THE F&A BPO MARKET LANDSCAPE IN 2011:

RE-EMERGING FROM THE RECESSION, RE-FOCUSING ON BUSINESS OUTCOMES

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Executive Summary

HfS believes the market for finance and accounting business process outsourcing (F&A BPO) services is poised for a new phase of growth, as businesses recover from the Recession and focus on new strategies to drive more efficient operations in an increasingly global economy. F&A BPO fits the bill for an increasing number of organizations, while some still prefer to maintain their finance and accounting operations in-house. However, one thing is certain – once a company makes the decision to outsource F&A processes, it will be committed to working with a service provider for many years, if not decades, hence, getting this right is going to have a major impact on its culture and operational performance over the long-haul.

This report delivers an unprecedented view of the F&A BPO industry, based on 788 live engagements, where organizations have outsourced two or more core F&A processes to a service provider. In addition to exhaustive contract information, HfS draws upon recent demand-side survey analysis to deliver the complete view of the market dynamics, the service provider landscape and the future expected direction of the industry. Key findings are summarized as follows:

- **Untapped market.** The market for F&A BPO is largely untapped moving into 2011, with fewer than 800 live engagements and only one-in-six enterprises outsourcing transactional accounting activities to a third party service provider.
- **Recovering economy rekindles outsourcing motives.** While the F&A BPO market grew rapidly between 2004 and 2008, interest cooled during the Recession as enterprises focused on shorter-term survival measures and put disruptive initiatives, such as BPO, on the backburner. However, with recovery under way, many businesses are refocusing attention on global outsourcing opportunities as a means, not only to reduce operating cost, but also to provide an impetus to globalize operations and transform processes. Consequently, 13% of enterprises are now intending to move into an F&A BPO model over the next year, with strong motivation coming from mid-market organizations ($750m - $3bn revenues).
- **Availability of smaller engagement models drives sustainable growth.** With engagement sizes falling below $20m total contract value for the first time, and service providers developing more “repeatable” delivery models that can be provisioned across multiple clients, HfS expects 15% annual growth in total F&A BPO expenditure over the next two-to-three years.
- **Gainshare incentives becoming an integral component of F&A BPO engagements.** With close to 50% of recent engagements involving gainshare (outcome-based) incentives, the aggressive competitive climate will provide attractive opportunities for many enterprises evaluating their first steps into F&A BPO, in addition to experienced buyers seeking more value from their current model. Moreover, gainshare initiatives can provide the

differentiation between providers, as opposed to simply low-cost provision, which HfS views as a major step forward in taking F&A BPO value beyond short-term labor-arbitrage savings for clients.

- **The competitive landscape takes shape with four clear market leaders.** The global F&A BPO market is dominated by Accenture and IBM, with both Capgemini and Genpact providing the major competition for large-scale engagements. However, aggressive competition is expected from a host of other providers eager to secure a stronger market presence, including multi-billion dollar offshore-centric service providers Infosys, TCS and Wipro, in addition to BPO pure-play specialists EXL Service and WNS. Other providers with strong BPO businesses include Xerox and HP, but they have not proven to be as aggressive in the marketplace since recent mergers with ACS and EDS respectively. HfS expects further consolidation in the competitive environment.
- **IT-enablement of BPO becoming pivotal to development of services.** HfS anticipates increased hybrid IT-BPO engagements where service providers provide application wrappers to enhance process standardization for buyers. More than over half of today's buyers are now enhancing or replacing their existing finance IT systems with their BPO engagement. However, HfS Research shows that adoption of **C**loud **c**omputing with finance applications is still some way off for most high-end enterprises.

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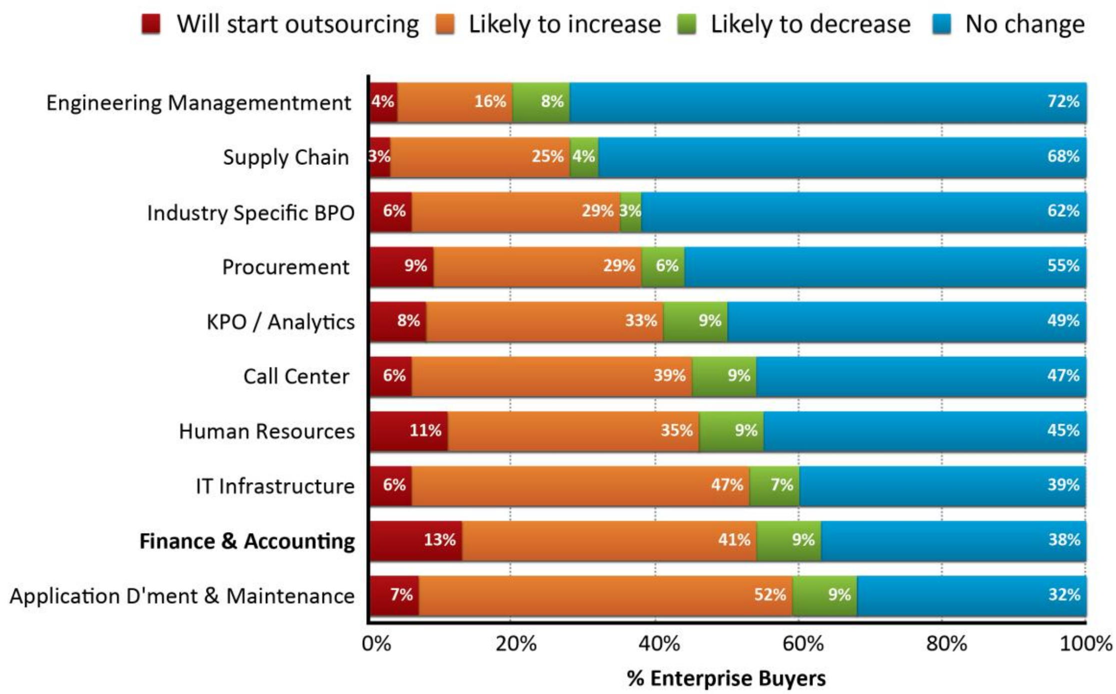
Part 1
The market picture: Demand for F&A is coming back after lackluster activity during the recession

Recent HfS Research of 209 organizations (see Exhibit 1) indicates that F&A processes are the second-most prolific candidates for moving into an outsourced environment, after application development and maintenance. Thirteen-percent expect to start an F&A BPO engagement for the first time over the next 12 months, while 40% plan to increase the scope of their current F&A BPO activity.

Exhibit 1
Today's focus on outsourcing – interest in F&A is strong, despite "post-recession lethargy"

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: HfS Research, 2011

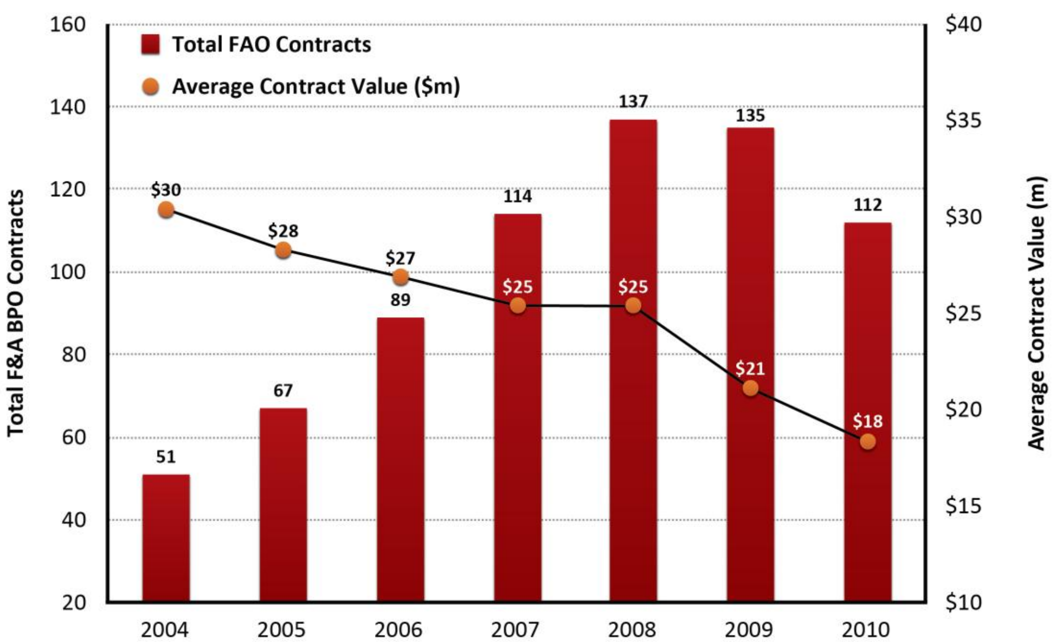
Why F&A interest cooled during the recession years, and why it is now rebounding

HfS has observed a number of factors (see Exhibit 2) why the market for new F&A BPO engagements boomed from 2005-2008, before slowing to a more modest growth rate:

Large numbers of organizations dived into F&A BPO before the recession looking for quick savings

Most of the "Phase 1" F&A BPO engagements were centred heavily on large organizations from energy, utilities, manufacturing and consumer goods industries jumping into F&A BPO to reap quick substantial savings on labor arbitrage-based engagements, due to large numbers of onshore accounting staff (often in the hundreds per contract) being displaced with offshore staff. The tendency for organizations in these industries to have large centralized, and often regional, shared service centers, combined with a strong affinity to engage in outsourcing delivery models, put them in a strong position to take advantage of a provider base, eager to offer attractive pricing to grow their delivery businesses. While there is still untapped potential in these sectors, the heavy adoption from these sectors really drove market growth in the period leading up to the Recession.

