A Horses for Sources Research Report, March 2010

Straight from the Horse's Mouth:

The IT Outsourcing and Business Process Outsourcing Industry Landscape in 2010

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I. Executive Summary

The uptake in outsourcing services has always had an inverse relationship with the state of the global economy, and the recent economic crisis has proven to be no exception. When economies are in advanced periods of recession, most businesses plan for their survival, and act on these plans when they start to see some daylight.

The promise of outsourcing in today's global economy involves substantial – and rapid - cost efficiencies for many mid-large businesses, while for smaller business it gives them access to services and skills that can improve their business performance. However, evolving into a global outsourced business-support environment is one of the most impactful and culture-changing experiences most companies ever have to experience.

When the recession-survival strategies of companies are being executed by their business leaders, radical transformative endeavors, such as outsourcing, are discussed as future potential action plans by most firms, but largely not acted upon in the short-term. Outsourcing can simply disrupt a firm that is steadfastly focused on restructuring its business to survive short-term economic pressures.

As the recession slowly lifts, many businesses, secure in the knowledge that their financial performance is on safer ground, start to act on their more transformative planning to increase productivity and source new avenues for revenue. This is exactly the state of play for most industries in 2010, with an unprecedented number of new firms moving into outsourcing engagements, with the objective of driving down operational cost, but also to globalize processes and force change into jaded business models of yesteryear.

In January 2010, Horses for Sources leveraged its vast network of global enterprises to survey the adoption dynamics and intentions of enterprises, with regards to their IT and Business Process Outsourcing (BPO). We called the survey "Seeking the New Normal in Outsourcing Delivery". With the support from the communities at Global Services Media and the Shared Services and Outsourcing Network, we were able to secure the opinions of 1,055 senior executives involved with either buying, selling or advising outsourcing services.

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II. Key Findings

- 2010 is primed to be a very strong year for outsourcing adoption
- The key areas of increased outsourcing scope are expected to be in areas with heavy low-cost labor arbitrage support (nearshore and offshore) – software applications, call center, engineering management, finance & accounting, analytics and human resources. In some cases, half companies interviewed will be increasing outsourcing scope
- The middle-market ($750m-$3000m annual revenues) is poised to be the most active
- The principle drivers behind outsourcing are cost reduction, desire to globalize business operations and to transform / re-engineer business processes
- The main Inhibitors are other priorities brought on by the economic crisis and internal politics / resistance to change
- When evaluating vendors, global scale, financial stability and operational excellence are the table-stakes. Business transformation capabilities are the differentiators
- Customer-willingness to evaluate cloud-based "business utility" offerings is strong as they increasingly look at hybrid IT/BPO solutions
- There are strong signs of increased adoption of industry-specific BPO solutions, most notably in the Financial Services and Life Sciences sectors

III. It's not all about cost any more—outsourcing provides a powerful change agent

There's been a lot of talk about a "New Normal" or a "Reset Economy"; that things will never be quite the same as before. However, we need to zone-in on reality to grasp what these new dynamics really entail in order to understand how we can address them.

Most industries are in a state of profound change, where businesses must achieve new levels of productivity and sources of revenue simply to survive—let alone grow—in this climate. Whether a company makes cars or pharmaceutical products or provides consulting services, chances are there's someone else in the industry vying to do the same thing at a lower cost and potentially with better quality. Almost every industry today is being impacted by profound shifts in the very nature they operate, for example:

Table 1: Industries experiencing a profound period of change

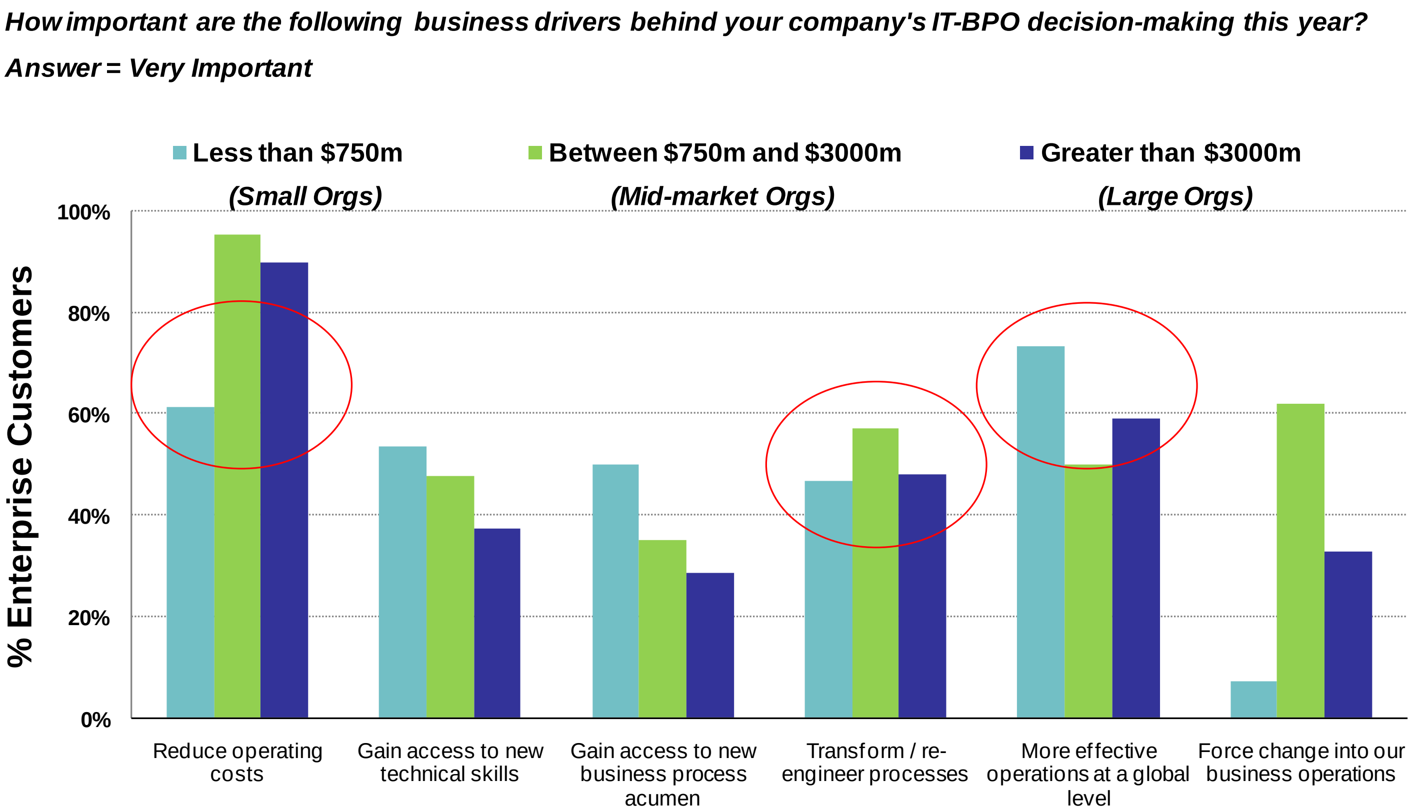
Industry	Profound Challenges for Organizations in Today's Economy
Financial Services	Massive deleveraging; Re-regulation
Life Sciences	The destruction of the R&D cycle; Large-scale M&A
Media	The crash of newspapers and network news; The Web 2.0 impact
Entertainment	Distribution models driving entirely new business models
Retail	The newly frugal consumer; Mortgage Refi's command 12% of US economy
Technology	The end of the WinTel / Enterprise App lifecycle; Industry consolidation

There aren't really any major developments on the near-term horizon to fuel a fresh wave of new economic growth, such as those provided by the Internet, computing and telecoms revolutions of the last 20 years. This time, the name of the game is for companies to optimize the tools they have and be smarter than their competitors. Eventually, we'll see real progress being made in areas such as medical research, cloud computing and green tech that should fuel a new growth era, but it's not going to happen quite yet.

