once they were signed. Instead, potential clients were much more cautious about letting third parties interact with their customers, especially when those third parties were located across the world and were start-ups that lacked reputations, references, and resources.

In 2000, as the business failed to grow as anticipated, the partners altered the business model. They recognized that the company needed to build capacity first and then sell the contracts to use it, a change that made the outsourcing business more capital-intensive and riskier than they had expected. By mid-2000, Kapoor and Talwar were raising money again.

Fundraising Complications

Just before ExlService closed that round of financing, Gary Wendt came out of retirement to become the CEO and Chairman of troubled insurance company Conseco. The company had recently replaced its founding CEO after ill-conceived acquisitions and out-of-control costs had brought it close to bankruptcy. Two years earlier, in April 1998, Conseco had purchased Green Tree Financial Corporation, the country's largest financer of mobile homes. It quickly became apparent that the business was not as robust as originally thought. When the company tried and failed to sell Green Tree in March 2000, its credit rating fell, its cost of capital rose, and investors nearly halved the stock price within a week. BusinessWeek summarized the situation:

"By the time Wendt took over in June, 2000, Conseco had restated earnings twice and didn't have the cash to pay the $1.2 billion in bank loans coming due in 80 days. The shares had fallen to $4.75 from a high of $57.75 in April 1998."[3]

Wendt's highly public new position caused several potential ExlService investors to balk for fear that he would no longer serve as ExlService's rainmaker. Wendt personally assured each concerned investor that he would indeed remain involved in ExlService and had even negotiated that point with Conseco's board of directors before accepting the position. The assurances worked, and ExlService closed an $8.1 million second round in August 2000.

Wendt consistently pushed Kapoor and Talwar to expand into increasingly value-added and complicated outsourced services. He correctly foresaw that ExlService's e-mail and chat-help businesses would eventually become commodities. Indeed, Kapoor noted that over the course of a few months between 2000 and 2001, the pricing on Indian e-mail processing fell by 80 percent as entrepreneurs recognized the insignificant barriers to entering the e-mail processing business.

Winners in that commoditized business would be the companies with the lowest costs, a business that did not interest any of the partners or investors. Accordingly, the company planned to move "up-market," performing more complicated services that would come increasingly close to its clients' value propositions. Again, the partners re-learned the chicken-egg rule of outsourcing when they tried to sell those upscale services. Even with Wendt's assistance, ExlService could not convince clients that it could handle processes more complicated than e-mail replies.

Cracking the Problem

At Conseco, Wendt began aggressively cutting costs. Part of the Conseco recovery plan included savings won by aggressively moving certain processes overseas. In late 2000, the company projected that it could save up to $120 million annually by transferring the work of 3,000 employees to Indian contractors. Naturally, Conseco turned to ExlService. By February 2001, ExlService proved that it could handle Conseco's work, and the company began migrating some of Conseco's back-office processes.

Kapoor reported that his company needed the Conseco contract. While the existing contracts were producing revenues, they were related to commoditized services and were subject to increasing pricing pressures. Meanwhile, the company had invested in the technological infrastructure and human capital it needed to offer more complex outsourcing solutions; nevertheless, the company had not yet signed the clients who would use that capacity. "We were obviously cash-flow negative," Kapoor recalled.

As ExlService prepared to take on the Conseco work, problems erupted between Talwar and the third founder. Wendt stepped in decisively, and when the dust settled, the third partner took a generous severance package, Kapoor became the president (based in the U.S.), and Talwar was named CEO (based in India).

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[3] Pallavi Gogoi "Gary Wendt: How's He Doing?" (*BusinessWeek Online* July 31, 2001). http://www.businessweek.com/magazine/content/01_30/b3742108.htm (March 2006).

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Conseco quickly became eager to save more money by transferring more processes to ExlService. In short order, Conseco was ready to purchase all of the capacity that ExlService had built to woo large customers. In February 2001, Conseco approached ExlService and offered to buy 100 percent of the company. (Conseco was already responsible for nearly 70 percent of ExlService's revenues at the time.)

The offer gave Kapoor and Talwar pause. They had just left large companies to follow their own entrepreneurial ambitions, and both felt that they had not achieved all that was possible with ExlService. On the other hand, Conseco had offered a 40 percent premium over the second-round, which had closed just six months earlier. The capital markets around them were slipping into decline, thus offering weak exit and financing prospects in the foreseeable future.