Exhibit 2
The F&A BPO market has seen 788 multi-scope engagements to-date, reaching a peak in 2008

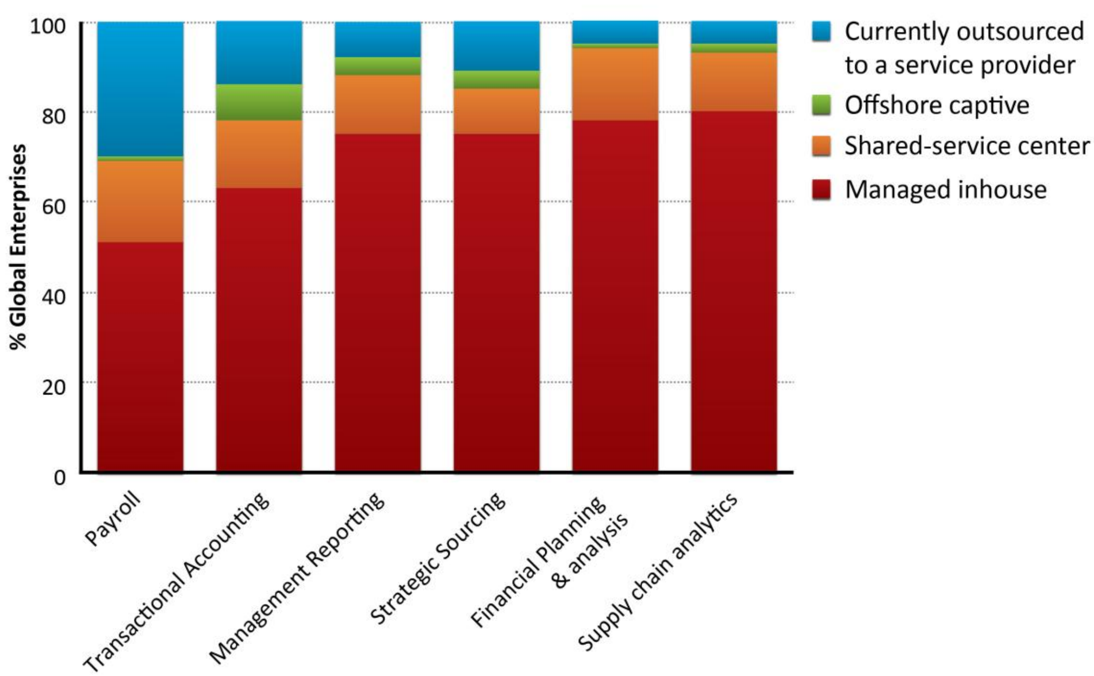


Source: HfS Research, 2011

The majority of large organizations have yet to move core business operations processes into either an outsourced or shared services model

Another core reason why the market for F&A BPO services has yet to reach maturity is the fact that the majority of medium-to-large enterprises have yet to move away from in-house delivery (see Exhibit 3) for many of their operational support processes.

Exhibit 3
The total addressable market for BPO is still largely untapped



Source: HfS Research, 2011

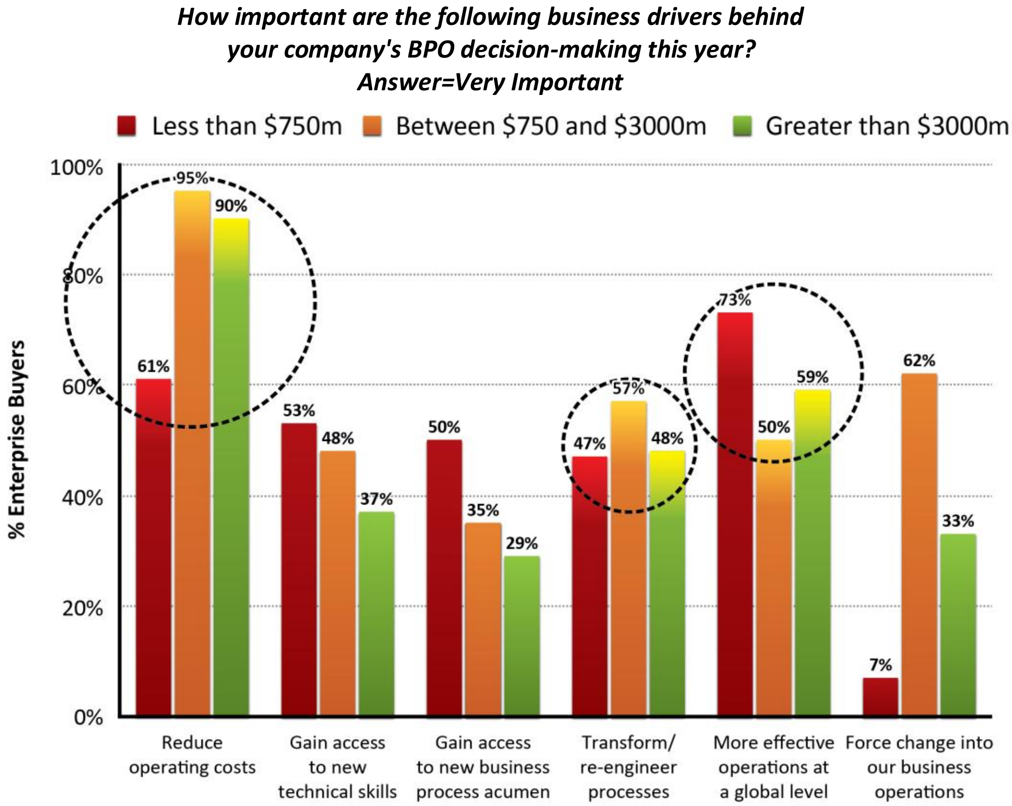
Even payroll, which is the most mature and widely-adopted outsourced business process, is still managed in-house by over half of enterprises, while only a third have outsourced transactional accounting (receivables and payables). Other processes with maturing offshore-ability potential, such as management reporting and analytics, are still overwhelmingly managed in-house by three-quarters of enterprises.

Many organizations put BPO plans on the backburner when tackling the Recession, but are now looking to overhaul their cost-structures and global operations.

The change and short-term disruption that BPO entails moved it down the priority list for many companies during the unprecedented downturn, where mere survival was the priority. However, now the global economy is in recovery and organizations have reassurance their immediate futures are safe, attention is now turning not only to driving out cost, but also to their operating more effectively as global organizations in this new economic environment. More than half of all buyers are citing the need (see Exhibit 4) to globalize and transform processes as prime outsourcing motives - and this is across all size classes of customers. The need to globalize is impacting the majority of companies today, and outsourcing is providing one vehicle to help firms achieve it.

Exhibit 4

Customers are looking to drive change into their business operations to become more effective globally



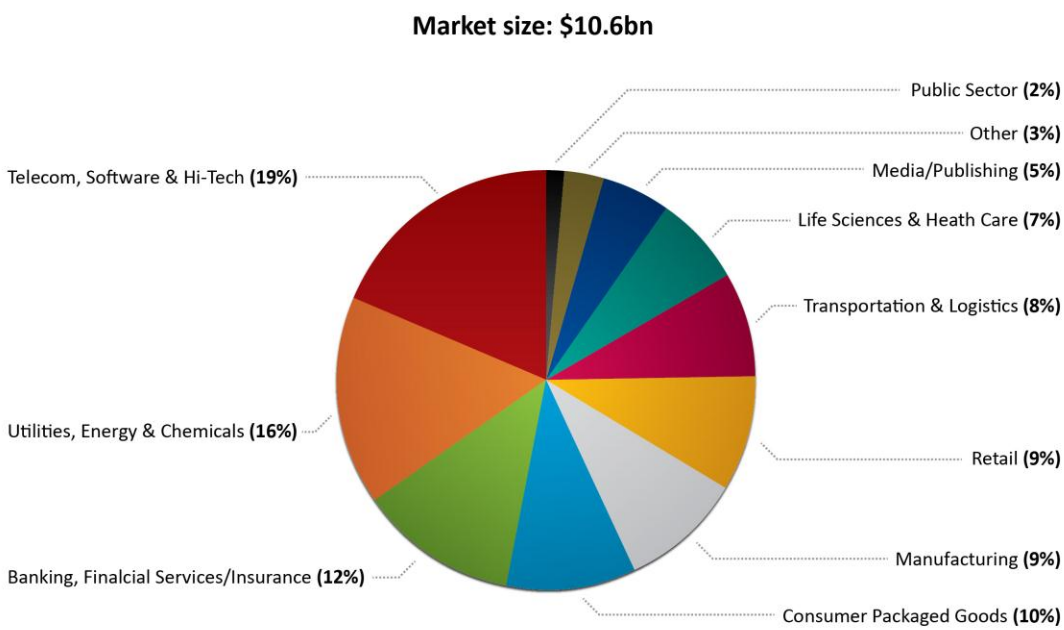
Source: HfS Research, 2011

Other industries are now opening up to F&A BPO delivery.

