THE BPO MARKET OUTLOOK

Changing competitive dynamics, key players and best practices

By Gary Eastwood

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Executive Summary

Executive Summary

An introduction to business process outsourcing (BPO)

- BPO is not just another term for outsourcing, but brings strategic value by creatively examining the processes that underlie the business function and changing the way they are performed

- BPO vendors claim savings of between 10 and 30 per cent, which can jump to 70 per cent if the outsourced work is offshored.

- As well as savings on labor costs, offshore outsourcing offers round-the-clock work benefits and hence reduces time-to-market.

- The perceived risks surrounding BPO are generally misguided. BPO has matured as an industry in recent years – services are now efficient, robust and secure, with best practices having been finely tuned in many areas of BPO, such as human resources, finance and accounting and Customer Relationship Management (CRM) outsourcing.

- Human resources BPO (known as 'HRO') is one of the most mature and largest sectors of the market, driven by the need to reduce costs, the desire to improve service levels and quality of delivery and, increasingly, by the desire for HR to be more global and strategic in nature.

- Finance and accounting BPO – otherwise known as 'FAO' – is still an immature market, but is expected to take off in 2006 and 2007.

- Offshore BPO providers claim to offer cost savings of between 30—70 per cent, mainly as a result of labor arbitrage. In addition, offshore BPO can reduce the headcount of organizations as function or process expertise is taken on by the BPO provider.

- The BPO market is the single fastest growing area of the IT services sector. Growing 8 per cent annually, spending on BPO services is expected to grow from $112.1bn in 2005 to $144bn in 2008, an increase of 40 per cent.

- By 2008, BPO spend will account for 22 per cent of all IT services revenues.

Customer relationship management BPO (CRM BPO)

- The range of CRM BPO services available is continually expanding – in addition to customer-care and transaction services, companies now can contract for more knowledge-based tasks, such as customer data mining and analysis.

- Organizations are using BPO in customer relationship management to accomplish a wide range of objectives at both the process and the enterprise levels.

- There has been a shift in the demand for CRM services in the past two or three years partly because organizations are overwhelmed by customer data from their CRM systems and do not have useful ways to organize and apply the data. BPO providers are plugging some of those gaps.

- Indian providers are some of the most significant players in the customer care BPO market and have taken advantage of the move of the call center offshore and lower labor costs.

- The market for CRM BPO is predicted to grow from $41.3bn in 2004 to $56.7bn in 2008, at a CAGR of 8 per cent.

- The size of contracts in the CRM BPO sector is generally much smaller than those seen in the general BPO market, with a wide range of vertical industries represented.

- Cost savings from CRM BPO can be significant, but for real success improved productivity is needed. At the same time, while cost savings can be extensive, they are becoming more difficult to achieve due to the labor market in developing countries becoming more competitive and leading to higher salaries.

- Those purchasing BPO services often guarantee savings of 10 to 20 per cent (onshore) and 30 to 70 per cent (offshore).

Finance and accounting BPO (FAO)

- As well as providing all the usual benefits of outsourcing, FAO can also help organizations to reduce the complexity of the finance and accounting (F&A) department and help them to meet increasingly complex regulation and compliance requirements.

- The most popular tasks to outsource are usually repetitive functions and those prone to economies of scale when performed by one company. A more radical approach involves outsourcing basic accounting and all book-keeping entries, balancing and reconciling that forms the basis of a company's accounting books.

- One of the main inhibitors to FAO is the perception of risk from organizations and Chief Financial Officers (CFOs), and a general reluctance to outsource 'sensitive' financial functions. However, practitioners insist that the risks are far less daunting than some organizations might imagine.

- The majority of the FAO market with regards to contracts signed during 2004 and 2005 belonged to Accenture. 32 percent of all agreements in 2004 and 31 percent in 2005 were signed by Accenture. Capgemini also won a significant share of contracts signed – 14 and 11 percent in 2004 and 2005 respectively.

- Unlike the Human Resources Outsourcing (HRO) market, FAO does not revolve around technology issues, but is mainly a labor arbitrage play, which means the barriers to entry are lower and Indian offshore providers have been able to gain a strong foothold in the market.

- The market for FAO is immature compared to other horizontal BPO sectors, but it is set to grow from $13.9bn in 2005, to over $18.5bn in 2008, at a CAGR of 10 per cent.

Human resources BPO (HRO)

- Human resources outsourcing is one of the largest and most mature sectors of the BPO market.

- Nearly all HRO deals involve transitioning to a self-service model whereby automation reduces headcount and many employee services are delivered through an intranet.

- Companies have three primary drivers in making an HRO decision: to reduce the ongoing cost of HR, to free up time and resources for the company to focus on its core business objectives and to improve HR service to its end users.

- In recent years, there has been a deluge of entrants to the market. Accenture, ACS, Convergys, EDS and IBM have all won major deals in the last few years, and a number of the HR specialists have broadened out their services to offer end-to-end HRO. Hewitt Associates is the HRO market leader by some way.

- Current pricing levels of HRO contracts are estimated at around $600 per person per year (pppy), down from $1,100 pppy in 2000 - 2002

- Recruitment process outsourcing (RPO) has gained a lot of publicity over the last year. In recent quarters, many of the major HRO players have highlighted recruitment (as well as training) as an area of high demand in which they need to increase their skill sets.

- The HRO market is predicted to grow from just under $23bn in 2004 to over $30bn in 2008, at a CAGR of 7 per cent.

- A changeover to an HRO business model has the ability to affect the entire organization, a fact that is often underestimated.

- To help ensure a good 'handover' experience, it is important to clearly define the organization's needs, understand industry trends, and have proof of the chosen vendor's capabilities and approach to customer service.

Procurement BPO (PO)

- PO may have started to gain market traction, but it has yet to emerge with full momentum. Its horizontal cousins HRO and FAO are bigger and more mature, but the growth opportunities in PO are far greater.

- Procurement outsourcing can reduce prices paid for goods and services, improve contract compliance, cut sourcing and procurement cycles in half, and reduce procurement administration and procurement automation costs.

- To date, the primary focus remains on the indirect procurement of goods and services, although increasing elements of direct procurement are also being outsourced.

- Areas most likely to be outsourced to procurement services providers are such indirect expense categories as office supplies, travel, temporary labor, printing services and facilities management.

- While the upstream processes are more difficult, this is where PO can really deliver significant cost savings, as it involves consolidating the number of suppliers and negotiating better deals using the vendor's scale and expertise.

- There is also a convergence taking place with FAO and procurement outsourcing services, whereby companies outsourcing procurement are increasingly outsourcing the payments functions related to procurement services, such as accounts payable.

- The outsourcing of procurement can provide significant cost savings for companies that rely heavily on indirect materials costs, such as manufacturing.
- Those in the services industry also have much to gain via PO, since their domain expertise is not strategic sourcing.
- Procurement outsourcing can be viewed as a classic build-versus-buy decision.

Offshore BPO

- Practitioners claim that offshore BPO can provide savings of 30—70 per cent, in comparison to the 10 per cent that was considered worthwhile a decade ago, when companies first began to outsource their business processes.
- India remains by far the largest provider of offshore BPO services, although China is expected to grow rapidly. According to estimates, India accounts for nearly half of the global offshore BPO market.
- Organizations now see process performance, rather than cost savings, as the main benefit of transferring back office processes to an offshore location.
- Indian BPO companies are increasingly exploring new service offerings, taking them beyond simple customer care and support services. Although these services currently account for nearly 38 per cent of the industry’s employee base and a third of its revenues, alternative service lines (such as Engineering/R&D, logistics and sales) are growing fast.
- As a part of mainstream business strategies, offshore outsourcing initiatives are being accorded significant senior leadership oversight, and there is increasing emphasis on leveraging the model for greater strategic business impact; not restricted to functional support.
- In 2005, India witnessed steady growth across the key service categories of finance and accounting, customer interaction and human resource administration. These

three segments accounted for an estimated 89 per cent of Indian BPO revenues during the year.

- Choosing the right services provider is critical in offshore outsourcing. A high-quality facility, extensive industry knowledge, the ability to structure innovative and collaborative deals, scalability and financial muscle are critical.

- The parties involved in an outsourcing relationship belong to distinct cultures, these differences have to be accepted and bridged.

BPO best practice

- Outsourcing business processes can bring significant benefits to companies looking to cut costs and improve overall business performance.

- There are three underlying strategies on which BPO value propositions are based: the *cost reduction* argument, the *core competency* argument and the *transformation* argument.

- Transformation lies at the heart of most BPO. However, the fact that most parts of the vertical BPO market are still relatively immature means that there is still much variety in the transformation elements to be found in individual deals.

- The strategic nature of some vertical processes has been underestimated, and makes proven vendor capabilities the highest priority for organizations.

- BPO cannot actually be looked at as a mere service offering at all, but should be considered as a continuous journey towards the commoditization of individual business processes.

- Outsourcing agreements can be extremely complex depending on the nature of the process being outsourced, the level of skills required, the extent to which the process is outsourced and the desired results.

- The best way to procure BPO and maintain a focus on adding value is to drive the transaction from a strategic level and facilitate an interactive process with the potential service providers.

- Value-based pricing is becoming increasingly common – value-based transactions are structured around strategic outcomes and business profitability. In many cases, performance incentives and gain sharing are put in place if these objectives are met or exceeded.

CHAPTER 1

An introduction to Business Process Outsourcing

Chapter 1 An introduction to Business Process Outsourcing

Summary

- BPO is not just another term for outsourcing, but brings strategic value by creatively examining the processes that underlie the business function and changing the way they are performed
- BPO vendors claim savings of between 10 and 30 per cent, which can jump to 70 per cent if the outsourced work is off shored.
- As well as additional cost savings, offshore BPO can provide 24-hour work benefits and hence reduces time-to-market.
- The perceived risks surrounding BPO are generally misguided. BPO has matured as an industry in recent years – services are now efficient, robust and secure, with best practices having been finely tuned in many areas of BPO, such as human resources, finance and accounting and CRM (Customer Relationship Management) outsourcing.
- Human resources BPO (known as 'HRO') is one of the most mature and largest sectors of the market, driven by the need to reduce costs, the desire to improve service levels and quality of delivery. Another driving force is the desire for HR to be more global and strategic in nature.
- Finance and accounting BPO – otherwise known as 'FAO' – is still an immature market, but is expected to take off in 2006 and 2007.
- Offshore BPO providers claim to offer cost savings of between 30—70 per cent, mainly as a result of labor arbitrage. In addition, offshore BPO can reduce the headcount of organizations as function or process expertise is taken on by the BPO provider.
- The BPO market is the single fastest growing area of the IT services sector. Growing 8 per cent annually, spending on BPO services is expected to grow from $112.1bn in 2005 to $144bn in 2008, an increase of 40 per cent.
- By 2008, BPO will account for 22 per cent of all IT services revenues.

Purpose of this report

This report provides a competitive analysis of the business process outsourcing (BPO) market, as well as best practice advice for end-user organisations. It should be of interest to any organisation considering the use of BPO services, and for global BPO service providers and consultants.

Introduction to outsourcing

The use of IT outsourcing has increased significantly in recent years as organisations have become more comfortable with the concept of handing off ICT (Information and Communications Technology) responsibilities to third-party services providers. So much so that businesses today are reliant on having a diverse network of specialist IT outsourcing suppliers, for the provision of a growing range of ICT infrastructure and application services.

The impetus behind IT outsourcing is often the expertise and specialist knowledge that external services providers can bring, which not only provides the client organisation with ICT expertise beyond its own capabilities, but also enables it to concentrate on its core business functions.

As the modern enterprise seeks to focus ever more narrowly on its core activities, outsourcing services are increasingly being considered as a business strategy that provides access to 'best in class' processes and cost predictability.

At the same time, IT outsourcing avoids the need for expenditure on technology and kit that is likely to become obsolete within just a few years, and thus allows organisations to keep pace with ICT technology advances while avoiding the need for costly technology upgrades and even total re-deployments.

As a result, outsourcing can improve efficiencies, reduce costs, provide expertise and modernity. Organizations of all sizes now have access, through outsourcing, to the kinds of IT systems and expertise that was once only the preserve of the elite. In turn, this has freed up the CIO (Chief Information Officer), which today should not be managing day-to-day operations, but becoming a corporate leader and contributing to business strategy. The CIO now has time to focus on the alignment of IT and the business strategy by spending less time on tactical management of IT resources, or on IT ‘fire-fighting’.

Business process outsourcing

The term ‘business process outsourcing’ (BPO) has evolved over recent years and, each time it evolves further, its definition changes. It is not simply another term for outsourcing – in BPO, BPO is not just another term for outsourcing, but brings strategic value by creatively examining the processes that underlie the business function and changing the way they are performed., rather than merely applying technology solutions to existing business processes.

Therefore, a BPO contract would see a third-party service provider take on the running of an entire business process (rather than just the IT systems that underpin it), such as: human resources, finance and accounting, customer relationship management (CRM), procurement, supply management, payment and billing, and financial process management – each of which can be managed by the BPO service provider either locally or offshore, depending on the individual requirements of the customer and the expertise and business model of the provider. The selected processes would then be managed against defined and measurable business metrics.

BPO is increasingly in demand as organizations look to cut costs from the bottom line and to focus on their core business functions. As a result, an increasing number of outsourcing deals are blurring the lines between traditional IT outsourcing projects and BPO deals that see vendors take on the management of their clients’ business functions.

Benefits

Outsourcing business processes can bring significant benefits to organizations looking to cut costs and improve overall business performance. Because external providers focus on key processes as their core competency, customers are able to effectively leverage their knowledge and experience for their own benefit. The core benefits can be categorized into five separate areas:

- *Lower costs* – because BPO providers focus purely on the processes that they provide, they are able to offer a lower cost to organizations than they might otherwise be able to get themselves. For many of the processes outsourced such as contact centers, the startup costs are significant, and for many companies hard to justify given the alternative of a BPO service. Similarly, the BPO provider will often guarantee that it is using the most appropriate and up-to-date technology, allowing the organization to avoid issues such as sourcing and upgrading.

- *Improve service* – because outsourcing contracts are constructed using SLAs, a predefined level of service is guaranteed to the customer. In most situations, this level is higher than the organization itself could provide internally. For applications such as customer interaction, this is critical as poor communication with customers can affect revenues. For other processes such as human resources, the organization receives specialist staff and the provider ensures that existing staff are managed properly, thereby leading to better internal efficiencies.

- *Gain access to expert skills* – as organizations in all verticals are faced with increasing regulation, the demand for appropriately skilled staff is growing. Often, it is difficult for companies to ensure that they have an adequate level of knowledge within their internal staff to guarantee performance. Using a BPO provider for select processes, however, provides them with staff who are experts in specific areas. With this extra knowledge, companies are able to relieve the pressure of issues such as regulation. Similarly, external experts can help companies optimize and streamline internal processes through the application of best practices methodology.

- *Focus on core activities* – by outsourcing non-critical elements of their business, companies are able to pay more attention to their core competencies. In this way, they can effectively forget about managing lines of business such as HR or finance and accounting. This frees up considerable resources to try and gain as much market share and revenues as possible, while at the same time maintaining or improving the level of services within their business.

In addition to the above advantages, outsourcing offers other benefits such as provider alternatives, transfer of risk to vendor, elimination of internal policies, elimination of recruitment, training and staff retention in non-core functions, and scalability (faster scale-up or scale-down capability).

Risks

The perceived risks of outsourcing can act as a big inhibitor for BPO. However, it is important to note that these risks are ‘perceived’ rather than ‘real’. BPO has matured as an industry in recent years – services are now efficient, robust and secure, with best practices having been finely tuned in many areas of BPO, such as human resources, finance and accounting and CRM outsourcing. Some of these perceived risks are described below:

- *Loss of control* – Companies are reluctant to relinquish control over the operation of their processes.

- *Financial instability of providers* – If a provider encounters financial difficulties in the near- to mid-future, the buyer may be forced to search for an alternative services provider, which could put the operation of the business process at risk.

- *Loss of expertise* – Customers may lose the expertise and knowledge of carrying out the outsourced processes over time.

- *Culture of provider* – The factors surrounding financial stability of BPO services providers, and the quality and type of BPO service they offer means that choice of service provider – not just in terms of technology and services, but also type of relationship and cultural fit with the buyer – is a critical decision.

Introduction to horizontal BPO

Customer relationship management (CRM) BPO

Customer relationship management (CRM) BPO began life as a way to significantly reduce labor costs for low-value or transaction-based activities, such as helpdesk calls and bill payments, but it is now emerging as a way to deal with more sophisticated, value-added activities, such as consulting and implementation, training and support, customer care and analytics.

The outsourcing of customer related processes has received extensive press coverage given the number of companies using low-cost regions such as India for call centers. As the importance of customer relationships has grown within the mindsets of organizations, the question of how to provide the best service at the lowest cost has often been asked. For many, outsourcing of customer relationship processes is a sensible solution. Companies have the option of establishing call centers that are staffed by people, or setting up automated systems that guide customers through a series of prompts. For many, the cost of having call centers within their own region is extensive, given that the cost of providing premises, managing technology, training and recruiting staff can each be individually significant – yet are all required. BPO providers, however, are able to focus their skills purely on providing call center technology and customer care capabilities. As such the processes they provide support for are optimized and run at a lower cost than the customer could ever hope to achieve without significant financial investment and time.

