An Exploratory Study of How Entrepreneurial IT Firms in India Compete in the Market

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ABSTRACT

It is widely accepted that in a number of industries smaller firms are at a distinct disadvantage compared to their larger counterparts. This paper takes a close look at the information technology (IT) sector in India. It is a sector doing very well in a fast growing economy. The business model primarily followed by this industry is very advantageous to the larger firms. Even in this scenario, many small emerging IT firms are doing well. This article explores the various strategies followed by entrepreneurial IT firms while competing with larger, established firms.

INTRODUCTION

Entrepreneurship can be defined as the creation of new, growth oriented firms engaged in the process of creating value by bringing together resources necessary to exploit an opportunity (Stevenson, Roberts and Grousbeck 1989; Guth and Ginsberg 1990; Pinchot 2000). Entrepreneurial organizations are characterized by innovativeness, risk taking and a proactive orientation.

It has been observed that start ups are plagued by very high rates of failure. Gruber (2004) observed that discontinuance rates of new ventures can be as high as 70% in the first five years. Even for those who manage to survive and have some growth for the first few years are not able to successfully make the transition from an entrepreneurial start up to a mature organization.

At the same time, there have been numerous cases of inspiring entrepreneurial success. It is the success of firms like Microsoft, Apple, Easyjet and Skype that continues to inspire entrepreneurship.

In this article we take a close look at the Indian Software Industry. The Indian software industry has been growing at a phenomenal pace over the past 15 years. The Indian IT – ITES industry has been growing at an average CAGR of over 28% since FY’00. In the same period, the industry’s contribution to the GDP has risen from 1.9% in 2000 to an estimated 4.8% in the current fiscal year (NASSCOM McKinsey Report 2005). The A.T. Kearney Global Services Index 2005 puts Indian in the first position.

This export oriented growth has been fuelled by a high level of IT outsourcing from the developed nations to India. This growth has been spearheaded by India’s growing dominance in the arena of customized software services.

NASSCOM, the industry body in India, has divided this industry into tier-1, tier-2 and emerging players.

Exhibit 1

<table>
<thead>
<tr>
<th>Category</th>
<th>No. of players</th>
<th>Share of India’s total IT/BPO export revenues</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier I Players</td>
<td>4</td>
<td>• 45% of IT Services</td>
<td>Revenues greater than USD 1 billion</td>
</tr>
<tr>
<td>Tier II IT Players</td>
<td>10 - 15</td>
<td>• 25% of IT Services</td>
<td>Revenues USD 100 million-USD 1 billion</td>
</tr>
<tr>
<td>Emerging Players</td>
<td>&gt;3000</td>
<td>• 10-15% of IT Services</td>
<td>Revenues less than USD 100 million</td>
</tr>
</tbody>
</table>

Source: Nasscom
As is evident from the table above, the industry structure is heavily tilted in favor of larger firms. Entrepreneurial, emerging firms account for only 10 to 15 per cent of industry revenues.

**Exhibit 2: A scatter graph representing the profitability and turnover of listed IT firms in India.**

Turnover = Annual Sales  
Profitability = (Net Profit / Sales) x 100

![Graph showing Turnover and Profitability of Indian IT firms](image)

Data Source: Centre for Monitoring of Indian Economy

As seen from the graph, in the case of small firms, there are a lot of variations with regard to profitability but larger firms exhibit much lesser differences with regard to profitability. In fact, all the tier-1 firms show profitability in the relatively narrow range between 19% and 27%.

A business model based on providing manpower-intensive customized software development and maintenance services to foreign clients has enabled Indian software to transit smoothly from software ‘body-shopping’ services to offshore software development in India (Krishnan and Prabhu, 2004). This service delivery model is manpower intensive and growth can be achieved only by a proportionate increase in manpower employed. Due to the requirements of infrastructure necessary for training, quality control and knowledge management and other aspects of service delivery, the scope for economies of scale is immense.

In this competitive scenario, it is hard to imagine how entrepreneurial firms are able to survive. There does not seem to be much scope of entrepreneurship and entrepreneurial growth in this industry. On the contrary, there is evidence of frenetic entrepreneurial activity, with a number of new firms registering with Software Technology parks of India (STPI) to start software exports. There were only 1000 registered software exporters in 2000. This number has tripled over the last 5 years. Entrepreneurial firms are not only able to survive but many manage to grow at a rapid pace too.

**OBJECTIVE**

This paper attempts to present the strategic orientations of successful high growth entrepreneurial firms in the Indian software services industry. The paper looks at characteristics of these entrepreneurial firms that put them at a disadvantage. Then the paper goes on to list the strategic options followed by entrepreneurial Indian software firms to overcome the disadvantages and thrive in the industry.
METHODOLOGY

This is a conceptual paper and it presents a picture of entrepreneurial strategy, which emerges from practices in a high growth industry in a growing economy. The concepts discussed in this paper draw on a range of contemporary research and thought on entrepreneurship and strategy. Even though entrepreneurial strategy is a new field of research interest, there has been a lot of interest shown by academicians, researchers and the industry in the recent past. Industry reports and newspaper and magazine articles were also taken into consideration.