In today's global economy, the options available to provide products and services leveraging global talent and new technologies are almost suffocating for most firms. There's never been a more crucial time to find the right partners to help source global talent effectively.

When we asked 209 enterprise buyers of outsourcing services what were the most important reasons driving them to evaluate outsourcing in 2010, we received the results shown in Figure 1 across small (under $750 million in revenues), midsize ($750 million to $3 billion) and large (more than $3 billion) customers.

Figure 1: Customers are looking to drive change into their operations to become more effective globally



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

There is clearly a contrast in the motivations behind outsourcing for small, medium and large enterprises. Cost reduction dominates, but only where there is significant scale to exploit labor arbitrage opportunities. While midsize to large customers (90%) overwhelmingly view cost reduction as their prime driver, smaller firms do not have the same scale to enjoy such immediate cost-cutting potential, with only 60% citing reducing costs as a primary driver. They actually regard accessing new business process acumen and technical skills as well as having support to operate more effectively at a global level as similarly powerful motives.

Empowering global operations and re-engineering processes are coming to the fore. When Horses for Sources ran a similar study six months ago, it was already becoming clear that customers are anticipating more business benefits from outsourcing than merely driving out some initial cost. As we emerge from the recession, these customers' desire to leverage global sourcing to help them operate more effectively as a global organization and re-wire their operations to support that process is becoming even more apparent, with more than half of all customers citing the need to globalize and transform processes as prime outsourcing motives. And this is across all size classes of customers. The need to globalize is impacting all companies, and outsourcing is providing one vehicle to help firms achieve it.

The mid-market increasingly views outsourcing as a vehicle to force change into their business operations. Many businesses are struggling to break out of the old way of running operations, and outsourcing is increasingly being viewed as a major change agent, with close to two-thirds of midsize customers citing this as a very important driver for outsourcing this year. While mid-market customers clearly feel the need to combat fatigue from old business support models, large firms are less inclined to view outsourcing this way. They are more comfortable using customized sourcing approaches and captive/shared services models that are harder to change solely with outsourcing engagements. Small firms tend to use outsourcing more to augment the value it brings from an added resource, talent and global standpoint; but because of their lack of scale, they will struggle to force real change into the business models with limited labor arbitrage opportunity.

The bottom line – profound changes to industries are driving the need for more radical transformative endeavors, and outsourcing is one of them. This unique view of the real drivers behind outsourcing clearly complements the profound and fundamental changes taking place across most industry sectors. Global business is rapidly changing, and outsourcing provides a vehicle for many businesses to change with it. This is clearly a time when some enterprises are finally finding the appetite for profound and radical changes to their business, while others are looking nervously at their shrinking businesses, too scared too wrapped in their old world business model to try anything different – we examine this trend further in this report.

IV. When labor arbitrage deals dry up (and they will), customers will select vendors that can deliver business value beyond basic low-cost services

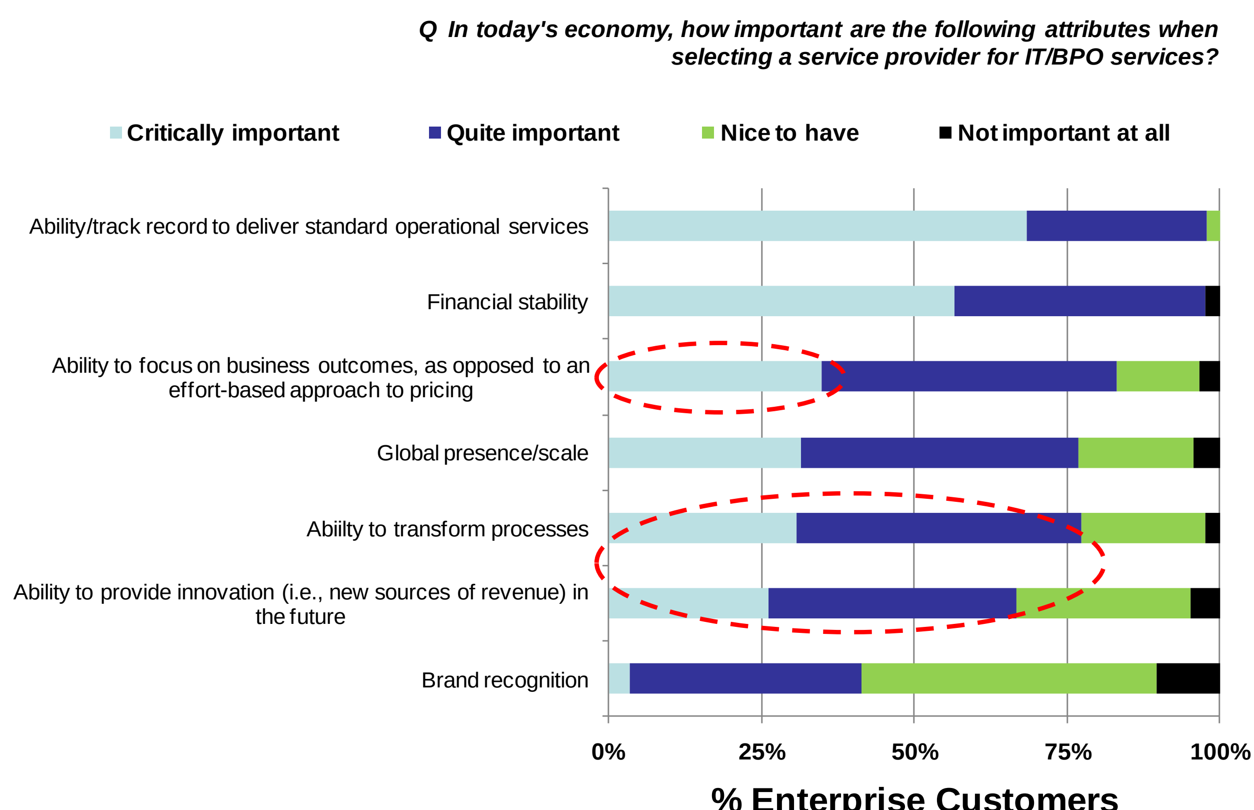
Operational service provision is commoditizing and leveling the playing field. Customers did their planning during the recession; and now that Armageddon has (apparently) been averted, it's time to execute on that planning. Part of many customers' planning right now is to take advantage of moving operational support offshore and driving out some cost.

This is bonanza time for offshore specialists that can deliver basic IT and BPO services at competitive prices. Contract signings that were delayed during the painful recession months are now in full swing, service vendors are reporting healthy results, and even the sourcing advisors have stopped moaning about their lack of deals and are making money again.

However, let's not get too carried away. Although the outsourcing market has rebounded, and it's likely to remain strong for most of 2010, these labor arbitrage deals are not infinite. Once customers have moved out as much of the easy work to service vendors as they can, their focus will move to finding that next tranche of productivity—and it's not going to be as simple as documenting standard processes and training an offshore team to replicate them. Customers may be delighted today that they trimmed 30% on this and 50% on that, but next year those savings will be eradicated and they won't keep harking back to that successful outsourcing initiative they did back in 2009. They'll be looking at what initiatives they can take advantage of next.