At the same time, organizations are drowning in information held in their CRM systems, without the knowledge or resources to use it in a meaningful way. BPO providers can provide the technology and expertise to bridge that gap.

The functions provided by CRM BPO include, support (such as billing queries and order taking), marketing (such as outbound contact center communications via email or telemarketing), sales (inbound and outbound), technical support (such as helpdesk) and customer analytics.

Human resources BPO (HRO)

By definition, human resources (HR) BPO – commonly known as 'HRO' – is the integrated delivery and operation of a number of HR processes performed on a long-term contract basis by a single service provider. Most HRO contracts cover services such as payroll, employee benefits, recruitment and selection, training and development and compliance. However, definitions of HRO vary widely and are still a matter of debate.

HRO is one of the most critical assets of a company. Carrying out these tasks through an internal HR department is costly and diverts attention away from core business issues. Hence, companies are now resorting to HR outsourcing.

HRO is one of the most mature and largest areas of BPO, with several factors driving interest in it. As well as cost reduction benefits, organizations are looking to HRO to improve service levels and quality of delivery. Increasingly important, however, is the desire for HR to be more strategic. HRO can also pass the legal responsibility of employees onto the provider (depending on the type of contract and provider).

Finance and accounting BPO (FAO)

Finance and accounting BPO – otherwise known as 'FAO' – is still an immature market, but vendors have high hopes for FAO services as the next great horizontal BPO opportunity after HRO and FAO.

FAO includes services such as internal auditing, time and expense management, travel expenses, credit and debt analysis, collections, invoicing, accounts payable, accounts receivable and billing-dispute resolution.

The FAO market is prepared for increased growth as CFOs (Chief Financial Officers) get to grips with Sarbanes-Oxley regulations (US Federal accounting regulations) and the reorganization of financial processes that has been required. FAO service providers believe that CFOs will be much happier to use their services once they have fully documented processes because it makes the management of such an outsourcing agreement much clearer.

On the demand side, factors such as client concerns about regulatory compliance, perceptions of FAO's strategic value, and a lack of broad market acceptance may limit opportunity in the short term. FAO mainly remains viable principally at the lower end of the transactional scale — these tasks include data entry, accounts payable, and invoice reconciliation.

However, already in 2006 there are signs that those perceptions are breaking down, with some major FAO contract announcements.

Procurement BPO (PO)

2005 was supposed to be procurement outsourcing's breakthrough year. It wasn't. But it seems that it was just a delay in the inevitable rise of procurement BPO (or 'PO'). Its horizontal cousins HRO and FAO are larger and more mature, but the growth opportunities in PO are far greater.

Procurement BPO is currently a very small market, but analysts agree that it represents a massive opportunity, because it promises to deliver not only cost savings on operations, but also cheaper supplies which impact the bottom line directly.

Currently vendors such as Ariba, ICG Commerce, IBM, and Accenture are the main players, but other BPO providers – notably CSC and HP – are likely to become increasingly influential in the sector during 2006.

Offshore BPO

Strictly speaking, all of the horizontal BPO functions can be delivered either by the onshore or offshore model. However, the massive impact that offshore BPO providers, especially in India, have had on the industry landscape deserves special focus.

Offshore BPO allows companies to outsource routine office functions to developing countries, such as India, China, The Philippines and Mexico to take advantage of lower labor costs. While offshore BPO is currently much smaller than the broader market for offshore outsourcing of IT services, the former is growing rapidly.

The claimed cost savings offered by offshore BPO vary from anything between 30—70 per cent, mainly as a result of labor arbitrage. In addition, offshore BPO can help to reduce the headcount of organizations as function or process expertise is transferred to the BPO provider.

Call centers were one of the first BPO functions to be outsourced to offshore locations, however, the market and services offered are maturing quickly. According to Indian trade group Nasscom, one-third of all BPO work is in the area of customer care, followed by finance, administration, content development, payment services, and human resources.

However, the tasks being remotely processed are moving relentlessly up the value chain, from low-margin, transaction-based services to more sophisticated services, such as analytics and knowledge process management.

At the same time, many Western BPO services providers – such as Accenture, Affiliated Computer Services, IBM Global Services, EDS, HP Services, and others – continue to build up their offshore presence in order to pass on the lower labor costs to their own BPO services customers.

The Indian BPO market is still consolidating, as firms find it harder to stay afloat without a certain minimum size in terms of balance sheet strength, people, skills, global footprint, and quality. The resulting competitive landscape is a mix of pure-play vendors (companies with a single business focus), the BPO divisions of the major IT outsourcing vendors, and captive shop. In addition, specific players in verticals such as insurance and retail or across a certain horizontal space such as FAO are also bidding for large offshore BPO deals.

Market dynamics

The size of the total IT services market (including applications, infrastructure, consulting, and business process outsourcing [BPO] services) is estimated at $513bn, with the 50 largest vendors claiming a share of 51 per cent (with combined revenues of $262bn in 2005). The vendors – which range from the largest, IBM Global Services (IBM GS) with 2005 sales of $47bn, to Indian outsourcing specialist Patni Computer Systems with $450m – increased their combined sales by 1.9 per cent during the period.

This increase in sales is in fact lower than the 8 per cent growth seen across the overall IT outsourcing market. The lower increase reflects a shift in BPO services from large single outsourcing contracts going to major players, towards the signing of multiple, smaller contracts that are shared among specialist vendors.

IBM GS, EDS, Fujitsu Services, and Accenture take the top four positions but, interestingly, the 10 fastest-growing IT services vendors in the top 50 rankings last year were either specialists in low-cost offshore delivery (Cognizant, Satyam, Patni, TCS, Infosys, HCL and Wipro), or focused on the lucrative US central government and defense sector (SRA, CACI and SAIC).

In addition, with BPO representing the single fastest growing area of the IT services sector, IT service providers, management consultancies, and specialist BPO vendors are all positioning themselves to gain a share of this lucrative market. The market itself is seeing a convergence of traditional IT services and specialist business process management services. The growing array of vendors in the marketplace and services offered ensure that keeping track of the marketplace will be a challenge. It is interesting to note that the top 10 fastest growing IT services providers in 2005, showed that the vendors in the top seven rankings were significant players in the BPO market (see

Table 1.1).

Table 1.1: Top 10 fastest growing IT services providers, 2005

Rank	Company	Annual revenue ($m)	Revenue growth (%)
1	Atos Origin	6,851.0	75.0
2	Cognizant Tech Solns	587.0	59.0
3	Infosys Technologies	1,592.0	49.8
4	Satyam Computer Svcs	794.0	40.3
5	CGI Group	2,640.0	40.0
6	Wipro Technologies	1,388.0	39.6
7	Tata Consultancy Svcs	2,220.0	37.0
8	SRA International	616.0	36.9
9	CACI	1,146.0	35.9
10	WM-data MB	1,121.0	24.9

Source: Business Insights

Business Insights Ltd

Equally, BPO is the main business of seven of the top 10 vendors ranked by profit margins – Infosys Technologies, Tata Consultancy Services (TCS), CGI Group, Satyam Computer Services, Cognizant Technology Solutions, Affiliated Computer Services (ACS) and Perot Systems - (see Table 1.2).

Table 1.2: Top 10 services providers by profit margin, 2005

Rank	Company	Net income ($m)	Net profit margin (%)
1	Infosys	419.0	26.3
2	Tata Consultancy Svcs	510.0	23.0
3	CGI Group	179.0	22.1
4	Satyam Computer Svcs	154.0	19.4
5	Cognizant Tech Solns	100.0	17.0
6	Affiliated Computer Svcs	530.0	12.9
7	SRA International	39.0	6.3
8	Anteon International	62.0	5.9
9	CACI International	64.0	5.6
10	Perot Systems	95.0	5.3

Source: Business Insights

Business Insights Ltd

While all the major IT services players have made some inroads into BPO. So far they have taken a “pick and mix” approach, looking for opportunities in certain vertical sectors that they can leverage against their IT outsourcing (ITO) customer base, or singling out a particular horizontal area.

For example, IT services and BPO vendor, EDS, first used its ITO customer base to extend into vertical BPO areas such as check processing for banks, and healthcare administration. It only began to seriously compete for corporate BPO services in 2005 with the formation of its ExcellerateHRO joint venture with Towers Perrin (a global HR Consulting and Services firm). It has still to make any major impact in FAO or PO.

Hewlett-Packard was also a late entrant to the BPO market and has concentrated on FAO, winning several low-key contracts, but has yet to address HRO and PO even though it is currently thought to be looking towards these areas..

Although IBM is a major player across the horizontal markets, it is being outranked in HRO by Accenture, Hewitt Associates, and Convergys. It is unlikely the company will continue in this way but it is unclear whether the company will be able to catch up through organic growth alone.

To date, no one company has developed a full set of BPO services. However, it is unrealistic to expect any one vendor to develop the deep domain expertise demanded of vertical BPO across all industries. Vendors will continue to specialize in vertical industries where they see opportunities, but it is clear that the horizontal BPO market is different in that the major IT services players will look at offering services across the corporate back office.

Table 1.3 is a list of the 10 largest BPO contracts signed globally in the 12 months up to 30 June 2006, and provides an indication of the types of BPO services that are currently in high demand (such as human resources (HRO) and procurement (PO)) as well as the verticals that are leading the way – notably, manufacturing, government and financial services.

Table 1.3: Largest BPO contracts in last 12 months, (to 30 June 2006)

Vendor	Client	Value ($m)	Announced	BPO sector	Vertical
CSC	BAE Systems	1,900	02-05-06	Procurement	Manufacturing
Convergys	DuPont	1,100	02-11-05	HR	Manufacturing
Accenture	Unilever	1,000	06-06-06	HR	Manufacturing
Tata	Pearl Assurance	837	18-10-05	F&A	Insurance
Capita Group	Zurich FS	510	22-12-05	Financ'l proc	Insurance
ACS	Lockheed Martin	500	17-04-06	HR mgmt	Manufacturing
Agilisys	Rochdale MBC	330	14-07-05	CRM, HR	Local gov't
Fujitsu Svcs	NI Dept Fin & Pers	321	30-03-06	HR	Banking
iGov	US Op'ns Command	300	11-10-05	Procurement	Defense
Hewitt	Off of Persnnl Mgmt	290	04-05-06	HR	Federal gov't

Source: Business Insights

Business Insights Ltd

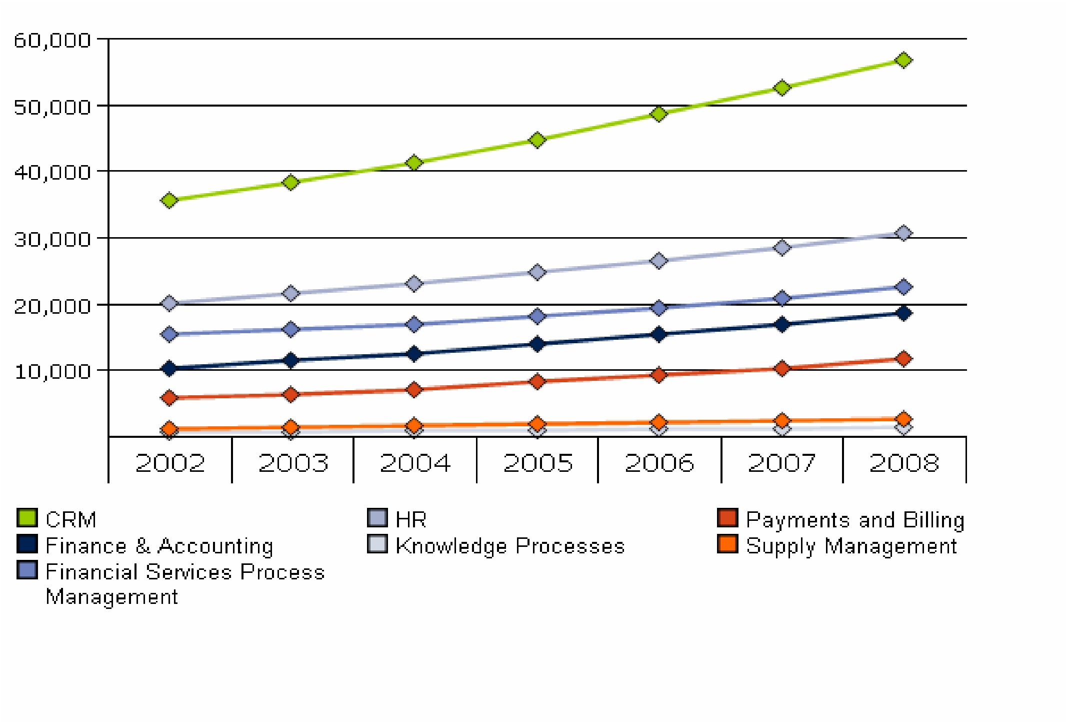
Global contract signings may have been disappointing in 2005, but the BPO market is expected to grow at a healthy rate over the next few years, compared to the wider outsourcing market. In fact, the difference between the two types of outsourcing has never been starker, and will encourage IT services vendors to further accelerate moves into BPO.

Market sizing

The BPO market is the single fastest growing area of the IT services sector. Growing 8 per cent annually, spending on BPO services is expected to grow from $112.1bn in 2005 to $144bn in 2008, an increase of 40 per cent (see Figure 1.1 and Table 1.4). By 2008, BPO costs will account for 22 per cent of all IT services revenues.

Of that total, customer relationship management (CRM) BPO is expected to account for around 39 per cent of total BPO spending in 2008 (down slightly from 40 per cent in 2004), followed by human resources BPO (HRO) which will account for 21 per cent of BPO spending (compared to 22 per cent in 2004). FAO and PO (as part of knowledge process outsourcing) are the fastest growing BPO horizontal sectors.

Figure 1.1: BPO market sizing ($m), 2004-2008



Source: Business Insights

Business Insights Ltd

Table 1.4: BPO market sizing ($m), 2004-2008

	2004	2005	2006	2007	2008	CAGR (%)
CRM BPO	41,300	44,744	48,510	52,450	56,702	8
FAO BPO	12,539	13,861	15,302	16,827	18,483	10
HR BPO	22,977	24,645	26,471	28,426	30,555	7
Procurement BPO	816	937	1,068	1,214	1,360	14
Other BPO	25,421	27,912	30,381	33,425	37,033	
Total BPO services	**103,054**	**112,098**	**121,733**	**132,342**	**144,133**	**9**
Total IT services	475,311	513,236	556,115	603,802	657,445	8
% of IT Services	21.7%	21.8%	21.9%	21.9%	21.9%	

Source: Business Insights

Business Insights Ltd

BPO market conclusions

For the BPO market as a whole, 2005 was disappointing in terms of deals signed. The market was still expanding, only not at the rate some had expected.

However, the HRO market did achieve 53 deals (of over $1m each), worth a total of $7.4 bn, signed in 2005. This showed a 52% increase from the 39 deals in 2004, worth $4.87bn. Further contract deals did slow down towards the end of the year, fuelling concerns of supply-side problems including lack of capacity, leading to the main players “cherry-picking” opportunities. However, these are seen as short-term problems and growth is expected to return to its rapid pace during 2006. Consolidation within the market although reaching a peak in early 2005, is also expected to gain momentum in between 2006 and 2007.

The FAO market is also preparing for increased growth as CFOs finally adjust strategies in order to handle the Sarbanes-Oxley regulations and reorganize financial processes as required. Full documentation of the processes will ensure that management of outsourcing agreements is made easier. At present though, FAO services are almost completely dependent on labor arbitrage, and for some companies this alone will not allow them to cope with the expanding market.

Procurement outsourcing (PO) is currently a very small market, but represents a massive opportunity because it promises to deliver not only cost savings on operations, but also cheaper supplies which impact directly on the bottom line. Currently Ariba, ICG Commerce, IBM, and Accenture are the main players, but other BPO providers are likely to keep a close eye on the sector in 2006.

In vertical BPO sectors, vendors have continued to develop domain knowledge in order to grab higher margin niche industry work. Indian players are now endeavouring to take advantage of India’s abundant IT graduate, scientist and engineering workforce and moving into R&D services.

In October 2005, the most significant move by the (offshore) Indian players, was undoubtedly Tata Consultancy Services' (TCS) deal with UK insurance giant Pearl, which came just after its ITO deal with Dutch bank ABN AMRO. The size of the deal was unexpected considering the company's lack of experience in the area. The company also moved away from its business model which it began with a predominantly onshore deal (it involves taking on almost 1,000 UK staff). How TCS fares on the transformational aspects of the deal, and how quickly it moves work offshore will be of interest to players within the market and the impact on the company's Indian rivals and their business strategies (on-shore models or offshore models) should be monitored.

CHAPTER 2

Customer relationship management BPO

Chapter 2 Customer relationship management BPO

Summary

- The range of CRM BPO services available is continually expanding – in addition to customer-care and transaction services, companies now can contract for more knowledge-based tasks, such as customer data mining and analysis.
- There has been a shift in the demand for CRM services in the past two or three years partly because organizations are drowning in customer data held in their CRM systems without the resources or 'know-how' to analyze and apply it. BPO providers are plugging that gap.
- Indian providers are some of the most significant players in the customer care BPO market and have taken advantage of the move of the call center offshore and lower labour costs.
- The market for CRM BPO is predicted to grow from $41.3bn in 2004 to $56.7bn in 2008, at a CAGR of 8 per cent.
- The size of contracts in the CRM BPO sector is generally much smaller than those seen in the general BPO market, with a wide range of vertical industries represented.
- Cost savings from customer care BPO can be significant, but improved productivity is the real benefit. In fact, cost savings are becoming more difficult to achieve.
- Vendors often guarantee savings of 10 to 20 per cent (onshore) and 30 to 70 per cent (offshore).

