

## "OLD STANDBYS" ARE NO LONGER THE SAFE BET FOR COMPANIES LOOKING TO OUTSOURCE THEIR INFORMATION TECHNOLOGY... INDIA IS HERE TO STAY

**New Capital Markets Research Shows that India-Based Upstarts Are Positioned to Serve Clients Better and be Even Tougher Competition Than U.S.-Based Outsourcers Anticipated; Legacy Outsourcing Players May Disappoint in Third or Fourth Years of IT Contracts**

**Consumers of Outsourcing Should Rethink Criteria for Choosing: Growth Companies are Set to Outperform and Deliver More than Those that Appear to "Have Economies of Scale"**

**NEW YORK (August 11, 2005)** - New research by consulting firm Katzenbach Partners LLC suggests that a set of India-based information technology and outsourcing companies could ultimately lead on a global basis, potentially unseating such giants as EDS, Computer Sciences Corp., Capgemini, Unisys, Perot Systems, Accenture and BearingPoint.

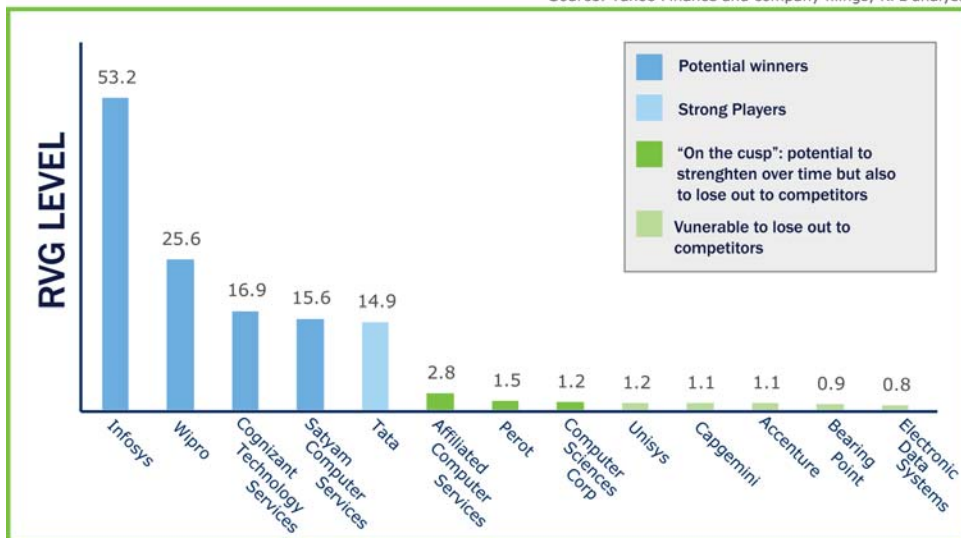
Further, the research suggests that corporate customers who believe that the legacy players' size and reach will translate to more efficient, higher quality and cost-effective service are probably mistaken. The Indian players - Infosys, Wipro, Satyam Computer Services and Tata Consultancy Services - will have greater market incentives and capabilities to consistently serve customers and make good on promises during the critical third and fourth years of contracts.

The analysis is based on the work of a Katzenbach Partners team led by Richard Schroth, a technology and outsourcing expert, Nathaniel J. Mass, who has developed a new corporate performance metric called the Relative Value of Growth™ (RVG) and Roopa Unnikrishnan, a manager at the firm. RVG determines the degree to which a company is rewarded - in terms of market capitalization - for growth and/or margin improvement. Companies with high RVGs that are predominantly rewarded by growth tend to be rewarded handsomely for achieving it - and also tend to have strong profit margins.

On the other hand, those rewarded predominantly by margin improvement tend to have inferior

To learn more about KPL's Strategic Approach to Evaluating Outsourcing or about RVG, contact: **Alexandra Corriveau Sommerfield Communications, Inc.** (212) 255-8386 [alexandra@sommerfield.com](mailto:alexandra@sommerfield.com)

Source: Yahoo Finance and company filings; KPL analysis



Major outsourcing players segment into four basic groups, led by Indian competitors with the strongest economic incentives to grow

profit margins today and may realize less pronounced gains in shareholder value -- largely because of the complexities of trying to deliver cost improvements within the context of long-running customer contracts.