When Horses for Sources spoke to 1,055 customers, intermediaries and vendors across the global sourcing industry in January 2010, we drilled into the criteria behind vendor selection decisions, with an eye on how these decisions will be made in the future (see Figure 2).

Figure 2: When evaluating vendors, financial stability and operational excellence are the table stakes; business transformation capabilities are the differentiators



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media and SSON, January 2010

How have the table-stakes changed in this new economy?

Vendors need a proven delivery record and financial stability just to get to the table. The vast majority of buyers now see these criteria as table stakes just to start a discussion. The Satyam fiasco has left some bad memories with customers who do not want to experience a repeat of their vendor going belly up, like Satyam almost did. Would you sign up with an electricity provider that might go out of business? The same applies to whoever is processing your business transactions and managing your IT.

Moreover, with the industry for commodity work (e.g., technical support, application development, transactional accounting) now quickly maturing, there's little room for companies without proven customer successes and experience within the customer's industry.

Once at the table, customers are asking "What else can you give me?" Quite simply, there are several vendors today pushing services within a similar price range and offering a sufficient track record of successful delivery. Furthermore, most large enterprises have already experienced offshoring and outsourcing in varying degrees in their operations for several years now, and are smart enough to realize outsourcing provides an opportunity to deliver more than simply cost savings (see Section I). Consequently, the ability to provide outcome-based pricing is now a critical component among a third of customers, and an important consideration for most of the rest.

Global presence and scale are less of an issue these days. Merely a couple of years ago, they would have been among the most critical selection criteria. However, today's customers are less concerned with these issues, as most of today's vendors are already expected to have a multi-shore strategy and sufficient ability to add resources when required. Moreover, most of today's deals have an onshore/onsite component complemented with offshore support from India, the Philippines or some other location. Everyone has that in spades. It's like asking whether your electricity provider has enough generators.

Innovation and transformation are now becoming major decision-swayers. On the surface it may appear that transformation and innovation are only secondary considerations (i.e., not a "deal-breaker" for three-quarters of customers). But considering that most vendors are offering similar solutions at similar prices, these categories are fast becoming the decision swayers.

Brand is not nearly as much of a consideration. However, people rarely admit they are swayed by brand. Therefore, the fact that it is the least important selection criterion tells us that service delivery these days is much more about the realities of delivery excellence than the label under which it is provided. It is now considered as acceptable to engage with a second-tier offshore brand as with a household Western brand. Moreover, executives these days can get fired for using a big brand and messing up. The sheer number of customers that have engaged the new breed of offshore services vendors in recent years has significantly leveled the playing field when it comes to brand.

The bottom line: Those that fail to invest in the future delivery model will likely get cast aside. It's clear this business has reached a critical juncture where vendors are being judged on their ability to go beyond standard services and deliver real business value for their clients. Decisions are made based on which vendors have invested in creative staff with industry domain skills, backed up by the table stakes of delivering bread-and-butter services at competitive prices.

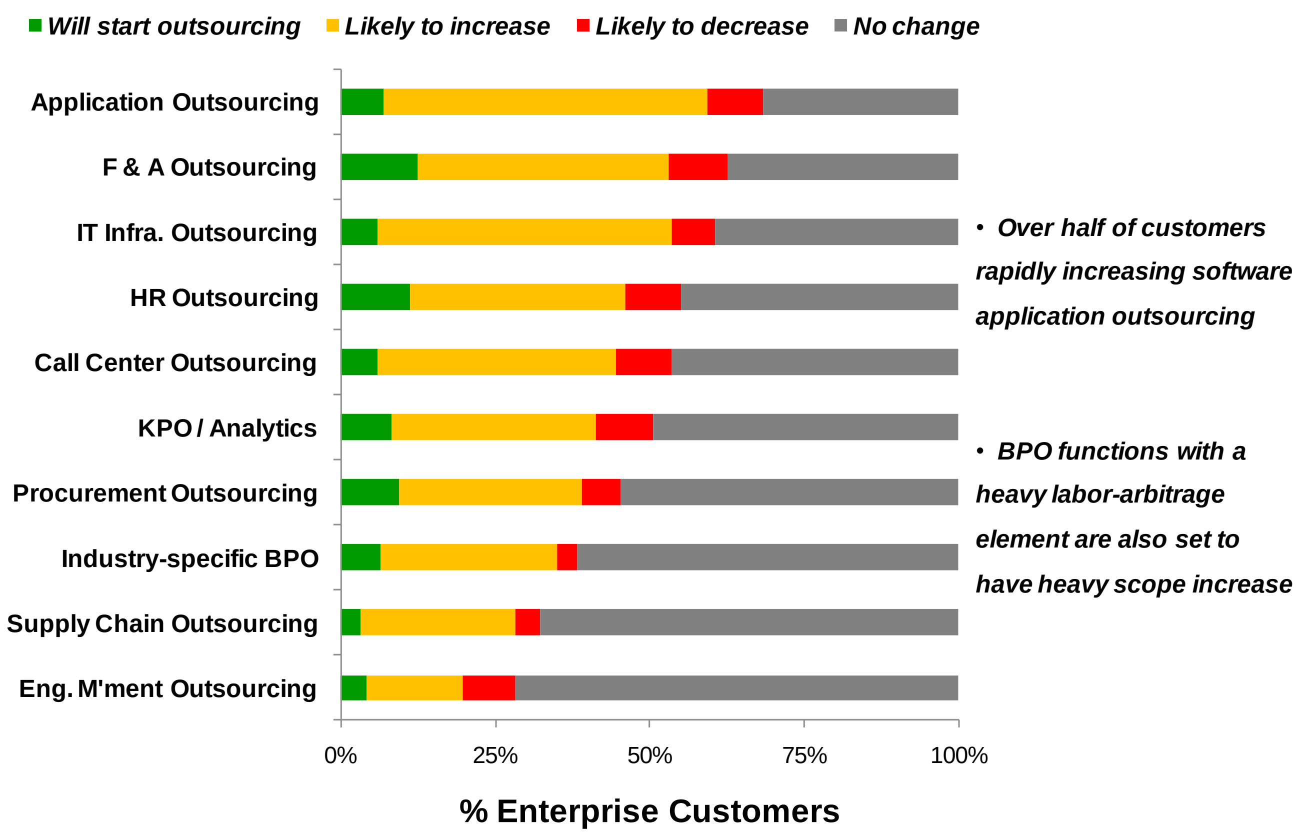
Everyone's talking a big game right now and it may get them to the table—it may even win them new business. But the real challenge is whether they can truly move clients up the value chain and help them find new avenues for productivity and growth. A lot of basic services contracts are being divvied out in this post-recessionary era. If today's winners fail to invest in increasing the value of their service provision, they may find their clients seeking alternative service partners before long. Some vendors will always be happy delivering low-end services. However, if they see their business going to competitors with higher-value propositions, they will desperately seek out ways to remain competitive. The question is whether they have the appetite and culture to invest to find that next level of performance for their customers.

V. Demand for outsourcing is reaching new heights, but will vendors disappoint?

What do customers intend to do this year with their outsourcing strategies? When we spoke to 1,055 customers, intermediaries and vendors across the global sourcing industry, they gave us the real picture (see Figure 3):

Figure 3: How 2010 will play out (from the customers' perspective): IT outsourcing will reach its peak and a banner year for BPO is likely

Q. In light of the recession, are you more or less likely to increase your investment in the following IT-BPO services in the next 12 months?



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

Figure 3 reveals the dynamics of enterprises now looking to execute on plans to reduce costs and drive change into their business operations after hunkering down during the recession.