HfS' analysis of all F&A BPO engagements since the beginning of 2008 shows the emergence of other industries opening up to the F&A BPO value proposition, namely hi-tech/telecom and financial services (see Exhibit 5). While these industries have been traditionally very aggressive with their use of outsourcing models for IT and customer operations services, they initially shied away from F&A due to the complexity of their accounting operations and a cultural affinity to keep their cash cycle management in-house. However, the improved capabilities of some service providers to cater for these industries, combined with a changing mind set among many operational leaders to BPO models, have combined to see these industry sectors now dominating new F&A evaluations.

Exhibit 5
Hi-tech, utilities, energy and financial services have dominated half the FAO expenditure since 2008

F&A BPO engagements signed since 2008 (share of TCV)



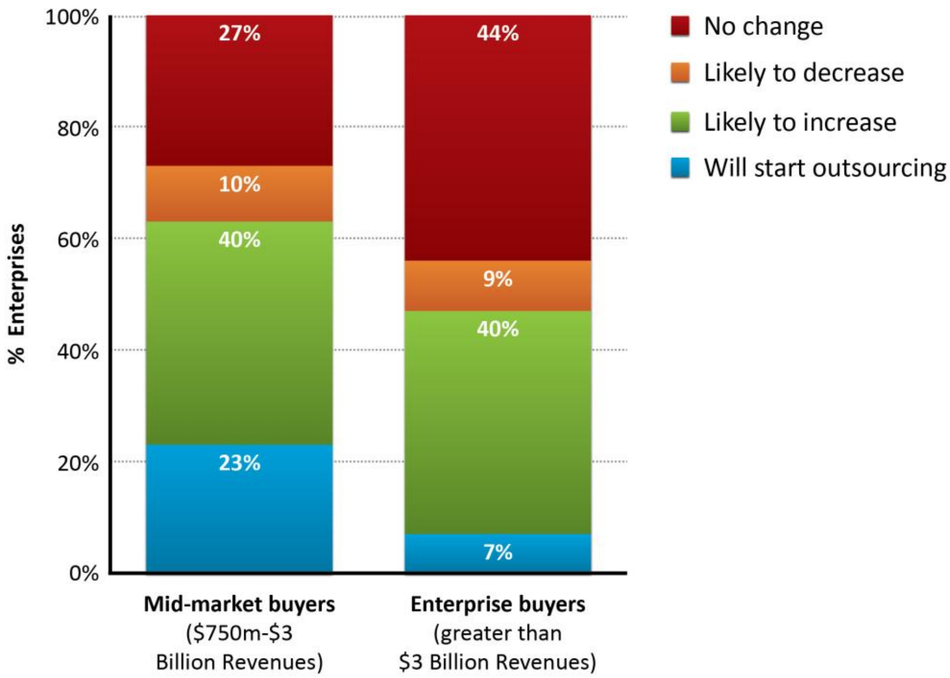
Source: HfS Research, 2011

The mid-market for F&A BPO is opening up, fuelling new growth but also driving down the average engagement size.

As Exhibit 2 illustrates, the average contract size for an F&A BPO engagement has declined from $30 million in TCV in 2004 to less than $20m in 2010. This size decrease is not only caused by increased competitiveness and falling price-points, but also the increased number or engagements being signed with organizations in the $750 million to $3 billion revenue category. Recent HfS research (see Exhibit 6) shows that close to one-in-four organizations in this sector are expecting to evaluate moving into an F&A BPO environment for the first time over the next year.

Exhibit 6
2010 Enterprise outsourcing adoptions intentions: Finance & accounting outsourcing

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



Source: HfS Research, 2011

Part 2
The F&A BPO competitive picture: Enterprise-level engagements stay with the traditional incumbents and the mid-market opens up to a broad array of providers

Key dynamics driving provider behavior

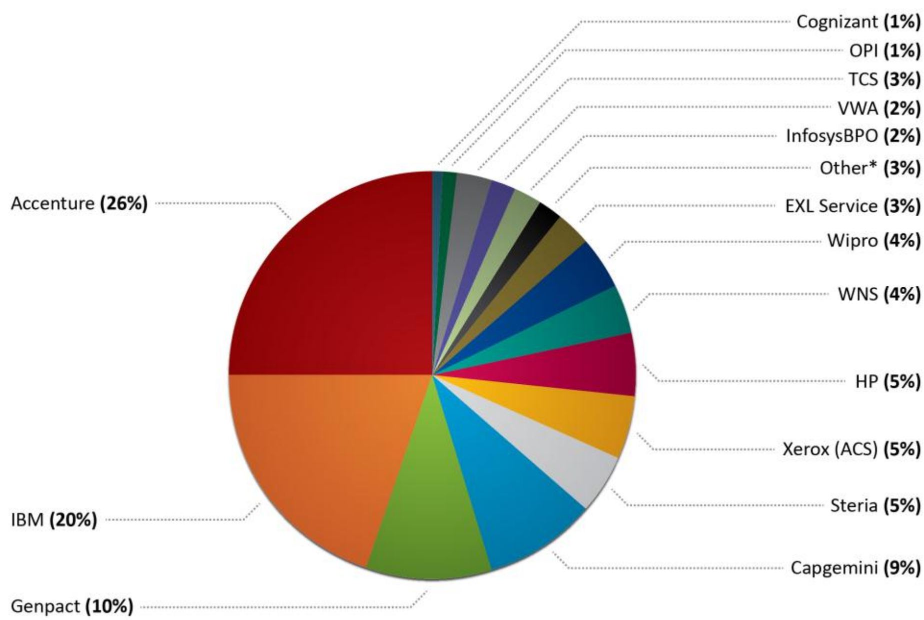
- **A consolidating market.** The F&A BPO market today has a robust set of providers, however, HfS does expect further market consolidation with some providers clearly indicating their intent to pursue acquisition strategies to increase market footprint. Additionally, HfS expects some providers to phase out their F&A BPO activity, and may seek to sell of these divisions. Moreover, HfS expects some additional acquisitions of offshore and nearshore captive operations, as leaving providers look to scale up operations. This is especially the case in the financial services sector, where many banks are looking to adopt BPO delivery models and offload captive operations.
- **Globalized delivery is reducing risk, while responding to clients' global needs.** The expanding global delivery footprints from all major providers are reducing foreign exchange and inflation risks that help protect margins. In addition, demand for providers to develop stronger presence in regions such as China, Central Europe and Latin America in increasing, where they can service regional clients with multi-lingual staff and higher-touch processes.
- **Increased momentum to move work offshore and nearshore.** HfS analysis shows aggressive strategies to move more F&A scope offshore for routine activities, with only a limited emphasis on increasing US onshore footprint for highly sensitive activities. Close to 90% of BPO scope has been targeted for offshore and nearshore delivery with engagements in recent years.
- **Increased willingness to take on smaller deals.** HfS analysis shows increased competition for smaller-scope engagements as market for high-end "mega deals" reduces. Major providers, such as IBM and Genpact and TCS, have shown a consistent strategy to take on smaller-scale engagements since the Recession.

The leading providers have developed sufficient scale to take advantage of the smaller deal scope and mid-market demand.

Over half the market expenditure for all live engagements sits in the hands of three providers (see Exhibit 7), and several of the multi-billion dollar IT services market entrants are clearly struggling to take any significant share away from the "Big 4" incumbent providers; Accenture, IBM, Genpact and Capgemini. HP and Xerox (ACS) have lost some ground, especially in light of their recent mergers, while the smaller pure-plays WNS and EXL are impressively holding their own against the likes of multi-billion dollar offshore giants Wipro, Infosys, TCS and Cognizant.