Introduction to CRM BPO

The concept of customer care BPO is nothing new, with organizations having outsourced call center operations, in particular, for some time. Outsourcing such processes have helped organizations cope effectively with fluctuating capacity demands, reduce costs by shifting call centers to less expensive locations, and to offload the high turnover and people-intensive burden of call center processes to a third party.

Since then, the scope of customer care/CRM BPO services available to organizations has steadily broadened, and now includes more sophisticated and knowledge-based tasks such as customer analytics, data mining and marketing.

As a result, companies are beginning to outsource a much wider range of processes, including outbound sales, the integration of multiple points of customer contact, customer segmentation, and even product management.

Drivers

Organizations use BPO in CRM to accomplish a wide range of objectives at both the process and the enterprise levels. At the process level, CRM BPO can improve efficiency through consolidation and integration of customer relationship processes and by providing organizations with access to CRM-based IT systems without the capital expense. It also provides greater transparency, business discipline, access to best practice processes such as customer segmentation and analysis

At the enterprise level, CRM BPO can improve customer satisfaction and, hence sales, as well as the ability to up-sell and cross-sell to customers as the chance arises.

Inhibitors

Of course, this move up the value chain from low-cost voice transactions in call centers to more knowledge-based CRM BPO services comes at a greater cost, requiring more highly educated and better trained specialist staff. At the same time, it requires a closer working relationship with the services provider and greater input from the customer, in order to align the capabilities of the services provider with the requirements of the organization..

Market dynamics

Market background

Oracle's $5.85bn purchase of Siebel Systems at the end of 2005 narrowed the field of enterprise CRM vendors to just two companies – Oracle and SAP. The landmark deal underlined how much the CRM applications market has evolved and consolidated in the last five years, and this has also triggered some significant changes in the community of IT service companies focused on CRM integration and consulting projects.

Since the heyday of CRM implementations in the late 1990s, the market cooled off and organizations spending on new CRM systems decreased, especially around 2002 and 2003. In the last 18 months, demand has picked up again, and Forrester Research estimates that worldwide spending on CRM service projects will hit $13 bn this year.

But CRM has fundamentally changed in its nature. Now organizations are looking for specific analytical tools and other services to extract useful sales and marketing knowledge from their customer and marketing data. The rise of on-demand hosted CRM services, from vendors such as salesforce.com, has also penetrated the enterprise CRM market.

The CRM services market is reflecting the shift in CRM priorities, with service companies and system integrators offering more analytics and consulting work on top of clients' existing CRM systems. As a result, vendors are seeing a greater proportion of overall CRM revenue going to services, particularly services for hosted CRM systems.

One reason there has been a shift in the demand for CRM services in the past two or three years is that many organizations are overwhelmed with customer data from their CRM systems and do not have useful ways to organize and apply the data. That's where mid-sized CRM services vendors, such as Extraprise, or global services providers, such as IBM and Accenture, can assist a company in segmenting the data accordingly, retooling the client's CRM strategy, or offering tools for analytical or specific customer and marketing insight.

There is also a changing mix of CRM services. Accenture, for example, has a multibillion-dollar CRM business and claims to lead the market for services in this area. More than half of its total CRM revenue comes from system integration for Siebel, SAP and on-demand system implementations. A considerably smaller portion comes from its practice work – providing CRM strategy, customer analytics, marketing analytics, and other insight tools to its clients. But a third, and growing, revenue source for vendors is BPO work in the CRM market.

Indian providers are some of the most significant players in the customer care BPO market and have taken advantage of the move of the call center offshore and the lower labour costs, although as discussed above many of the traditional CRM players see the market as a new opportunity. The BPO market in India is dividing into three segments. The first two, traditional contact-center operations and transactional systems, have been established for some time. But companies are increasingly relying on a skilled and lower-cost workforce in India for knowledge-based tasks, including customer analytics, research and marketing.

Market sizing

The market for CRM BPO is predicted to grow from $41.3 bn in 2004 to $56.7 bn in 2008, at a CAGR of 8 per cent (see Table 2.5).

Table 2.5: Customer care BPO market sizing ($m), 2004-2008

	2004	2005	2006	2007	2008	CAGR (%)
Customer care BPO	41,300	44,744	48,510	52,450	56,702	8
Total BPO services	103,054	112,098	121,733	132,342	144,133	9

Source: Business Insights

Business Insights Ltd

The main service providers include:

- Accenture
- ACS
- BearingPoint
- BeCogent
- Capita
- Convergys
- EDS
- IBM Global Services
- Infosys
- Minacs Worldwide
- Perot Systems
- Scandent Solutions

- Tier Technologies
- Unisys
- Xansa

Major contracts

As shown in Table 2.6, the size of contracts in the customer care BPO sector is generally much smaller than those seen in the general BPO market, with a wider range of verticals represented. The largest ten contracts in the last 12 months cover banking, telecoms, technology, healthcare, retail and public sector industries. At the same time, these contracts were awarded to a broad spectrum of vendors, in terms of history, geography, size and business model. The following section profiles some of the leading customer care BPO vendors.

Table 2.6: Major CRM BPO contracts in last 12 months (to 30 June 2006)

Vendor	Client	Value ($m)	Announced	Vertical
Agilisys	Rochdale MBC	330	14-07-05	Local gov't
EDS Corp	La Caixa	240	20-12-05	Banking
IBM Global Svcs	Bharti Tele-Ventures	230	08-08-05	Telecoms
Capita Group	DSG International	210	23-02-06	Retail
Xansa	NI Water Service	123	19-01-06	Utilities
IBM GS	Carlson Companies	100	20-07-05	Retail
Minacs Worldwide	Unnamed SI company	100	01-12-05	Services
Mphasis	State Bank of India	58	01-08-05	Banking
Affiliated Comp Svcs	Aetna	56	30-01-06	Healthcare
Minacs Worldwide	Unnamed company	45	30-08-05	Other

Source: Business Insights　　Business Insights Ltd

Competitive dynamics

Accenture

Accenture has a global Delivery Center Network that comprises 40 facilities that are used to deliver a full range of APO (Agent Position Outsourcing), ITO (IT Outsourcing) and BPO services including call center outsourcing. Today Accenture bids for large, globally wide-reaching and complex engagements. Its BPO services are in demand within the industry.

Accenture targets the high-end of the market and is involved in multi-year, multi faceted deals with global multinational companies. However, the company has recently announced plans – backed up by strategic acquisitions in the BPO space – to target mid-market companies. Within call center outsourcing, target clients usually have in excess of 5,000 agent positions (APs) and many clients understand what they want to achieve and often have the internal expertise to deliver these initiatives themselves. However, they are more often than not hindered by lack of a clear coordinated holistic vision and an executive mandate to ensure effective delivery of the project. Accenture's strategy is to aid its clients to utilise their resources to drive process improvements and achieve high performance.

Within its CRM service line, Accenture has a go-to-market service named Customer Contact Transformation that offers clients a variety of value propositions relating to call center operations and outsourcing that include:

- Sourcing for and/or running the call center operation.
- Managed services such as vendor relation management.
- Creating innovative ways to transform customer interactions.

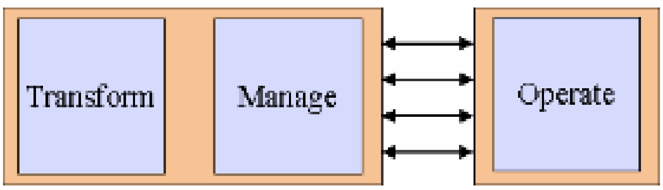
Accenture's value proposition is structured around the three building blocks of Operate, Manage and Transform (see Figure 2.2).

"Operate" pertains to the running of call center operations. Initially Accenture set about extending its own delivery capabilities in India and other locations by establishing a number of 1000+ AP centers so that they could legitimately claim to deliver this scale of call center outsourcing project. However, today the company prefers to use its call centers as hubs for innovation and to manage third-party vendors, who in turn deliver the large-scale back-office and call center operations. It is frequently the case that the outsource provider will have a contract with Accenture and not directly with the client.

The "Transform" element of the service reflects the fact that businesses have moved beyond solely delivering cost reduction programs in recent years and are now consciously looking at ways to better integrate and transform their businesses infrastructure and core competencies in order to deliver on customers' expectations and those of their investors. There are only so many costs that can be removed from an operation before it needs to be fundamentally reviewed and redesigned. Such projects are complex and take time as well as requiring previous practical delivery experience to be successful.

Finally, it is important to sustain change over time. Accenture ensures that the change happens by managing relations with outsource providers on behalf of the client. Accenture operates as the prime contractor on behalf of its clients in many instances, which means the outsource providers sign their contracts for delivery of services with Accenture rather than with the client. Accenture has established its expertise in this field and is able to leverage partner relationships as well as its procurement expertise on behalf of its clients.

Figure 2.2: Accenture's customer contact value proposition



Source: Accenture & Business Insights

Business Insights Ltd

The call center market is mature and as such behaviors, attitudes and metrics are now largely standardized. Therefore firms like Accenture concentrate on using their call centers as centers for innovative practices. By operating a part of the call center delivery on deals that incorporate call centers, Accenture can set benchmarks and best practice standards for adoption throughout the remainder of the delivered operation. Often, Accenture will act as the vendor manager in those areas of the business.

Affiliated Computer Services (ACS)

As well as signing some significant CRM BPO deals, ACS has strengths in HR, finance and accounting (F&A), and back office BPO practices (see 'Finance and accounting BPO' chapter for a full profile).

Agilsys

Agilisys offers a full range of back-office solutions from payroll and credit control to hotel bookings and utility management. Its deal with Rotherham Borough Council not only involved a CRM BPO element, but also elements of finance and accounting BPO ('FAO') and human resources BPO ('HRO'). A full profile of the company appears in the 'Finance and accounting BPO' chapter.

Atos Worldline

Atos Origin won its largest ever UK contract in March 2005, worth £500m ($947m) over seven years, when it captured a renewal of a BPO deal with the Department for Work and Pensions, first signed in 1998 by Sema.

Atos Origin is also expecting significant growth in its dedicated BPO division called Atos Worldline. Worldline was created when Atos Origin completed an internal merger of six operating units based across several countries. This included the payment processing capabilities that the company gained through the acquisition of the Sema business of SchlumbergerSema in September 2003. However, Atos Origin's BPO capabilities go back several years. Today, the Worldline division has 2,500 employees based in Austria, France, Germany, and the UK, and made full-year 2005 revenue of €350m ($450m) from pure BPO and related systems integration and consulting work.

Worldline has three main service and product offerings: payment processing (which accounts for approximately 60 per cent of Worldline's total sales); Multi Channel Contact (Internet and Voice services); and customer relationship management (CRM). These are delivered to a number of vertical markets, the largest being financial services followed by telecoms and public sector. The operation has eight dedicated BPO centers in Europe: two apiece in France and Germany, with further facilities in the UK, Spain, Italy, and Sweden.

The focus of Atos Origin's BPO strategy is to provide and run the systems that underpin payment processing, contact center services and CRM, and that it does not take on large numbers of administrative staff as part of contracts. Worldline does not run as many of its clients' systems on a fully outsourced basis as large US vendors in the more mature outsourcing market of the US (such as Fiserv). France is Worldline's largest market, but the outsourcing-averse companies in France tend not to outsource their payment platforms to Atos Origin, but to manage them internally.

In the area of contact center services, Worldline focuses on implementing and running the technology that underpins multichannel contact centers, such as speech recognition and synthesis Voice XML, unified messaging, transactional Web sites, and computer telephony integration (CTI) technology. The company has industry expertise in banking, government, e-commerce, publishing and communications. Worldline does not own or operate any contact centers of its own.

The current strategy of Worldline is to work towards providing a uniform range of services across all its vertical markets, based on standard infrastructure such as business continuity and disaster recovery backup. The company is also looking at targeting new payments processing business with clients in emerging Eastern European countries such as Hungary and the Czech Republic, as well as the Asia Pacific region.

beCogent

beCogent has gone through a significant development since its inception in 1999 and has grown from a small company, to one with 1,300 employees and an annual revenue of £21m. During this time, the company has developed innovative technologies such as integrated workforce planning, IP Hosted Solutions/Centres, VoIP and a datawarehouse concept providing integrated, historic and real time management information across all transactions and channels.

Capita Group

Capita provides frontline customer service, human resources services, account management and pensions, outplacement and career counselling, recruitment and financial services. Vertical focus includes local and central government, education and the private sector. The company is headquartered in London, and is the leading BPO provider in the UK.

Capita has confidently predicted annual growth rates of between 11—13 per cent over the next four years. This level of performance would see the company's revenue grow to around £2 bn ($3.5 bn) by 2008.

Despite its history of strong growth, however, Capita has suffered high-profile setbacks in recent years. The company has had strong criticism for its performance in major government outsourcing deals with the Department for Education and Skills and the Criminal Records Bureau. Despite this, Capita has continued to win major deals in both the central and local government spaces.

Like many large outsourcing companies, Capita is building up its low-cost resources in offshore locations in order to reduce the cost of project delivery. The company currently has some 400 employees in Mumbai, India, and opened a second center in the city last year to take its potential capacity to 1,250 seats.

Convergys

Convergys provides integrated customer care and billing services to companies involved with telecommunications, cable and broadband, technology, financial services and next-generation services, in more than 40 countries around the world. The company conducts its activities within two operating units - The Information Management Group and The Convergys Customer Management Group. Convergys is headquartered in Cincinnati, Ohio.

Net profits for full-year 2005 were $122.6m, up from $111.5m in the previous year. Revenue rose 3.8 per cent to $2.6bn. Convergys splits its business into three main areas – Customer Care, Employee Care and Information Management Group. The largest of these is Customer Care which covers contact center and helpdesk management. The division increased operating profit by 19 per cent to $46.2 m, and revenue grew 5 per cent to $434 m.

Convergys is also aiming to establish itself as one of the key players in the HR outsourcing sector alongside Hewitt Associates and Accenture. The company's employee care operation, Employee Care, which incorporates its nascent HR outsourcing activities, has grown strongly, including last November's signing of a landmark 13-year, $1.1bn contract with chemical manufacturer DuPont Co. The division reduced its operating loss to $9.6m from $17.3m in the year-ago period. Revenue increased 47 per cent to $52.5m.

In November 2004, Convergys strengthened its position in the call center outsourcing services market by acquiring Finali Corp. The deal came six months after Convergys expanded into the account collections side of BPO with the $68m acquisition of Encore Receivable Management.

EDS

EDS' BPO services division provides CRM and call center services, as well as financial processes such as credit and insurance, payment and settlement, card processing and billing, clearing transactions, and content management services. This division also focuses on HR outsourcing solutions through ExcellerateHRO, a joint venture with Towers Perrin.

The company's BPO division recorded revenues of $2.8bn in fiscal year 2005, an increase of 7.9 per cent over 2004, and accounting for 14.3 per cent of total annual revenue. EDS expects its BPO business to grow to $3.1bn in 2006 and $3.9bn in 2007, at an annual growth rate of 14.5 per cent. Expansion of its ExcellerateHRO and call center services is a key step to broadening its overall offerings.

In June 2006, EDS also acquired a majority stake in offshore services provider Mphasis BFL Ltd in a deal worth approximately $380m (see EDS (Mphasis) for more detail).

IBM Global Services

Like many of its major rivals, IBM Global Services is looking to stretch its reach beyond its clients' IT infrastructure and into their business functions, through BPO contracts. IBM announced its arrival as a serious player in the BPO sector in 2003 with a 10-year, $400m global agreement with Procter & Gamble to run its human resources functions. This deal was followed, in May 2004, with the acquisition of India's third largest BPO services vendor, Daksh, providing it with a large base of low-cost back-office skills (see IBM (Daksh) for profile), as well as the subsequent takeovers of KeyMRO and Liberty.

Although IBM Global Services continues to win and renew significant IT outsourcing and BPO deals with Western clients, it is worth noting that it is also securing major deals in other countries, such as Latin America.

IBM has been criticized in the past by smaller organizations who feel that its top support employees tend to be focused on the company's large accounts. Business process management functions include: sourcing and procurement, employee services and CRM as well as development, implementation, operation and continuous improvement of IT and business processes.

ICICI OneSource

A full profile of ICICI One Source appears in the 'Offshore BPO' chapter.

Minacs Worldwide

Canadian BPO specialist Minacs was acquired by TransWorks - the business process outsourcing (BPO) arm of the Aditya Birla Group of India - for $125m in June 2006. Minacs has a contact center service, but the company also offers marketing services and back office administration. It operates across six major industries: automotive, consumer products, financial services, public sector, telecommunications, and technology. Contact centers contribute 67 per cent of revenue to Minacs. See 'Offshore BPO' chapter for the Transworks profile.