Ultimately, Kapoor and Talwar agreed to the acquisition after negotiating a structure that gave them autonomy and offered them incentives similar to the financial exposure they would have had in an independent ExlService. The transaction also restricted the shares that Wendt would receive so that he could not liquidate them until Conseco had recouped the cost of the transaction. The parties signed the all-stock deal (representing 3.411 million shares of Conseco valued at $52.1 million) on April 23, 2001. A day later, Conseco announced earnings that beat expectations, and the $14 stock shot up 50 percent. Those gains went a long way toward silencing the option-holding employees who questioned why the firm would sell out.

Kapoor explained the company's approach to the acquisition, "The endeavor was to transition all the work of Conseco and learn that business. Then we would use those learnings to win other clients and build on this business. It was critical for us to get the experience and knowledge to transition to more complicated work for large clients." In time, they would discover that about half of that rationale would become reality.

Unfortunately, the transaction did not close until August 1, 2001, about five days before Conseco announced that it would take a charge totaling nearly $500 million. On that news, the stock fell to about $7. As it continued to fall, reaching the $3 range by December, Kapoor and Talwar worked to control the damage among their employees. As Conseco sank, the Indian outsourcing sector began its rapid rise. New entrants in the business began vying for ExlService's well-trained employees, and some companies actively spread rumors that Conseco would soon file for bankruptcy. Kapoor and Talwar met with employees, explained the company's situation as transparently as possible, and demonstrated their own enthusiasm for the business. Kapoor reported that eventually "everyone bought into" the argument that ExlService was in a growing industry, and that "even if we developed this business within a failing enterprise, this entity on its own would have value. We would be able to win business outside of Conseco, or someone else would buy us out, or we could restart this business with all of the knowledge we had acquired from Conseco."

Staying Focused

Even as Wendt struggled to right Conseco and the stock rose and fell (more often the latter, unfortunately), Kapoor and Talwar focused on building their business. (See **Exhibit 4** for more information on Conseco's stock price). The company began to handle complex processes, including managing insurance claims and a variety of back office accounting processes. While the Green Tree acquisition nearly sank the parent company, it gave ExlService another industry vertical to learn. The company soaked up knowledge of the consumer financial services sector as it managed credit analysis, bad debt collection, and other processes from India. ExlService's operating results showed the effects of the increased volume. As an independent entity (managing some of Conseco's processes before the acquisition), ExlService was realizing an annualized $3.6 million EBITDA loss on annualized revenues of $9.6 million.[4] After the acquisition, the company's 2001 annualized revenues climbed to $20.88 million, resulting in $2.64 EBITDA profit.[5] (See **Exhibits 5** and **6** for information on ExlService's operations.)

ExlService, though wholly owned, aimed also to serve clients other than Conseco. In spite of their interest in outsourcing, most potential clients were concerned by the financial weakness of the company's parent. Furthermore, 95 percent of ExlService's revenues were coming from Conseco, so potential clients feared that they would not receive significant attention.

Contemplating a Spin Out

Kapoor reported that by the first quarter of 2002, it became apparent that Conseco might not be able to work itself out of its financial problems. He and Talwar became especially concerned when their revenues started falling as Conseco's core businesses suffered. The entrepreneurs worried that a drop in work volume would hurt morale and start waves of employee turnover.

The partners asked Wendt to bring in a corporate partner—Kapoor suggested IBM, Accenture, or another similar company—that could not only bring new business to ExlService but that could diversify the ownership and revenue base, making it easier to win other third-party business. Wendt initially refused; he was certain that Conseco would recover and adamant that ExlService was Conseco's "crown jewel." He declaring, "I don't care if Conseco becomes a BPO company, but this one I will not sell."

By May 2002, some analysts and pundits were talking about the real possibility of a Conseco bankruptcy, and Wendt finally considered divesting ExlService in order to protect the capacity to handle Conseco's outsourced processes. He recognized that if the workforce lacked incentives to stay with ExlService, Conseco could be crippled. In turn, Kapoor and Talwar engaged 19 potential investors. Seven of those potential acquirers proceeded with due diligence, and four of them extended purchase offers. Among those suitors was Oak Hill Capital Management.

Oak Hill Capital Management

"We do not start with the question of what is available for sale," Oak Hill Capital managing partner Steve Gruber explained. "We start with the question of what are the big themes that we want to focus on."[6] In 2000 and 2001, the private equity firm turned its attention to offshore outsourcing providers. He recalled that BPO still looked somewhat dubious in 2000. Some in

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[4] These results are based on the period from April 1, 2001 through July 31, 2001.

[5] These results are based on the period from August 1, 2001 through December 31, 2001.