Exhibit 7
Global F&A BPO Marketshare dominated by Accenture and IBM, with strong competition from Genpact and Capgemini

Global market shares of live Finance & Accounting BPO engagements (based on total contract value), 2003-present



Source: HfS Research, 2011

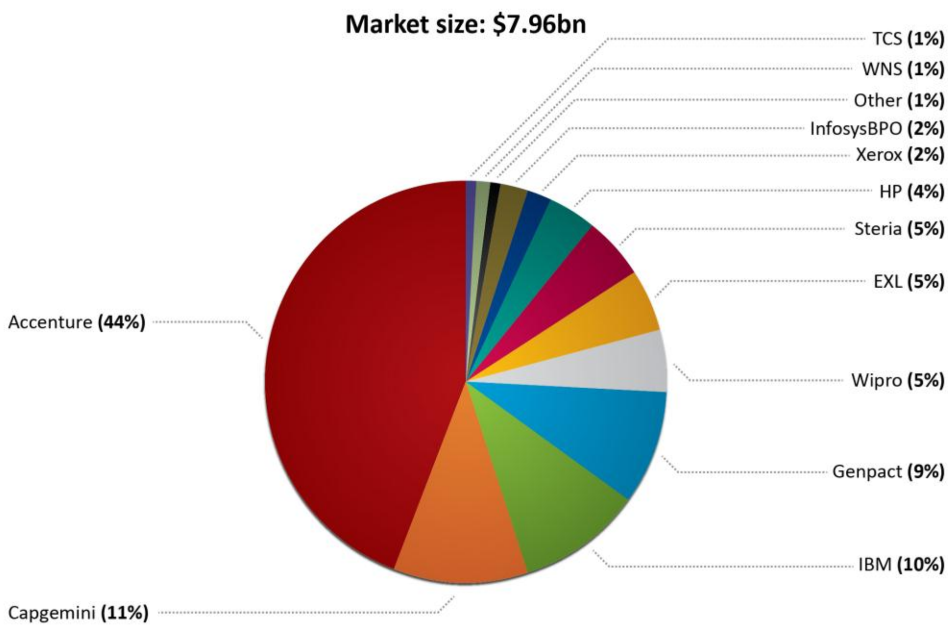
Different competitive dynamics exist across enterprise-level and mid-market engagements

The prime reason why the "Big 4" F&A BPO providers dominate market share, is their ability to pick up multiple engagements in the $50m+ range over recent years, increase their scope and renew them – with Accenture proving the most adept at winning large enterprise clients and cultivating their portfolio. Accenture has developed a commanding position with enterprise engagements, while IBM has gained a lot of ground winning smaller-scale engagements and mid-market clients. Most striking, are the divergent strategies of the market leaders, Accenture and IBM. While Accenture has consolidated its commanding presence with the large-scale enterprise customers, IBM has determinedly gone after the mid-market to take a commanding position in that sector. This could well change over the course of the next year, as both providers compete for high-end enterprise clients, which are in advanced stages of finalizing F&A BPO strategies.

As Exhibit 8 illustrates, all F&A BPO engagements signed since the beginning of 2008 that have a Total Contract Value (TCV) of $25 million dominates 80% of the total market, with a total expenditure close to $8 billion. Accenture has been dominant in retaining and developing its client base of enterprise-level engagements, with Capgemini, IBM and Genpact providing the main competition with the enterprise-level engagements.

Exhibit 8
Accenture, Capgemini, IBM and Genpact strongest in enterprise F&A BPO deals over $25m TCV

Market shares of F&A BPO Engagements greater than $25m Signed 2008-2010 (based on TCV)

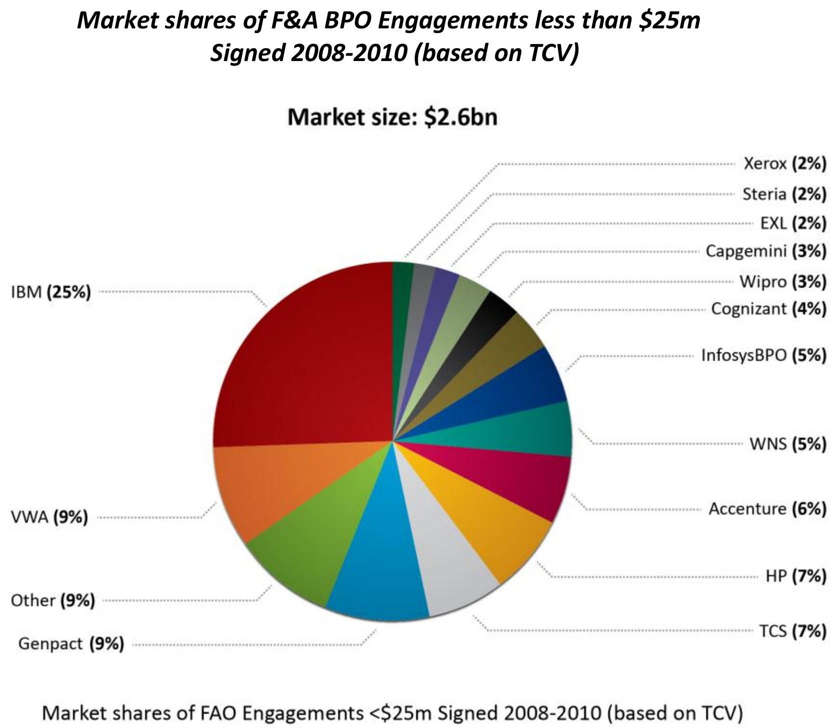


Market shares of FAO Engagements >$25m Signed 2008-2010 (based on TCV)

Source: HfS Research, 2011

The newcomers, over recent years, have struggled to win many (or, in some cases, any) enterprise-level deals, and have aggressively sought to grow their respective footprints by taking on much smaller-sized engagements – many of which fall into the sub-$5m TCV category. Exhibit 9 illustrates the service provider shares of the smaller-scale F&A BPO engagements signed since the beginning of 2008, where the one notable market-mover in the mid-market segment has been IBM, winning the lion's share of business with a commanding 25% market share.

Exhibit 9
IBM, Vengroff Williams and Genpact strongest performers in mid-market F&A BPO deals (under $25m TCV)



Source: HfS Research, 2011

The order-to-cash specialist, Vengroff Williams and Associates, also performs strongly in this segment, while there has been a relatively even spread of business across all of the major service providers, such as TCS, WNS, InfosysBPO and Cognizant, and the F&A BPO pure-plays, WNS and EXL. Genpact has proven the most consistent at developing a balanced portfolio of enterprise and mid-market clients.

Developing a broad mix of mid-scale and enterprise engagements is the key to providers building a scalable, repeatable and cost-flexible delivery model

Essentially, the F&A BPO industry is readying itself for life beyond the simple "lift and shift" engagement, where providers' profit margins were made from large onshore labor pools being shifted offshore, and both buyer and provider profiting from the difference. However, saving money through labor transition provides the customer with a one-time cost savings lever. Once that labor overhead is removed from the balance sheet, their ability for further productivity gains and new business value is now dependent on process improvements, increased quality of technology delivery and any other innovative methods of which it can take advantage.

Moreover, labor-arbitrage doesn't amount to nearly as much, when buyers and providers dealing with, for example, a 30 employee transition. HfS believes that service providers need to start scaling their resources across multiple clients, or face a depressing *race to the bottom*, where their only real differentiator is their ability to provide low-cost labor. Having scale and flex from ingesting several large-scale clients is extremely valuable for providers, but only if they can leverage those resources to new clients as they take them on, in order to optimize their margins on the new business and remain cost-competitive.

HfS Research believes that providers need a good balance of both large and mid-scale engagements, whereby they can allocate delivery resources and process acumen across their customers in order to develop repeatable process flows with application wrappers to enable them (see Exhibit 11 later in this report).

While small-scale engagements can struggle to be profitable, they do *force* the provider to develop a utility model that keeps then in the black. Providers need to be able to "plug-in" new clients to their delivery organization, reallocate personnel, and balance resources – often without having to invest in a lot of additional personnel to service the client. Clearly, we're in a highly competitive market situation, and this isn't a market for the faint-hearted.

Scaling a global BPO business based on multiple small client engagements is wearing on resources – and profit margins, and the providers fighting for their share of the smaller business, are faced with a simple choice:

> *Either stick with it and view this as a 10-year journey, or if you simply don't have the patience or appetite to put in the investment, then get out and refocus your services on other activities.*

For those providers which stay the course (and we expect most will), they need to keep putting in the investment and dedication to win small engagements, and scale their BPO delivery resources in order to develop a utility model that is profitable for them, while delivery cost-savings and business value for their clients.

Exhibit 10 illustrates the main strengths and challenges of each of the main F&A BPO service providers in 2011.