Perot Systems

Perot Systems became the first US-based outsourcer to buy a BPO operation in India through the acquisition of Chennai - India-based Vision Healthsource - for $10m in March 2004. Today Perot Systems provides most of its BPO work from offshore where the majority of its workforce is based. Perot now employs some 6,000 people (35 per cent of total workforce) in its centers in India.

Perot Systems' BPO practice spans three core areas - call center and customer care outsourcing, helpdesk services and claims administration. But the company is convinced that retaining expertise in a select few disciplines is the recipe for success in the rapidly evolving market. For example, Perot Systems claims to be the largest technology provider in claims administration for the US healthcare industry.

Xansa

See full profile in 'Offshore BPO' chapter.

Recommendations

An organization's interaction with its customers is becoming increasingly important as consumer demand cycles shorten and the business environment becomes increasingly competitive.

As with other outsourcing strategies, by outsourcing customer interaction processes, companies can continue to focus on their core competencies, while maintaining effective customer relations. The interaction with customers varies greatly across different industries, as the type and number of customers varies. The challenge is how to get the balance right, and one option available is outsourcing to a service provider.

Outsourcing of customer support and interaction has been a hot topic over the last few years as the role of customer service has increased. Previously regional barriers meant that customers had a limited choice of companies to buy from. But with the advent of ebusiness, globalization and advanced logistics, that choice has grown dramatically and as such, organizations are looking to leverage customer interaction as a form of competitive differentiation.

Many organizations will likely opt for a limited functionality outsourcing agreement first to assess the impact that implementing such a strategy has on their business. Timescales for increasing functionality or scope will vary depending on the initial strategy, however the likelihood of such an increase is strong. As customer interaction is such an important part of the business, it will have a high priority when ranked next to other process technologies that also assist the business's performance.

Cost savings from CRM BPO can be significant, but the real benefit is one of improved productivity which, in turn, leads to greater customer satisfaction, lower churn rate and, ultimately, higher sales.

Given the strategic nature of customer care as a competitive differentiator, and as the type of services offered by vendors moves up the value chain, particularly in offshore locations such as India, it is increasingly important for organization's to play a role, alongside the services provider, in the management of outsourced CRM processes.

Choice of provider is, therefore, critical, as is the identification of the right CRM outsourcing opportunities. By using more value-add services provided by BPO today, and combining them with traditional productivity improvements, organizations can create differentiated and compelling CRM strategies through the use of customer care BPO.

CHAPTER 3

Finance and accounting BPO

Chapter 3 Finance and accounting BPO

Summary

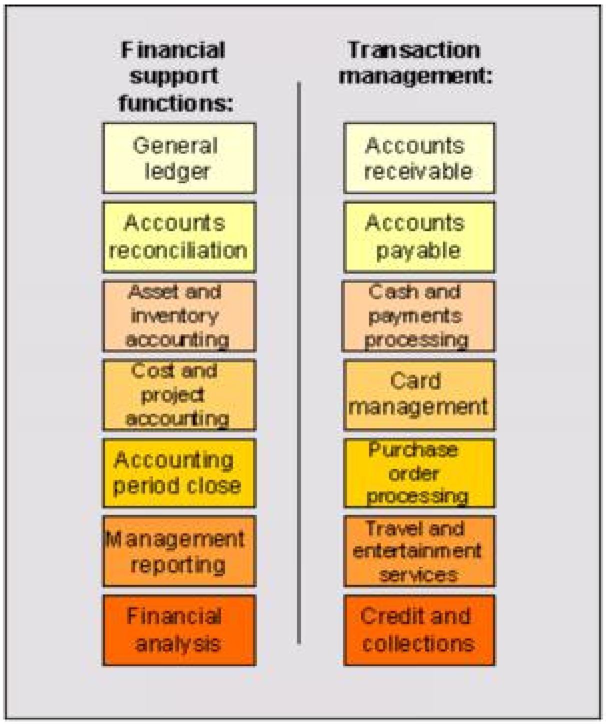
- As well as providing all the usual benefits of outsourcing – such as improved efficiency, reduced costs, access to specialist technology and expertise, and the ability to focus on core functions and business strategy – FAO can also help organisations to reduce the complexity of the finance and accounting (F&A) department and help them to meet increasingly complex regulation and compliance requirements.
- The most popular tasks to outsource are usually repetitive functions and those prone to economies of scale when performed by one company.
- One of the main inhibitors to FAO is the perception of risk from organisations and CFOs, and a general reluctance to outsource 'sensitive' financial functions. However, practitioners insist that the risks are far less daunting than some organisations might imagine.
- The majority of the FAO market with regards to contracts signed during 2004 and 2005 belonged to Accenture. 32 percent of all agreements in 2004 and 31 percent in 2005 were signed by Accenture. Capgemini also won a significant share of contracts signed – 14 and 11 percent in 2004 and 2005 respectively.
- Unlike the HRO market, F&A BPO does not revolve around technology issues, but is mainly a labor arbitrage play, which means the barriers to entry are lower and Indian offshore providers have been able to gain a strong foothold in the market.
- The market for F&A BPO is immature compared to other horizontal BPO sectors, but it is set to grow from $13.9bn in 2005, to over $18.5bn in 2008, at a CAGR of 10 per cent.

Introduction

Finance and accounting BPO – or 'FAO' – offers the opportunity for organisations to hand over the management of the transaction processing and procedure-driven functions of finance and accounting business units. As well as providing all the usual benefits of outsourcing – such as improved efficiency, reduced costs, access to specialist technology and expertise, and the ability to focus on core functions and business strategy – FAO can also help organisations to reduce the complexity of the finance and accounting (F&A) department and help them to meet increasingly complex regulation and compliance requirements.

Finance and accounting outsourcing includes services such as internal auditing, time and expense management, travel expenses, credit and debt analysis, collections, invoicing, accounts payable, accounts receivable and billing-dispute resolution.

Figure 3.3: Finance and accounting outsourcing



Source: Business Insights

Business Insights Ltd

The most common functions to outsource are employee benefits administration, travel services, payroll processing, tax processing, accounts payable and even collections. In addition, FAO is growing in the following areas: accounting and reporting, receivables and payables, and expense processing.

In particular, the FAO market is being driven by the lower labor costs provided by offshore locations. It is estimated that a company moving its F&A processes offshore can achieve cost savings of 15 - 30 per cent on its own (i.e. a company moves its F&A processes to an offshore location, but retains them in-house), and double that if it uses a third-party BPO service provider.

As a result, many Indian BPO providers are strong in the market, while Western-based providers are building up their offshore presence in order to compete with the local service providers.

One of the main inhibitors to FAO is the perception of risk from organisations, and a general reluctance to outsource 'sensitive' financial functions. However, practitioners insist that the risks are far less daunting than some organisations might imagine. Some of the perceived risks include:

- Loss of control over business functions.
- Data falling into competitors' hands.
- Costs exceeding expectations.
- Erosion of in-house knowledge.

In addition to the risks there are a number of barriers to outsourcing:

- Security and confidentiality of information.
- Inability to separate highly integrated work.
- The cost of outsourcing.

- Lack of successful examples amongst similar companies.
- The CFO’s resistance to change

But these perceptions are changing as more CFOs become convinced that the risks can be managed and that the substantial benefits far outweigh them.

As a result, the growth of FAO is being driven by CFOs as they finally get to grips with Sarbanes-Oxley regulations and the reorganization of financial processes that has been required. Vendors believe CFOs will be much happier to use their services once they have fully documented processes because it makes the management of such an outsourcing agreement much clearer.

At present, FAO offerings are almost completely dependent on labor arbitrage, and for some companies, this alone will not be enough to overcome their reluctance to outsource financial functions. However, as the market and services offered becomes more mature, the broader productivity and strategic gains that FAO can bring, will overcome this reluctance with FAO set to take off in 2006 and 2007.

Market overview

The majority of the FAO market with regards to contracts signed during 2004 and 2005 belonged to Accenture. 32 percent of all agreements in 2004 and 31 percent in 2005 were signed by Accenture. Capgemini also won a significant share of contracts signed – 14 and 11 percent in 2004 and 2005 respectively.

Other outsourcing service providers that inked major FAO contracts in 2004 and 2005 include: ACS, EDS, Genpact, Hewlett-Packard, IBM, Infosys, Tata, WNS Global Services, and Xansa, among others.

While Accenture, Capgemini and IBM GS continue to dominate the FAO market, they are increasingly being challenged by Indian offshore providers, such as Genpact (formerly Gecis Global) and WNS Global Services, which are able to provide the cost advantages of an offshore location.

Unlike the HRO market, F&A BPO does not revolve around technology issues, but is mainly a labor arbitrage play, which means the barriers to entry are lower and Indian offshore providers have been able to gain a strong foothold in the market with their highly skilled, low-cost workforce.

The vast majority of contracts include transaction-based work such as accounts payable and accounts receivable, but higher value services such as management reporting and budgeting are also in high demand.

Market sizing

The market for F&A BPO is set to grow from just under $13.9bn in 2005, to $18.5bn in 2008, at a CAGR of 10 per cent (see Table 3.7).

Table 3.7: Finance & accounting BPO market sizing ($m), 2004-2008

	2004	2005	2006	2007	2008	CAGR (%)
FAO	12,539	13,861	15,302	16,827	18,483	10
Total BPO services	103,054	112,098	121,733	132,342	144,133	9

Source: Business Insights

Business Insights Ltd

Major contracts

In terms of major contracts, financial services, manufacturing and local government have the led the way over the last 12 months (see Table 3.8), with the most active service providers partly reflecting a list of the major players in the sector. In general, the size of single contract is lower than, for example, CRM BPO or HRO, reflecting organisations' caution around outsourcing entire F&A processes, preferring to retain in-house the more sophisticated or sensitive functions of the F&A department.

Table 3.8: Major FAO contracts in the last 12 months (to 30 June 2006)

Vendor	Client	Value ($m)	Announced	Vertical
Tata Consult Svcs	Pearl Assurance	837	Oct 2005	Insurance
IBM GS	Unilever	250	Dec 2005	Manufacturing
Capgemini	Zurich FS	250	Jan 2006	Banking
Accenture	Microsoft Group	200	Feb 2006	Technology
IBM GS	Colgate-Palmolive	100	Mar 2006	Manufacturing
Capita Group	Bexley Council	88	Nov 2005	Local gov’t
Genpact	Linde AG	60	Jan 2006	Manufacturing
IBM GS	Omron Corp	50	Dec 2005	Manufacturing
Genpact	Glaxo SmithKline	50	May 2006	Manufacturing
Xansa	Hants & IoW Health Auth	35	Aug 2005	Healthcare

Source: Business Insights

Business Insights Ltd

Competitive analysis

Accenture

In March, Accenture announced its acquisition of the BPO assets of Savista, a privately held company that serves medium-sized companies. Terms of the deal were undisclosed, but it created two distinct BPO divisions for Accenture. As a result, Accenture will continue to offer its bundled BPO services, (including HR, finance and accounting (F&A), and procurement), to its global 500 clients (with over 12,000 employees). But Savista, which will operate as a wholly owned subsidiary of Accenture, will give the company a range of HR and F&A offerings for the mid-market (companies with between 2,000 and 12,000 employees).

The company believes there is also a demand for bundled BPO in the mid-market, and that the acquisition will help Accenture ‘capture the lion’s share’ of deals in this area. Accenture also hopes that Savista’s experience in HR and F&A will separate it from the rest of the mid-market BPO players in HRO, and niche players in the FAO space. Analysts estimate total annual mid-market BPO sending at some $17bn and expect it to hit $25bn by 2009.

The two BPO businesses will operate as separate divisions in an attempt to avoid the often unsuccessful experience of mid-market providers trying to cross over into bigger clients, or of large-scale BPO firms trying to capture the mid-market with their same services.

One of the key differences between mid-market and large enterprise BPO is that Global 500 customers often, although not always, have the platform for the outsourced business process in place, while mid-market firms tend not to have an existing platform and require one from a supplier such as Savista.

Additionally, the sales cycle is longer – often nine months for global 500 deals, often spending more money on winning the deal and the initial investment and resource allotment in order to get it up and running. For mid-market companies, Accenture believes that BPO providers must have a much more efficient and cost-conscious sales engine, quicker turnaround, and a more geographically widespread sales force.

Affiliated Computer Services

The commercial BPO practice of Affiliated Computer Services (ACS) is focused in five major categories: administration, human resources, finance and accounting, customer care and payment services. ACS gained a strong early mover advantage in the nascent FAO space with reference clients such as General Electric, United Technologies, Sprint Corp and Office Depot. But it faces growing competition in this area from IBM Global Services and Capgemini.

In terms of FAO, ACS provides revenue/invoicing accounting, disbursement processing, expense reporting, procurement, payroll, cash management, fixed asset accounting, tax processing, general ledger and other services associated with finance and accounting that are process and technology sensitive. In customer care, the company provides dispatch and activation services, call center services and technical support. Within payment services, it provides check and credit/debit card processing, loan origination and servicing, electronic benefits transfer, electronic funds transfer and clearinghouse services.

The company's 2005 acquisition of Mellon Financial's HR business is expected to contribute single-digit growth to its BPO business in 2007, in line with growth rates across that industry. Mellon is one of the world's leading financial service providers to corporations, institutions and individuals. The company has approximately $4 trillion of assets under management. Mellon Financial generated total revenues of $4,522m in 2004, up 6.7 per cent on the previous year.

ACS wants to increase its IT infrastructure outsourcing abilities in Europe as it believes that it needs foundations upon which to build additional business from its US clients and its global BPO business. The company is also looking at ways of increasing its presence in the European contact center market, possibly through an acquisition, though it seems more likely to take the partnership route.

ACS is targeting the top 100 multinational companies operating in Europe, which require multi-process work across national boundaries, and it can offer offshore locations across the globe. To date it has almost a third of its 53,000 employees in low-cost offshore centers. Unusually for such a big BPO player, India is not its key location – it is Mexico, where it has 4,100 employees.

Agilisys

Agilisys Business Process Services offer a full range of back-office solutions from payroll and credit control to hotel bookings and utility management.

Core services include:

- *Accounts Payable* – Processes over 250,000 invoices from its centers in York and Mumbai, and provides assistance with compliance issues and taking transactions through to payment. Agilisys also offers contact centre capability to manage supplier queries.

- *Payroll* – Runs payroll services covering 11,000 individuals in the public and private sectors.

- *Accounts receivable* – Offers accounts receivable and credit control service.

- *General ledger* – Offers a ledger integrity service, as well as providing control and a more comprehensive service.

Capgemini

Capgemini has been one of the most successful of the major IT services vendors in building up a business process outsourcing (BPO) operation. Approximately 4,000 of Capgemini's 59,000 employees work specifically in BPO, with the company focusing on three core service areas:

- *Finance and Accounting* – Capgemini's services in this area include: general ledger accounting; accounts payable; accounts receivable; fixed assets; travel and expense; payroll; cost and inventory accounting; budget planning and support; and management reporting.

- *Supply Chain Management* – Services include: strategic management and oversight services for the supply chain; strategic sourcing and procurement; freight management; fulfillment; transactional buying; and supplier relationship management.

- *Customer Relationship Management* – Capgemini offers: inbound/outbound call center management; customer intelligence management (including data mining/data warehousing); billing; collections; and technology management (covering IVR and Web-enablement).

F&A and procurement is the company's main focus. In January 2006, it won a major BPO deal with insurance giant Zurich Financial Services. The multi-year deal covers Zurich's finance and accounting processes in the US, UK, Switzerland, and Germany, which Capgemini will provide from its BPO center in Krakow, Poland.

CGI Group

CGI's BPO services cover human resources, billing and administration, customer relationship management and customer care, transaction processing for banks, document management, and finance and accounts (F&A) outsourcing.

CGI moved into the area of F&A outsourcing through a deal with manufacturing company GrafTech International in September 2002. Under the terms of that contract, CGI deployed best practices to optimize transactional activities including accounts payable and accounts receivable, as well as perform certain analytical functions such as financial business champions, general accounting, cost accounting and analysis activities.

CGI’s BPO activities can be broken down into four main areas:

- *Financial Transaction Processing* – CGI offers claims processing, and payments processing services to a range of vertical markets. It processes payment, settlement and point-of-sale transactions. The company claims to manage two million insurance policies representing over CA$3bn ($2.22bn) in premiums annually, as well as managing CA$157bn ($116.2bn) in payments daily for Canada's central bank.

- *Customer Care Services* – CGI’s services include call center management, in-bound and out-bound calls, CRM integration (including data mining, data warehousing), billing;

- *Administrative Services* – CGI provides a range of administrative services focused on the insurance, banking and government sector markets. These services encompass claims and policy administration and check processing work; and,

- *Enterprise Services* – CGI’s umbrella term for services that span HR, document management, supply chain, and finance and accounting related functions. Services offered include payroll, HR/benefits management, accounts payable/receivable, purchasing and procurement, printing, mail operations, and records management.

Convergys

In June 2005, Convergys announced the acquisition of the finance and accounting BPO business of Deloitte Consulting Outsourcing LLC. Prior to the takeover, the company’s F&A BPO skills were limited to basic accounts receivable management. The takeover will allow Convergys to offer a wider selection of services, and illustrates the company's decision to establish an F&A skill-set to set alongside its HRO offering. It is also likely that Convergys will seek further acquisitions in the HRO space. The company was strongly linked with Mellon HR before ACS bought the company for $405m. The company is also profiled in the 'Human resources BPO' and 'Offshore BPO' chapters.