[6] Interviews with Steven Gruber. Subsequent quotations are from the author's interviews unless otherwise noted.

the investment community had "a healthy skepticism" about the sector after having bad experiences with poorly trained operators at Indian call centers. Nevertheless, Oak Hill believed that offshore outsourcing companies could handle more complex, value-adding processes. The problem, the firm recognized, was finding an opportunity to invest. Most of the independent outsourcing players were stuck at the lower end of the spectrum, operating call centers and lacking any means to move up-market. The Indian outsourcing operations that could handle complex processes were almost exclusively captive entities. As wholly owned subsidiaries, those operations learned from their parent companies, which did not have the same aversion to moving key processes to their own offshore operations. Few if any of them were soliciting business from third parties. Thus, the firm had been watching for captive entities that might become acquisition targets. (See **Exhibit 7** for select details of Oak Hill's offshore outsourcing industry analysis and **Exhibit 8** for information on ExlService's competitors.) As Conseco lurched toward bankruptcy, Oak Hill saw an opportunity to buy a high-end BPO operation.[7]

Oak Hill spent significant time with Kapoor and Talwar. Gruber noted that Oak Hill's partners were not operators, and so they would depend heavily on the two business partners to remain engaged in managing the enterprise. Oak Hill quickly became very comfortable with Kapoor and Talwar. Gruber noted:

> We had the opportunity to spend six months in the trenches with the management team. You really get to know a person's make up—how they operate, what they're like in terms of business ethics—when you go through the process and experience that we went through with Vikram and Rohit. They had a business that they had built—not just once but twice—at risk of frittering away before their eyes, and they knew they could lose the equity they had built up in the business. . . . They had been doing all of this on a 24x7 basis for three and a half to four years. Through all of it they were the most upright, good, honest, fair partners.

Once Oak Hill became comfortable with the ExlService leadership, it had to address that the company had a proven cost structure but not a proven revenue model. Then, the firm nearly balked at the timing and risks associated with an Indian outsourcing operation. Gruber recalled:

> In a post 9-11 environment, where India and Pakistan had a million people on each side of the line [of control, we had concerns] about the political risk in with doing business in India, a place that we hadn't owned operations previously. [We were concerned with] being able to get new customers to move business off-shore into an environment that had geo-political hostility written all over it.

To help manage those concerns, Oak Hill wanted only to buy an American company or an operation that could avoid the notoriously tortuous Indian legal and regulatory regimes.

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[7] Should Conseco file for protection from its creditors, the insurance businesses would continue to operate under the custody of regulators, a condition called conservatorship. Thus, the policy holders would remain protected, and they would continue to pay premiums per usual. Under conservatorship, the parent company could no longer initiate new business, so ExlService's volume would decrease, but it would not disappear. The same conditions did not hold for ExlService's consumer finance business that came from the former Green Tree Financial. If Conseco filed for protection, all of that business—30 to 40 percent of ExlService's volume—would disappear very quickly.

Putting Deals on the Table

Negotiations between Oak Hill and ExlService proceeded affably in the spring of 2002. The parties established acceptable terms for a transaction that would reserve a significant portion of ExlService's capacity for Conseco. In June and July, Oak Hill proposed to buy out 70 percent of ExlService for $46.3 million (implying a valuation of about $66 million), and Conseco would sign a contract to pay for the capacity it would reserve. Under those terms, Conseco would retain 9 to 11 percent of the equity, while ExlService's management would retain 19 to 21 percent. As the parties worked on the details of the transaction, Conseco's business continued to deteriorate, which was starving ExlService. Eventually, the parties recognized that Conseco could not guarantee that it could pay for the capacity it projected to need.

To reflect the increased risk to revenues from Conseco, Oak Hill restructured its offer, using preferred securities that would give Oak Hill seniority over the founders. Kapoor and Talwar found those terms unacceptable. Though the parties continued to negotiate through August, they could not reach an agreement, and they ultimately ended the negotiations.

On October 3, 2002, Gary Wendt resigned as CEO of Conseco (though he remained chairman of the board). With a new CEO in place and bankruptcy apparently inevitable (on the day Wendt resigned, the stock was trading at $0.07), Conseco seemed ready to effect a transaction. Oak Hill returned to the table with a new strategy: It bid of $1.00 for 100 percent of the company, betting that Conseco's primary concern would be protecting its own outsourced processes. Separately, Kapoor and Talwar structured a management buyout bid of about $4 million, which consisted of almost all of their personal capital plus some borrowing. Conseco then had three options: it could "reverse migrate" the process back to Conseco and shut down the operation, it could sell to management for $4 million, or it could sell to Oak Hill for a dollar. Letting ExlService continue to operate as a captive offshore outsourcing operation was not an option. Kapoor and Talwar were facing the departure of key employees, and soon no one would be willing to stay with what Gruber called "a melting ice cube" of a business.

