



2009 Market Predictions October 2008

**Topics: FAO, Global Sourcing, HRO, ITO, PO, and
Supplier Intelligence**

- This document contains Everest Research Institute's 2009 predictions for key outsourcing and offshoring markets

- The report includes the following markets:
 - Finance & Accounting Outsourcing (FAO)
 - Global Sourcing (GS)
 - Human Resources Outsourcing (HRO)
 - Information Technology Outsourcing (ITO)
 - Procurement Outsourcing (PO)
 - Supplier Intelligence (SI)

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Finance & Accounting Outsourcing (FAO) predictions for 2009 (page 1 of 2)



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Market growth and buyer adoption

- FAO growth will continue rolling through 2009 on the back of broad-based adoption
 - The multi-process FAO market will continue to grow at 20%+ growth rates to reach US\$2.5 billion by 2009
 - Buyers will continue to be concentrated in the United States, UK and Western Europe; but relatively newer geographies like Netherlands, Switzerland, etc. will contribute significantly to the growth in the next 18 months
 - Macro economic conditions will impact demand in the financial services but consumer products, manufacturing, health care, and retail will fuel the growth
 - With a growth rate in excess of 35% larger mid-market companies (revenues between US\$1-5 billion) will sustain the adoption wave through Europe and North America

Solutions and value proposition

- A stable FAO value proposition is emerging with different value levers
 - The FAO value proposition will evolve from a pure cost-driven approach as reducing complexity, increasing business excellence, and retaining expertise become the buyer focus
 - Buyers and suppliers will adopt a global sourcing approach rather than a pure offshore-driven model
 - Augmenting the buyer's existing technology infrastructure with proprietary tools will create technology differentiation and leadership
 - Incentive-driven pricing and gain-sharing will gain broader acceptance as scope enhancements become more common in established contracts
 - The market will see more suppliers piloting "Platform-based FAO" in order to enhance their value offering and create predictability in their own operating models

Finance & Accounting Outsourcing (FAO) predictions for 2009 (page 2 of 2)



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Supplier landscape

- With 20+ recognized FAO suppliers in the market, the need for intensive capability development and targeted go-to-market strategies will shape supplier differentiation
 - Emerging players will gain market share as top market leaders will become selective in pursuing opportunities
 - Established players will primarily drive growth by cross-selling and up-selling, compared to emerging and new suppliers that would focus on differentiated offerings to new buyers
 - Suppliers will take advantage of global sourcing strategies involving geographies like Latin America and Eastern Europe to reduce dependency on a single offshore region and de-risk their business
 - Mergers and acquisitions will continue to rise with players adopting for in-organic growth to capture a larger share of the market
 - The number of new market entrants will gradually taper off as solution requirements gain in complexity and sophistication and serve as entry barriers

Global Sourcing (GS) predictions for 2009

Growth & adoption

- The Global Sourcing market will pick up pace in 2009 after the relative slowdown in 2008 because of the “sub-prime crisis” in the United States
- Europe will emerge as the fastest growing source geography; dependence on North America will decline further. Some increase in activity is likely in the Asia-Pacific geography
- Financial services companies will push the envelope on offshoring; breadth and depth of offshoring set to increase and scope of offshoring will expand to include “core functions” as well
- Non Forbes-2000 companies will embrace offshoring much more rapidly than in previous years

Locations

- Tier-2 locations’ delivery strategy will become exceedingly important; over 50% of new delivery centers will be located in Tier-2 cities
- The Philippines will expand market share for BPO services; in addition to voice-based services, capabilities in non-voice BPO will be recognized
- Central America will continue to see increased activity. At least four suppliers/buyers will set up large delivery centers in the region

Suppliers/ captives

- The captive model will stay solid despite divestiture by select captives
- The gap in the offshore centricity (percentage of total headcount in offshore locations) between traditional global suppliers and offshore-centric suppliers will reduce further
- Offshore-centric suppliers will enter a “margin compression” phase. Market trends will drive margin rationalization