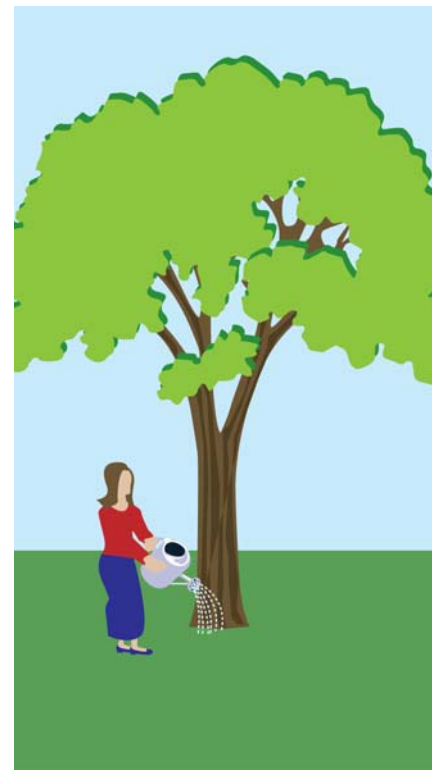
### INDIAN IT COMPANIES HIGHLY INCENTED TO GROW AND MAINTAIN QUALITY

In analyzing IT and business process outsourcing companies, Katzenbach Partners found that the Indian players have extremely high RVG ratings, meaning they're highly incentivized to grow and that the marketplace has taken into account the quality of their operations, cash flow and prospects in providing this incentive. Meanwhile, U.S. and European players have much lower RVGs, meaning they're mainly incentivized to build value by cutting costs.

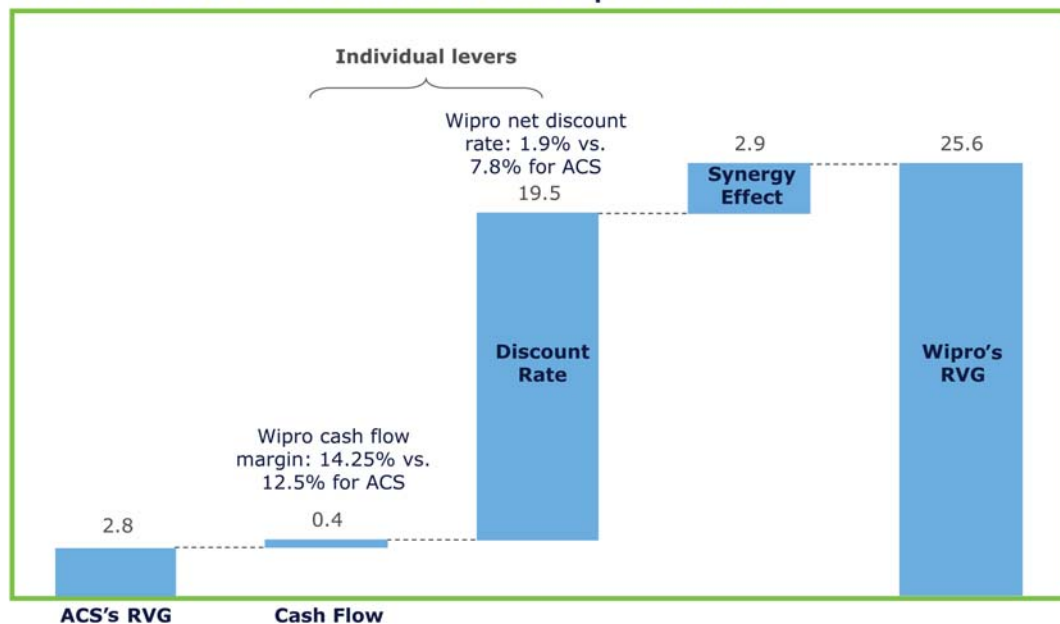
"The best of the Indian outsourcing companies derive 80% to 85% of their market cap from investor growth expectations, so we expect that they'll continue to invest in growth, invest in people and invest in client retention," said Dr. Mass, a Katzenbach Partners senior fellow and managing director of N.J. Mass Associates, Inc.

Added Dr. Schroth, also a Katzenbach Partners senior fellow and CEO of Executive Insights, Ltd., "We believe the Indian companies will continue to invest in clients even three and four years into a contract, when half of all outsourcing deals normally would fall apart. We see a virtuous cycle with Indian outsourcing companies: Strong growth boosts valuation ratios, which, in turn, create reinforcing incentives to grow."

"At the same time, U.S. players will not be rewarded by Wall Street for growing and investing - only for streamlining, and that's not good for customers. They may talk about economies of scale, experience and commitment to customers, but that's a disconnect when it comes to the basic incentives and the marketplace. Faced with cost pressures, they may be prone to turn over projects to more junior staff, pay less attention to older customers and focus on rationalization, consolidation and even withdrawal from businesses that require greater innovation investment," Schroth added.