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Conseco rejected the management buyout offer, even though it was the highest bid. The company feared that the cash-strapped partners would not be able to support the business with follow-on investments; any deterioration in ExlService's business, then, would threaten Conseco's own processes. Oak Hill, on the other hand, pledged to invest $10 million in cash immediately into the business; thus, its bid had more credibility. The real decision was between closing the business and selling it to Oak Hill.

Conseco and an independent consultant calculated that liquidating the business and returning the processes to the U.S. would cost $20.93 million dollars, and would subject the company to a variety of risks. Selling the business to Oak Hill would cost the company $19.55 million (including the costs of winding down business, settling certain employment agreements, and the cash it would leave on the company's balance sheet). Furthermore, the costs cited above did not include the 30 percent ongoing cost savings to Conseco associated with continuing to outsource those processes to ExlService (instead of repatriating the processes).

Given that economic analysis, Conseco elected to sell ExlService to Oak Hill Capital for $1.00. Kapoor and Talwar were again independent entrepreneurs. The transaction closed on November 15, 2002, and Conseco filed for Chapter 11 bankruptcy protection on December 17, 2002.

Looking to the Future

Immediately after closing the transaction, Oak Hill invested $10 million, most of which Gruber called "window dressing," meant to assure potential customers that the company was indeed viable and had a strong capital partner. The newly independent company paid retention bonuses to key employees, and it invested heavily in training all employees to manage increasingly complicated processes. Oak Hill then supported the management in expanding its own capacity (helping with recruitment and strategic analysis).

Gruber, then chairman, would be joining Kapoor and Talwar on sales calls to help close the largest deals. His sales assistance would be sorely needed: The company's monthly burn rate was $500,000, and it had become apparent that Conseco's business (accounting for some 95 percent of ExlService's revenues) would disappear completely within three months.

New Revenues

ExlService aimed to continue marching up-market, working on more complex, price-protected processes. The decline in business from Conseco would free capacity to be sold, but the company had to keep those employees engaged during the sales cycle. The employees had excellent alternatives; if they had little work to do at ExlService, they would find it elsewhere.

The company faced a dilemma. There were abundant opportunities to sell call-center work. Kapoor and Talwar could bring in as much business as they wanted by selling down-market services; the business would help keep employees engaged, and it would generate much-needed revenues. While it would have been immediately profitable, no one knew how long it would stay that way. The company's operations had not been built specifically to compete in this marketplace, and consequently ExlService did not have a cost structure optimized for commodity process outsourcing.

As the executives contemplated the strategic implications of such business, Dell Computer approached the company to inquire about setting up an offshore call facility to handle some of the company's technical service inquires. Kapoor estimated that the contract would generate $10 million in annual revenues once the call center reached steady-state operations.

New Market Opportunities

On July 30, 2002, President George W. Bush signed the Public Company Accounting Reform and Investor Protection Act of 2002 (more commonly known as the Sarbanes-Oxley Act or SarbOx). Passed in reaction to financial scandals at Enron, Tyco International, and MCI, the Act revised American securities laws more significantly than any legislation since the 1930s.

Among its major provisions, SarbOx Section 302 requires that companies define, maintain, and certify their internal systems that manage financial controls and reporting. Section 404 requires companies to account for internal controls with every annual report filed with the SEC. (See **Exhibit 9** for additional details on SarbOx.) Accordingly, companies would need to perform annual internal audits of their financial controls (in which they would document existing systems and processes) so that management could report on their effectiveness.

As ExlService sought new markets, the partners considered offering SarbOx Section 404 auditing services. It already had a highly trained staff that would understand the implications of SarbOx on American generally accepted accounting practices (GAAP). Nevertheless, SarbOx work would require an even better-trained workforce with an on-shore presence that could perform the face-to-face and hands-on work of auditing. Such an arrangement would represent a significant change from the company's existing BPO services, wherein `ExlService employees would manage the processes entirely from India. Indeed, an internal study at ExlService projected that 80 percent of the SarbOx processing work would need to be done on-site at companies (for the most part in the U.S.), with only 20 percent of the work being allocated to Indian employees. By contrast, 100 percent of the BPO processing was performed by Indian employees. Billing for SarbOx services and compensating the employees who performed them would be different from those practices deployed for ExlService's BPO business. ExlService also anticipated that SarbOx auditing would be a largely seasonal business, with most internal audits occurring in the third and fourth fiscal quarters.

In 2003 it was not clear how much those audits would cost companies. If SarbOx 404 compliance was too expensive, the laws would likely change to make compliance more affordable. (Even before the law's implementation, its critics noted that most Section 404 auditing would be redundant with external auditors' work.)