Human Resources Outsourcing (HRO) predictions for 2009 (page 1 of 3)



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Market growth & buyer adoption

- As many suppliers continue to pursue deals selectively and buyers sign deals that are smaller in scope and size, multi-process HRO market will grow at 5% in terms of annualized contract value, to reach US\$3.2 billion in 2009
- However, with increased capacity in the market due to the entrance of new suppliers, more HRO deals are expected in 2009 compared to 2008
- Contracts worth nearly US\$1.6 billion will be up for renewal in 2009. With the new business segment continuing to grow slowly, the bargaining power will shift towards buyers with renewal opportunities with incumbent suppliers
 - First-generation buyers are likely to run a competitive rebid process, even if they are satisfied with the incumbent supplier, to compare offerings and price points
 - Deals in which the incumbent suppliers have become inactive in the multi-process HRO market will go to competitive bids
- With the global economy remaining challenging, there will be an increased focus on cost reduction and the speed to achieve it. This will lead to a greater number of “componentized” deals where transaction-intensive processes are outsourced
- Large-scope transformational deals require significant up-front investments and thus will likely come from industry verticals that are less impacted by economic recession and have a relatively high spend on HR/employee (such as pharmaceuticals)
- Growing from a relatively smaller base, Europe and UK will continue to see a higher growth rate compared to North America. Buyers with fast-growing operations in Asia-Pacific and Latin America will use HRO to scale up quickly
- Increased competitive intensity in the mid-market will drive down price points and make HRO more attractive in this market segment. This will lead to faster growth of the mid-market (in terms of number of deals) compared to the large market

Human Resources Outsourcing (HRO) predictions for 2009 (page 2 of 3)



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Supplier landscape

- Supplier profitability will improve as suppliers:
 - Drive a more standardized solution and utilize lessons of past implementations for new clients to reduce the implementation time and realize economies of scale
 - Move existing clients to the standardized solution and platform from the original “lift and shift” configuration
 - Increasingly leverage global sourcing in existing stable deals
- With suppliers focusing on their core capabilities, there will be more partnerships to bring together complimentary skill-sets, especially in the case of large scope multi-country deals. For example, global HRO suppliers will partner with specialized RPO providers to offer deeper and/or geography-specific recruiting services
- As India-headquartered suppliers (e.g., TCS, Wipro, Caliber Point, Infosys) create a global delivery footprint as well as experience in HRO, incumbent suppliers will increasingly face direct competition from them in competitive rebid situations as well as for net-new business
- With 18+ suppliers in the current HRO market, mergers and/or acquisitions that will consolidate the market are expected. This consolidation will be driven by suppliers’ need to gain expertise (process and/or technology specific) or geographic footprint rather than pure market share

Human Resources Outsourcing (HRO) predictions for 2009 (page 3 of 3)



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Solution

- With increased adoption of the Software-as-a-Service (SaaS) technology model, more innovative HRO suppliers will create service offerings around the SaaS model to decrease the total cost of service delivery for the buyer
- Increased adoption of a pay-as-you-go pricing model for HRO, especially in componentized deals will be seen
- Beyond payroll and benefits, mid-market buyers will have access to affordable technology options in other HR processes, such as recruiting, performance management, compensation, and learning
- Adoption of global sourcing will increase due to a combination of factors:
 - Increased focus among buyers on cost reduction in a slowing economy
 - Suppliers needing to improve their profitability
 - Maturing offshore delivery locations for HRO
 - An increased comfort level and experience among buyers regarding data privacy and data movement

Information Technology Outsourcing (ITO) predictions for 2009 (page 1 of 2)