Exhibit 10
Quick view of the F&A BPO services providers in 2011

Service Provider	Strengths	Challenges	HfS Opinion
Accenture	Largest global footprint, two decades of history, broad industry portfolio, finance consulting and IT strengths. Has developed workable consulting /outsourcing culture, and client partners regularly position BPO high on their client agendas. Real depth in procurement and sourcing to compliment F&A – especially with recent acquisition of Ariba's services business.	Tends to be over-focused on mega-deals and existing clients. Needs to develop a greater footprint in the middle-market. Needs to avoid complacency with its current success.	Has found itself in a great position leading the market. Needs to move fast to create solutions for mid-market enterprises before the competition catches up. Has strong vertical competencies which need to be "solutionized" for clients.
Capgemini	Global delivery model based on strong regional hubs. Very strong with clients outside of the US. Very strong with consumer products and manufacturing. LatAm delivery is a strong plus. Developing strengths in sourcing and supply chain.	India/offshore support model not as strong as key competitors. Can make its pricing uncompetitive. Historically been weak at winning US-only business	Has become a very strong "alternative" to Accenture and IBM and a genuine top-tier contender. Needs to consider an acquisition to bolster offshore strength.

Service Provider	Strengths	Challenges	HfS Opinion
Cognizant	Deep vertical footprints are creating opportunities for discreet engagements. Has developed strong presence for retail F&A BPO deals. Strong IT services business is helping its nascent BPO brand.	Lack of focus on horizontal BPO deals has prevented Cognizant's development in winning significant F&A BPO presence. Hard to differentiate its F&A BPO competency against likes of Infosys, TCS and Wipro.	Needs a large acquisition to provide scale, strength and depth and a stronger F&A client portfolio. Needs to decide whether is it serious about being a top tier F&A BPO provider, or is simply content have a cursory presence in the market
EXL Service	Depth and proven expertise in insurance sector, with strong portfolio of clients. Good offshore model with recent European expansion.	Weak marketing and sales strategy has held EXL back from succeeding with large client wins. Has struggled to compete effectively with top tier outside of its insurance niche	Needs to improve its go-to-market approach and positioning. Lets itself down, where it has some real strengths it can leverage. Attractive acquisition candidate for one of the market leaders needing added BPO depth and scale.
Genpact	The largest BPO pure play – a consistent, proven performer in both the high-end and mid-market. Strong presence in CPG, manufacturing, pharma and financial services. Recent acquisition of Headstrong adds IT consulting acumen to growing banking presence. Has leveraged the GE brand successfully to win its share of business with a strong global model.	Lack of a top tier IT services presence could hold Genpact back from winning hybrid IT-BPO deals. Market speculation of being an acquisition candidate could damage the brand, however, recent acquisition of Headstrong should diffuse this speculation.	Could benefit from acquisition or merger with an IT services major to cement its position in the top tier of the market. Developing IT-enabled BPO solutions is increasingly important, as it gets tougher for BPO "pure-plays" to compete for complex engagements.
HP	Historically strong, with impressive portfolio of CPG clients. Strong global model and SAP competency to underpin BPO deals	Lack of focus on BPO since EDS merger has held back development after impressive performance pre-2008. Limited development in other BPO areas, such as procurement, and its recent HRO divestiture further weakens its F&A business.	New leadership needs to decide whether BPO is a serious service line for HP. If not, HP should consider selling off its BPO businesses and focus on other areas.
IBM	Very strong performer for two decades. Broad industry client portfolio. IT services strengths further bolstering F&A solution delivery. Very strong mid-market performance puts IBM is a very strong position as deals reduce in size. Procurement, payroll and supply chain strength plays strongly for multi-tower deals.	Has been outperformed, from a sales perspective, by Accenture in the high-end market in recent years. Needs a more consistent sales approach at the enterprise level to complement its superlative showing in the mid-market. Bringing knowledge of F&A BPO competency to the IBM client partners is critical for growing high-end business.	Recent mid-market performance is exemplary. Needs to follow-through with verticalizing its approach to cement its positioning. Could potentially benefit from a major acquisition to take market leadership position.

Service Provider	Strengths	Challenges	HfS Opinion
InfosysBPO	Very strong offshore and global delivery model. Good presence in media, telco and CPG industries. Compelling analytics strengths and developing a strong footprint in procurement. Strong IT and order management relationships open doors for developing F&A engagements. Acquisition of McCamish platform creates a compelling proposition in the insurance sector.	Has struggled to win enterprise-scale engagements outside of Philips, despite competing aggressively and demonstrating strong potential. Was difficult for Infosys to win engagements during Genpact's heavy growth era.	Needs to stay the course and continue to win mid-sized engagements and build its client portfolio. Well-positioned in the financial services sector to develop deeper footprints, but needs to work on converting IT relationships into broader BPO engagements. An acquisition to bolster client footprints and market share would be a positive move.
Intelenet Global	Some client depth in banking and travel verticals. Strong contact center business.	Has struggled to develop any real footprint from its initial UK banking client relationship (from 2003). Poor brand recognition.	Could be effective at winning small-scale engagements with some smart investment in a go-to-market strategy. However, small client base, limited brand and its late arrival into the US market make this a hard task. Merging with a larger entity may be a better move.
OPI	Solid niche F&A BPO provider, with flexible global operations. Good array of clients across multiple industries. Popular with clients.	Its small size and scale has left OPI vulnerable with the entry of the larger ITO/BPOs. While effective with niche clients that like a more personable relationship, the competitive environment is making it very challenging for OPI to win new clients.	Needs to look at M&A opportunities if it wants to compete effectively for larger engagements. There are several IT-centric providers seeking a foothold in F&A BPO which could benefit from acquiring OPI.
Perot Systems (Dell)	Deep healthcare IT relationships and some nascent BPO endeavours. Good offshore healthcare process support presence.	Prior to Dell merger, Perot was making efforts to develop broader healthcare BPO competency, with F&A and revenue cycle management high on the agenda. Appears to have dropped off the map since merger.	Dell needs to develop an F&A strategy soon, or slip out of this market altogether.
Steria	Very strong presence in the UK public sector (including the nationalized health service). Also has major engagements with British Telecom and Lloyds Bank. Good IT services strengths and offshore model.	Non-existent outside of the UK and no longer "guaranteed" UK public sector BPO wins. Has limited multilingual capabilities and pan-European presence.	Had a major opportunity to broaden into Europe as an international BPO provider, but that seems to be slipping away in recent years. Will struggle to be anything more than a UK-centric provider if it doesn't acquire pan-European delivery capabilities.

Service Provider	Strengths	Challenges	HfS Opinion
TCS	Broad industry portfolio of clients that includes CPG, retail, media and financial services. Developing its top Tier IT relationships to win F&A business. Acquisition of Citigroup captive adds to its Nielsen enterprise-level engagement. Good industry-process sourcing competency and had growing reputation with clients for developing innovative solutions and ideas.	Lacks enterprise-level clients in F&A and a tier 1 pan-European delivery center. Needs to grow its horizontal F&A capability beyond its vertical silos. Over-reliant on its "IT channel" to win new BPO business.	Has a similar issue to IBM 5 years' ago – it needs to brand its F&A capabilities and not rely solely on its great IT service brand strength. Needs to "stay the course" and continue to build its presence. Would benefit significantly from a BPO-led acquisition that encompasses client scale and pan-European delivery. Developing a growing reputation as an innovator with clients.
VWA	Established order-to-cash BPO with deep footprints across healthcare, consumer products, retail, hi-tech and financial services. Compelling mid-market approach with strong US presence, and growing European business. Developing a strong client portfolio using its hosted Webcollect O2C application. Solution competency in healthcare revenue cycle management and subrogation a major opportunity for the firm.	Delivery model is 100% onshore. Will find it increasingly difficult to compete with offshore-centric providers as they get more aggressive in the mid-market engagements.	Will find it challenging to find significant growth organically in the current climate, but could benefit significantly from strategic partnerships with other global providers. Would be a highly acquisition opportunity for a global BPO looking to bolster onshore presence, offer a utility O2C solutions and go after the lucrative healthcare sector.
Wipro	Has quietly gone about developing a very strong BPO competency across multiple towers, most notably F&A. Strong client presence notable in telecom, CPG and retail. Growing footprints also in financial services. Good delivery reputation and attention to process competency. "Price friendliness" has helped Wipro develop market share quickly.	Outside of India, Wipro's delivery presence in Europe is not as strong as the top tier. Lacks a strong value proposition and "BPO identity" – far too focused on low-cost and adequate operational delivery. Previous leadership hasn't invested enough in positioning and communicating Wipro's value to market and differentiation as a BPO provider, in addition to its IT competency.	New CEO TK Kurien has a prime opportunity to re-define its BPO business with a promising growing client base. Investing in developing industry-BPO solutions around its process competencies is imperative. Investing in developing a stronger BPO identity and value-to-market is key. Should look to make an acquisition (or two) to bolster European delivery presence.