Building a Sales Organization

While a captive entity, ExlService had let its sales capacity wither. Now independent, the company had to build a robust sales organization that could manage the 6-to-12-month sales cycle for complex BPO contracts. Most of the company's clients were in the U.S. (many were also in Europe), so the sales team would continue to be based in New York with significant operations in England.

The sales process was complicated, nuanced, and different for every customer. The largest multinational companies would have had some experience with outsourcing (likely in IT services), and often they would engage advisors (often top-tier management consultancies) to guide them through the outsourcing process. In some cases, particularly in selling to mid-market companies, ExlService would need to educate its potential customers about the benefits the company could impart, the nature and quality of its processing work, and the cost savings it could provide. After "teaching" potential customers, the sales force had to establish the deep trust that clients understandably required before moving any processes to an outsourcing service provider. As ExlService's solutions were highly customized, the sales organization would need to negotiate contracts and pricing. Eventually, the sales organization would be engaged in migrating the processes from the client to ExlService. Eventually, someone in ExlService—either the sales representative or another relationship manager—would take responsibility for farming existing customer relationships and increasing the value of the customer base. Throughout this complicated cycle, the American sale representatives would work extensively with Indian teams in marketing, operations, process migration, and other functional areas to pitch and close deals. (See **Exhibit 10** for additional information on the sales cycle.)

Building a sales force was not as simple as hiring an experienced executive vice president to establish a robust outside sales force. ExlService resembled the typical Indian enterprise in that it had built its operational capacity before its sales organization. Many Indian companies—and ExlService's own Indian operations—believed that operational excellence really closed sales and that the sales forces were of secondary importance. Well-developed, well-compensated sales forces were foreign to both Indian companies and ExlService's Indian employees.

Controlling Turnover

As the company moved through the transition from captive ownership to independent entity, employee turnover reached its highest level (50 to 60 percent, annualized) that Kapoor and Talwar had ever seen in the course of their partnership. To date, most of that turnover had come from the associate ranks, but they feared that the managers (almost all of whom stayed with the firm through the transaction) would jump ship if ExlService did not sell a lot of new business soon. Its earliest contacts and accounts would likely be smaller than those provided by Conseco; they would not require the same level of executive management that already existed in ExlService's managerial ranks. Kapoor and Talwar considered replacing some executives with more junior managers who would be better suited to the smaller accounts. The alternative, finding ways to keep the most highly qualified employees engaged while ExlService rebuilt its business, would test the partners' leadership.

CONCLUSION

In selecting markets to pursue, building a sales force, and retaining its employees, ExlService would confront the ambiguities of the emerging BPO marketplace and the complications of international business. While those decisions and actions would transpire in state-of-the-art offices in India and New York, the market environment was as cutthroat as the African savanna, but in BPO the winning strategy would be much more complicated than simply running faster.

Exhibit 1
An Introduction to Business Process Outsourcing in India

The modern phenomenon of off-shore outsourcing to companies in India began in the early 1990s when multinational companies began to recognize India's vast and under-utilized intellectual resources.[8] Indian universities had been producing thousands of well-trained professionals and technical experts, but the Indian economy, hampered by socialist-leaning policies and a restrictive regulatory environment, could not satisfactorily absorb them. These conditions began to change with the advent of inexpensive, real-time communication technologies and regulatory reform initiated in 1991, which allowed Indian graduates connect with international and foreign firms.

GE and other companies had initiated software and microchip design centers in India when, in the late 1990s, the outsourcing phenomenon flourished with Y2K-bug-related programming. Preparing computer systems for the year 2000 required specialized but somewhat rote programming work. Many American companies looked to other enterprises to provide those programming services. Indian firms (or, in some cases, multinational companies' Indian operations) could employ capable programmers who earned a lower salary than programmers in, say, Silicon Valley. As American telecommunications bubble burst in the late 1990s and bandwidth became cheaper and cheaper, the Indian IT firms' advantages became even greater, as they could move large volumes of code between India and the rest of the world at minimal cost. Between 1993 and 2000, Indian IT service exports grew at between 50 and 68 percent each year such that associated revenues grew from under $500 million to over $6 billion over the same period.[9]

After the Y2K-bug preparations had passed, American companies again looked to Indian IT firms to provide lower-cost services as multinational companies soldiered through difficult economic times. From the rote programming around the Y2K bug, Indian programmers began to offer more and more up-market IT solutions, including customized programming jobs.