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Overall

- The global economic slowdown has had a surprisingly minor effect on ITO in 2008, and the key question is whether resilience of the ITO market is likely to continue into 2009
- The effect of cost-optimization efforts on IT services spending will be more profound in 2009; but it will vary depending on the segment ITO (i.e., IT consulting, Application Development & Maintenance (ADM) outsourcing, Infrastructure Outsourcing), and the type of supplier (offshore vs. multinationals)
- According to a survey jointly conducted by Bernstein Research and Everest Research Institute, if the business environment of IT customers were to substantially weaken, most buyers believe that there will be a slowdown in on-shore budgets and they will look to move work offshore, which might benefit offshore suppliers
- Further on, continued decline in mega-deals and continued increase in competitive intensity for the renewals and re-competes will likely be seen

Application Development and Maintenance (ADM)

- The ADM market will continue experiencing increasing maturity of the offshore trend and a shift of value from pure labor arbitrage to higher-value work (e.g., system integration, package implementation, proprietary IP-based work)
- Several Indian suppliers are reaching critical mass, making fast organic growth difficult, and exhibit a desire to move up the value chain in ADM. This will lead to more M&A activity in 2009, especially around acquiring domain skills and consulting capabilities
- Finally, the ADM market is likely to be very significantly affected if things get worse from the economic point of view. An analysis of the 2000 recession demonstrates that ADM is highly sensitive to the economic conditions and usually shows 6-12 months' lag to changes in the economic performance. This serves as a warning that 2009 might be a year when ADM market growth gets significantly impaired

Information Technology Outsourcing (ITO) predictions for 2009 (page 2 of 2)



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Infrastructure Outsourcing (IO)

- Infrastructure outsourcing (IO) is generally a “non-discretionary” service (often under a long-term contract) that is prone to prove resilient, even in an economic downturn. Hence IO will continue growing at a sustained pace in line with the rest of the IT industry
- The key theme in 2009 will be convergence of the market models. The traditional model, based on asset-ownership transfer to the supplier and transformation of the infrastructure organization, will continue converging with the asset-light remote infrastructure management outsourcing (RIMO) model, based primarily on labor arbitrage
- This convergence will lead to offshore and multinational suppliers rapidly adopting each other’s game and investing in new capabilities (e.g., offshore labor arbitrage for multinationals, transformation capabilities for offshore suppliers)
- Aggressive adoption of labor arbitrage by both offshore and multinational suppliers will continue adding to the pricing pressure in the IO industry

Procurement Outsourcing (PO) predictions for 2009

(page 1 of 2)



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Market growth and buyer adoption

- Market growth rates continue growing based on heightened interest in PO across market segments
 - Adoption rates will vary each year; however, the multi-process PO market will reach almost US\$1 billion with 30%+ growth rates
 - North America and UK will continue to be the biggest buyers; however, Continental Europe and Asia Pacific will increasingly feature in contracts for delivery
 - Service-oriented industries like financial services will lead the growth wagon with more than 40% growth rates while traditional industries like manufacturing and consumer products continue to lead the adoption
 - Large buyers will continue to sign almost 40% of the contracts with an equal contribution from the upper end of the mid-market
 - The PO market will receive a boost from higher adoption rates among experienced outsourcing buyers
 - VC interest and buyer interest will continue to rise with newer players entering the market and looking to tap niche categories and industries
 - The mid market will continue to be hotly contested space with newer suppliers winning a significant number of contracts as leaders choose to stay away

Solution design and Value proposition

- The PO value proposition will become more acceptable as it evolves to represent the synergies between traditional FAO and PO markets
 - With an increasing number of players preferring smaller-scoped contracts, the market is witnessing the onset of the “phased” approach” as opposed to the traditional “big-bang” approach
 - Mature and experienced outsourcing buyers will find it easier to adopt PO, compared to adopters less experienced with outsourcing
 - Suppliers will build internal CoEs (centers of excellence) to groom internal sourcing experts and improve scalability of their offerings
 - Use of offshoring for cost advantage will increase on the back of increased P2P focus
 - Suppliers will continue to use technology or industry expertise to build differentiated offerings
 - Solutions will be designed to start with smaller scopes (category and process) but move towards full-scope S2P with the maturity of the engagement
 - Suppliers will prefer to overhaul the buyer’s existing technology system as procurement ERP penetration levels continue to be low