EDS

See other chapters for in-depth profiles of EDS' various horizontal BPO divisions.

Genpact

See 'Offshore BPO' chapter for full profile.

HP Services

HP Services currently ranks as the fifth largest IT services vendor worldwide with fiscal 2005 revenue standing at $15.5bn, and although HP is making progress in BPO, compared to its major IT services rivals, HP is still relatively immature in the BPO space. However, the company now claims to be winning market share, and to have signed a number of "significant deals", mainly in the finance and accounting space.

HP's FAO capabilities can be traced back to 1996 when it began the reversal of a policy in the early nineties of decentralizing its general accounting processes into country-based shared services. The company then spent the rest of the decade consolidating its country centers into four regional centers in Atlanta, Brussels, Colorado Springs and Singapore, cutting costs by 20 per cent. In 2000, it further consolidated those regional centers to an offshore model with two main hubs in India (Bangalore and Chennai), with support centers in Barcelona, Singapore and Guadalajara, a move which it claims has allowed it to cut costs by a further 30%.

HP's acquisition of Triaton in 2003 was also significant in expanding its BPO capabilities. The former captive unit of German industrial giant ThyssenKrupp, which is HP's largest pure services purchase to date, offers payroll outsourcing services.

In 2005 HP also signed a contract with Gillette to perform its full F&A processes worldwide. In total HP claims to have seven "significant" BPO deals at the moment, of which includes one procurement deal, five FAO deals, and one multi tower deal across HRO, FAO and procurement. HP's main competitors are IBM and Accenture.

IBM GS

IBM announced its arrival as a serious player in the BPO sector in 2003 when it clinched a 10-year, $400m global agreement with Procter & Gamble to run its human resources functions. This was followed in May 2004 with the acquisition of India's third largest BPO services vendor Daksh (see profile in 'Offshore BPO' chapter), providing it with a large base of low-cost back-office skills, and the subsequent takeovers of KeyMRO and Liberty.

However, IBM's move into FAO BPO has not met with wholesale acceptance, and it failed in a bid to win an outsourcing contract with fast food retail giant McDonald's in 2003. The bid was to run McDonald's finance and accounting functions, but the client cited IBM's intention to send 70 per cent of the work offshore as too risky.

IBM needs to quickly establish its BPO credentials because several of its major services rivals are making significant inroads into the FAO market. It went some way towards doing that in December 2005, with two major contracts: Unilever ($250m) and Omron ($50m) – these were followed by a $100m deal in March 2006 with Colgate-Palmolive.

Infosys

See full profile in 'Offshore BPO' chapter.

Tier Technologies

Tier Technologies is a provider of transaction, payment processing, packaged software, and systems implementation services for federal, state, and local government clients. Tier operates its business through three strategic business units: Official Payments Corp. (OPC), Government BPO and Government Systems Integration.

The Government BPO unit offers child support payment processing, financial institution data match, health and human services consulting and has a contract with a large metropolitan child support enforcement department. The unit allows clients to outsource their information technology functions and responsibility for large project oversight on internal systems projects.

Vertex

Vertex, the BPO arm of United Utilities, offers a range of services, including:

- *Customer management* – Offers contact center services alongside back office processing capabilities.

- *Finance and accounting* – Provides F&A services including invoice and payment processing, risk management, debt collection, asset accounting, cash management, payroll and pensions and benefit administration. In total, the company completes 95 million payment transactions per year and collects £200m ($347.9m) in cash receipts.

- *Human resources outsourcing* – HRO services include recruitment administration, professional advisory services, pensions and benefit administration, payroll, performance appraisal and severance services.

Unisys

Unisys' outsourcing business is expected to be the company's main growth area in the next couple of years. Unisys splits its BPO business into three core areas:

- *Payment Processing* – Services focus on transferring traditional paper-based payments into electronic formats. The company claims that no less than 80 per cent of the world's banks rely on Unisys' payment processing tools and services to some degree. Services include document capture, imaging, electronic bill presentment and payment processing.

- *Insurance Processing* – Unisys offers policy administration for some 400 insurers covering property, casualty, life insurance, and pensions annuities. Services include migrating operations to handle multicurrency capabilities, changing regulatory requirements, as well as providing the insurance administration and claims processing functions.

- *Finance and Accounting* – Provides a range of services including accounts payable and receivable, banking and cash management, financial analysis and management reporting, fixed asset accounting, general accounting, general ledger, payroll, purchasing, time and attendance and travel and entertainment processing. Clients include Federal Deposit Insurance Corp, Ingersoll-Rand, and Johnson & Johnson.

Unisys remains focused primarily on the first two back-office functions - payments and insurance processing services. The company does not bid on call center and finance and accounts processing as standalone projects.

WNS Global Services

See profile in 'Offshore BPO'.

Xansa

See profile in 'Offshore BPO'.

Recommendations and FAO best practice

The next three years will witness significant developments in the evolution of FAO solutions, marked by the industry expanding in a rapid-growth cycle and a 30 per cent increase in multi-process FAO contracts expected this year.

Customer requirements are quickly expanding beyond traditional cost reduction, and multiple accounting processes are being integrated under a single supplier to achieve top-line growth and cost efficiencies.

As is the case with many horizontal BPO sectors, FAO was kick-started by the cost-savings offered by moving lower value tasks to cheaper offshore locations, but as the cost-reduction benefits become standard across the services providers, the focus has shifted to suppliers that can also integrate core accounting processes with these more general administrative processes.

Vendor selection (minimizing risk)

Due to the sensitive nature of F&A processes and the reluctance by many CFOs and organizations to outsource them, vendor choice is critical. At the same time, FAO engagements should be a co-created relationship with shared responsibility between the services provider and customer. Each party must provide a clear view of the inherent risks and challenges in order to minimize risk, focus on the same goals, and too nurture the relationship. Thus, the cultural and strategic compatibility between the client and provider is critical to creating a successful FAO relationship.

Some of the key questions to be considered in an outsourcing proposition for finance and accounting transactions include:

- Which finance and accounting functions to outsource? Why?
- How well does the provider understand the business?
- What experience of the same vertical industry does the provider have?
- What type of training does the supplier provide for its own staff?
- Does the provider possess expertise in specialized accounting subjects?
- How does the provider’s culture fit with the customer?
- Is the provider’s approach flexible?
- What do existing clients say about the provider?

CHAPTER 4

Human resources BPO

Chapter 4 Human resources BPO

Summary

- Human resources outsourcing (HRO) is one of the largest and most mature sectors of the BPO market.
- Nearly all HR BPO deals involve transitioning to a self-service model whereby automation reduces headcount and many employee services are delivered through an intranet.
- Companies have three primary drivers in making an HRO decision: to reduce the ongoing cost of HR, to free up time and resources for the company to focus on its core business objectives and to improve HR service to its end users.
- In recent years, there has been a deluge of entrants to the market. Accenture, ACS, Convergys, EDS and IBM have all won major deals in the last few years, and a number of the HR specialists have broadened out their services to offer end-to-end HRO. Hewitt Associates is the HRO market leader.
- Current pricing levels of HR BPO contracts are estimated at around $600 per person per year (pppy), down from $1,100 pppy in 2000 - 2002
- RPO (Recruitment Process Outsourcing) has gained a lot of publicity over the last year. In recent quarters, many of the major HR BPO players have highlighted recruitment (as well as training) as an area of high demand in which they need to increase their skill sets.
- The HRO market is predicted to grow from just under $23 bn in 2004 to over $30 bn in 2008, at a CAGR of 7 per cent.
- A changeover to an HRO business model has the ability to affect the entire organization, a fact that is often underestimated.

Introduction to HRO

The rise in importance of the HR department has been relentless over the last few decades. There was a time when it was better known as the personnel department, and its main task was to ensure workers were paid; but now its role has developed to give it far more strategic importance. HR is no longer a passive administration unit: its remit is to actively seek ways to increase the productivity of the workforce.

As such, companies require senior HR executives to spend more time on strategy, and less on non-core administrative duties, which has been a key driver for the rise of HR BPO. While getting a third party to take on the payroll function is not new – Automated Data Processing (ADP) started providing such a service in the 1940s – it was not until 1999 that the first major HR BPO deal was signed. A start-up called Exult, based in Irvine California, can claim to be the pioneer of the industry after it managed to persuade oil giant BP Amoco to hand over control of the majority of its HR processes in a seven-year deal worth $600m.

Since then, the HR BPO market has grown to $4.6 bn according to some estimates, with predicted growth forecasts over the next few years ranging from high single-digits to 30 per cent, depending on the source.

The increasingly strategic ambitions of the HR department have helped the market, but as ever, money is the real incentive for customer demand. Nearly all HR BPO deals involve transitioning to a self-service model where automation eliminates jobs and many employee services are delivered through an intranet.

Companies have three primary drivers in making an HRO decision: to reduce the ongoing cost of HR, to free up time and resources for the company to focus on its core business objectives and to improve HR service to its end users.

The size of company largely influences outsourcing decisions. According to a survey by *HR Management* magazine, 66 per cent of companies with an annual revenue over $1bn or greater, currently use HRO providers. In comparison, 40 per cent of mid-sized companies ($50—999m) and 39 per cent of small companies (less than $50m) currently outsource some or all of their HR functions.

To consider moving to a total HRO model of service delivery, three points must be demonstrated: the services are better than those that the organisation currently provides, balance of cost and level of service is better, and the cost of providing benefits and other services is radically less.

Market overview

Since Exult's initial flush of success, there has been a deluge of entrants to the market. Accenture, ACS, Convergys, EDS and IBM have all won major deals in the last few years, and a number of the HR specialists have broadened their services to offer end-to-end HRO.

Exult sold out to Hewitt Associates in May 2004 for $630m, and the latter has gone from strength to strength. Hewitt Associates is now considered to be the sector leader in HRO and as the company has consolidated its position, the major IT services players have struggled to keep up in terms of contract signings. However, many have made strategic moves in order to increase market share, by pairing up with specialist HR service providers.

Although EDS has scored a few HR BPO contracts, the company soon realised that it needed to make a bold move if it was to be a significant player in the industry. In January 2005 it created a joint venture, called ExcellerateHRO, with professional services company Towers Perrin. EDS paid Towers Perrin $420m and acquired 85 per cent of the venture, which is a combination of the two companies' HRO capabilities with a total of $600m in annual revenue.

ACS also made a major acquisition in 2005, paying $405m for the HR consulting and outsourcing operation of asset management giant Mellon Financial. Mellon had struggled to grow its HR business over the last few years, and was seen in the market place as being uncompetitive. But with the acquisition by ACS, Mellon significantly improved its position in HR consulting and its outsourcing businesses and felt that it would benefit from ACS as an organization devoted solely to the BPO and the IT services industry.

IBM and Accenture are the two biggest HR BPO players yet to make a major acquisition within the HRO market. Accenture has significant market share, being number two behind Hewitt, and has recently acquired Savista which specialises in HRO for mid-market companies. However, the company is better known for an organic rather than acquisitive approach. IBM, on the other hand, is further behind and is eyeing the market place for targets in order to build scale. It has been linked to many of its HR BPO rivals, but has yet to make a move.

Beyond the major players there are a number of providers targeting the mid-market, which has become a significant opportunity over the last 18 months due to the rise of the 'one-to-many' model. Rather than shipping their ERP (Enterprise Resource Planning) systems out to the IT services companies, the mid-market involves the migration of processes over to the systems of the vendor.

While this does not allow for the amount of customisation often needed by large enterprises, the ability of the vendor to deliver multiple clients from the same platform enables it to offer significant cost benefits. The one-to-many model is gaining traction in the industry and the major IT services firms have been quick to react. IBM has built eHR, a web-based front end that it can build on to its client's existing systems.

The market is still maturing and few vendors can claim to have delivered a full set of HR processes that do not rely on sub contractors, or are able to deliver a fully global solution covering separate country payrolls and different sets of employment law.

However, HR BPO is a massive opportunity for IT services vendors. The cost and strategic benefits are clear to customers, and the market is growing fast. HR BPO is a scale game - the more contracts you win, the more aggressively you can price future deals - so those unable to build on their initial successes will find it hard to turn a profit. Despite consolidation in the market, it is still overcrowded and further M&A activity is expected in the coming year.

Table 4.9: Major contracts in the development of HRO, 1999-2005

Vendor	Client	Value ($m)	Announced	Length (mnths)
IBM GS*	NiSource	1,600	June 2005	120
Exult**	Prudential Financial	700	Jan 2002	120
ACS	Motorola	650	Dec 2002	144
Hewitt Associates	Pepsi	600	Apr 2005	120
Exult**	British Petroleum	600	Dec 1999	84
Exult**	BMO Financial Group	593	Apr 2003	120
Accenture	BT Group	576	Feb 2005	120
Convergys	Texas Health Commission	400	Jun 2004	60
Hewitt Associates	Marriott International	350	Feb 2005	84
IBM GS	Williams	320	Jun 2004	90

*Multi-tower deal, including outsourcing, BPO and other functions
**Exult is now owned by Hewitt Associates

Source: Business Insights

Business Insights Ltd

Hot topics

Capacity and pricing

A lack of capacity at HR BPO providers has hampered market growth in the last 12 months. Rather than providers having to convince enterprises of the benefits of outsourcing HR, a capacity shortage on the provider side has meant that companies are effectively queuing up to sign contracts. While providers are expected to sort out the problem, an increase in demand has exacerbated it, and resulted in the stabilizing of prices for the first time in years.

Current pricing levels of HR BPO contracts are estimated at around $600 per person per year (pppy), down from $1,100 pppy between 2000 - 2002.

Rise of multi-service deals, and offshore delivery

Until recently, the HR BPO industry has been predominantly characterised by single country deals – usually US and UK – with services typically delivered within that country. However, recent deals are becoming more multi-country, multi-process in nature. Offshore is also becoming a component in just about every deal, as the demand increases.

Mid-market moves

Accenture's acquisition of Savista highlights a trend where providers are intent on developing a separate mid-market offering rather than simply try to sell them the enterprise offering. Can vendors find a scalable way of selling end-to-end HR BPO services? At the moment, the mid-market uses payroll and benefit administration services vendors, and these have been trying to extend into other wider HR areas. Whether HR BPO vendors can move in, without offering the sort of customization that enterprise clients get, remains to be seen.

M&A not as expected

Last year's big topic was consolidation – Excellerate HRO had just been launched after EDS and Towers Perrin got together, ACS acquired Mellon, and Hewitt signed a series of deals after the successful integration of Exult. But market activity within enterprise HRO has been quiet in the last 12 months and instead there has been a high level of niche acquisitions as firms expand their service offerings. This could change at any time – however, new entrants to the market may be put off by concerns about profitability.

Rise of recruitment BPO (RPO)

The number of recruitment BPO (known as 'RPO') providers has increased dramatically in the last 12 months. Numerous RPO companies such as Kenexa, Hyrian and Pinstripe have sprung up in the last few years offering to take on all aspects of recruitment in multi-year contracts.

RPO providers offer full outsourcing of the recruitment function, including workforce planning, sourcing candidates, interviewing, screening employees and even entering new starters onto the company payroll system. RPO vendors are targeting the enterprise space, at the same time as recruitment is moving in-scope more often in major HR BPO contracts.

RPO has gained a lot of publicity over the last year. In recent quarters, many of the major HR BPO players have highlighted recruitment (as well as training) as an area of high demand in which they need to increase their skill sets.

While using recruitment agencies is not a new phenomena, the new bunch of players who call themselves RPO vendors, have emerged claiming to offer a much broader service. They take on the operation and day-to-day management of the recruitment process, from workforce planning, through sourcing candidates, interviewing, reference checking to the ‘onboarding’ process such as sending out offer letters, and payroll setup.

One of the largest RPO providers is Los Angeles-based Hyrian LLC. While it serves the small and medium business markets, it also has an enterprise offering which involves full outsourcing of the recruitment function. Typically offering contracts based on five years or more, it focuses on taking over recruitment, usually offering the client a short list of three screened, pre-interviewed candidates.

The emergence of RPO players raises some questions as to whether such recruitment specialists can co-exist in the enterprise market with HR BPO providers such as Accenture HR Services, ACS and Hewitt Associates.

While RPOs claim to have the specialist skills that the generalists cannot hope to match, companies are looking for a single point of contact for their HR suppliers. It should be pointed out that in ITO, the reverse is happening, where the trend has been to split up major contracts into components and take the ‘best of breed’ approach. However, companies may well have a different attitude to HR suppliers, as the market is not as mature.

Contract pricing is not done per hire. By liaising with the customer to produce projected requirements, the HRO company will quote a price to run the function on a monthly or quarterly tariff which is adjusted by a “cost per requisition”. This protects providers against positions that don’t get filled, and protects the employer from getting low quality staff as the pressure to fill positions to increase vendor profits is negated. Few providers take on any internal staff from customers.

One problem that RPOs face is that of exclusivity. Because the RPO depends on being able to offer a high quality talent pool of candidates, the RPO's clients often are unwilling to allow their RPO provider to share this pool with its rivals, stipulating that the RPO cannot do business with a rival, thereby hampering its ability to leverage its expertise and experience in a vertical sector.