Further, the paper is based on detailed interviews conducted with owners, managers and even clients of successful Indian software firms exhibiting annualized growth rates in excess of 20 per cent. In addition to the profitability criteria, the firms chosen for this study exhibited some consistency in their strategic intent. The individuals chosen for the interviews were senior managers or CEOs, who had spent a long time in the industry.

Eight of these firms were ‘emerging players’, two were tier-2 companies and there was one tier-1 company. The strategic approaches of the tier-1 and tier-2 companies were contrasted with strategies of emerging companies and also with their own strategies when they were much smaller.

The interviews included both structured questions and open-ended discussions. A variety of topics were discussed, most of which was directly related to their strategic outlook but some unrelated topics were included to get an understanding of the broader picture.

CHARACTERISTICS OF SMALL FIRMS

Over a period of time, researchers have observed the following major characteristics associated with new firms which result in a disadvantage for them vis-à-vis larger, entrenched competition. Strategy of entrepreneurial firms is basically directed towards overcoming the problems presented by these characteristics.

Small size

The main issue with smallness is that it leads to the problem of having limited financial resources (Gruber 2004). Also, limited market presence, owing to small size, leads to limited marketing power, which can put the firm in a disadvantaged position in negotiating with both channel partners and customers. In small firms, decision making may be associated with high risk. Wrong decisions may result in fatal consequences for small firms with limited resources. A larger well established firm may be able to weather these shocks. Small size means it is difficult to reach economies of scale. Expenditure on activities like marketing quality control and training is given a much lower priority to other costs of doing business like production. Small firms try to overcome their disadvantages by differentiating or by trying to find a niche in the market where they may enjoy a competitive advantage.

Newness of the firm

The new firm is an entity unknown to most of the potential customers and suppliers. There is likely to be a widespread lack of trust in the offering of the new firm (Hannan and Freeman 1984). Even though there is likely to be some familiarity with some key customers, owing to their past relationships with the entrepreneur or significant others associated with the firm, mostly the new firm will rely on interaction with strangers. As a firm, it would not have a track record of business relationships.

Newness of the firm also prevents the firm from being able to attract quality manpower. This may result in the firm lacking critical skills necessary for competing against the large firms. At the least, the new firm will have to pay more than the established firm to attract the same manpower.

The new firm will lack experience in the marketplace and will not have structures, processes and past data one associates with formal, mature organizations.
Owner-led strategy

There is an over-reliance on the competence of the promoters. This sort of problem has been highlighted by Stokes (2000). Even though there are significant inputs from senior employees and other stakeholders, most strategy in smaller organizations is determined by the promoters. The fallout of this can be that strategy can be severely affected by lack of vision or effective implementation on part of the entrepreneur.

Also, when a firm grows in size, it will not be possible for the entrepreneur to fully comprehend the variety challenges and opportunities facing the firm. Unless there are others contributing significantly to the formulation of strategy, the firm will not be in a position to make the transition to a large firm.

STRATEGIES ADOPTED

In spite of the obvious problems faced by smaller firms, they are able to successfully compete, survive and grow. Some of the characteristics of entrepreneurial competitive strategy, which may result in an advantage for entrepreneurial firms over their larger competitors, are listed below. The competitive strategy of entrepreneurial software service providers in India was composed of one or more of the following strategic orientations:

Low pricing

The larger IT companies in India are able to price their services at a higher point that the emerging players. A low price seems to be at the core of the competitive strategy for most entrepreneurial software firms in India. Small IT firms in India price themselves between 10 to 25 per cent lower than large IT firms. In spite of having higher costs than the larger firms, the highly competitive nature of the market prevents them from being able to raise their prices unless under exceptional circumstances.

A cost leadership strategy has to be supported by other competencies which lead to low costs of operation in the long run. In the software industry, smaller firms have a clear cost disadvantage compared to larger firms. Currently the demand for their services far exceeds the supply, so they are able to price at a lower point and still have an adequate profit margin and maintain a high rate of growth. Emerging firms foresee a problem when the competitive scenario gets crowded by Chinese, Vietnamese and other international players and there is a downward pressure on prices. Shrinking margins are much likelier to hurt them than the larger players. So there is a scramble to find ways of cutting down costs and growing rapidly to achieve economies of scale.

Innovative value creation is an important facet of entrepreneurial marketing, as value creation is a prerequisite for transactions and relationships (Morris et al, 2002). The entrepreneurial firm is always on the lookout to discover untapped sources of customer value and to create unique combinations to produce customer value.