Service Provider	Strengths	Challenges	HfS Opinion
WNS	The dominant provider in transportation, but also making good progress in banking, financial services and healthcare payer sectors. Also developing a foothold in the lucrative retail vertical Has competed aggressively on several enterprise engagements in recent years and has firmly established itself as a strong "pure play" alternative to the likes of Genpact. Achieves positive accolades from many of its mid-market clients, with a strong reputation for client-focus.	Has operated under constant speculation of being "up for sale," which harms client pursuits and employee morale. The company has been slow to articulate anew direction under its new leadership, since appointment of Keshav Murugesh over a year ago, further fuelling speculation that the firm is being primed for a merger. Pan-European delivery is currently limited to Romania and struggles in comparison with likes of Tier 1s.	Needs to renew its market focus and direction with a clearly articulated strategy. Could potentially benefit from a merger where it would become the BPO arm of one of the ITO providers. Has significant potential in several vertical sectors and has always fared well in mid-market pursuits.
Xchanging	Strong vertical approach, with deep client industry-specific process engagements in the banking, insurance, manufacturing, retail and real estate sectors. Has a broad footprint across F&A, HR and procurement towers and its acquisition of Cambridge solutions increases its offshore capabilities. Has good presence in the UK, Continental Europe and Asia/Pac.	It's partnering approach where customers can operate in a "Joint venture" financial arrangement, but has lost momentum in recent years as new providers have entered the industry with lower-cost and less complex delivery options. Has failed to capitalize on the Cambridge acquisition and develop a viable US presence. Recent departure of founder and long-time CEO David Andrews poses more questions than answers for the company's future.	Xchanging has significant potential to offer multitower, cross regional and industry-specific BPO, but has badly lost its way since the Recession and needs a complete strategic re-vamp under new leadership. Company could likely be split up into solutions areas and sold off to global services providers looking for increased scale and process acumen.
Xerox (ACS)	Until a few years' ago, ACS was the "darling of BPO" with significant traction across F&A and HR towers. Always led with its strong focus on global delivery and transition experience, and client focus. Showing signs of a renaissance under Xerox leadership and adds some strong quivers to its capabilities with broader client relationships and leading-edge workflow solutions.	During the period leading up to its Xerox-merger, ACS lost much of its market momentum, especially with the arrival of Genpact and aggressive competition from the likes of Accenture, IBM and Capgemini. Needs to reassure clients and industry influencers the new-look Xerox F&A business has moved on from the old "lift and shift" model upon which ACS built its reputation.	Xerox seems serious about F&A and now needs to make some investments to re-establish the business. This includes establishing an integrated sales leadership which can leverage the Xerox/ACS synergies. The recent Atos F&A acquisition gives it a strong European presence with Polish and Spanish centers, but could significantly benefit from a strong IT-BPO value proposition. HfS believes Xerox should consider acquiring an offshore IT services business to solidify its global offerings.

Source: HfS Research, 2011

Part 3
The future shape of F&A BPO offerings

The majority of small-midsized F&A BPO engagements now encompass the IT-enablement of finance and accounting processes

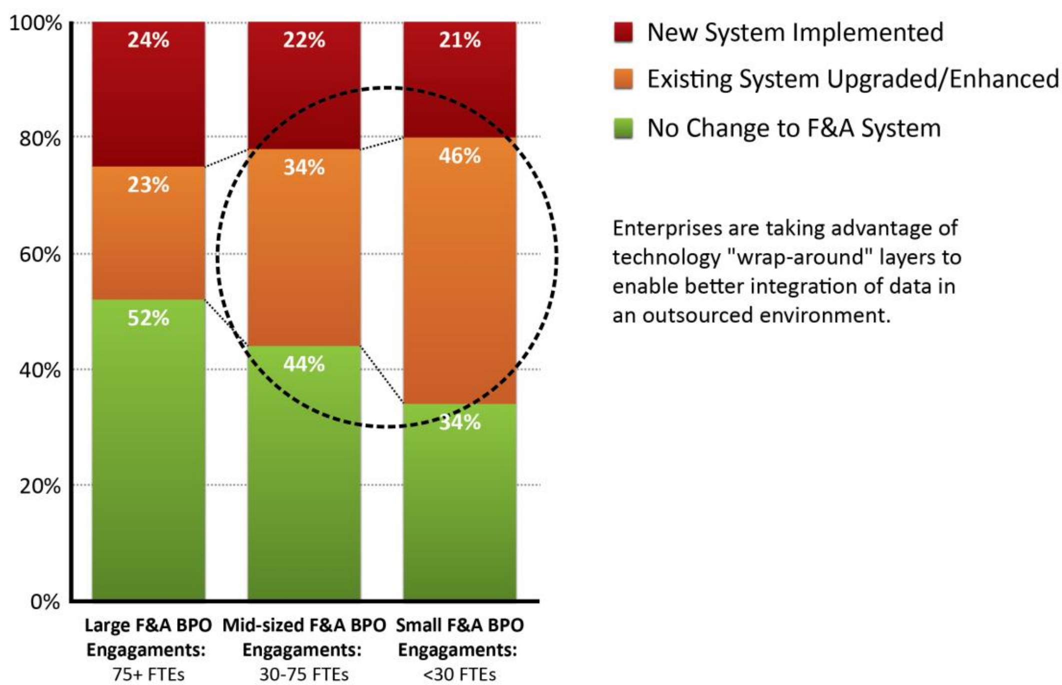
The early years of F&A BPO were dominated by large-scale "people-only" engagements, which essentially encompassed large numbers of administrative finance staff either being re-badged into the F&A BPO provider, or displaced with a lower-wage offshore employee. As many of the leading providers were looking to build scale in their global operations, they were happy to take on clients where they could absorb some of their existing operations and staff (sometimes through a straight service center acquisition). It was also easier, and often less contentious, to move customers into an F&A BPO scenario where many of the existing staff would be retained – at least initially.

However, as most of the leading providers are now operating with sufficient global scale and process acumen, their focus is quickly moving to operating and developing a utility model, which can be replicated across multiple clients. By developing utility, it becomes easier to train and develop staff to work with standard process operating models, understand how to operate common technology, and develop clear career paths as the business grows. Moreover, the more standardized the operating model, the easier it is to cope with staff attrition and currency fluctuation – especially as the cost of managing clients becomes so much more predictable over the course of a long term contract.

In order to achieve repeatability of process, HfS believes the development of a technology layer, whether it is an "application workflow wrapper," or an underpinning software platform, that enables a standard BPO delivery model, becomes increasingly important. Exhibit 11 illustrates the technology strategy being deployed across all F&A BPO engagements today. Clearly, with larger-scale deployments, focus is still primarily centered on a "process-only" scenario, with 52% of engagements with over 75 employees transitioned not involving any enhancement or replacement of existing F&A IT. However, with the mid-scale and small engagements, the majority are now enhancing their existing F&A IT in tandem with the BPO transition. Two-thirds of small F&A BPO engagements now deploy and Hybrid IT/BPO strategy.

Exhibit 11
Hybrid IT/BPO activity more prevalent in smaller-scope engagements

Financial system strategy with existing F&A BPO engagements



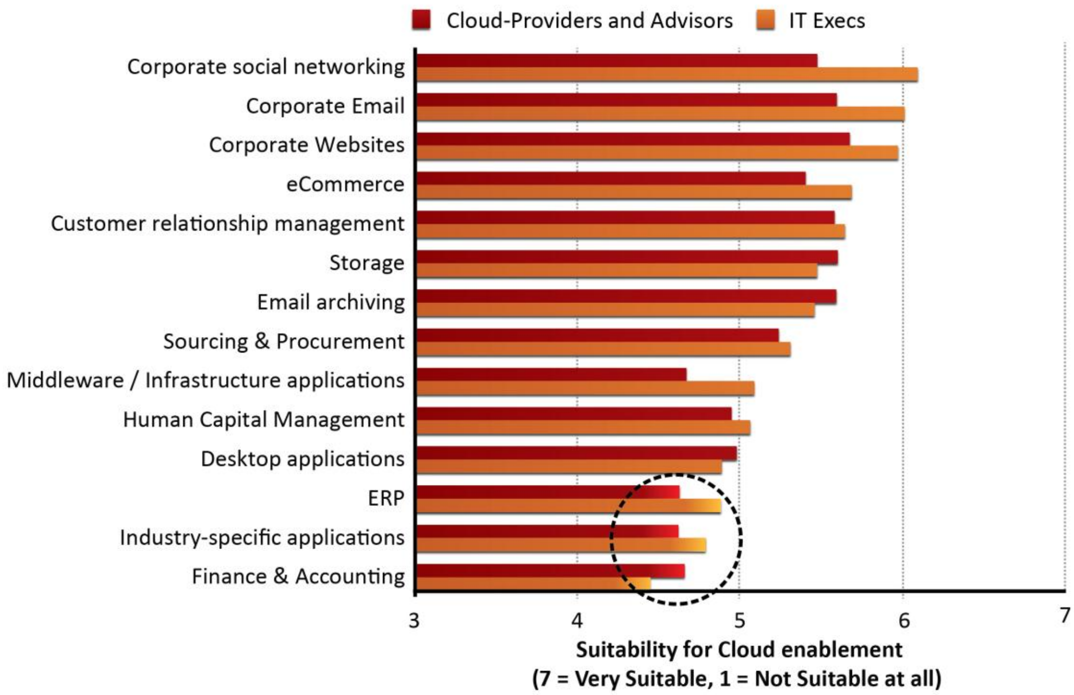
Source: HfS Research, 2011

F&A BPO not ready for cloud-enablement where legacy ERP applications are involved

While IT-enablement of F&A process is an increasingly important capability for providers, the industry still has some way to go before F&A processes and be delivered in cloud enabled models, with Exhibit 12 illustrating recent findings from a major study HfS Research conducted on cloud business services adoptions with the London School of Economics.