Market dynamics

In 2005, there were 53 deals with an HR BPO element, worth a total of $7.38bn. This compares to 39 deals in 2004, worth $4.87 bn. The market is notable for consisting of a small number of leading vendors – notably Hewitt Associates, Convergys, Accenture, ACS, HP and IBM GS – which compete (and in some cases, partner with) a large number of smaller specialist vendors.

The defining aspect of HR BPO in 2005 was the amount of key signings made by Hewitt Associates, which proved that its acquisition of Exult in 2004 was a resounding success. It signed deals with Duke Energy, Marriott International, Mervyns, Omnicom, Pepsi Co, Rockwell Automation, Rohm and Haas, Thompson, and Wachovia.

Hewitt's consistent signings in the first half 2005 confirmed the success of its 2004 acquisition of Exult, and its market leadership position. Convergys followed up a deal with an unnamed technology company in May 2006 with major wins with DuPont and Whirlpool, thus becoming a significant player within the market.

HRO signings did slow down towards the end of 2005, fuelling concerns of supply-side problems including lack of capacity, leading to the main players' cherry-picking opportunities. These are seen as short-term problems though and growth is expected to return to its rapid pace for the rest of 2006.

It is also expected that the consolidation that reached a peak in early 2005 to heat up again. The big question is whether any company will be able to surpass Hewitt or Convergys. Both companies were reported to be targeted by IBM at some point last year, and Hewlett Packard (HP) may also be looking to make a move into HRO after its recent successes in F&A BPO. Culturally, HP and Hewitt are considered to be an almost perfect fit. However, HP's BPO ambitions could be served by the purchase of Computer Sciences Corp (CSC) if recent reports are to be believed.

While the likes of IBM GS, Accenture, and HP may be encouraged to make acquisitions in HRO by the success of the Hewitt-Exult merger, they may be a little concerned about the lack of contract announcements from EDS-owned ExcellerateHRO and ACS. Both invested heavily in the market in early 2005, and while they can claim that longer sales cycles mean they are still on track to deliver major contract wins, it is critical that they deliver in 2006.

This cherry picking may also account for the relative quietness of Accenture so far in 2006. Although it successfully renewed its flagship deal with BT Group in February, and it is in exclusive negotiations to sign a $1bn deal with Unilever, many major deals have eluded the company.

IBM also failed to make much impact on the market - a $1.6bn multi-tower deal with NiSource aside, and despite constant rumors of acquisitions, it has yet to make a move.

HP is waiting on the wings of the HR BPO market – so far it has concentrated on its finance and accounting operations which have been very successful, winning some major deals with consumer products companies but declining to say much about them publicly.

HP and IBM may well consider making major acquisitions in HRO in 2006. IBM has openly said that it will consider buying for scale in HR BPO, and if HP has any real ambitions in the market it cannot do it organically. Both could be tempted by Hewitt or Convergys. Rumors persist that Hewitt's investors think that the time is right to cash in on its stock price which currently gives it a market cap of around $1.7 bn.

Market sizing

The HRO market is predicted to grow from just under $23bn in 2004 to over $30bn in 2008, at a CAGR of 7 per cent (see Table 4.10). In terms of BPO, the market is second only to CRM.

Table 4.10: HRO market sizing ($m), 2004-2008

	2004	2005	2006	2007	2008	CAGR %
HRO	22,977	24,645	26,471	28,426	30,555	7
Total BPO services	103,054	112,098	121,733	132,342	144,133	9

Source: Business Insights

Business Insights Ltd

Major contracts

In terms of major contracts, manufacturing, healthcare and local government are dominant. However, contracts represent the full spectrum of vertical industries. The relatively large size of deals reflects organizations' comfort with outsourcing most HR functions to third parties.

Table 4.11: Major HRO contracts, 2005-2006 (to 30 June 2006)

Vendor	Client	Value ($m)	Announced	Vertical
Convergys	DuPont	1,100	Nov 2005	Manufacturing
Accenture	Unilever	1,000	Jun 2006	Manufacturing
ACS	Lockheed Martin	500	Apr 2006	Manufacturing
Agilisys	Rochdale MBC	330	Jul 2005	Local gov't
Fujitsu Services	NI Dept of Finance	321	Mar 2006	Local gov't
Hewitt Associates	Off. of Personnel Mgmt	290	May 2006	Local gov't
EDS	Cardinal Health	250	Apr 2006	Healthcare
Convergys	Whirlpool Corp	240	Jul 2005	Manufacturing
Hewitt Associates Services	Wachovia	220	Aug 2005	Financial
Hewitt Associates	Omnicom Group	175	Jul 2005	Media

Source: Business Insights

Business Insights Ltd

Competitive dynamics

Accenture HR Services

Accenture is attempting to replicate recent successes in IT outsourcing in the BPO sector, where HR is now the key to the company's strategy to gain access to the maintenance of its clients' back-office processes.

Accenture Services is one of eight BPO divisions within Accenture that cover HR, procurement, finance and accounts, CRM, supply chain management, learning, and vertical industry specific services (such as airline ticketing service Navitaire, and election services operation eDemocracy Services).

HR Services is one of the largest divisions, which has experienced double-digit growth, as customers continue to look to outsource their HR functions for cost reduction. Accenture HR Services was formed out of the $70m sale to Accenture by BT of its 50 per cent stake in ePeopleserve, the HR outsourcing joint venture it set up with the company in September 2000. Accenture took ePeopleserve in house to create Accenture HR Services as a new third-party unit.

Accenture’s HR shared service centers have grown to the point where the company rarely needs to take on HR assets or personnel from its clients in order to deliver the service. Company sources say that HR departments that are being outsourced tend to be very inefficient, and for this reason Accenture often dramatically reduces headcount in the operations. With its focus on offshore delivery, Accenture claims that it can offer Western clients cost savings of between 30—70 per cent.

Though Accenture focuses on enterprise level clients, it has also revealed a new mid-market strategy with the acquisition of Savista in March this year. Rather than attempt to sell its enterprise HR BPO offering downstream to the mid-market, the acquisition has helped it realise a separate offering aimed at companies with employees of between 2,000 and 12,000.

Accenture breaks its HRO services into eight separate divisions:

- *Customer contact services* – Services include customer billing, customer contact transformation, customer insight, customer interaction and marketing services.

- *Exit services* – To assist the client in transferring its personnel and assets over to the company. Services include exit administration-reference management, unemployment claims, severance/redundancy and absence management programs; exit data services - payroll, pension systems, health resource management systems, benefit providers, share-option providers, fleet management, health insurance providers and MIS; and pension management.

- *Information services* – Division responsible for managing the cost of projects, where the company claims to share the cost of future technology upgrades, and to reduce the total cost for serving employees between 20—40 per cent. Services include: employee data (analyzing absenteeism, grievances, accidents and resourcing), data integration and data enablement (consulting and integration around systems such as PeopleSoft, SAP and Cognos), reduced reporting costs (by standardizing administration processes), and regulatory compliance (claims to be able to establish 100 per cent compliance with legal requirements on data security).

- *Learning services* – Function responsible for managing the training and learning process of the HR employees. Services include event and program design, delivery, administration, vendor management, training evaluation management, and knowledge management.

- *HR advisory services* – Provides HR employees with employee assistance programs, practice solutions that cover discipline, grievance, equality, diversity and harassment issues, HR transactional services, and health and safety services.

- *Pay & benefits services* – Accenture claims to reduce the costs of in-house pay and benefits by 15—20 per cent. Services include salary strategy, salary and incentive pay distribution, compensation notifications, and benefits administration.

- *Performance services* – Includes performance management strategy development, performance management solutions, competency management, performance review coordination and administration, feedback, career development, and annual reviews.

- *Resourcing services* – Provides recruitment services including resource planning, vendor management, job requisitions, application screening, logistics, reference, background checks and referrals, scheduling, deployment and integration, and workforce strategy.

Affiliated Computer Services (ACS)

ACS's most mature horizontal BPO sector is human resources outsourcing where ACS has established itself as a key player alongside the likes of Hewitt Associates, Accenture and Convergys. Having won flagship deals with companies such as Motorola, Chubb & Son and General Motors, ACS made one of the largest takeovers in the sector to date when it paid $405m for the HR consulting arm of Mellon Financial in March 2005.

The company says the integration of Mellon has gone well, and expects it to begin contributing to single-digit growth in its HR business in 2007, in line with growth rates across that industry. Signed new business in the first quarter of 2006 reached a record $251m, 79 per cent of which is commercial work and 93 per cent of which is BPO.

Through the deal, ACS took on board 3,000 clients, and gained additional services in HR consulting, retirement, health and welfare and compensation services. ACS said the deal has also enabled it to expand ties with half of the Fortune 100. The combined business brought together some 5,000 employees focused on HRO, with pro forma revenue of $805m, of which just $145m came from ACS and $660m from Mellon. Of this figure, outsourcing represents 54 per cent of the total revenue, with the remaining 46 per cent from consulting.

With four service centers located in the Far East, ACS claims to have the broadest scope of HRO services of all of its rivals, with services covering ITO, software transformation, consulting, employee self-service, retirement, health and welfare benefits, payroll, compensation, direct delivery of services, and for at least five full services HRO clients.

Further HRO contract wins with Chubb & Son, Rohm & Haas and Delta Airlines will help ACS maintain its position among the front-runners in the HRO market. These contracts have been made in the face of competition from vendors including Hewitt Associates, Accenture and Convergys.

ADP (Employer Services)

The company offers HRO Services in the following areas: payroll, benefits administration, HR information management, HR administration, self-service, data management, performance management, compensation management, applicant management.

In the past year, the company has made a bigger push into the smaller enterprise HRO market. Partnering with companies such as Employease, ADP is broadening its reach into areas such as on-demand platform for recruitment, on-going HR functions, and employee and manager self-service. It also recently entered into the accounts payable market to offer a more integrated solution in the FAO segment.

Capita Group

Although Capita does provide some HRO services, its full profile appears in the Finance and accounting BPO chapter.

Capgemini

As in its traditional IT outsourcing business, Capgemini is trying to lower the cost of project delivery by sourcing BPO skills from low-cost countries. The company is also increasingly looking to partner with best-of-breed suppliers in the BPO sector. In November 2004, the company formed an alliance with HRO provider Hewitt Associates. The alliance intended to provide HR BPO services to Capgemini's US and Canadian operations for the following 10 years. Hewitt took over some 40 Capgemini HR staff as part of the deal. See also Capgemini profile in Finance and accounting BPO section for more detail.

Ceridian Corp

Ceridian is on course to achieve revenue of over $1bn from its HR business in 2006. Its main target is the mid-market from where the majority of its revenue is sourced, and where it has moved from selling HR products and services to an outsourced model. Ceridian estimates that selling HR services on an 'a la carte' basis would generate around $574 per employee per year. However, that figure rises to $750 per year on a HRO basis. The company has won around 15 such contracts in this market, and expects 2-4 per cent of its top line growth to come from this area.

In the large enterprise sector (over 10,000 employees), rather than market full HR BPO services, Ceridian works on specific HR services which interface with ERP systems, and it then wins subcontractor work from the major IT services players.

Ceridian began marketing comprehensive HRO services last year, but deals so far typically include conversion and implementation consulting services; and processing services related to payroll, tax filing services and benefit needs. All its services are sold separately so there is a standalone value for each service, which it claims establishes the fair value of each of the services sold when a customer buys into the multi-service HRO model.

Currently Ceridian is competing with other mid-market vendors, which also grew from more basic HR services provision, typically payroll such as ADP. Ceridian usually pitches for business below the radar of services giants such as Capgemini, EDS and HP, which is currently bidding on large-scale HRO deals. The company claims to be looking at possible acquisitions to build on its services. The two most likely areas are in human capital management and healthcare cost containment.

Convergys

Having started out as a billing and contact center services provider, Convergys has successfully branched out into HRO in recent years. Estimates put the company's share of this highly lucrative market at around 4 per cent. A big improvement in its HR outsourcing business was at the center of strong results from the company in its first fiscal quarter of 2006, which saw net profit grow 18 per cent to $36.7m on revenue that rose 6 per cent to $675.3m.

It is possible that Convergys will seek to consolidate its position in the sector with a strategic acquisition in the future. In February 2005, the company was reported to have bid for the HRO business of Mellon Financial Corp, which was eventually taken over by ACS. A number of mergers have occurred in the HRO market over the last 12 months, and Convergys will be aware of the need to keep up with its rivals.

Convergys' most recent acquisition, of the finance and accounting BPO business of Deloitte Consulting Outsourcing, represents the company's eagerness to broaden its range of skills in the F&A outsourcing market. Before the takeover, the company operated in this area at a relatively basic level. It is clearly keen to improve its position in another key area of the BPO industry.

Convergys HRO operation is called Employee Care, although it does not split out its HRO sales from the rest of the group's operations, which include inbound and outbound customer care, technology helpdesk support, outbound sales work (although this is not a core part of its offering), and business-to-business services. Other key services offered by this unit are: customer acquisition and retention, market research and customer value management, database marketing services, campaign management, lead generation and dealer referral programs, and internet account management.

EDS (ExcellerateHRO)

In April, EDS' human resources BPO unit, ExcellerateHRO, revealed that it had signed its first end-to-end human resources deal with healthcare company Cardinal Health.

ExcellerateHRO is the jointly owned HR outsourcing business of EDS and Towers Perrin. The company was created when EDS combined its technology and HR business process expertise with Towers Perrin's benefits administration and HR domain expertise. ExcellerateHRO currently serves more than 400 clients in the United States, Canada, Europe, and Central and South America, providing benefits, payroll and other workforce administration services to more than 33 million active and retired employees from its client organizations.

EDS expects ExcellerateHRO to make a significant contribution to contract signings in 2006. The company expects its total BPO business to grow from $2.8bn in 2005 to $3.1bn in 2006 and $3.9bn in 2007, at an annual growth rate of 14.5 per cent. Expansion of its ExcellerateHRO, and call center services were key steps to broadening its overall offerings.

It is estimated that there are currently around 150 active HR outsourcing deals up for grabs, worth a combined $3bn, including several very large awards. EDS believes that the strength of the IT component and HR depth in the ExcellerateHRO offering will be a key market differentiator and create further opportunities in the future.

Fujitsu Services

BPO is one area of the IT services market tipped for strong growth over the next five years, and Fujitsu Services has announced its intention to take a more active interest in the BPO sector than it has previously suggested. While the company has avoided certain parts of BPO in the past, it now sees some areas as a natural extension to some of the IT services it already provides. Fujitsu has not ruled out following the lead set by IBM Global Services, EDS, and Accenture in creating a new business unit focused on pursuing opportunities in areas such as human resources and finance and accounting outsourcing. In March, Fujitsu Services and Capita Group won a £185m ($322m) project to overhaul the HR department supporting Northern Ireland's civil servants. Fujitsu will work with BPO vendor Capita Group, Oracle Corp and accountancy firm PricewaterhouseCoopers to centralize and modernize the delivery of personnel services to 28,000 people across the Northern Ireland Civil Service (NICS) over the next 15 years. The deal was one of the first major HR outsourcing initiatives in the public sector anywhere in the world.

Hewitt Associates

Perhaps the defining aspect of HR BPO in 2005 was the amount of key signings made by Illinois-based Hewitt Associates, which has proved that its acquisition of Exult in 2004 was a resounding success. The company signed deals with Duke Energy, Marriott International, Mervyns, Omnicom, Pepsi Co, Rockwell Automation, Rohm and Haas, Thompson, and Wachovia.

Hewitt has been the clear market leader in terms of contract signings over the last 18 months since it acquired Exult. However, in February, it revealed a 7 per cent drop in net income in the first quarter of its fiscal year after a drop in third-party supplier revenue and charges related to staff reductions.

Both Hewitt and Convergys were reported to be targeted by IBM at some point last year, though HP may also be looking to make a move into HRO after its recent successes in FAO.

While the company continues to lead the field in the human resources outsourcing (HRO) market (with an estimated 39 per cent share of the value of contracts signed to date in HRO), leaving more recognizable global brands such as IBM and Accenture trailing behind, it has admitted that there are few new deals currently available in the HRO space, and the company continues to be dogged by rumors that it is a takeover target for its rivals.

The company currently has approximately 25 live HRO clients, and aims to sign a minimum of seven new outsourcing contracts during 2006. The company also said that its efforts to secure new contracts had been hampered by the fact that sales cycles, already longer in HRO than in other areas of outsourcing, were extending still further.

While Hewitt's acquisition of Exult took the company to a new level in the market, it also brought with it problems which are still having an effect: Hewitt's financials continue to be impacted by Bank of America's cancellation of its deal with Exult in the months prior to Hewitt's takeover. Hewitt has also recently announced that another, as yet unnamed, Exult customer is looking to negotiate a termination of its deal.

The company has successfully extended its contract with BP, another major client left over form the Exult portfolio, although the new contract will only run until 2008.

For fiscal 2006, Hewitt has forecast total net revenues in line with the previous fiscal year, with a small drop in outsourcing sales offset by growth of around 5 per cent in its consulting business.

Hewitt has more than $300m of annualized outsourcing revenue in the pipeline, of which more than 65 per cent is related to HRO. The HRO business continues to make a loss, and is not expected to break even until late 2007 or early 2008. By the end of 2006, Hewitt aims to have 4,000 staff working in offshore locations.

Hewitt splits its HRO offering into four main areas:

- *Talent Management*, which encompasses recruitment, succession planning, learning and development.

