INSIGHT

HCL Technologies and its Verticalization Strategy at Work in Europe

Angela Vacca

IDC OPINION

This Insight deals with HCL's European Analyst Day, held in London on February 22, 2007. HCL is an Indian IT services company focusing on product engineering, enterprise applications, industry solutions, infrastructure management, and BPO services.

- HCL business volumes in Europe and customer references are impressive: growth rates as well as executive commitment promise even better performance for the short term.
- HCL wants to compete on added value and, unlike other traditional Indian IT companies, not on price. The company positions itself directly in competition with big IT giants such as IBM and Accenture, as it is also strongly focused on infrastructure management.
- The verticalization strategy that HCL launched in 2002 confirms its willingness to improve its customer-centric approach. HCL in Europe targets five sectors (financial services, retail and utility, telecom and media, high tech and manufacturing, and life sciences), which are further segmented in a number of micro-verticals.

IDC believes that focusing on a selected number of vertical markets is the only realistic way to increase its European presence since the market is still quite fragmented and targeting the whole range of segments at a time would disperse its efforts and create difficulties in offering a credible value proposition.

IDC recognizes the value that HCL is creating through its verticalization strategy since it can be very difficult to target big and complex European companies without expertise on their business issues. On the other hand, the micro-verticals strategy seems fairly vague as it appears to be backed by a few projects and not by a thorough knowledge of the topic.

IDC believes that HCL's willingness not to compete on price is a long-term strategy, while for the short term cost saving is still a powerful means to gaining momentum in the European competitive arena, especially in those verticals in which IT budgets are still under pressure. It is worth noting that the value-add strategy is very forward looking and can provide a competitive advantage to HCL. HCL can beat big IT giants especially due to its competitive pricing, but this advantage will narrow and therefore it is essential to create a clear market positioning for tomorrow.

HCL still faces problems of communication. The company has not yet achieved a mature marketing strategy and is therefore working to improve its efforts in the short term.

Filing Information: February 2007, IDC #M52P, Volume: 1

Viale Monza, 14 20127 Milan, Italy P.39.02.28457.1

IN THIS INSIGHT

This Insight reviews the announcements and messages of the HCL European analyst day held on February 22, 2007, in London.

HCL executives illustrated their growth strategy in the European region, their differentiating factors, and the results achieved in this marketplace.

IDC presents its view on the path that this Indian company is taking within the Western European competitive arena, with a focus on HCL's verticalization strategy.

SITUATION OVERVIEW

HCL in Brief

HCL Technologies is an Indian IT services company that focuses on product engineering, enterprise applications, industry solutions, infrastructure management, and BPO services.

Revenues for calendar year 2006 were $1.16 billion, which represents a 34% increase over 2005. The company employs 38,300 people.

HCL leverages an offshore infrastructure and a network of offices in 17 countries to deliver solutions across selected verticals including financial services, retail and consumer, life sciences, aerospace, automotive, semiconductors, telecom, and MPE (media, publishing, and entertainment).

58% of HCL's revenues are from the Americas, 28% from Europe, and the remaining 14% from the Asia/Pacific region.

European revenues for calendar year 2006 were $326 million. Within Europe the vast majority of the business comes from two countries: the U.K. and Germany. They are followed by Benelux, Nordics, and France.

TABLE 1

HCL Technologies: A Summary

Area	Data
Corporate headquarters	India
Business focus	IT services, infrastructure management, BPO, and product engineering
Revenues CY06	$1.16 billion
Employees (2006)	38,300
Revenues geographic split	Americas 58%, Europe 28%, APAC 14%
Revenues industry split	High-tech and manufacturing (31%), financial services (25%), telecom (17%), retail (11%), M&E (6%), life sciences (4%), others (7%)
Revenues service areas split	Software services (74%), BPO services (13%), infrastructure services (13%)

Source: HCL, 2007

In Europe, the revenue split by vertical markets is different since the financial services sector is by far the biggest sector. It is followed by the retail and utility sector, telecom and media, high-tech and manufacturing, and life sciences.

HCL employs around 3,000 people in Europe, most of whom are based in the U.K., followed by Germany, Benelux, and the Nordic region.

HCL's Verticalization Strategy in Europe

In 2002 HCL decided to invest in building a verticalized approach to market in order to provide products and services tailored for the needs of specific industries with the aim of building competitive differentiation.

In Europe HCL currently focuses on five vertical industries: financial services, retail and utility, telecom and media, high-tech and manufacturing, and life sciences.

European countries in which HCL is developing its business are the U.K., Germany, Benelux, the Nordics region, and France.

Therefore HCL is targeting a selected set of verticals and countries. HCL is committed to specializing on a number of markets where it aims to provide high-quality services, as it wants to create an offering that can add value to its customers' business.