### Drivers of RVG Differential Between Wipro and ACS



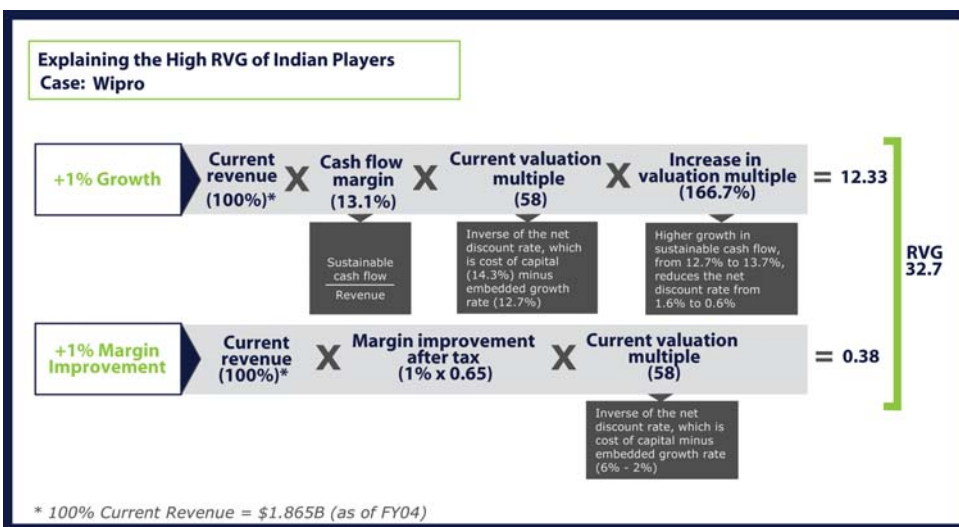
- Wipro CF margin is barely 2% above ACS, which already exhibits solid margin
- Wipro mainly outperforms ACS on lower net discount rate – due to nearly ten point advantage on embedded growth rate, and despite four point debit on cost of capital

## INFOSYS AND WIPRO: MODEL COMPANIES

"According to our outside-in research, the Indian companies' have many advantages for investors and customers alike: superior operating margins due to low cost of service; strong vertical market focus; an obsession with quality; re-investment in innovation; leadership in conformance to global standards; an end-to-end approach to service, and solid world-class corporate governance", says Roopa Unnikrishnan. "They are evolving into truly global players, going beyond India and developing their international strategies by recruiting high-value talent in new markets like China and Russia. Given all that, it's not surprising that their RVG's are closer to companies like Google (with an RVG of 60) or even pharmaceutical giants like J&J or Novartis (with RVG's around 7.6), than to their U.S. counterparts."

Infosys, in 1999, was the first Indian company to follow U.S. GAAP listings; early on it put in place tools for integrated project management and quality systems; was rated best in employer in India by Hewitt Associates; received an AT Kearney "Best Managed Company" award; achieved three times the average CAGR of the top 100 outsourcers; and realized 74.5% revenue increase over five years, compared with 22% for Accenture during the same period.

Wipro was one of the first global companies to get the SEI 6 rating; in 1999, it instituted an innovation program whereby it invests 5% of after-tax profits in innovation; has the most mature Six Sigma program in the outsourcing industry; has CAGR of 42% in the last five years, compared with 20% average for the top 100 outsourcers, and is part of the Technology-Media-Telecom Index of the New York Stock Exchange.