The green represents where customers intend to initiate outsourcing for the first time, the yellow where they intend to increase the scope of existing outsourced processes, the red where they intend to pull back in scope, and the gray where they haven't made any plans or just intend to maintain their status quo. Let's take a closer look at some IT-BPO services referenced in this study:

- **Applications and infrastructure outsourcing:** Most larger firms have already been using IT services vendors to deliver work in outsourced contracts for some time now, hence the relatively small percentage of customers starting ITO for the first time. The notable trend here is the sheer magnitude—over 50%—of firms intending to increase the scope of their existing IT outsourcing engagements. We're already seeing significant revenue growth from several ITO vendors over the last couple of quarters as they layer on work for customers. There's still a lot of room for labor arbitrage deals in the short-to-medium term, with 75% of ERP still being maintained and supported onshore. Hence 2010 will constitute something of a land grab for the arbitrage work from the leading services vendors. The big question will be who wins the higher-value transformative work when the obvious arbitrage opportunities eventually dry up.

- **IT outsourcing:** We expect IT outsourcing to peak this year. The delivery models for standard ITO services are mature and scalable enough to cope with the demand. 2010 will be a banner year for the ITO business as the services vendors rapidly mop up the labor arbitrage deals. The gauntlet really will get laid down toward the end of this year, as customers want to find new ways to drive productivity after the arbitrage is exploited (e.g., virtualization and cloud-based services).

- **BPO:** Simply put, many BPO functions are a lot less developed, less scalable and less "productized" than those of IT outsourcing. Therefore, expect a lag between the resurgence in ITO and a bounce-back in BPO engagements being signed. However, it's clear that a lot of pent-up demand from business case evaluation during the recession months will come into play in 2010.

- **Transactional finance and accounting (F&A) outsourcing:** Transactional F&A (i.e., payables and receivables) has become well resourced and supported by a number of vendors, with more than 70,000 delivery staff working for services vendors across the globe. One in six customers expect to venture into an F&A BPO engagement for the first time this year; but more significantly, 40% of them will be layering additional F&A processes onto existing engagements, with only a small fraction actually pulling back work. Much of this demand is coming from mid-market firms, so expect a multitude of smaller transactions in the $5 million to $20 million range being signed this year.

- **HR outsourcing:** Some HR outsourcing functions will be outsourced, with 11% of customers expecting to outsource for the first time, and a third adding additional scope. Unlike the multi-process HRO business of yesteryear, most of the new HRO engagements will be single process in areas such as payroll, staffing (recruitment process outsourcing) and benefits administration, where vendors have established and more scalable delivery models underpinned by technology platforms and a blend of onshore, nearshore and offshore delivery.

Other areas of note involve an uptake in call center work, to be expected during a period of some economic recovery, and a lot of firms exploring analytics/knowledge process outsourcing, especially among mid-market customers. Most interestingly, we're seeing a real interest among customers to explore industry-specific BPO models, most notably in the financial services and life sciences sectors.

We believe BPO will re-emerge, but demand will outstrip supply. Many firms that laid off heavily during the recession are opting for more flexible support models as we move into an uncertain period of economic recovery. Outsourcing fits the bill in many cases, as it provides a more flexible, lower-cost option that can support uncertain business volumes.

Moreover, outsourcing can provide a unique change opportunity for firms as they look for better payroll systems, flexible recruitment support, a streamlined global accounts payable process flow, etc. However, BPO areas usually necessitate more intricate business re-engineering and change management than those in IT support areas, and the cost savings can be a lot less attractive in many instances. In addition, a lot of the fresh demand is coming from the mid-market, where the numbers of process staff involved are smaller, and the labor arbitrage savings less attractive than those of larger companies with greater scale. Not to mention the pressure on vendors to maintain their profit margins, which will make it tough for them to be as cost-competitive with mid-market deals as they are with higher-end pursuits.

The bottom line: Outsourcing is back on the table, but most vendors will only be able to respond initially to demand in commodity areas. It's encouraging for the outsourcing industry that customers are seriously considering outsourcing to solve many of their performance issues. However, many services vendors are not able to give them the cost savings they hope for. Not many customers will turn away opportunities to drive out cost savings of 30% or more and improve their support operations—hence the resurgence in demand after such a long period of careful planning. However, the industry has been geared toward exploiting low-hanging fruit outsourcing opportunities, such as application support and standard transactional business processes, where the common denominator has been cost reduction via high-scale labor arbitrage.

Although there is clearly a lot of new outsourcing demand in this environment, the real issues are arising in the mid-market, where a smaller scale necessitates a vendor partner that can deliver more than low-cost staff in a scalable delivery model. The transformation many mid-market customers need to move into an outsourced environment often requires new technology implementations that incorporate elements of SaaS and cloud computing, deep domain-specific consultative support and a skilled change management program. Although several services vendors have these capabilities today, they are scarce and come at a price. Consequently, many of these customers will be disappointed at the level of immediate cost savings on the table and will be challenged to create outsourcing business-case justifications to their leadership in order to proceed.

The challenge is on for services vendors to craft creative solutions for clients that provide more than merely standard delivery underpinned by labor arbitrage. The winners will be those that can step up and craft creative, innovative offerings and convince their shareholders they are doing the right thing.

VI. Cloud services will separate the real business service providers from the "body shoppers"

Cloud computing signifies the coming together of business process and IT delivery in a fully outsourced model. Cloud is not simply about outsourcing the heavy-duty computing grunt—it's about the delivery of real business services, enabled by the applications needed to support them, powered by the requisite computing and network infrastructure to host and deliver them.

If cloud was only about gutting the clunky, expensive and environmentally-unfriendly infrastructure, and having Amazon and co. deliver the computing power, then it really would be just an infrastructure utility offering. However, if a company's data and applications are hosted externally in the cloud, does it really need to manage them itself anymore? It all depends on whether the company needs to customize the applications itself because there is some sort of competitive advantage in doing so. For example, does a company really gain a competitive edge from the way it runs its benefits administration, or processes its insurance claims? Or is it time for the company to find a services vendor that will host the app and the associated infrastructure, and even process the transactions? If a company's edge is customer service or great internal employee care, then the company can keep in-house staff to take care of that. But what's the point in managing all of the related IT and back-office processing if someone else can do it?

To refer back to the fundamental principle of outsourcing: If a third-party services vendor can perform a task for a company at lower cost and to an equal or higher standard, and the costs and risks of transitioning into the outsourced environment are outweighed by the business benefits, then there's little sense in the company doing it. And if that vendor can add genuine consultative value to improve that task and add to the company's overall business performance, then we're talking about real business effectiveness, and not simply a cost arbitrage scenario.

