Getting best out of a Virtual Captive (A Business Case)

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EXECUTIVE SUMMARY

'Virtual Captives' are a very new model of outsourcing and globalisation that brings the best of every existing model in outsourcing. This model is still nascent and yet to be understood by those who only know and practice the only two ways of globalisation and outsourcing: Traditional outsourcing and company owned captives.

After understanding the fast changing business ecosystem, the key factors that have emerged in favour of 'Virtual Captive' models have been the rapid growth of startup ecosystem globally that has given rise to small and mid sized technology driven companies that see no geographical boundaries for their business expansion.

Authors surveyed several CXOs from outsourcing companies and IT executives from the captive and outsourcing companies by asking them some questions. It comes out very clearly that the most compelling factor for outsourcing and offshoring in form of captive companies has been cost and continues to be that. All other factors happen only with cost advantage taken care. This fact was demonstrated in detail on our last white paper released in December 2018.

Last paper discussed in detail as to why the traditional outsourcing and company owned captives are not the best solution for small and medium sized global companies. While a lot of small and mid sized companies have opened captives and have traditional outsourcing, most of them surveyed in this new paper have obvious issues that clearly indicates the suboptimal level of outcomes in the existing two models for such companies.

Virtual captives give the benefit of Captives and the traditional outsourcing providers, while eliminating the disadvantages of both. More focussed at start-ups, small and mid sized companies who are unaddressed as compared to the

large companies. Such virtual captives are showing a great promise of giving far lower cost as compared to any other model so far and is likely to be a disruptor to the traditional IT outsourcing model.

In this paper, we will focus on understanding the business case for 'Virtual Captives' and why it is a recommended idea for smaller companies to try out.

Authors of this research papers are experienced executives and have vast experience in global outsourcing scenario having experience of being an outsourcer as well as a service provider. The author is well referred in technology industry in India and is an author of various book and papers.

THE DEBATE

With increase in the changing business models from large established ones to smaller startup mind set driven companies, enterprises will no more remain the same. Today large companies are more vulnerable than the smaller ones, who are quickly finding their footing with innovation and fast execution. If they are unable to do that, they do not exist too long to be even noticed. These companies may start in any country, but they all dream global. Internet and globalisation has given every company, whosoever small to go global.

One of the largest global business transactions happen in services where India tops the global technology services business with more than 75% business share. However, this share is set to decrease over the decade if the outsourcing model is not tuned to cater to smaller companies. Authors have tried to understand the challenges of smaller companies and finding if Virtual captive model that ScrumStart pioneered would have a better outcome for such companies. The questions that this paper ties to answer are focussed around the challenges and how Virtual captives of ScrumStart can provide an outcome.

Fundamental difference in thinking between small and large companies on outsourcing

With startups and the new wave of young, risk taking entrepreneurs, the business fundamentals are now being tested to absolutely new levels. The way large and even some mid sized companies think of outsourcing is coming out to be very

Understanding the company size category (Manpower wise)

	Business Support	IT Support	ER&D / Products
Small	Less than 250	Less than 100	Less than 50
Medium	Upto 500	Upto 250	About 150
Large	More than 500	More than 250	More than 150
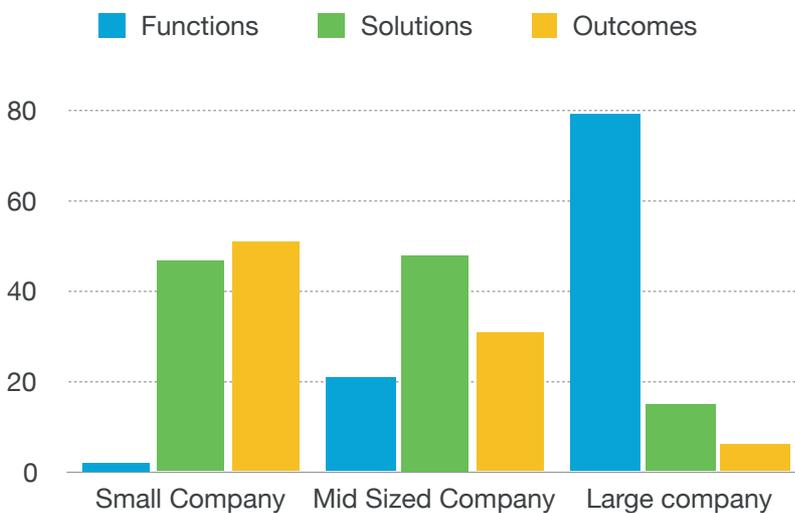
different to what the smaller and to a great extend mid sized companies think. One thing that stood out clearly is that fact that small companies and startups look at "End outcomes" as something that they seem to be interested in outsourcing. While most of them openly admit that getting this commitment from a vendor is very difficult due to several factors, they would like the outsourcing to happen with clear outcome commitments. The reason also seems easier to understand. IT has been primarily due to less headcount, focus on their core and lack of expertise in areas that they do not focus. The most interesting part of outcome was the way large companies outsource and how small companies think diagonally opposite. Large companies outsourcing to either their own