Europe is currently going through a homogenization process but is still a very fragmented market, where every country has its own peculiarities and characteristics. HCL is addressing all the top 5 Western European countries for IT spending volume except Spain, while it is creating a reputation and a recognizable brand in the countries that it has selected as its first focus. Similarly, for vertical markets, the company prefers to concentrate its efforts on specific sectors.

In order to create vertical-specific capabilities, the company is appointing senior executives that can bring in-depth industry expertise and is grooming younger employees that can grow within the company with a vertical specialization.

In addition, in September 2006 HCL launched a new initiative called "Enterprise Transformation Services" (ETS) that aims at strengthening HCL's focus on value centricity. This initiative is aimed at tapping the market potential of key verticals, providing premium domain services.

HCL has identified the following key services:

- Business and IT consulting
- Legacy modernization
- Application architecture services
- Business analytics services

The three most important vertical industries in Europe are:

- **Financial services.** The financial services sector is segmented into the retail and corporate banking, insurance, and capital markets areas. HCL's expertise and references are particularly strong in investment banking and life insurance.

- **Retail.** HCL is focused on distinct segments such as specialty retail (apparel and footwear, health and beauty, fashion, pharma retailers, electronic and electric retailers), food and grocery, general merchants, hotels and restaurants, and consumer packaged goods.

- **Telecom.** Within the telecom vertical, HCL's integrated offering includes turnkey implementations, system integration, and concept-to-field implementation as well as services such as remote infrastructure management and business process outsourcing across all elements of the communications ecosystem (telcos, ISVs, and OEMs).

HCL's Differentiators

An Unusual Competitive Arena

HCL Technologies does not compete with the usual Indian IT companies but instead positions its offering directly against the big IT giants such as IBM and Accenture. HCL's focus on infrastructure management is unusual for a company with Indian origins and allows HCL to offer to its customers a new type of IT infrastructure outsourcing option. This approach is expected to provide increased flexibility to customers while providing more control. The concept is based on a partnership relationship between HCL and its customer that frees the customer of day-by-day activities while granting control and at the same time flexibility and continuous technology upgrades.

Full Outsourcing

HCL is able to engage in projects that involve the responsibility for an IT function, unlike from those companies that engage mainly in application development or maintenance projects. HCL's investments and focus on infrastructure management enable the involvement in full outsourcing engagements.

The concept to market that HCL proposes provides organizations with the opportunity to source a set of integrated services from a single partner.

Employees First

HCL believes that employees are its most valuable asset. For this reason HCL encourages employees to speak with executives as it believes this will create a better environment in which to work. To facilitate internal communication, HCL asks employees to provide 360-degree feedback. This aims to promote a continuous improvement cycle, improving employees' job satisfaction and their productivity.

The Fixed-Salary Approach

At HCL, 85% of non-BPO employees have a fixed salary. HCL believes that by motivating employees through linking salary to something on which employees do not have a direct impact can be very frustrating and misleading. HCL, in order to motivate employees, prefers to offer a fixed salary, and this is expected to increase employee satisfaction.

FUTURE OUTLOOK

European revenues have seen continuous growth in the last few years. In 2004 Europe accounted for 22% of HCL's total turnover while today the region has grown to count for 28% of HCL Technologies' total turnover. In the last quarter of 2006, European revenues grew 94% compared to the corresponding quarter ended December 2005. This very healthy expansion is a continuous process since the CAGR of European revenues from 2004 to mid 2007 was 46.5% while at a worldwide level revenues grew 33.1%.

European revenues are expected to continue to grow above worldwide levels since HCL's commitment to creating an improved strategy in Europe is likely to maintain strong growth rates in the region.

A major barrier for HCL is the issue of overcoming cultural and language barriers.

HCL is aware of these major obstacles, as its strategy is to create partnerships with customers in order to gain more insight into their business. Also HCL is used to hiring local executives from customer companies in order to gain local knowledge and to internalize knowledge over the business of its customers. IDC believes that this strategy has already brought visible results, as demonstrated by the large transformational deals that the company has won in Europe.

Therefore IDC believes that major focus points for the short term in order to better target the European market will be:

- Focus on communication
- Continuous investment in building vertical-specific expertise
- Concentrate efforts on building customer proximity, working hard on cultural barriers
- Consider the opportunity to build delivery capabilities in Europe in order to gain more proximity and to better spread geographic risk
- Continue to rely on a culture of meritocracy and on investing in employees

Customer References in Europe

Due to non-disclosure agreements, HCL prefers not to mention customer names. Nevertheless IDC recognizes that HCL has been able to build a solid customer base with relevant Western European companies especially in the main targeted vertical markets (financial services, retail, telecom, and manufacturing).

Published Under Services: European Vertical Markets