Exhibit 12
Moving F&A into the cloud is a major challenge for many organizations

Please rate the suitability of the cloud for the migration of the following functions/application types



Source: HfS Research, 2011

F&A processes are often the toughest to move into the cloud, and only the small-to-medium business sector is likely going to enjoy any modicum of success of moving processes such as finance and HR, into the cloud in the near-term. And this is mainly with very standardized and straightforward Internet-hosted apps (i.e., simple interface, no integration requirements), as opposed to genuine cloud-enabled ERP apps that leverage IaaS/PaaS/SaaS architecture.

At HfS, we have been at pains to dissect the potential of business processes that can be provisioned by a BPO provider, where its underpinning software and hosted infrastructure are "in the cloud". However, core BPO functions, such a finance and HR, are typically serviced by legacy software that is poorly integrated (if at all), or simply embedded into a complex ERP architecture that's hard-wired into back-end systems and databases. Most firms today would have to transition completely onto entirely new cloud-enabled platforms before they could even consider outsourcing the related processes to a third-party in a "cloud F&A BPO" model. It is generally a lot easier with apps that are either already "in the cloud," or where it's simply more desirable to move quickly onto a standard cloud model, for example the NetSuite application.

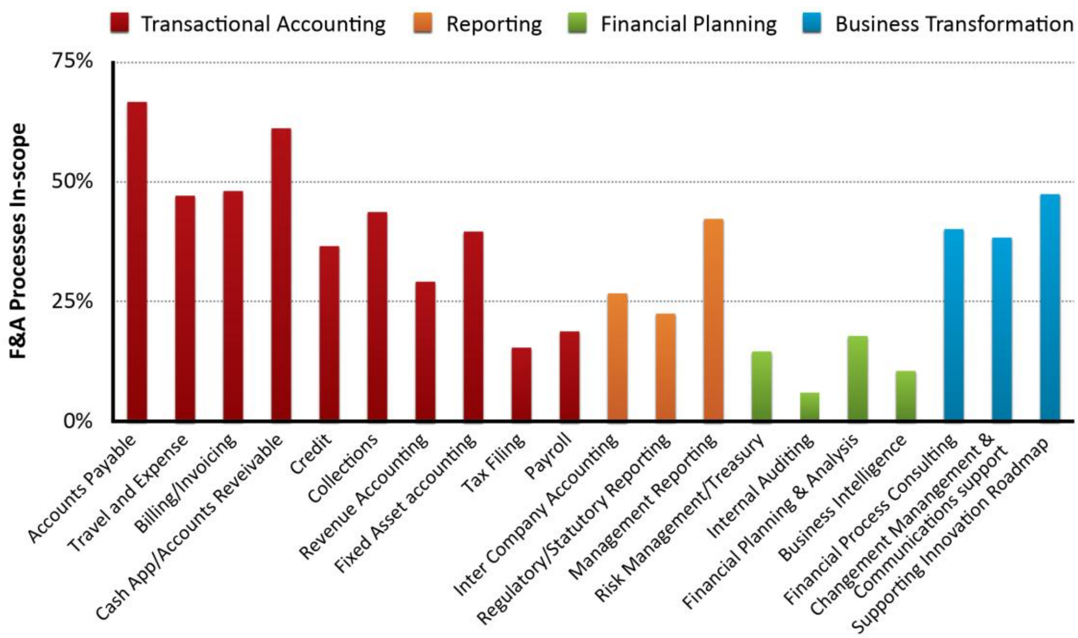
HfS believes cloud-enablement of F&A BPO is simply not going to happen anytime soon – the ROI is not there and the legacy ERP firms are nervous to derail their software license models that have served them so profitably for so many years. Yes, they *can* outsource their SAP support to an ITO provider and have them process their paychecks and invoices as part of the contract, but that is not "cloud BPO." That is IT-enabled BPO, which Exhibit 11 illustrates.

We are seeing the early beginnings of true "cloud services/BPO" partnerships around core ERP processes, for example Genpact and Netsuite's early efforts to offer "F&A BPO in the cloud" for medium-sized business. We're also seeing encouraging advancements that both Accenture and IBM are working on, to offer HRO on Workday, which could be the true beginnings of "HRO in the cloud."

Market still heavily focused on transactional processes, but business transformation acumen is critical

When looking at the actual finance and accounting processes "bundled" into an F&A BPO contract, it is abundantly clear that the industry is still very much centered on delivery of transactional accounting services (see Exhibit 13), as opposed to controllership activities, such as financial planning and analysis.

Exhibit 13
Multi-process FAO engagements center heavily on cash-cycle, reporting and business transformation



Source: HfS Research, 2011

As buyers become more experienced managing outsourced finance processes, HfS has seen many of them increase engagement scope to encompass some more customized and often more complex processes. For example, over 40% of current engagements are now incorporating management reporting processes and a fifth have elements of financial analytics. The one element very prevalent are the "transformative" support areas that enable buyers to move successfully into a BPO delivery environment, which close to half of all engagement incorporating financial process consulting, change management and innovation support as part of their F&A BPO initiative.

HfS sees these transformation components as critical differentiators among service providers as the industry matures. While many buyers today have to incur additional cost to reap these benefits from their provider, HfS believes it is becoming increasingly standard for BPO providers to bundle transformation elements into their contracts as standard offerings. Moreover, if existing providers fail to deliver the right level of transformation support for their clients, HfS believes buyers will turn to other providers and consultants for help. With management consultants such as AT Kearney, Deloitte, Ernst & Young, KPMG, McKinsey and PwC developing global sourcing advisory practices, we expect them to get increasingly involved with support buyers' BPO transformation needs.

The trend towards transactional pricing in F&A BPO is slow, however, gainsharing and outcome-based activities are on the increase

Many of the F&A BPO providers have become strongly reliant on pricing their customer contracts based on labor commitments from their customers. For example, if a customer can commit to 500 full-time-employees being provisioned for a five-year engagement, the service provider as the security of knowing it us guaranteed a minimum fixed income for that period of time.

However, HfS believes this effectively disadvantages both the provider and the buyer from developing new sourcing of productivity over the course of the relationship:

- The buyer pays for a fixed delivery by employee and stands to lose out of business volumes decrease during the relationship;
- The provider has little financial incentive to implement business improvements that can enable it to deliver more with less. It merely has to deliver the basic contract terms with the set number of staff is has committed to providing, and it will turn a nice profit.

HfS believes if both buyer and provider and work towards a model whereby services can be priced by transaction, it will allow flexibility for the buyer to have the knowledge that only pays for what it uses, and enables the provider to invest in more scalable, repeatable process workflows that can be developed across multiple clients. It also gives providers more flexibility to deploy staff resources strategically across clients – i.e. is clients in one industry are experiencing a lower volume of business, that provider can redeploy some resources to service clients in another industry that may be experiencing higher-than-anticipated business volumes.