Procurement Outsourcing (PO) predictions for 2009

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Supplier landscape

- The PO supplier landscape is maturing faster than the market
 - Newer service-related categories, like HR related and marketing and sales, will become more amenable to outsourcing as differentiated suppliers will develop specialized capabilities
 - New players will continue to enter the highly concentrated PO market, where the top four suppliers account for more than 70% of the total contract value
 - An increased number of suppliers will prefer to develop specialized skills in P2P or sourcing and then use partnerships, mergers, and acquisitions to expand into a full-scope S2P offering
 - 2009 will see continued movement by PO suppliers towards end-to-end solutions; these moves will involve continued strategic investments in technology and process delivery capabilities
 - Geographically focused suppliers will continue to pose a significant threat to global leaders in sourcing- related activities

Supplier Intelligence (SI) predictions for 2009



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Overall market trends

- Supplier operating margins, especially for offshore players, will continue to decline due to currency fluctuations and increasing operating costs
- Optimization of supplier portfolio: An increasing number of buyers will look to consolidate their supplier portfolio and outsource to a smaller set of suppliers, thereby decreasing the number for suppliers serving a particular buyer
- Offshore-centric suppliers will continue to expand their remote infrastructure management (RIMO) service offering, and pursue large deals in the space. These suppliers are likely to continue to win deals over the traditional global suppliers on an opportunistic basis
- Diversified offshore-centric suppliers will continue to grow their BPO practice and make significant investments in “Platform BPO,” a combination of Software as a Service (SaaS) and BPO, and thus offer more robust solutions to their clients
- New client geographies will emerge, with China and India leading the pack and accounting for a large percentage of overall demand from emerging regions

Global delivery footprint

- As traditional suppliers continue to expand their offshore presence, the gap in offshore leverage between offshore-centric suppliers and traditional global players will decrease further
- While traditional global suppliers will move towards strengthening their offshore delivery capability in key locations including India and Philippines, the offshore-centric suppliers will expand delivery presence in new onshore regions (e.g., North America) and near-shore locations (e.g., Latin America). While this may lead to a decrease in margins for suppliers, it will increase their top-line revenues and increase their geographic reach

M&A and alliance strategy

- M&A and alliance activity is expected to be strong across the supplier community
 - Offshore-centric suppliers will continue to prefer the lower-investment option of alliances and partnerships to expand presence into newer verticals and buyer geographies, especially in the IT space
 - Traditional global suppliers will maintain their strategy of acquiring established companies in order to enter new regions and segments

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Everest Research Institute

Two Galleria Tower
13455 Noel Road, Suite 2100
Dallas, TX 75240
U.S.A.
+1-214-451-3110
www.everestresearchinstitute.com
info@everestresearchinstitute.com

Everest Group

150 E., 52nd Street, 16th Floor
New York, NY 10022
U.S.A.
+1-646-805-4000

Everest Canada

The Exchange Tower
130 King Street West,
Suite 1800
Toronto, ON
Canada M5X 1E3
+1-416-865-2033

Everest UK

1st Floor, Accurist House
44 Baker Street
London, W1U 7AL
United Kingdom
+44-870-770-0270

Everest Netherlands & Continental Europe

Atrium Building 3rd Floor
Strawinskylaan 3051
1007 ZX Amsterdam
Netherlands
+31-20-301-2138

Everest India

Ground Floor, Tower A
Unitech Business Park
South City - I, Gurgaon
National Capital Region
India 122001
+91-124-304-1000

Everest Australasia

Level 6, 90 Mount Street
North Sydney,
NSW 2060
Australia
+61-3-9833-1018

Everest Australia

409a Wattletree Road
East Malvern
Melbourne, VIC 3145
Australia
+61-3-9509-3933