- *Workforce Management*, including compensation administration, workforce administration, leave management and domestic relocation.

- *Core Process Management*, covering payroll, benefits and payments.

- *Service Center IT*, which includes IT service delivery, global application support, application development, infrastructure management and information delivery.

Alongside its HRO business, Hewitt provides: health care services, including the design, negotiation and administration of health benefits; retirement and financial services, including actuarial, investment and legal analysis; and organizational change consulting, including executive compensation, employee engagement, HR analysis, corporate restructuring and change management.

HP Services

HP's BPO operation has been slow to develop, and it has made slower progress than rivals such as EDS, IBM, and Accenture. The company has also failed to build on the momentum generated from its deal with Proctor & Gamble Co in March 2004.

HP is still on the periphery of the HR BPO market – so far it has concentrated on its finance and accounting operations which has been very successful, winning some major deals with consumer products companies but declining to say much about them publicly. If HP has any real ambitions in the market it cannot do it organically.

But if it is really serious about becoming the market leader, it will be looking in the direction of Hewitt Associates, the most desirable player in the market – with a market cap of $1.7bn, it would not be cheap.

IBM GS

IBM, made headway in 2005 in HRO and coupled with its F&A outsourcing capabilities, IBM is well positioned to tap into the current movement of integration of HRO and FAO, especially in the mid-market segment.

However, it has been overshadowed in HR BPO by rivals such as Accenture, Convergys and Hewitt, the latter two having both been reported to be targeted by IBM at some point in 2005. IBM may be encouraged to make acquisitions in HRO by the success of the Hewitt-Exult merger, but may be a little concerned about the lack of contract announcements from EDS-owned ExcellerateHRO and ACS. Both invested heavily in the market in early 2005, and while they can claim that longer sales cycles mean they are still on track to deliver major contract wins, it is critical that they deliver in 2006.

IBM has so far failed to make much impact on the market, its $1.6bn multi-tower deal with NiSource aside, and despite constant rumors of acquisitions, it has yet to make any significant impact on the market.

SAP

Software vendor SAP AG has a number of alliances with outsourcing vendors in the hope of planting its ERP software at the core of companies' business process outsourcing initiatives. SAP's four HRO alliance partners account for a combined 20 per cent of the HRO deals signed to date. Hewitt Associates, the market leader with a market share of around 39 per cent, gained SAP expertise through its purchase of Exult last year.

These alliances are designed to give SAP a more central role in BPO projects. SAP has already scored some notable successes with clients standardizing on its platform as part of a BPO deal, including Procter & Gamble, which signed a $400m, 10-year HRO deal with IBM Global Services in September 2003.

In April, SAP signed a partnership with Deutsche Telekom's IT services unit T-Systems, which will see the company offer clients billing and human resources services on the software vendor's platform. The two companies also made a separate agreement to offer human resources services based on its mySAP ERP Human Capital Management software.

Other

Other vendors include: Personec, Arinso, BearingPoint, Vertex, Agilisys, Computer Sciences Corp, Capita Group, Fidelity Employer Services, WNS Global Services.

Recommendations and HRO best practice

HRO has become a widely utilized business method, despite being a concept that is still in its early stages. Many organisations are overcoming their initial reluctance to outsource services that have been handled in-house since the start of their business, due to the benefits it can offer. Now, nearly every company of substantial size relies on outsourcing for some or all of their HR functions. At the same time, HRO service providers have expanded to encompass all HR functions, becoming one-stop shops for companies looking to outsource any and all of their HR responsibilities.

In the initial stages of HRO, companies would generally outsource single areas of their HR department, such as payroll, recruiting and benefits, but HRO has expanded to become a service that allows companies to create a unique HR model by picking and choosing which services they bundle together.

Change management

A changeover to an HRO business model has the ability to affect the entire organization, a fact that is often underestimated. From the executive who can benefit from better information about the workforce, to the worker who will interact with HR in a whole new way, HR's management of the HRO transition process will determine how each of its constituencies responds to new ways of working.

When is HRO right for the organization?

This is the most critical question organisations can ask, and should be considered well before making the decision to outsource. If the answer to any of the following questions is “yes”, then HRO is a distinct opportunity:

- Does your HR team spend more time on paperwork and employee issues related to HR, payroll or benefit administration than it does on sourcing and recruiting strategies, talent management, benchmarking HR best practices, or strategic business planning?

- Do your company’s leaders rely on your HR team for ‘blocking and tackling’, but rarely involve HR when building and executing business plans?

- Are HR professionals underutilized and unchallenged in their ability to make contributions to the strategy and operation of your business?

Overcoming reluctance to outsource

Many HR professionals place great value on their internal relationships, and the thought of outsourcing part of those relationships to a third-party can cause distress. To help ensure a good experience, it is important to clearly define the organisation’s needs, understand industry trends, and have proof of the chosen vendor’s capabilities and approach to customer service.

The relationship with a service provider should be treated as a partnership, and is best managed by frequent, detailed, actionable discussion about practices and processes. It is critical that the service provider has proven expertise in this area. The HRO service provider should also come to the table with a portfolio of the standard metrics they are expected to deliver, and should be willing to negotiate on how the service metrics will be established, measured, reported and analyzed for trends which lead to service enhancements.

CHAPTER 5

Procurement BPO

Chapter 5 Procurement BPO

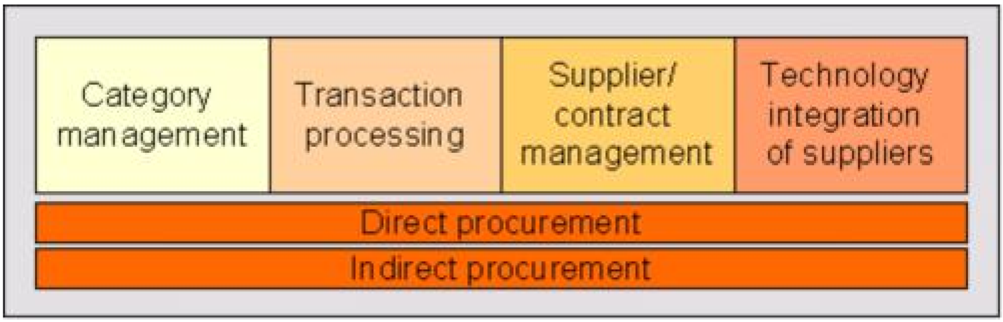
Summary

- Procurement BPO (PO) may have started to gain market traction, but it has yet to emerge with full momentum. Its horizontal cousins HR and F&A are bigger and more mature, but the growth opportunities in PO are far greater.
- Procurement outsourcing can reduce prices paid for goods and services, improve contract compliance, cut sourcing and procurement cycles in half, and reduce procurement administration and procurement automation costs.
- While the upstream processes are more difficult, this is where PO can really deliver significant cost savings as it involves consolidating the number of suppliers and negotiating better deals using the vendor's scale and expertise.
- There is also a convergence taking place with FAO and procurement outsourcing services, whereby companies outsourcing procurement are increasingly outsourcing the payments functions related to procurement services, such as accounts payable.
- The outsourcing of procurement can provide significant cost savings for companies that rely heavily on indirect materials costs, such as manufacturing.

Introduction to Procurement BPO

If 2005 was supposed to be procurement outsourcing's (PO) breakthrough year. It wasn't. PO may have started to gain market traction, but it has yet to emerge with full momentum. Its horizontal cousins HR and F&A are bigger and more mature, but the growth opportunities in PO are far greater.

Figure 5.4: Procurement outsourcing



Source: Business Insights

Business Insights Ltd

The fact that there are very few experienced vendors in the market also means capacity has been limited. The upshot is that analysts remain optimistic about the future of the PO market, believing that deals have been delayed rather than halted, and vendors claim to have strong pipelines. Annual growth rates in excess of 20% are forecast, and vendor executives are expecting a breakthrough year for the market.

The type of spend outsourced typically includes facilities (building materials and services), operations (such as office supplies, administrative services and travel), IT and networking equipment and services, as well as industry-specific items. Human resources, marketing and sales-related spend are less frequently outsourced due to unproven supplier expertise or companies having internal expertise in these areas.

While PO is not a technology-led solution in the way that HR BPO is, it is complex in that it impacts the entire organization, and requires significant change management and knowledge management. This complexity has held back the development of the sourcing and compliance components of PO. So far, 71 per cent of PO total contract value (TCV) has been centered on the procure-to-pay (P2P) aspect. This is sometimes referred to as the downstream part of PO in that it deals with the administration (purchase orders, dealing with incoming invoices, and payment of accounts), rather than the “upstream” processes of sourcing, which involves spend data management, vendor management, and demand management.

While the upstream processes are more difficult, this is where PO can really deliver significant cost savings as it involves consolidating the number of suppliers and negotiating better deals using the vendor's scale and expertise. This can bring cost savings of up to 12 per cent, compared to the 2-4 per cent savings that P2P can produce, which all impacts the customer's bottom line.

Procurement outsourcing remains a small market compared to human resources outsourcing, but is expected to be one of the highest growth areas of BPO over the coming years. Many clients are currently involved in pilot procurement outsourcing projects, while others are waiting to see the results of previous deals.

Benefits

Procurement outsourcing can reduce prices paid for goods and services, improve contract compliance, cut sourcing and procurement cycles in half, and reduce procurement administration and procurement automation costs.

Additional benefits achieved include reduced headcount, improved capture of rebates and volume discounts, and enhanced internal procurement skills through structured knowledge transfer.

Outsourcing procurement also allows companies to avoid the burdens of building, maintaining and administering an advanced procurement infrastructure for categories of spend that are either non strategic or that do not warrant additional resources.

Market dynamics

That 2005 was not the breakthrough year that might have been expected was down to a number of factors. Some buyers were window shopping but not ready to cut a deal, others were waiting to see the outcome of recent transactions rather than be early adopters themselves, and some opted for smaller pilot schemes.

With so much at stake, it is perhaps surprising that so few vendors have a foothold in the market, perhaps an indication of the complexity and experience required. Just four vendors: Ariba, Accenture, IBM, and ICG Commerce make up 31 of the 38 major deals in existence, and 78 per cent of their total contract value. Other major outsourcing companies are thought to be considering investments in the market.

As in FAO, Accenture and IBM together have a majority of total contract value. Aside from the two main players, it is interesting to note that the success of Ariba and ICG Commerce, both of which have grown through expertise in developing procurement software, have long-established relationships with procurement departments. Outside of these four, Capgemini has two multi-tower BPO deals in North America which include procurement services, and other suppliers include Corbus, HP, and Xchanging.

HP’s recent successes in FAO with consumer products companies could entice it to invest further in PO. Convergys is another major horizontal player which has yet to move into PO, but it might want to focus on implementing its new HRO customers and the FAO market which it only entered in June last year when it bought part of Deloitte.

Accenture and IBM Global Services have been the most prolific IT services vendors in the procurement space to date, along with specialist vendors ICG Commerce and Ariba. IBM acquired a foothold in the procurement space through the acquisition of French procurement services vendor KeyMRO last year, and further M&A activity is expected in the sector as vendors clamor for early market leadership.

Table 5.12: Key contracts in procurement BPO

Vendor	Client	Length (mnths)	Announced	Vertical
IBM GS	Goodyear Europe	120	Mar 2004	Manufacturing
Accenture	Lincoln Financial Gp	60	Dec 2004	Financial Svcs
Exchanging	Boots	84	Jun 2005	Manufacturing
IBM GS	Coty	60	Dec 2004	Manufacturing
ICG Commerce	Avaya	not known	Feb 2004	Technology
Accenture	Bank of Ireland	84	Dec 2005	Banking

Source: Business Insights

Business Insights Ltd

Competitive analysis

Accenture

Major IT services vendors finally seem to be gaining momentum in one of the hotly-tipped areas of business process outsourcing (BPO) – procurement outsourcing (PO). To date, the likes of EDS, Accenture, and IBM Global Services had enjoyed their biggest BPO contract awards in the more mature human resources outsourcing space, but significant procurement awards for the latter two suppliers this week, suggests that clients are opening up another part of their back office operations to outsourcing.

Accenture recently won a seven-year, $150m contract with the Bank of Ireland (BoI) to take over certain training and procurement processes for the bank. Services under the contract should begin in several months. About 180 BoI employees will be affected by the deal; they will face one of several scenarios, including transferring to Accenture, redeployment to other areas, and voluntary redundancy.

Ariba

Ariba is a provider of spend management solutions in the form of procurement software, with operations in the Americas, Asia Pacific, Europe, and Japan.

The company acquired Alliente, a privately held procurement BPO provider at the beginning of 2004. This marked the company's entry into the BPO sector. The same year Ariba also acquired FreeMarkets, a B2B Global Marketplace and eSourcing solutions provider.

IBM GS

IBM acquired a foothold in the procurement market through the acquisition of French procurement services vendor, KeyMRO, in 2005. Further M&A activity is expected in the sector as vendors clamor for early market leadership.

Earlier this year, IBM Global Services signed a five-year procurement outsourcing deal with consumer products giant Unilever NV in North America. The total value of the contract was not disclosed. Under the terms of the deal, IBM will handle all areas of procurement for Unilever, including managing analytics applications and restructuring Unilever's existing procurement processes.

The contract with Unilever North America, which owns food and drink brands including Ben & Jerry's, Hellmann's and Lipton, looks set to be larger than the procurement outsourcing deal IBM won just before that with fragrance company Coty Inc. IBM also handles the procurement of NiSource Inc, as part of the 10-year, $1.6bn multi-tower BPO deal signed between the two companies in June 2005.

ICG Commerce

US-based ICG Commerce has won 26 per cent of the contracts signed in the procurement outsourcing market to date. ICG leads IBM, which has secured 24 per cent of deals, Accenture (16 per cent) and Ariba (15 per cent).

Of these four leading suppliers, ICG and Ariba represent the specialist providers, as opposed to global IT services giants IBM and Accenture, who offer procurement outsourcing as just part of a BPO business that also includes areas such as finance and accounting and human resources – ICG is solely focused on procurement outsourcing.

ICG has offices in the US, the UK and Germany. The company operates a nearshore policy, rather than investing heavily in low-cost offshore locations such as India, China or the Philippines, which it views as good for data mining, classification and other non-customer facing processes. Without a strong technology base, ICG relies on its knowledge of the procurement market, and its relationship with suppliers, to deliver cost savings to customers.

ICG operates in a number of vertical markets, including the airline sector, pharmaceuticals and healthcare, retail, telecommunications, utilities and manufacturing. The vast majority of ICG's business involves outsourcing indirect procurement, but the company is seeing more interest in direct procurement, usually involving the purchase of chemicals, gases, packaging and transportation logistics.

The company divides its operation into four main categories:

- *Sourcing* – Sources a range of goods and services on behalf of its clients, using tools such as e-sourcing technology, data gathering templates, supplier databases and price benchmarks.

- *Savings Implementation* – Having sourced goods and services, ICG handles finding, ordering and receiving the items, including implementing standardized procurement processes and policies.

- *Transaction Management* – ICG's transaction management infrastructure includes an e-procurement platform for goods and services, content management tools and detailed transaction, spend and savings reporting capabilities.

- *Category Management* – Offers services to monitor suppliers' performance and company expenditure, as well as providing information on impending price changes and identifying additional improvement opportunities.

Recommendations and PO best practice

The procurement outsourcing (PO) market is currently in the early adopter and pilot scheme stage, with an increasing number of organizations experimenting with the market. Due to the inherent complexity involved in outsourcing procurement business processes, it has not yet emerged as a mainstream discipline, but the availability of an increasing number of providers on the supply side, and the success of pilot schemes on the demand side, suggest that it will not remain on the sidelines of BPO for much longer.

At the same time, some FAO projects are incorporating various functions of procurement – such as payments related to procurement – into the contract. Until now, most PO deals relate to indirect materials, although the market is shifting towards more value-added procurement management activities, such as sourcing, spend analysis, supplier management and transaction processing.

However, the complexity of PO sets it apart from traditional outsourced functions, and the same rules as those within HRO or FAO do not apply. Diverse supply markets, processes and large numbers of suppliers, relating to multiple spend categories mean that a high level of management expertise and knowledge is required on behalf of the services provider. Therefore, it is worth noting that specialist PO suppliers are currently the best option for organizations, with many traditional FAO vendors for example, not yet possessing the requisite expertise.

Despite this and the hype surrounding PO, it can deliver significant and quantifiable benefits when delivered correctly. In fact, organizations have been outsourcing aspects of procurement for decades, and PO represents the next logical step for BPO. Organizations that rely on indirect material costs, such as those in the manufacturing industry, will benefit the most, but it can bring substantial cost-savings to most types of organization.

CHAPTER 6

Offshore BPO

Chapter 6 Offshore BPO

Summary

- Practitioners claim that offshore BPO can provide savings of 30-70 per cent, in comparison to the 10 per cent that was considered worthwhile a decade ago, when companies first began to outsource their business processes.
- India remains by far the largest provider of offshore BPO services, although China is expected to grow rapidly. According to estimates, India accounts for nearly half of the global offshore BPO market.
- Organizations now see process performance, rather than cost savings, as the main benefit of transferring back office processes to an offshore location.
- Indian BPO companies are increasingly exploring new service offerings, taking them beyond simple customer care and support services. Although these services currently account for nearly 38 per cent of the industry's employee base and a third of its revenues, alternative service lines are growing fast.
- In 2005, India witnessed steady growth across the key service categories of finance and accounting, customer interaction and human resource administration. These three segments accounted for an estimated 89 per cent of Indian BPO revenues during the year.
- The parties involved in an outsourcing relationship belong to distinct cultures, these differences have to be accepted and bridged.