In mature process outsourcing activities, such as payroll or benefits administration, most companies will only ever to expect to pay per payslip, or employee call, and so on. Hence, there is no reason why transactional finance and accounting processes cannot be priced and accounted for in similar commercial models. Exhibit 14 illustrates some examples:

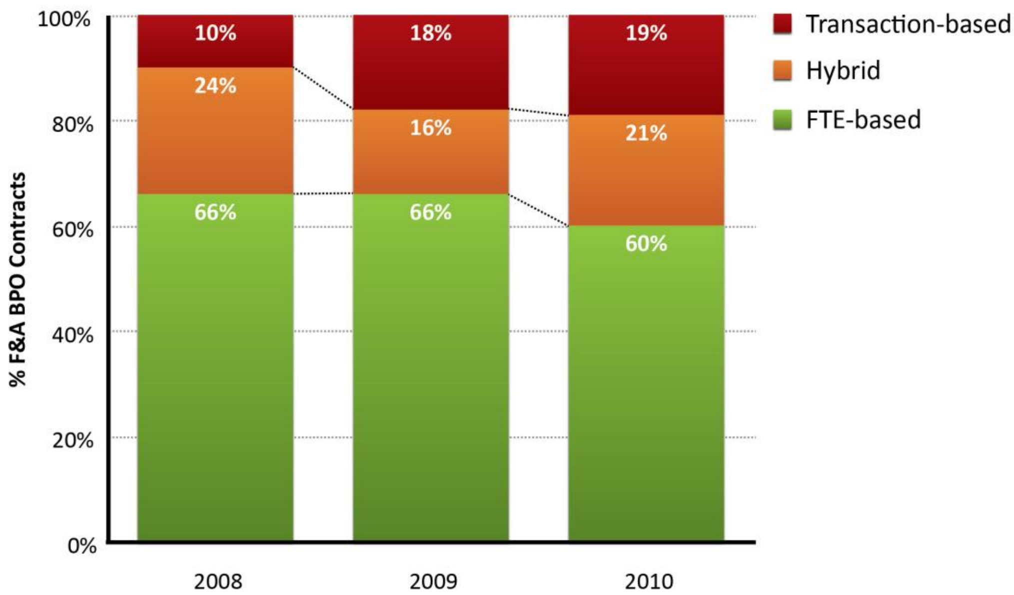
Exhibit 14
Examples of transactional pricing in finance and accounting BPO

Process value chain	High-level transaction unit
General accounting	Cost per journal or chart of account entry
Accounts payable	Cost per invoice
Accounts receivables	Cost per invoice, percent of collection
Fixed assets	Cost per fixed asset line item
Payroll processing	Cost per payslip
Travel planning	Cost per booked trip
Expense management	Cost per expense report

Source: HfS Research, 2011

HfS' discussions with both buyers and service providers have indicated a growing demand for more transactional and outcome based pricing models, particularly with existing customers and companies with more evolved processes. However, we are looking at a current install base of only 20% of F&A deals with transactional pricing mechanisms and a similar number evolving from a pure FTE-pricing model to a hybrid transaction-pricing scenario (see Exhibit 15).

Exhibit 15
Buyers are increasingly asking for transaction-based pricing in F&A BPO type of pricing deployed



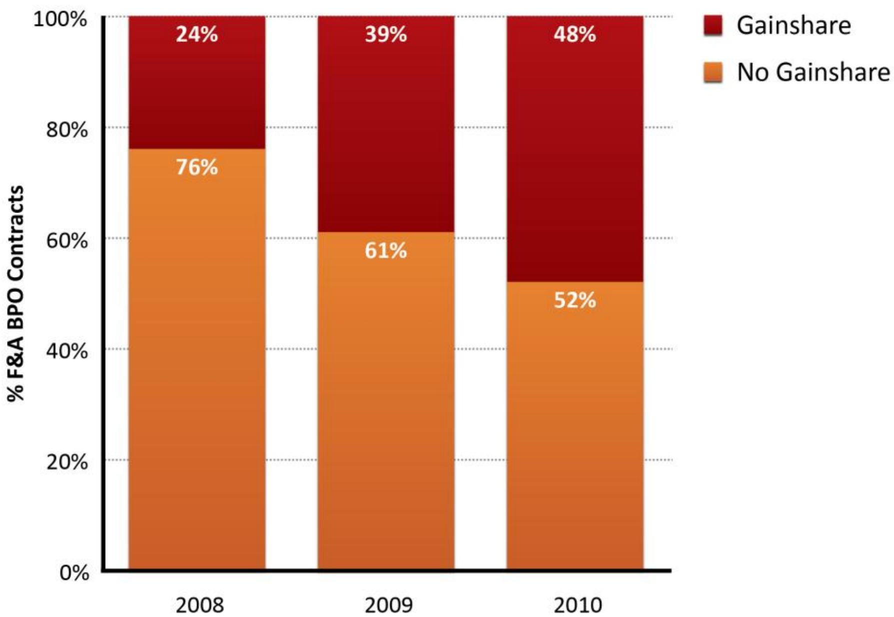
Source: HfS Research, 2011

HfS Research views the current pricing situation as a "chicken and egg" scenario, with several service providers unwilling to offer customers transaction/outcome based pricing until they understand the internal processes better. Moreover, many clients are also unwilling to jump into transactional pricing models until they have a stronger confidence over the predictability on their internal process, hence, they won't know whether a transactionally priced deal provides a beneficial operating scenario. So the norm is to revert to FTE, and we are only seeing a slow movement towards transactional pricing for F&A BPO contracts, with two-thirds of live engagements still preferring an FTE-based pricing scenario.

While movement towards transaction-based contracts is clearly complex, HfS is seeing much more energy between buyers and providers with incorporating gainsharing –or outcome-based–incentives within engagements (see Exhibit 16). If providers can be given a "piece of the action," they are clearly more encouraged to incorporate gainsharing into their agreements.

Exhibit 16
Half of the recent F&A BPO contacts involve gainsharing

Type of Pricing Deployed



Source: HfS Research, 2011

With close to half (48%) of 2010's F&A BPO engagements having gainsharing components included, HfS sees most focusing initially on payment collection – with the provider having financial incentives tied to the amount of money collected.

In addition, HfS is seeing outcome incentives being incorporated around reporting and general ledger processes. In many cases, it simply makes more sense to base pricing on outcomes rather than based on transactions - for example, the costs associated with individual asset entries vary so much. Also, the variance in costs can make outcome-based pricing for exception handling the likely direction of evolving pricing mechanisms.

Key takeaways

The F&A BPO industry has taken several years to move beyond labor-arbitrage transitions to engagements where most buyers are today trying to achieve more than merely taking cost out from the bottom line. Moreover, a maturing service provider base is – on the whole – producing better transition performance.

HfS believes there has never been a better time for buyers to craft an F&A BPO engagement that will get the attention of several service providers, and afford them the opportunity to incorporate various gainsharing incentives. However, buyers need to look beyond simple pricing metrics to make the right decision on selecting a service partner. They need to understand the long-term appetite of each provider to continually invest in their F&A delivery capabilities, and understand the potential of each provider's delivery organizing to be impacted by the expected consolidation with the supplier base.

Moreover, the business transformation capabilities of each provider to support process re-engineering, change management and help them achieve new ways of achieving productivity and growth need to be evaluated.

In addition, just because one provide may excel on paper in each of these areas does not necessarily mean they are the best fit for every buyer. Some of the more recent entrants into the market are eager to invest in clients to increase their market presence and delivery acumen – many buyers may find these providers mode flexible to add incentives and high-quality delivery talent to win new client business.

One final caveat for buyers to take away from this market assessment is the fact that once a BPO decision is made with finance and accounting, there is no turning back. Of the 788 engagements currently in existence, only a small handful have been brought back in house, or had the scope decreased. Moreover, buyers rarely have the opportunity to switch providers. Hence, the decision made today will potentially impact the business for decades to come. HfS is clearly observing many buyers take more time over evaluating their F&A sourcing options –many firms find continued success running shared services or captive operations, so why is BPO the answer for everyone? Quite simply, it is not, but it can provide excellent cost-efficiencies and a real change-agent for many to do things differently, to become more global in nature, to globalize the finance function and many of its key processes.

About the author

Phil Fersht is Founder, Chief Executive Officer and Research Director of HfS Research, the leading global research analyst organization covering global sourcing strategies. He was named "IIAR Analyst of the Year 2010" by the Institute of Industry Analyst Relations (IIAR). This is the most coveted global award for industry analysts in technology and services. His specialist coverage areas include finance, HR and supply chain BPO, and he also focuses on industry-specific issues and the convergence of BPO, SaaS and cloud in a business utility context.

Fersht 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. At HfS Research, Phil directs and contributes to the firm's research and social media strategy, in addition to administering the global finance operations.

During his career, Phil Fersht has worked at AMR Research (Gartner Group), 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.

He 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, the Shared Services & Outsourcing Network 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.

About HfS Research

HfS Research (www.HfSResearch.com) is the foremost research analyst firm and social networking community, focused on helping enterprises make complex decisions with their business process operations, IT outsourcing and shared services strategies. It has the largest audience and regular following in today's global sourcing industry.

With 50,000 subscribers, HfS Research provides the most impactful and frequently-visited global collaborative community platform in the global services industry, providing rapid and insightful commentary, analysis and debate of enterprise outsourcing and shared services dynamics. The organization is unique in the fact that it integrates personable social networking with market research and expert advisory services.

The HfS Research mission is to 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 HfS Research team is a multi-disciplinary group of analysts across North America, Europe and Asia/Pacific regions, with deep domain knowledge in business process outsourcing, information technology services and cloud business services.

Launched in 2007, HfS Research's acclaimed blog Horses for Sources has more than 120,000 monthly 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 HfS LinkedIn community, The BPO and Offshoring Best Practices Forum, is thriving with over 12,000 industry professionals sharing views and information daily. You can access information about HfS at HfSResearch.com and on Twitter at www.twitter.com/horses4sources.

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