Cloud's value will only be reaped when vendors and customers are honest with themselves

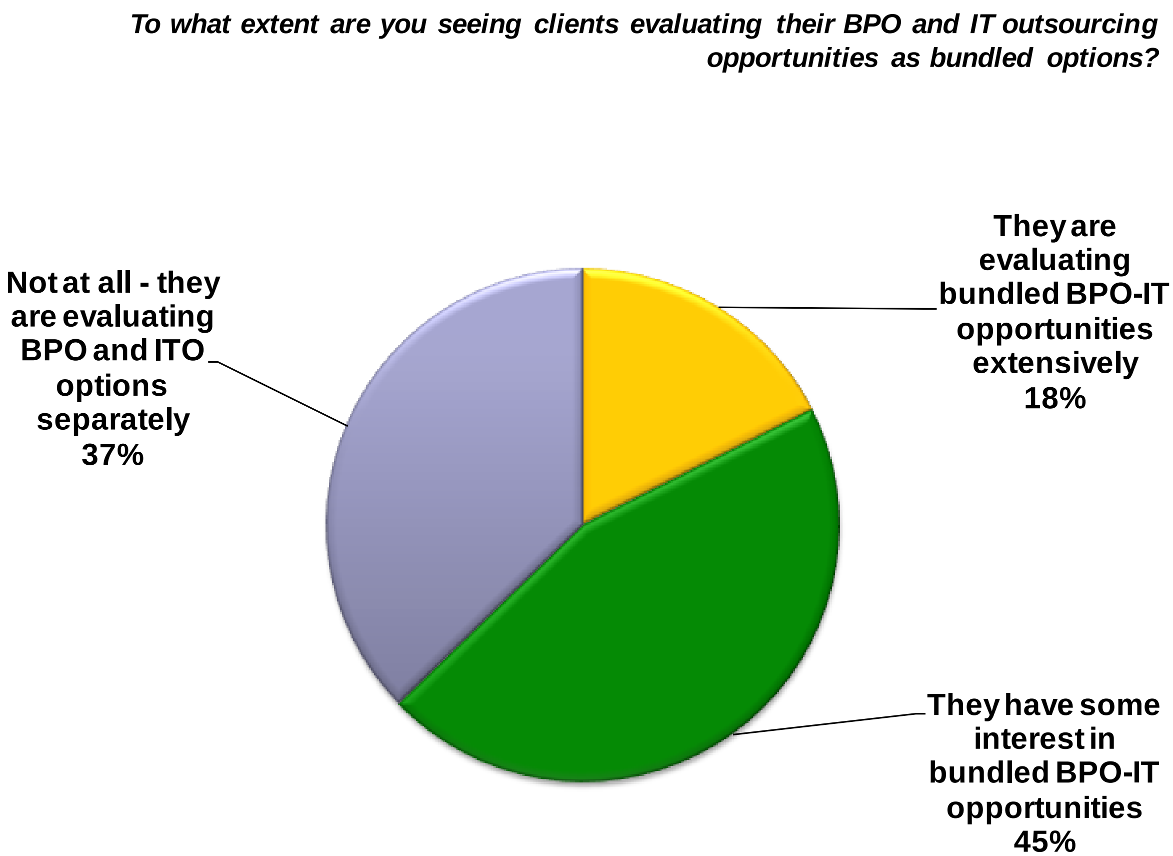
The challenge posed to the outsourcing industry to find new performance thresholds is shared equally by both customers and services vendors:

- **Customers:** Do you know how to take business performance to the next level, and are you having the right conversations with the right services vendors that have the process depth and delivery model to help you determine what that next level is? Do you have full confidence in the solutions being touted by the vendors with whom you are talking, or are you afraid you're simply being heavily "sold"? Have you seen real evidence of their capabilities to deliver real business effectiveness?

- **Services vendors:** Have you determined where you're truly distinctive in the market and can bring real business performance improvement to your clients beyond simple cost efficiencies? Or are you simply following the crowd and adding a thin veneer of industry jargon over your standard capabilities? And if you choose to ignore the hype and focus on standard service delivery, will you get squeezed out of the market in the future by smarter competitors with deeper process and delivery capability?

The question is how long it will take for customers and services vendors to dig deep and find honest answers to these questions. We knew back in 1995 that e-commerce was the future of retail, but it took a decade for it to become widely adopted. Cloud will likely take 3 to 5 years to become fully formed as a business utility offering, but we can be sure its seeds have been sewn and its roots are already taking shape, as our new study essentially reveals (see Figure 4).

Figure 4: The roots of cloud in an outsourced environment: Two-thirds of customers now evaluate ITO/BPO solutions as bundled options



Source: Horses for Sources, 2010
Sample: 844 Service providers & Consultants
Survey conducted in conjunction with Global Services Media and SSON, January 2010

The roots of cloud services can be found in today's blended ITO/BPO engagements

Just a couple of years ago, it would have been unthinkable that so many customers would be entertaining the concept of "hybrid" BPO/ITO solutions, where they would seek to outsource business processes alongside the IT componentry that supports them. Only a handful of customers had "bundled" both their BPO and supporting apps management with a single vendor. And these tended to be in cases where large customers had opted to "lift and shift" entire shared services operations over to their services vendor and it was simply easier (and contractually more attractive) to lump everything with one vendor to take care of it all. Today, as Figure 4 illustrates, close to two-thirds of customers are evaluating their outsourcing options looking at both ITO and BPO in a more blended model and nearly one in five are doing it extensively (that's a lot of engagements).

In many engagements today, we are seeing both ITO and BPO feed off each other, where services vendors are getting much more proficient at cobbling together hybrid teams of systems architects and business process analysts to develop broader engagements that tackle end-to-end business process flows. Many of the more recent BPO engagements we are seeing have been extensions of existing ITO relationships, where the incumbent IT services vendor has brought in BPO teams to layer on business services.

Increasingly, infrastructure executives are trying to find out how BPO fits in with their cloud strategies. Simply put, BPO provides a layer of flexible personalization to a cloud/SaaS offering that can make it workable for a business. We believe that service vendors that successfully develop cloud offerings supported by deep BPO expertise will win in the long term. Although today's "bundled" offerings may not be anything nearly as sophisticated as fully integrated cloud solutions, pulling together the business process and supporting IT apps and infrastructure within an outsourced model is the first step on the road to achieving integrated cloud services.

The bottom line: Cloud will separate the real business services providers from the "body shoppers." As companies increasingly look to take advantage of standardized business processes, the fusion of IT delivery supported by business process services will accelerate. The ultimate challenge is for IT architects to understand how BPO delivery works, and for business delivery analysts and operators to understand how to standardize their services on standard applications and infrastructure.

Moreover, services vendors need to decide whether to provide the data center and networking capability themselves, or manage it via partnerships. Customers care about where their confidential information is housed, and many will prefer it to be within the confines of a trusted services vendor. Don't be surprised to see some partnerships and mergers between strong infrastructure services and BPO vendors in the coming months as the move to cloud services picks up more steam.

Cloud computing presents the biggest opportunity for today's services vendors to deliver blended IT/BPO services—where they can not only drive down costs through labor arbitrage and the removal of IT hardware with its associated energy costs (that amount to 60% of the costs of maintenance), but also improve business performance through holistic, integrated business solutions. Having the ability to demonstrate real industry business process depth to complement a robust cloud infrastructure is the only way to do it, and the time to develop that acumen is upon us. 2010 will see the men separated from the boys in this market. Vendors pushing standard labor arbitrage services under a thin veneer of "cloud marketing" will quickly get cast aside as the table stakes get a lot tougher.