Source: Yahoo Finance and company filings; KPL analysis

## IMPERATIVES FOR LEGACY PLAYERS

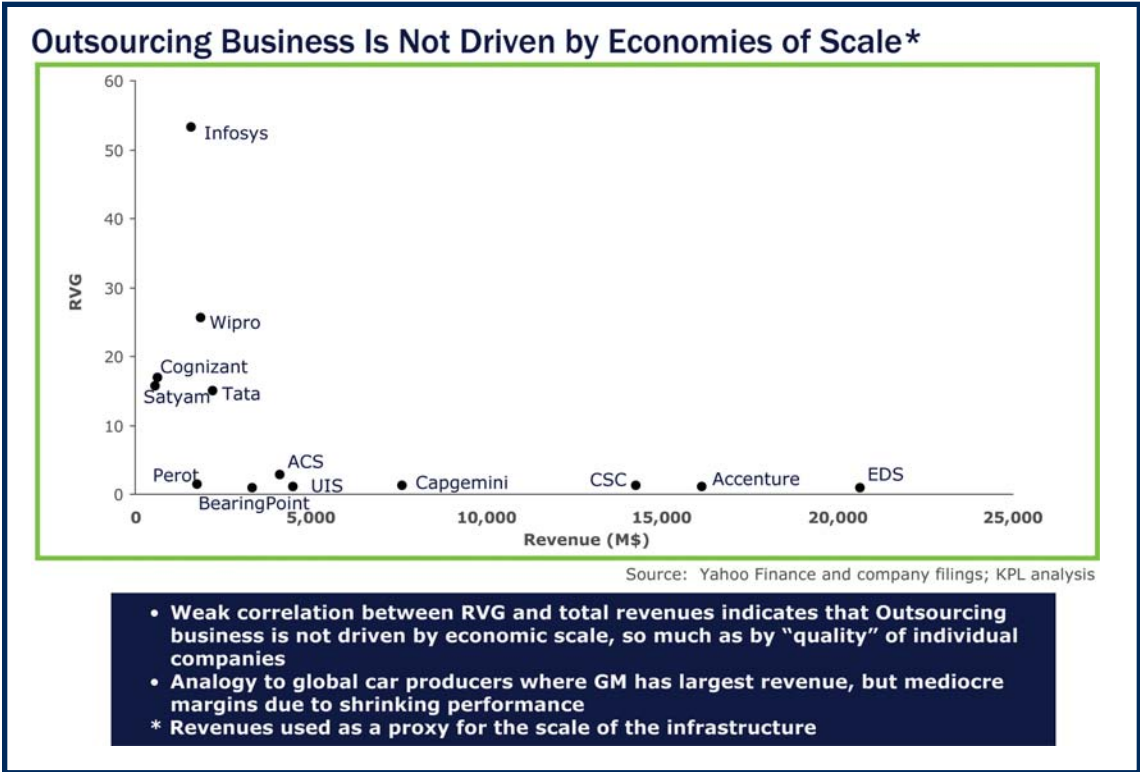
"In the face of heightening competition from Indian players like these, the major American and European outsourcers - traditional industry leaders like Accenture, EDS, Capgemini and Bearing Point - need to upgrade both their growth and margin performance significantly or face forced mergers, consolidation or a general loss of leadership positioning," said Schroth.

## ABOUT THE RVG METRIC

The RVG for a publicly held company can be calculated from information contained in a firm's SEC filings and standard financial analysis tools. RVG measures the increase in a company's market cap due to 1% extra growth vs. 1% margin improvement. RVG is calculated based on

a discounted cash flow (DCF) model driven off "sustainable cash flow," and is ultimately determined by four factors: operating margin, capital intensity, expected growth rate versus cost of capital and the synergistic effect of the combination of these elements.

The result is a single number expressing the impact on share price of additional growth versus a boost in a company's operating margin. An RVG™ of seven, for example, would mean that a company would have to have a 7% improvement in its margin to have the same impact on shareholder value as a 1% gain in revenues. (A deeper description of the RVG™ metric is available in the Harvard Business Review article, "The Relative Value of Growth™", April 2005.)



### RVG AND OUTSOURCING COMPANIES

The RVG™ of Indian outsourcing companies is many times higher than their American and European counterparts. The RVG™ of Infosys is 53.2, and Wipro's is 25.6. Satyam Computer Services' is 15.6, and Tata's is 14.9; all evidencing very strong incentives to grow sales.

Meanwhile, (ACS) Affiliated Computer Services' RVG is 2.8, strongest among the N. American and European players, but well below the Indian companies studied. Other competitors display low RVG values that evidence pressures to re-build profit margins before which growth strategies would be penalized by the capital markets: Perot Systems' RVG is 1.5; (CSC) Computer Sciences Corp.'s is 1.2; Unisys's is 1.2; Capgemini's is 1.1; Accenture's is 1.1; Bearing Point's is 0.9, and EDS's is 0.8.

Katzenbach Partners believes the RVG metric will provide a truly new lens for companies that have, or are contemplating, outsourcing relationships to gauge the long-term potential of such relationships. It will provide a way to gauge the outsourcer's incentives in a central way. These companies will need to ensure that their outsourcing vendors are driven to invest appropriately. "If a company is looking to outsourcing to improve the health of the organization as a whole, it should bring on outsourcers that do not work purely from a restrictive, cost-driven model, which may result in a lack of flexibility, or the use of less capable talent. Instead, the company should seek an outsourcing vendor and partner that drives down

overall costs and adapts to strategic business needs," adds Schroth.

"Our research into Indian outsourcing companies like Wipro shows that they seem to have benefited from being relatively new entrants into the US market. They do not have to unlearn old behaviors or adjust to old systems. Wipro has been focused on talent management, providing employees opportunities to innovate, experimenting and growing the company organically," said Roopa Unnikrishnan, a manager at Katzenbach Partners who works on technology and outsourcing issues.

## **ABOUT KATZENBACH PARTNERS**

Katzenbach Partners LLC is a leading consulting firm focused on organizational performance. The firm helps large companies achieve peak performance and solve major business issues by using an approach and perspective that integrates strategic problem solving with deep insight into people, organizations and how each client can best realize change. KPL has over 115 consultants and staff with offices in New York and Houston.