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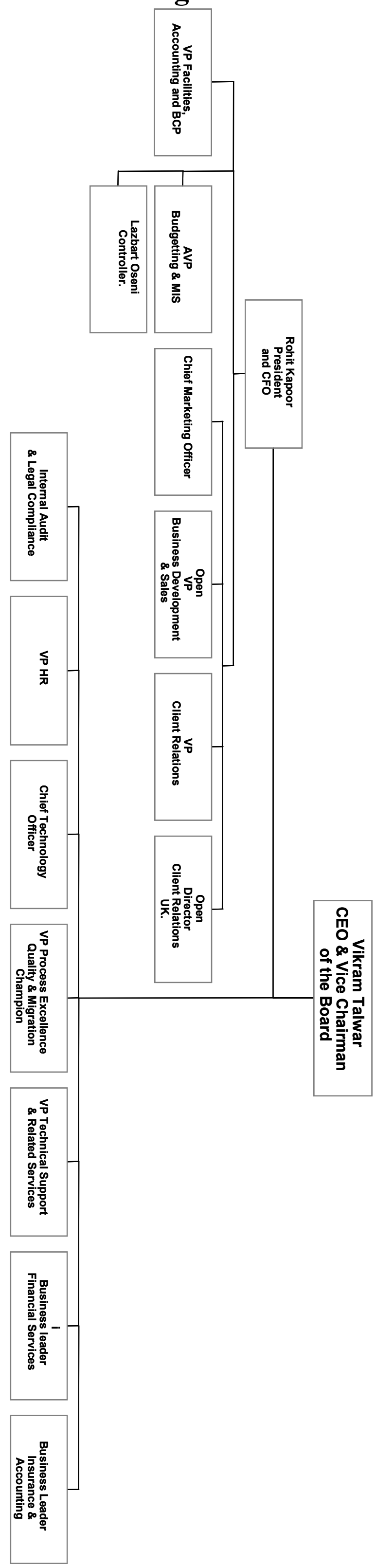
[8] This overview of the early history of Indian outsourcing simplifies Thomas Friedman's straightforward introduction to outsourcing in *The World is Flat* (New York: Farrar, Straus and Giroux, 2005) 103-113.
[9] Nasscom, citied by Oak Hill Capital in its internal market assessments.

Exhibit 2
Compensating and Retaining Employees: Comparing the U.S. to India

Lever	U.S.	India
Base compensation	Low (as % of total comp.)	High
Variable cash compensation	High (as % of total comp.)	Low
Options/equity	Significant	Little to no experience with it
Job titles	Unimportant	Important
Brand name company	Variable	Very important
Personal development through experience and exposure	Variable	Important
Total cost of an employee	High	Low
Associate total comp./VP total comp.	1/2-1/3	1/10

Source: ExlService.

Exhibit 3
ExlService Organization Chart



Source: ExlService.

Exhibit 4
Conseco Share Price

Source: Raw data from Center for Research in Security Prices.

Exhibit 5
ExlService Operating Results

(in millions)

	Independent			Captive			
Fiscal year	2000	2001		2001		2002	
Period: From	1-Apr-00	1-Apr-01		1-Aug-01		1-Jan-02	
To	31-Mar-01	31-Jul-01		31-Dec-01		14-Nov-02	
			Annualized		*Annualized*		*Annualized*
Revenues	$ 0.80	$ 3.20	$ 9.60	$ 8.70	$ 20.88	$ 23.80	$ 27.20
Cost	1.10	2.20	6.60	4.60	11.04	11.70	13.37
Gross profit	(0.30)	1.00	3.00	4.10	9.84	12.10	13.83
G&A	2.90	2.20	6.60	2.70	6.48	8.80	10.06
Selling	3.40	-	-	0.30	0.72	0.60	0.69
EBITDA	$ (6.60)	$ (1.20)	$ (3.60)	$ 1.10	$ 2.64	$ 2.70	$ 3.09

Source: ExlService. Form S-1, filed with the U.S. Securities and Exchange Commission December 6, 2004.

Exhibit 6
ExlService Headcount and Financing Histories

Date	Total Headcount
1-Jun-99	1
1-Jan-00	9
1-Jun-00	12
1-Jan-01	87
1-Jun-01	356
1-Jan-02	1333
1-Jun-02	1670
1-Jan-03	1819

Round and Date	Investors	Amount
Seed Funding April to December 1999	Founders	$250,000
First Round December 1999	Gary Wendt FG II Limited	$1,250,000 $1,500,000
Second Round August 2000	Deutsche Bank, P.C. Chatterjee, Strategic Ventures, Springboard Harper & others	$8,100,000
Buy back from Conseco November 2002	Oak Hill Capital	$10,000,000

Source: ExlService.

Exhibit 7
Excerpts from Oak Hill Capital's Indian BPO Market Assessment

The total offshore BPO market is $2.5 billion worldwide, expected to grow to $35 billion by 2007. Within financial services, the worldwide off-shore BPO market, including captive operations, is estimated to be approximately $1.2 billion today and is projected to grow to $6.1 billion in 2007, a CAGR of 38 percent. The CAGR for back office and contact center services are projected to be 40 percent and 35 percent respectively.