VII. As the mid-market looks aggressively at F&A BPO, the move to standardize heats up

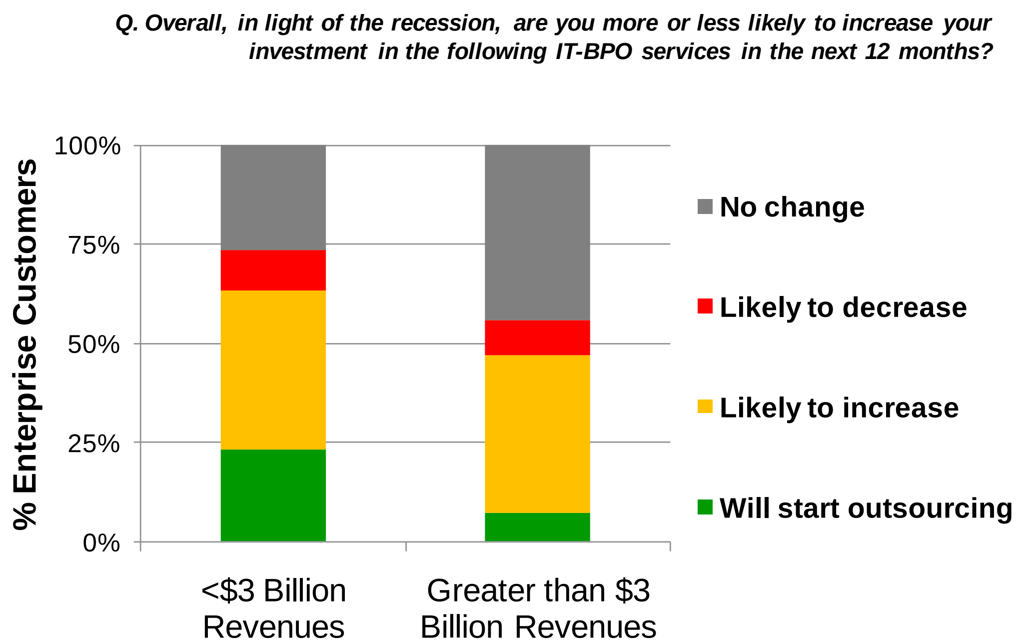
Outsourcing is no longer a game for the glitzy Fortune 100 where clients can demand their vendors take their existing processes and simply run them at lower cost, with very few changes to the actual way they do things. And if the resulting savings aren't quite as good as originally promised, and the books aren't getting closed promptly, the vendor always bears the full brunt of the blame.

The big difference today is that more clients are tending (though not always) to take more responsibility for the success of their BPO engagement. If clients take flawed processes and run them offshore, it will only expose how flawed they were in the first place. Plus, if someone is put in charge of managing a BPO engagement today, that person is charged with making it work, not coming up with reasons for failure. If someone can prove that they can do this successfully in one firm, many other firms will want to hire him or her to do it for them too.

Like anything else, we have to learn through trial and error—and F&A BPO is certainly no exception. Once clients realized they weren't making anything near the savings they initially expected, it forced them back to the table to work with their vendors to understand why this was the case. In nearly every BPO instance, it wasn't the fault of the vendor for supplying inadequate personnel, but more the client's inability to use the BPO as an opportunity to examine some better process flows for getting things done more effectively, and work more collaboratively with the vendor to implement them. In the case of F&A BPO, most of the work today is relatively transactional, so the argument not to look at more standard ways of doing things doesn't wash anymore. How many ways can you "transform" an accounts payable workflow?

As we discussed in Section I, many customers—especially in the mid-market ($750 million to $3 billion in revenues)—now view outsourcing as a change agent to go beyond simply driving out cost. They want to exploit the opportunity to globalize processes and become more effective at doing things. And as the supplier base has matured and started to move into smaller-scale engagements, the impact on customer demand emerging from the economic crisis is eye-opening (see Figure 5).

Figure 5: Mid-sized enterprise customers are ready to exploit F&A BPO



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

So, what does this mean for the BPO industry?

There is no turning back for the large customers. Our study clearly shows that many large-scale customers have now outsourced some elements of F&A, with only 7% moving in for the first time in 2010 (see Figure 5). However, 40% of current F&A BPO customers will increase their engagement scope this year. This is a strong endorsement that once customers take the plunge, they are seeking to enhance their engagements. And when we drill deeper into the numbers, it's clear that customers are seeking to add more capability to support management reporting and analytics.

Once a company is using BPO to do its work, why would it hire new staff? Another reason why so many customers are looking to increase scope is the simple fact that it's easier, cheaper and more flexible to have a vendor provide the staff as opposed to hiring it themselves. Moreover, the process many firms must go through to have staff requisitions approved is often so prohibitive that it's a lot less hassle to contact their outsourcing PMO to ramp up a few FTEs on an engagement.

As the high end saturates, attention turns to the mid-market. Considering that close to a quarter of mid-market customers will seek their first forays into F&A BPO this year, we know where this industry is headed. Vendors have become much more organized about pushing more standard processes at the mid-tier, and they are becoming more adept at taking on smaller-scale employee transitions and still turning a healthy profit. While just a couple of years ago, most of the top-tier services vendors would only look at engagements with a minimum of 50 FTEs involved, most will now dabble in much smaller affairs, especially where there is a strong future upside to increase scope and cross-sell other services. Moreover, some customers are bundling F&A BPO with IT systems development work (see Section IV), which allows for vendors to take on smaller-scale BPO engagements as part of a larger contract.

The bottom line: F&A BPO has opened up to the broader market, but the tough transitions for clients really start now. With the industry-at-large widely looking at F&A BPO, it's clear that customers are more prepared to change their existing processes to move to a more standard delivery model. Services vendors that adopt the old "lift and shift" mentality when taking on smaller engagements in this space will quickly fall short—there simply isn't the same wiggle room in the mid-market to throw bodies at the problem.

The core to success with smaller-scale engagements stems from encouraging customers to standardize much of their workflows onto process maps that vendors can understand, and have the vendor staff-up quickly to service them. The transition for clients will often be painful, but at least they realize that they must do things differently and take more responsibility for their own outcomes.

VIII. Customers increasingly look to industry-specific BPO solutions, but which vendors will ultimately invest to define them and deliver?

Customers are looking beyond the old simplicities of outsourcing to find new and creative ways to find new performance thresholds. One of these areas is to exploit BPO opportunities within industry-specific domains, especially where there is opportunity to bundle both BPO and IT services together under a single vendor's provision to generate more efficient business outcomes.

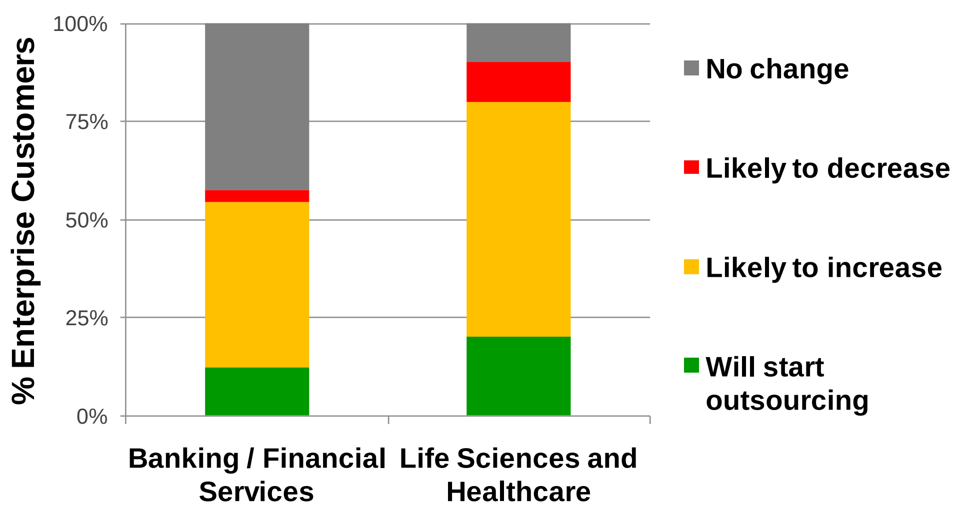
The industry-specific (vertical) process domains are where some of the newer vendor entrants are infiltrating, almost unnoticed, into the BPO industry. Most of the strong IT services vendors have been developing BPO niches in verticals where they have gained some strong process acumen and client credibility, and have the determination to invest in becoming best-in-class within that industry.