Involvement of top management

Not all projects will be of equal importance to the client. There will be some projects which are very critical. In such a situation, the client may want the direct involvement of the top management. That will not be possible in larger firms. Typically a tier-1 firm will have hundreds of clients and may execute over a thousand projects in a year. The top management will not have the time and the inclination to get involved in the nitty-gritty of the project execution process. A critical project being led by a middle level manager will not inspire confidence in the client. The client may want the involvement of a major stakeholder.

That will not be the scenario in an emerging company. The client is likely to secure the involvement of top management in case of critical projects. In some cases, it may be possible to involve the entrepreneur to directly lead or oversee the execution and delivery of the project.

Orr (1985) had observed that entrepreneurs spend a considerable period of time in contact with their customers. This allows them to interact with their customer base in a way larger firms are not able to match.
Flexibility

Figenbaum and Karnani (1991) have mentioned flexibility, particularly output flexibility, as a source of competitive advantage for small firms. Output flexibility becomes more of an advantage in case of customized services. Many of their clients are operating in dynamic environments. In the face of turbulence and uncertainty, the needs of clients are likely to change over time. In case a certain project needs major changes in its scope or direction, larger firms may find it difficult to accommodate these changes.

With their multi-layered structures, larger firms find it difficult to respond to changes in client requirements. So, in cases of projects with an unstructured framework, entrepreneurial firms have an advantage. For example, if the client requests a minor change in the setup of the screen, it can be implemented by the team leader in a small firm whereas it will need approval from much higher up in case of a large company.

Small projects

Some large firms agree to take on small projects. Usually these are executed by small teams in transition between projects and often they are called off when a new project materializes. Sometimes, these projects suffer from a total lack of attention and there are huge delays in their execution. There are instances when projects were taken on and midway through execution, they were dropped and the client was informed of the firm’s inability to go on with the project. This may happen even when the client is a large client regularly outsourcing other much larger projects.

A small project will be of interest to the emerging firm. It represents a significant proportion of its expected revenues and especially if the small project is from a potentially big customer, the project will get special attention. The entrepreneurial firm will strive to do a good job of it in the hope of moving up the value chain and getting larger projects in the future.

Specialized needs

Some entrepreneurial firms concentrate on finding a niche and developing competencies consistent with maintaining their advantage in their niche. The approach of these entrepreneurial firms was centered on finding a niche opportunity, attracting an initial customer base and expanding by doing more of the same with more such customers.

The niche may be defined in terms of technology platforms or in terms of a new emerging sector. For example, companies like Macronimus and Ranosoft are concentrating on mobile application development.

Innovation

Innovative firms have the ability to maintain a flow of new ideas that can translate into new products or services (Covin and Slevin, 1994). The entrepreneurial firm is focused on the need for creative approaches to acquiring, retaining and developing customers (Slater and Narver, 1995; Deshpande, Farley and Webster, 1993).

Service innovations are generally incremental in nature. There are cases when the customer has a problem or a situation but is not very sure of the solution. Some entrepreneurial firms have managed to position themselves as service providers who are willing to work with the client to find an optimal solution to the problem before implementing the solution.

Larger firms do not have dedicated resources to finding individualized solutions but rather look at individualizing generic solutions. Many small IT firms in India have managed to build a reputation for thinking out of the box and coming up with innovative solutions.

Currently the core strategy of the entrepreneurial firms revolves around providing a service at a lower cost, but increasingly software firms are looking at segmenting the market and targeting clients with smaller projects or projects which need special attention. Very few firms have taken the initiative to find a niche and develop competencies. This is perceived as a high risk strategy as the firm will be addressing a small target market. The need to innovate in the software services industry is being recognized by both researchers and the industry (Sreedharan 2004; Ojha and Krishna 2004).

World over, competition for providing software services is increasing with new competition coming from firms in Eastern Europe, China and other countries in Asia and South America. In the context of the three generic strategies of
cost leadership, differentiation and focus proposed by Porter (1985), given the obvious disadvantages in trying for cost leadership, entrepreneurial firms in the Indian software industry should try to move to strategies based on differentiation and focus.

**LIMITATIONS OF THIS STUDY**

There are over 5000 IT firms in India and a very small sample of only eleven firms was chosen for this study. Learning and conclusions from this study will have to be viewed in light of the limitations of a study based on a very small sample size.

**SCOPE FOR FURTHER RESEARCH**

There needs to be a more detailed exploration of this issue involving data from many more firms. Such studies need not be restricted to India alone. IT firms in a number of developing countries are proving to be competitive on the world stage. Samples used in further research can be expanded to include firms from all over the world. Also, collation of similar studies carried out in other industries will give us a comprehensive view of how entrepreneurial firms are competing with well entrenched competitors.

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