captive or to a traditional outsourcing company is primarily based on functions. It would be IT function, Finance, HR or similar functions that needs people and the outsourcing is primarily to replace the high cost labour with low cost ones. The value add part the large companies fail to acknowledge or take benefit from due to this fixed thinking. On the contrary, the small companies like to get the job done end to end. For them, it is not finance function, but ensuring that everything they need to be done in that area is done without they bothering about the issues and outcomes. They do not want to hire staff that is not core to them unless it becomes essential. Small companies are unable to retain and give growth to their non core team members and they acknowledge this fact openly.

Small and mid sized companies like to explore new solutions that can add value to their business with more openness than the large companies. A partner who can take care of their logistics as a solution is more preferred than to have their own logistics department. While large companies seem to be less open to such transfer of ownership.

This study proved that traditional outsourcing or even a company owned captive that is put up in a traditional may may not be best suited option for most of the small and mid sized companies globally. ScrumStart therefore comes with a far more value added view on how small and mid sized companies can benefit through the model of Virtual Captives.

What worries the Small and mid sized companies the most

ScrumStart referred to a paper released by Naoyuki Yoshino and Farhad Taghizadeh-Hesary in April 2016 titled "Major Challenges Facing Small and Medium-sized Enterprises in Asia and Solutions for Mitigating Them" to understand the challenges faced by small companies globally. The eight challenges the paper listed states the issues of traditional small and mid sized companies.

1. Lack of resources (finance, technology, skilled labor, market access, and market information);
2. Lack of economies of scale and scope;
3. Higher transaction costs relative to large enterprises;

4. Lack of networks that can contribute to a lack of information, know-how, and experience of domestic and international markets;
5. Increased market competition and concentration from large multinational enterprises caused by globalisation and economic integration;
6. Inability to compete against larger firms in terms of R&D expenditure and innovation (product, process, and organisation);
7. Subject to "churning" and instability; and
8. Lack of entrepreneurial zeal, capacity, and know-how.
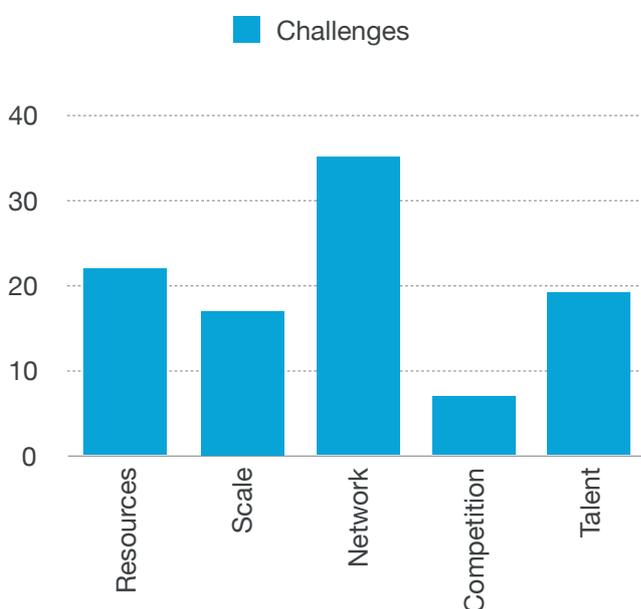
The startup ecosystem and the technology driven companies that are changing the global business ecosystem today have almost similar list of challenges. We spoke to various start-up/ small companies from India, US and Europe and came out with a smaller list and asked the small companies that are growing through startup model on their top challenges in order.