We've seen plenty of examples, such as in both the financial services and life sciences industries, where some offshore IT services vendors have been seeking to expand their footprints and layer-on BPO processes to their existing IT relationships. What's more, some of the IT services shops have begun to realize that BPO is a great lead-in to procure future IT work within clients.

For example, if a vendor is already crunching data for clinical trials, why not also manage and develop the supporting applications and infrastructure? Customers see more opportunity within some domain-specific areas, and our recent *Seeking a New Normal in Outsourcing Delivery* survey points to a continued upswing in BPO demand within verticals (see Figure 6).

Figure 6: Financial services and life sciences firms seek to exploit domain-specific BPO

Q. Overall, in light of the recession, are you more or less likely to increase your investment in the following IT-BPO services in the next 12 months?



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

Industries undergoing major fundamental change are moving aggressively into domain-specific BPO opportunities. One in 10 financial services firms and one in five life sciences firms are looking to move into some form of domain-specific BPO this year for the first time. These are typically areas where there is some immediate labor arbitrage opportunity, based on the availability of processing expertise offshore. For example, in financial services, we're seeing a lot of trade settlement transactions and mortgage processing move into BPO scenarios; and in life sciences, many of the data storage and management processes that enable the drug-to-market cycle are similarly evolving toward this delivery model.

Why these industries specifically?

The impact of profound change within industries. As Table 1 (see earlier) points out, most industries are in the process of going through genuine secular, not cyclical, change. The financial services sector has gone through such a fundamental change in its very infrastructure that moving into a BPO environment is no longer the strange, abhorrent procedure and experience it once was. Similarly, in life sciences, the major drug companies know their blockbuster drug models aren't going to last forever, and they are facing tough competition from lower-cost generic manufacturers. Hence, they are similarly exploring new and radical means to improve productivity, source new revenue opportunities and drive out cost.

The success of existing domain-specific BPO engagements is driving broader scope increase. More than half of all the financial services and life sciences firms surveyed are looking to expand existing BPO engagements this year, and very few are seeking to pull work back onshore. First, it's easier and far cheaper for operational executives to add scope within a BPO engagement than to hire new staff onshore when they need more work done. Second, in many cases these engagements started small, often with only a handful of staff provided by the vendor, so it's only a natural extension of the engagement to add more staff and additional process scope as the BPO environment develops. However, this doesn't necessarily entail massive increased spending overnight, but more of a gradual and incremental increase in engagement scope.

The bottom line: Industry specificity is clearly a major driver in outsourcing, but the financial pressures on vendors to maintain their profit margins may override its development. The capability to deliver genuine domain-specific process acumen to clients is quickly becoming a major differentiator in the market. However, investing in the talent to truly scale these capabilities is expensive, and the margins aren't as appealing as those currently being displayed by several vendors delivering the easy, operational work. Although some vendors are clearly content with a thin veneer of vertical capability, others are stealthily picking verticals where they feel they can gain an edge over the competition. But it's a gradual development, and you have to wonder whether every vendor has the patience and attitude to invest in the depth of talent it needs, when it's more concerned with satisfying Wall Street's short-term demands.

Although financial services and life sciences are both becoming saturated, we're already seeing many new BPO opportunities arise in industries that are also going through fundamental change, such as retail, manufacturing, healthcare and media. Moreover, the move to greater domain specificity is intrinsically tied to the business utility model of the future, where we are starting to see signs of the convergence of SaaS, cloud and BPO/ITO models within an engagement structure. The need for clients and vendors to define, develop and implement holistic end-to-end process solutions is slowly coming to the forefront—and industry-specific BPO is ultimately just one piece in a larger puzzle.

IX. Conclusion

As the global economy limps out of recession into a period of drawn-out uncertainty, a maturing of third party outsourcing services is clearly encouraging many enterprise buyers to increase their adoption of both IT and BPO services. Fundamental changes to industries are driving many firms to make bolder, more radical changes to their business operations to help them transform their processes and operate more effectively in an increasingly global economy. Outsourcing fits for bill for many enterprises today, and expectations are such that 2010 promises to be a banner year for the global outsourcing industry

However, while the is a renewed appetite to increase adoption, many enterprises will need to realize quickly that the promised cost savings are unlikely to materialize, if they are not prepared to make fundamental investments to re-wire their business operations. While some vendors are clearly stepping up to help their clients overcome these issues, others are still inherently focused on running basic labor-arbitrage services, that could ultimately fail to help their clients find new productivity gains.

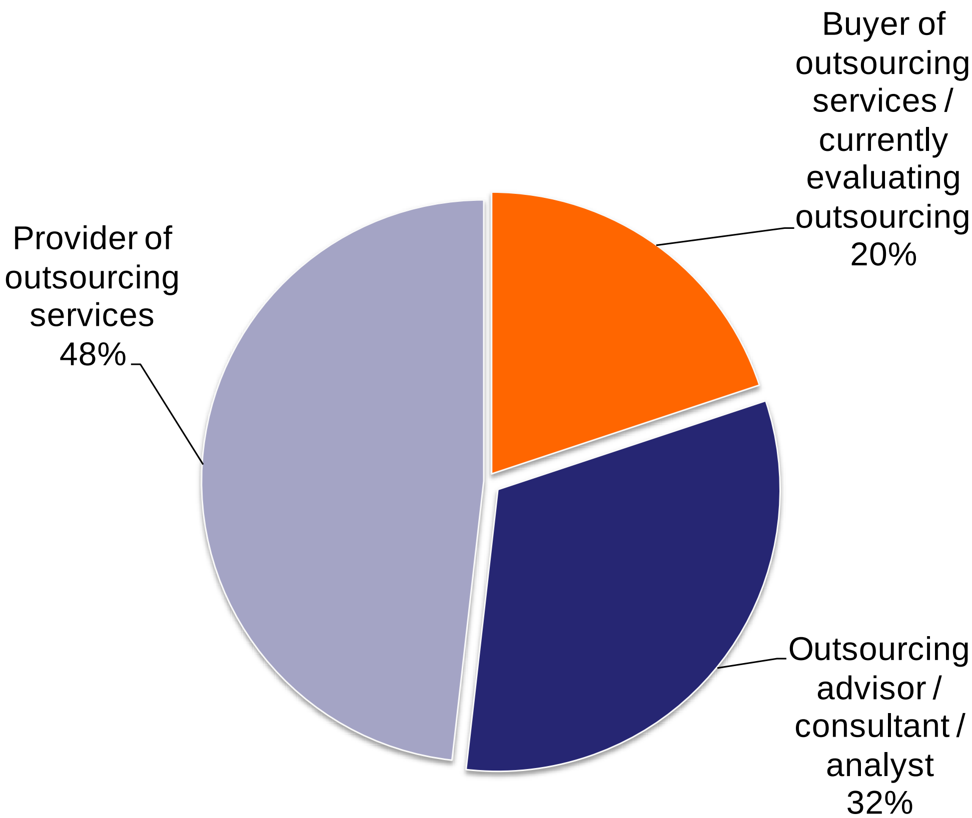
Enterprise buyers need to focus increased attention on selecting vendor partners which have the consultative and industry domain capability to help them improve their operations and business performance. Their challenge is getting beyond the vendor-hype and learning the reality of their capabilities before they make decisions that may ultimately become irreversible.