* * *

The market for non-captive India-enabled financial services BPO [is] projected to grow from $0.5 billion (17,000 average FTEs) in 2002 to $2.5 billion (91,000 average FTEs) in 2007.

* * *

Industry	Overall cost savings	Key opportunity areas
Insurance	10-15%	Claims Processing Servicing Call center operations
Banking	8-12%	Call center operations Loan processing
Pharmaceuticals	5-6.5%	Research and development
Telcom	1.5-2.5%	Call center operations Billing
Automotive	1-2%	Engineering and design Accounts payable and receivable
Airlines	0.8-1.8%	Revenue accounting Call center operations Frequent flyer programs

* * *

Summary of EXL Market Position and Competitive Analysis

- EXL is the only third party BPO provider with scale (>250 seats) in both back office and contact center operations for the financial service industry.
- EXL's top competitors include (1) large captives (GE, eServe), which have greater scale and experience but remain focused on parent business, (ii) Spectramind, a well managed company with a strong sales function . . . and (iii) WNS, a spin-off of British Airways, with strong operations, improved sales capabilities and a new focus on financial services.
- Spectramind has established a leading position in third party contact centers.

Source: McKinsey and Company study cited in Oak Hill Capital presentation.

Exhibit 8
ExlService's Competition

As the Indian outsourcing industry matured, competition increased. By 2003, low-skilled work (including all data-entry, simple programming, and some call center work) had become a commodity. Such companies could handle employee turnover because their processes did not rely significantly on specialized employee training. At the more specialized end of the outsourcing spectrum, where Indian companies were managing complex processes, many outsourcing providers were captive entities either built or bought by large international companies. Such companies often worked only on their parent companies' processes and did not take third-party business. The independent BPO companies, including Wipro, Daksh, WNS, and others, were providing general function-level outsourcing (in the middle of the outsourcing spectrum) to an array of third-party clients, but some were showing the signs of specialization that would allow them to move further up-market into process-level outsourcing solutions. Many of the true BPO providers operating at the most complex end of the spectrum were American companies such as Electronic Data Systems (EDS) and Accenture.

By 2003, Indian outsourcing firms were beginning to feel the pressure of a tighter labor market. While there remained a large supply of well-educated potential employees, those who had been trained by sophisticated employers willingly jumped from one company to another for marginal improvements in salary, benefits, or working conditions. As a result of such job-hopping, outsourcing firms were forced to face the costs of turnover plus the increasing costs of compensating and retaining valued employees. Those pressures began to make other geographies appealing as potential outsourced labor forces. Indian outsource service providers began to eye China, Eastern Europe, and Africa as potential future competitors.

Source: ExlService.

Exhibit 9
Sarbanes-Oxley Act of 2002: Major Provisions

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
- Established an independent board overseeing the auditing functions of public accounting firms

TITLE II-AUDITOR INDEPENDENCE
- Prohibited accounting firms from providing certain services to the public firms they are auditing
- Required certain auditing firms' partners to rotate off of audits periodically
- Included other provisions for ensuring that auditors are independent and objective

TITLE III—CORPORATE RESPONSIBILITY
- Required that independent directors sit on the audit committees of companies' boards of directors
- Required that companies' CEOs and CFOs certify audit reports
- Further limited insider trading

TITLE IV—ENHANCED FINANCIAL DISCLOSURES
- Mandated reporting and disclosure of off-balance sheet transactions and pro forma financial data
- Prohibited companies from making personal loans to executives and required them to disclose certain stock transactions executed by managers and principal stockholders
- Required that companies' annual reports include an "internal control report" (Section 404)
    - Affirmed managers' responsibility for maintaining robust internal financial reporting controls and procedures
    - Required companies' managers to assess and state an opinion on the quality of their companies' internal reporting controls and procedures
- Mandated additional disclosure procedures

TITLE V—ANALYST CONFLICT OF INTEREST
- Required registered securities analysts to avoid potential conflicts of interest in their coverage of publicly traded companies

TITLE VI—COMMISSION RESOURCES AND AUTHORITY
- Altered the SEC's resources, operating rules, and authority

TITLE VII—STUDIES AND REPORTS
- Mandated that the general accounting office perform additional studies relevant to the Act's other provisions

Exhibit 9 (continued)
Sarbanes-Oxley Act of 2002: Major Provisions

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

- Established new requirements for maintaining auditing paperwork and punishments for destroying such paperwork that would hamper a federal investigation
- Increased the statute of limitations for securities fraud claims and increased the penalties for securities fraud
- Required that companies establish "whistleblower" protections