1. Lack of resources (finance, technology, skilled labor, market access, and market information)
2. Lack of economies of scale and scope
3. Lack of networks that can contribute to a lack of information, know-how, and experience of domestic and international markets
4. Inability to compete against larger firms in terms of R&D expenditure and innovation (product, process, and organisation)
5. Subject to "churning" and instability

The results were clearly indicating that most of the entrepreneurs understood that that have limited network who can help them with advice and support for their

expansion and growth. The resources for small companies were certainly a challenge and coming in way of expansion, but this is what they bargained for before taking a plunge in the start-up venture years back. Few were bothered about the competition because they were in business to become more efficient and create reverse pressure on their competition, but economies of scale and need for stable talent also come out evenly in their top challenges. These choices were common challenges for almost every small and mid sized company we met barring few who have found their groove.

With this information, we were more confident on providing a good business case for small and mid sized companies in favour of Virtual captives that could solve more of their challenges as compared to any other model.

Managing the Resource Challenge through Virtual Captive model

Affording a highly paid and experienced CEO or a CFO is not something every small company can think of. This leads to compromise and obviously does not help companies to grow. ScrumStart Virtual captive model works on sharing the best resources at faction of a cost. When such high value resources that also come through highly expensive consulting companies are made available at a fraction of a cost, it is a win win situation for everyone.

On technology front, ScrumStart Virtual Captive brings best support resources and highly experienced CTOs on the table. To add to the benefit of the small companies, trained technology resources from smaller cities can be extended at cost that are way below market lowest cost. This has brought significant improvement in value for small companies ScrumStart is working with. The most important part of the resource is the infrastructure and assets that ScrumStart Virtual Captive provides on a rental model that eliminates expensive capes need.

ScrumStart has deep network within India to provide access to all kind of resources that is not possible by small companies on their own.

Managing the issue of Economic of Scale

This is the main reason why most of the small companies are unable to get the best deals. The scale and size is a very powerful tool that can help reduce the cost tremendously. This is where Virtual captive scores high. ScrumStart uses the power of aggregation of several small companies to get their own benefit of scale and passing the benefits to the clients. Traditional service provider companies do not engage with clients that have small volume business. Few companies have their threshold of atleast one million dollars worth of annual business before they give any focus. Once again, even if they engage, it is difficult for the customer to get a treatment like those who contribute to larger pie in their business. This is obvious and there is nothing one can do about. The Virtual Captive model of ScrumStart is created with a view to support companies with as small as it can make sense for either of the parties to get benefit out of the engagement.

Taking Indian ecosystem, if manpower count is to be taken, the above chart provides a clear understanding on what can be termed as small engagement when it comes to having company owned captive or outsourcing. Virtual captive provides the start of this journey and gives flexibility to move into own captive when the scales are good enough to give sustained business benefits.

Managing network of support system

ScrumStart ecosystem has investors, entrepreneurs, industry veterans, government and industry bodies, embassies and offices & partners in various geographies that can go beyond the standard cost arbitrage model. When small companies with great products find their fixed geography a big hurdle in their growth, ScrumStart can support by providing end to end consulting on what can be done to get a foothold in large markets like India, UK, USA and Middle East. Managing complex issues like tax, legal and regulations is efficiently managed by the support system of virtual captive on a pay per use model or even a retainer model.

Managing the global competition

Competition is a reality and that has to be managed by the top five things every small and mid size company must focus on:

1. Timing of the product/ service launch : If the timing is good, irrespective of the scale, the chances to grow is highest. It is only after the business grows, investors are interested in pumping more money and banks stand in queue to give money. Surveys done by experts in startup industry have proved that timing of the business is the top most factor between success and failure of the company.

2. Team and Execution: With a great team and timely execution, getting success is easier. It is therefore important to assemble a great set of team. ScrumStart virtual captive provides this through full time, shared and consulting support at a lower than market cost.

3. The novelty of idea & innovation: This is where the startup or any company can sustain their existence. Innovation and ideas are generally available in plenty but getting this idea off the ground is something that needs lot more.

4. The business model: Making money through a robust business model is important for business sustenance.

5. The funding & financial resources: Experts say that financial funding is only the fifth important factor and for a company with the top four points well taken care, this is least of the problems.