X. Key questions enterprise buyers and vendors of outsourcing services need to ask in 2010

- Innovation in outsourcing – what does it *really* mean to your organization, as a either en enterprise vendor or a buyer? What measures can both enterprise buyers and vendor partners take to work more effectively together to deliver this innovation?
- The gauntlet is being laid-down to vendors to deliver real business value to clients, but how can clients start to hold their vendors *accountable* for helping them reach new thresholds of performance?
- Increased IT-Business process outsourcing models create governance challenges, so how can both buyers and vendors *reorganize* to bridge both worlds of systems and business process architecture?
- How can enterprise buyers best re-skilling their *existing* management talent to embrace global business dynamics?
- Green SLAs versus performance: what's really important? How can both enterprise buyers and vendors account for client satisfaction, and "attitude"?

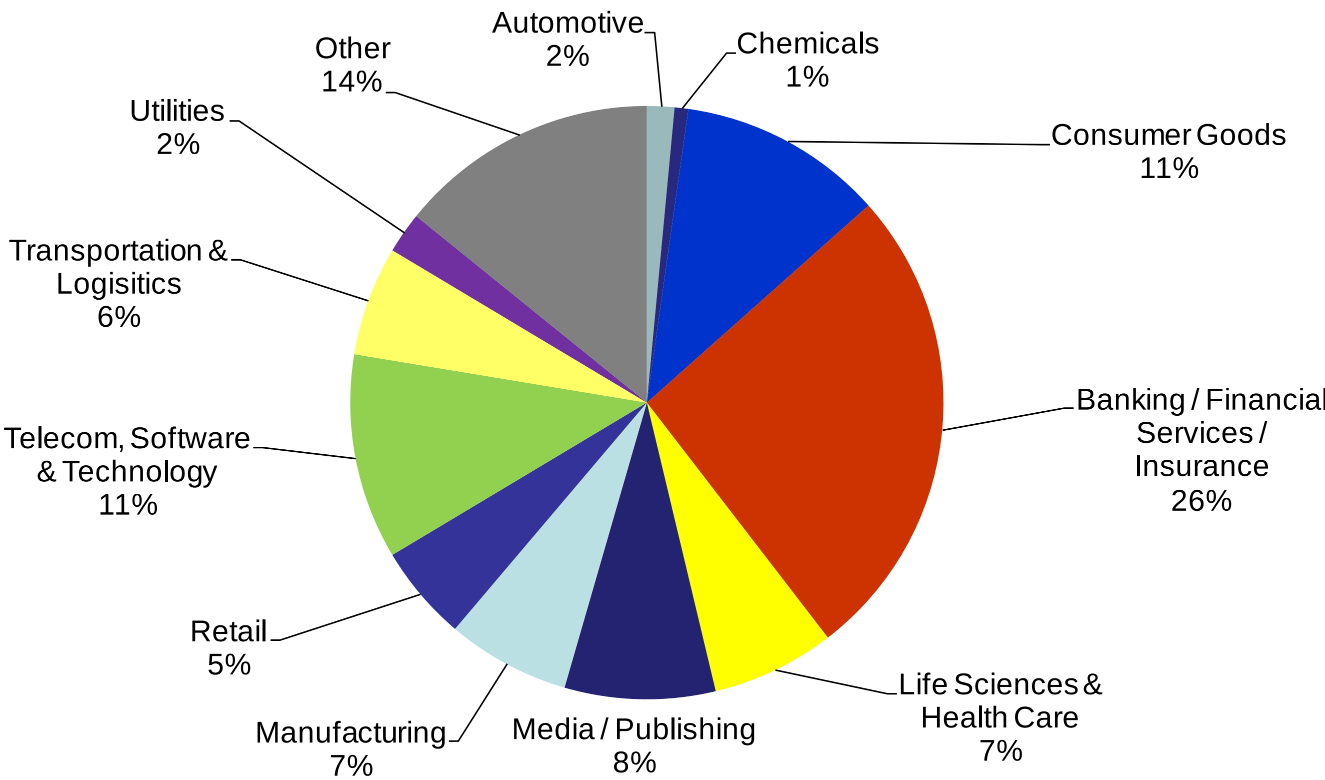
X. Appendices

Figure 7: Profile of survey participants: 1055 Respondents across the BPO / ITO services industry



Source: Horses for Sources, 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

Figure 8: Industry profile of enterprise-buyer respondents



Source: Horses for Sources, 2010
Sample: 209 Enterprises
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XI. About the Author

Phil Fersht, Founder and Chief Executive Officer

As Founder and Chief Executive Officer of Horses for Sources, Phil Fersht oversees all research, social media and operational areas of *Horses*, and is heavily involved with advising clients and driving the research agenda. His specialist coverage areas include finance, HR and supply chain BPO, and he also focuses on industry issues and the convergence of BPO, SaaS and Cloud in a business utility context.

He is an acclaimed industry analyst, practitioner, advisor and strategist across Business Process Outsourcing and IT services worldwide, having worked extensively in Europe, North America and Asia. During this time, he has advised on more than 100 major outsourcing and offshoring engagements and consults regularly with senior operations and IT executives on their global sourcing strategies.

During his career, Phil has worked at AMR Research (Gartner Inc.), leading the firm's BPO and ITO practice. Previously, he served as market leader for Deloitte Consulting's BPO Advisory Services, where he led numerous outsourcing and offshoring advisory engagements with Fortune 500 enterprises. He also worked for outsourcing advisor Everest Group leading the company's BPO research practice. Phil began his career at IDC across its European and Asia/Pacific operations.

Phil is a frequent author and speaker on IT services, Finance, HR and Procurement Business Process Outsourcing trends and issues. He was named both an "FAO" and "HRO Superstar" by FAOToday and HROToday Magazines for 2005, 2006, 2007, 2008, 2009 and 2010 and was featured as the cover story for the December 2006 issue of FAOToday as one of the outsourcing industry's most prominent advisors. He was also nominated for "Advisor of the Year" at the FAOSummit 2008. He speaks regularly at industry conferences, which have included The Conference Board, NASSCOM, IDC Directions, the Sourcing Interests Group and the Council of Supply Chain Management Professionals. He is also a regular columnist for several industry publications, including Global Services Media, SSON, FAOToday and Finance Director Europe.

Phil received a Bachelor of Science, with Honors in European Business & Technology from Coventry University, United Kingdom and a Diplôme Universitaire de Technologie in Business & Technology from the University of Grenoble, France.

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XII. About Horses for Sources

Horses for Sources is the foremost social networking community and advisory analyst firm, focused on helping enterprises make complex decisions with their global outsourcing strategies.

Horses provides the most impactful and frequently-visited collaborative community platform in the global services industry, providing rapid and insightful commentary, analysis and debate of enterprise outsourcing dynamics. The organization is unique in the fact that it integrates personable social networking with market research and advisory services.

Horses' mission provide a unique environment for collective research, opinion, experience and knowledge across the global outsourcing industry to help enterprises explore new performance thresholds. Led by industry expert Phil Fersht, the Horses for Sources team is a multi-disciplinary group of analysts and experts with deep domain knowledge in Business Process Outsourcing, Industry Specific Process Outsourcing and Cloud Computing.

Launched in 2007, the Horses for Sources blog has more than 80,000 regular visitors across the global outsourcing industry, and is widely recognized as the leading destination for collective insight, research and open debate of industry issues and developments. The Horses LinkedIn community is thriving with 9,000 industry professionals sharing views and information daily.

More information about Horses for Sources can be accessed at www.horsesforsources.com. The company can be followed on Twitter at twitter.com/horses4sources and LinkedIn by joining "The BPO and Offshoring Best Practices Forum group

For more information about Horses for Sources research, please email research@horsesforsources.com