TITLE IX—WHITE COLLAR CRIME PENALTY ENHANCEMENTS

- Increased the penalties for wire, mail, securities, and accounting fraud

TITLE X—CORPORATE TAX RETURNS

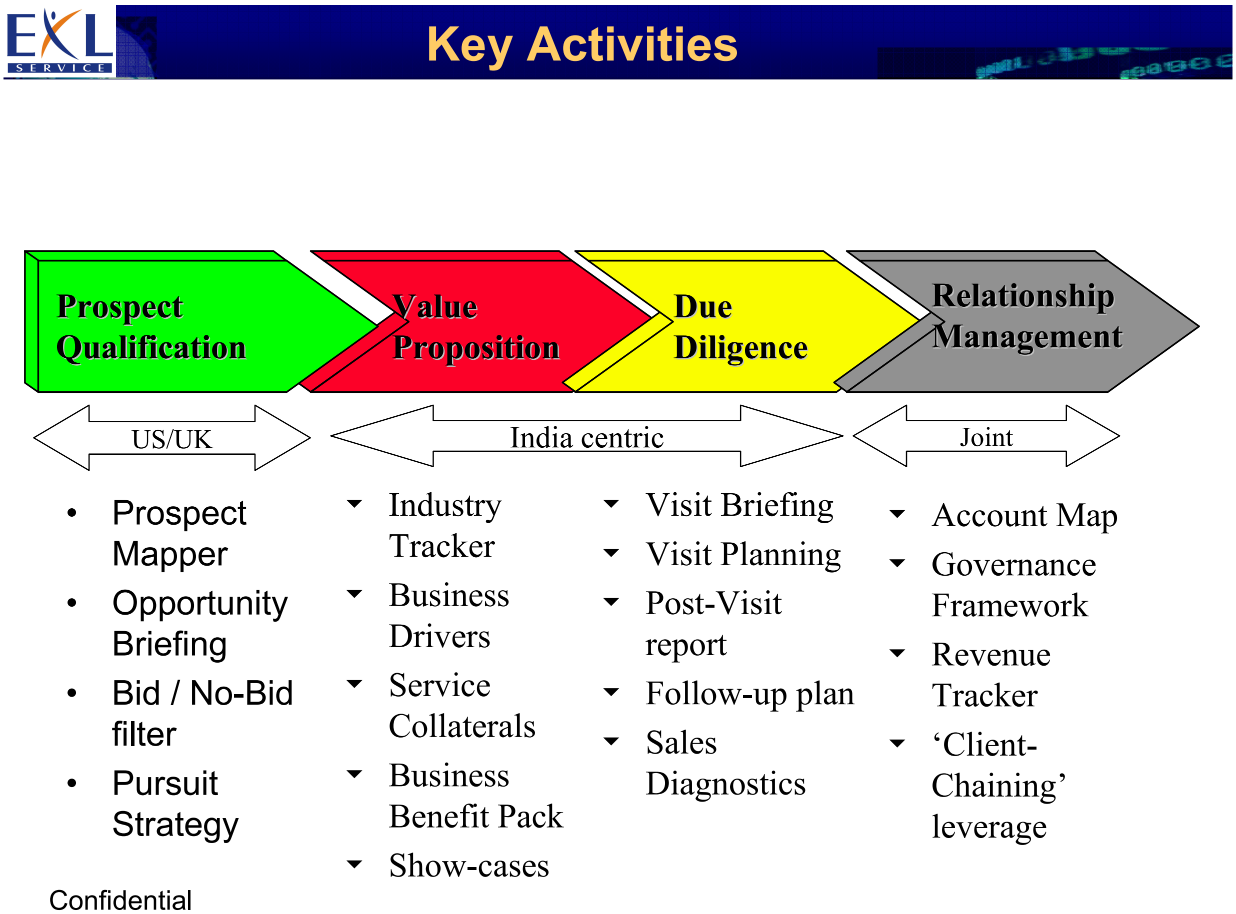
- Recommended that companies' chief executive officers sign their companies' tax returns

TITLE XI—CORPORATE FRAUD AND ACCOUNTABILITY

- Established penalties for interfering with federal investigations by tampering with documentation
- Allowed the SEC to restrict certain compensation and employment of individuals under investigation or found guilty of violation of securities laws

Source: The Sarbanes-Oxley Act of 2002.
http://files.findlaw.com/news.findlaw.com/cnn/docs/gwbush/sarbanesoxley072302.pdf

Exhibit 10
ExlService BPO Sales Cycle Activities



Source: ExlService.