	Matured Startups	Small sized Companies	Mid Sized Companies
Cost of starting	Medium	High	High
Management overheads	High	High	Medium
Hiring & retaining talent	Difficult	Difficult	Difficult
Size of operations	Small	Small	Medium
ROI	Low	Low	Medium

Managing churning & Instability

Talent churn is a common problem in small companies. The ambitious ones are at the steering wheel and the rest do not find enough motivation to work for a small company for a salary for too long. This is something that every outsourcing company is able to support. ScrumStart Virtual captive have a better placement due to its own talent producing academy and great ecosystem of support companies.

ScrumStart Virtual Captives : A win-win model for startups, small & mid sized companies looking for globalisation.

Virtual Captive model is a hybrid of traditional outsourcing and company owned captives by including the benefits and taking away the limitations of both existing models.

Virtual Captives dwell on the principle of transparency by putting forward the transparent pricing model that cannot be practiced by traditional IT Service providers. It is a common understanding that IT providers want to keep control on their margins and opening their books to the customer is contrary to their business model. This also works easy for everyone as a standard cost of $/hr rate ensures easy financial management of every deal. This model has an inherent issue that has become more pronounced over time. Service Providers tend to improve margins by compromising on the quality of resources. In the changing times where talent is the key to every company, this becomes a major bottleneck to long term benefit of the customer. However, the transparent pricing model of a Virtual captive and captive gives an incentive to hire better quality resources without bothering about cost and margins. This directly impacts the business outcomes and works as great incentive for both the Virtual captive provider and for the customer.

	Traditional Outsourcing	Virtual Captive	Company Owned Captive
Ownership	Service Provider	Service Provider or Hybrid	Company
Billing Model	Opaque (Cost/hr)	Transparent (Cost Plus)	Transparent (Cost plus)
Employee Ownership	Outsourcing Company	Flexible	Company
Capex Required	Low	Low	High
Management Overhead	Mid	Low	High
Startup Efforts	Service Provider	Service Provider	Company
Best Practices	Yes	Yes	Start from Scratch
ROI	Quick	Quick	Medium to Long
Financial Benefits	Medium	High	High
Transfer of Operations in future	No	Yes	Not Applicable
Control of overall operations	Low	High	High

Transparent pricing by a few Virtual captive provider takes away the overheads of managing margins and cost and the focus completely shifts to ensuring high quality outcome for the customers.

The best part of virtual captive is the low cost of startup and professional help available for a good and quick ROI for the customer. Having shared management and all professional help, customers need not bear high cost of management overhead. All best practices that a Virtual Captive provider brings to table get's replicated without much cost and effort. This makes it a better option to company owned captives.

Most of the start-ups want the setup to be owned by them when they start growing. Virtual captive works on the principle of built operate and transfer that is mutually worked between the two parties.

The cost per hour of a virtual captive company almost matches with company owned captive minus the capital expense, startup trouble, best practices issues and other issues like minimum number to operate, etc.

Two companies we discussed, after looking at the Virtual captive model and success stories, expressed their desire to understand the business case so that they can benefit from this new model.

The Three Verdicts:

Verdict 1: Virtual Captives can provide a wholistic globalisation solution to small and mid sized companies who do not have economies of scales when they start. This reduces their risk significantly and improves their ROI significantly. For large companies, Virtual captives can be a gateway to success with reduced risk and tremendous savings as they grow.

Verdict 2: Small companies look for solutions and outcomes. Existing outsourcing models do not suit this increasing tribe. For medium and large companies, traditional outsourcing can be eventually replaced by Virtual Captive delivery model giving far more savings and control.

Verdict 3: Owning is getting fast replaced by sharing model. It is increasingly true in outsourcing model also where Virtual captive works more on sharing model to lower the costs for every size of company.

Conclusion:

ScrumStart Virtual Captives have a significant business case for companies of every size. This model provides more relevant support and outsourcing outcomes with far better control and flexibility and cost.

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Headquartered in Mumbai (India) and presence in UK & US, ScrumStart specialises in Virtual Captive solutions for companies of all size. Virtual Captives brings best advantage to companies of all domains and sizes by giving the benefits of traditional outsourcing and captives. ScrumStart provides consulting and does build, operate and transfer models of company owned captives apart from virtual captives.

About ScrumStart

ScrumStart Services is a venture of SRKay Consulting Group with offices and partners across UK, US and India. ScrumStart specialises in building and operating Virtual Captives for global companies.

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