Introduction Offshore BPO

The cost savings that offshore BPO providers claim they can offer vary from anything between 30 and 70 per cent. But offshore BPO is about much more than labor arbitrage, as it offers organizations the opportunity to transform their operations and processes in a more strategic fashion.

Offshore outsourcing was initially seen as a convenient way of lowering the costs of peripheral, non-core, and mainly administrative activities. However, some organizations began to take advantage of the opportunities the service offered to move some of their strategic and core operations to low-cost locations, with the added benefit that it allowed them to re-think the business processes they were outsourcing.

Labor arbitrage can provide the first wave of savings by transferring processes as they are to an offshore location. But this can then provide a platform for improved efficiencies and the re-engineering of processes.

High education levels, technology and telecommunications advances have increased the choices available offshore, with providers now offering a growing range of BPO services, from simple voice-centric call center and processing functions right through to sophisticated strategic options for the outsourcing of entire CRM, FAO and HRO functions.

Indian BPO providers, in particular, have made a significant impact on the $600bn IT services sector, and the offshore delivery models they offer has forced the remainder of the supplier community to become more price-competitive and to offer a broader range of services.

India remains by far the largest provider of offshore BPO services, although China is expected to grow rapidly. According to estimates, India accounts for nearly half of the global offshore BPO market.

According to India’s IT services trade body, the National Association of Software and Services Companies (Nasscom), India’s offshore outsourcing industry continues to grow at an astonishing rate. Nasscom recently reported that revenue from call centres and business process outsourcing (BPO) services reached $5.2bn during in 2005, and this is expected to grow by a further 40 per cent in 2006. Over the last five years, it says, the industry has shown a CAGR of over 55 per cent, and as many as 400 of the Fortune 500 either have their own centres in India or outsource elements of their to

Indian technology firms. More than 660 multinational companies each bring business worth more than $1m annually to India, according to Nasscom figures.

The BPO market is now extremely competitive in India, with Indian IT services players (such as TCS, Wipro, WNS Global Services and Cognizant), vying with global IT outsourcing players (such as Accenture, EDS, IBM and HP), non-IT professional services firms, and non-IT organisations with specific domain strengths.

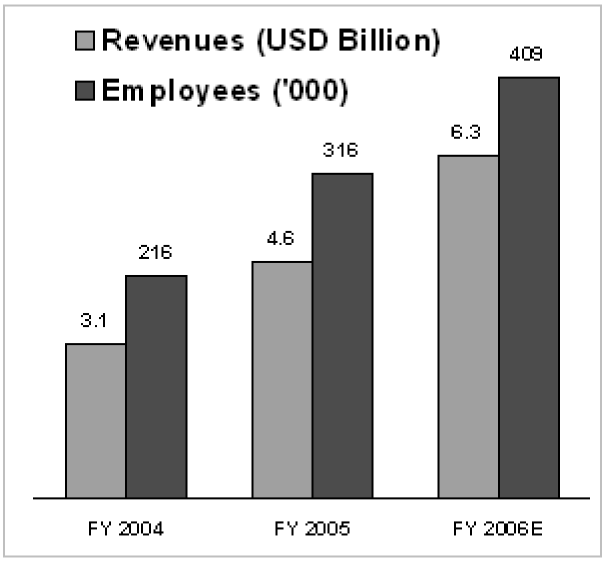
As discussed above, traditional Indian BPO companies are increasingly exploring new service offerings, taking them beyond simple customer care and support services. Although these services currently account for nearly 38 per cent of the industry's employee base and a third of its revenues, alternative service lines are growing fast. Finance (23 per cent of revenues), administration (14.9 per cent) and content development (15 per cent), in particular, are growing strongly, according to Nasscom.

Areas such as customer analytics and CRM, HR outsourcing, legal transcription support and financial process outsourcing (including equity research support, fund management and administration, risk assessment, insurance claims processing and debt collection and recovery) are also starting to gain traction.

Market context

The Indian BPO market is estimated to have grown from $4.6bn in 2004 to $6.3bn in 2005, recording a growth of nearly 48 per cent – accounting for 27 per cent of total software and services exports. Net employment in the Indian BPO segment is estimated to have grown by approximately 100,000 in 2005, taking the total direct employment to 316,000. The BPO sector is predicted to grow to more than $6bn in 2006 (see Figure 6.5)).

Figure 6.5: Indian BPO revenues and headcount, 2004-2006



Source: Business Insights

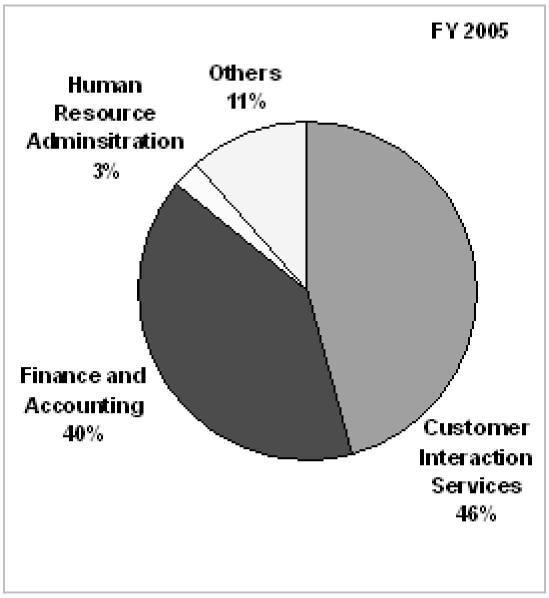
Business Insights Ltd

Key growth drivers include globalisation, overseas competition and the business economics imperative. Rapid growth of globalisation has added to competitive pressures across geographic markets that were previously relatively isolated from overseas competition. The resulting impact on growth and profitability continues to push organisations towards more cost efficient business models.

India has the largest English-speaking talent pool in the world with over 440,000 engineering degree and diploma holders added each year, while three-fifths of the Indian technical workforce has more than four years of experience.

In 2005, India witnessed steady growth across the key service categories of finance and accounting, customer interaction and human resource administration. These three segments accounted for an estimated 89 per cent of the industry revenues during the year (see Figure 6.6).

Figure 6.6: Horizontal BPO in India in 2005



Source: Business Insights

Business Insights Ltd

But, as well as facing competition from other low-cost locations, many Western IT services firms, such as Cognizant, EDS, IBM are building up a significant Indian presence in order to pass on the labor arbitrage advantages to their own customers.

Indian services providers

Genpact was recently named as the top Indian third party BPO provider by local IT industry association Nasscom. Genpact leapt ahead of British Airways spin-off WNS Global Services, which has held the top spot for the past two years. The remainder of the top five was made up of the BPO divisions of Wipro and HCL, with ICICI OneSource holding on to fifth place.

Nasscom’s rankings are based on revenue for (fiscal) 2005-2006 reported as part of its annual survey of the Indian IT industry. Genpact reported total sales of approximately $493m in 2005. The company currently employs around 23,000 staff worldwide, with centers in China, Hungary, Romania, the US, Mexico and the Philippines. In India, Genpact employs 14,000 people within eight sites in Gurgaon, Hyderabad, Jaipur, Bangalore and Kolkata.

Alongside Genpact in the 2006 list are a number of other companies with significant private equity backing. Second placed WNS Global Services, formerly a captive division of British Airways, is majority owned by Warburg Pincus, a US-based investor with an active portfolio of approximately 125 companies.

ICICI OneSource is majority owned by Indian financial services institution ICICI Group, but recent investments from Temasek Holdings of Singapore and Westbridge Capital Partners have allowed the company to pursue an aggressive growth strategy.

Table 6.13: Top 10 services providers by profit margin, 2005

	Company	Ownership	Prev rank
1	Genpact	Majority owned by General Electric and private equity firms General Atlantic and Oak Hill Capital Partner	-
2	WNS Global Services	Warburg Pincus is majority shareholder; British Airways holds minority stake	1
3	Wipro BPO	Subsidiary of Wipro Technologies	2
4	HCL BPO Services	Subsidiary of HCL Technologies	3
5	ICICI OneSource	Majority owned by the ICICI Group. Other major shareholders include Temasek Holdings and Westbridge Capital Partners	5
6	IBM Daksh	Owned by IBM, following its takeover of Daksh e-Services in April 2004	4
7	Progeon	Subsidiary of Infosys Technologies	10
8	Aegis BPO Services	Part of the Aegis Communications Group	-
9	EXL Service Holdings	Major investors include Oak Hill Capital Partners and FT Ventures	6
10	24/7 Customer	Investors include the company's management team and Sequoia Capital	11
11	Mphasis BPO	Division of Mphasis BFL Group Ltd	7
12	Intelenet Global Services	Backed by HDFC and Barclays	8
13	GTL	Listed on the Mumbai stock exchange and the Indian National stock exchange	9
14	TCS BPO	Division of Tata Consultancy Services	-
15	TransWorks	Wholly owned subsidiary of Aditya Birla Nuvo, part of the Aditya Birla Group, one of India's largest business houses	14

Source: Nasscom

Business Insights Ltd

Competitive analysis

Accenture

Accenture is aiming to drive down costs by managing a larger portion of its clients' application development and business process management work from lower-cost offshore centers in locations including India, China, the Czech Republic, Spain, Ireland and the Philippines (see Figure 6.7).

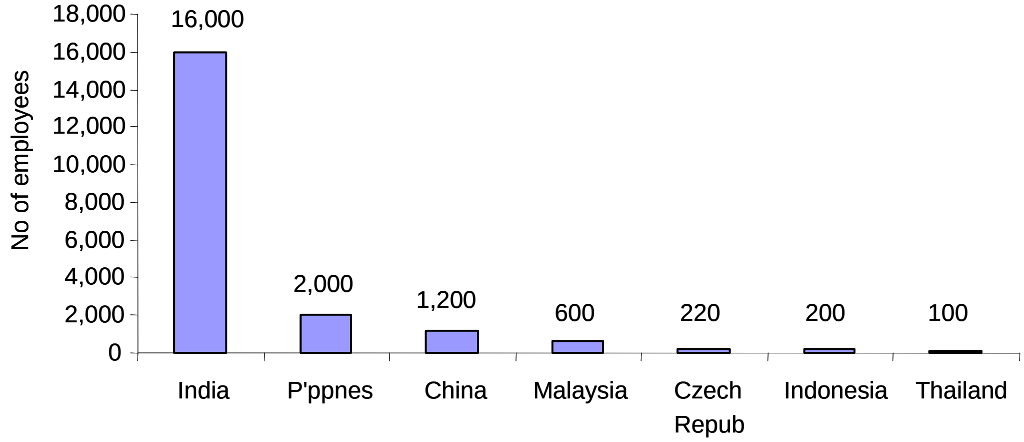
Accenture’s global delivery network now includes some 35,000 workers, 16,000 of which are in India. Accenture India serves over 150 clients through its operations in Bangalore, Chennai, Delhi, Hyderabad and Mumbai. The Accenture Delivery Centers in Mumbai and Bangalore have recently been assessed at the highest Capability Maturity Model certification, a level five rating.

Accenture’s two main Indian centers are in Mumbai (where it launched in India in April 2001) and Bangalore where it opened in November 2002. Out of these two centers, Accenture provides application maintenance, systems integration, software re-engineering, IT tools development and a full suite of BPO services covering finance and accounting, human resources, helpdesk management, and customer services management.

The company claims that it can offer Western clients cost savings of between 30-70 per cent by running BPO services from offshore locations. According to a report in the *Hindustan Times* in March 2005, Accenture offers Indian graduates an average salary package of INR 225,000 ($5,140) per annum. To counter the high attrition rate prevailing in the BPO industry, Accenture offers options to its employees to change their job role to reduce the monotony of work. For example, someone doing insurance can move to accounting or somebody in a call centre can shift to the IT help desk. Accenture offers six months of training to the new recruits.

The company is also looking to practice what it preaches, and is planning to centralize some of its own back office functions at shared services centers in India, and other offshore locations in the Philippines and China.

Figure 6.7: Accenture global delivery network, 2005



Source: Accenture/Business Insights

Business Insights Ltd

Cognizant Technology Solutions

US-based BPO provider Cognizant has been one of the most prominent companies to establish itself in offshore IT resourcing in the last five years, benefiting from being one the first vendors to blend an established client-facing operation in the US with a finely-tuned Indian delivery center.

Cognizant takes a different approach to the offshore model to many of its rivals, having pioneered a mix of onsite and offshore delivery, which has helped the company to build and maintain key US accounts. The unique nature of its business model enables Cognizant to not only drive lower costs into the overall project, but also to remain close to the client during the change management process. Cognizant established itself in India in 1997 when it acquired a 24 per cent stake in its Indian sister development company for $3.4m, giving it full control. The company currently has development centers in five Indian cities: Chennai, Kolkata, Pune, Hyderabad and Bangalore.

Like many India-centric offshore services vendors, Cognizant is aiming to reduce its reliance on the country by adding supplementary support centers in other offshore and near-shore locations. In December 2004, it opened a new development center in Toronto, Canada. The company has also started operations in China – tipped by many to be the only real competition to India as the premier offshore locations.

Cognizant operates in a number of vertical markets, of which financial services is the largest, accounting for around 50 per cent of revenue, with major customers in the sector including Credit Suisse, Royal & SunAlliance and IndyMac Bank. Healthcare is the company's second largest business unit.

EDS (Mphasis)

In June 2006, IT services giant EDS acquired a majority stake in offshore services provider Mphasis BFL Ltd in a deal worth approximately $380m. The Mphasis BFL Group was formed in 2000, with the merger of Santa Monica, California-based Mphasis Corp and Indian offshore company BFL Software Ltd.

Mphasis has nine offices in India, spread between Mumbai, Bangalore, Mangalore, Pune, Ahmedabad and Noida. In the US, the company operates in New York, Georgia, Tennessee, Texas, Arizona and California. European operations are mainly handled in the UK and Germany, while the company also operates in Canada, Mexico, Singapore, China, Japan and Australia.

The company derives just under 64 per cent of its total revenue from clients in the US. This level of client concentration makes Mphasis vulnerable to adverse market conditions and events in the US, so with this in mind, the company is actively seeking to expand its customer base in Europe, Asia-Pacific, the Middle East and India.

The strategy has already begun to make an impact. In the first half of fiscal 2006, European sales were up 85.1 per cent to $28.6m, equivalent to 29.2 per cent of total revenue. Overall, non-US sales were up 64.2 per cent to $35.3m.

Approximately 60 per cent of Mphasis total revenue is generated from clients in the financial services sector, including banks, brokerages and insurance companies. The company also operates in the retail, logistics and technology vertical markets.

BPO contributes 32 per cent of total revenue, although Mphasis' BPO division has now reported falling sales in three successive quarters. The BPO operation is particularly dependent on a small number of customers – in the quarter ended September 2005, for example, 56 per cent of BPO revenue was generated from the company's top five clients.

Mphasis' growth strategy is based around three emerging business areas:

- *Healthcare*, with specific focus on claims processing and payments. The takeover of Eldorado Computing Inc in March 2005 demonstrated Mphasis' determination to compete in the healthcare claims processing market.

- *Platform-based BPO*, such as virtual process manager (VPM), a workflow and collaboration application, which has been sold to a few major financial institutions.

- *Consulting*, across all Mphasis' vertical markets. The acquisition of Princeton in February 2005 gave Mphasis a footprint in the CRM consulting space.

Mphasis has some 12,000 employees, which is a significant addition to EDS' Indian presence especially at a time when the company's competitors are rapidly increasing their offshore presence. EDS has announced plans to boost its own Indian workforce to 5,500 this year, although this number still puts it far behind IBM's and Accenture's Indian headcounts.

Genpact

In April 2006, offshore BPO provider Genpact, formerly a captive unit of General Electric, announced plans to triple its headcount in China over the next two years. Like many of its rivals, Genpact is keen to expand its operations in China. The company currently has a center in Dalian that employs 1,500 people, but it is planning to open two new centers in the region over the next two years, and add some 3,000 staff to its Chinese headcount.

India-based Genpact is already the largest Indian BPO operator in China. The company plans to use its operations in the country as a base for expansion into technology services such as enterprise resource planning. The company was also named as the top Indian third party BPO provider by local IT industry association Nasscom.

HCL Technologies

HCL Technologies, the fifth largest software and services exporter in India, has been performing well over the last year, after emerging from a period of restructuring. But the company faces a number of new challenges as it looks to further narrow the gap on its rivals in a highly competitive market.

One of the keys for the future success of HCL lies within its BPO Services division. In the past, HCL has been reliant to a large extent on US business, so it is an encouraging sign for the company that inroads are being made into other markets. The company has secured a number of important clients in Europe, and nearly a quarter of its revenue is now generated in the EMEA (Europe, Middle East and Africa) region. The only real cause for concern is the relative stagnation of the company's home market, but this will only become a real problem if the BPO business fails to maintain its upward trajectory.

HCL's offshore IT services business was initiated in 1996 when a hardware development and sales joint venture with Hewlett Packard was dissolved, forming HCL Infosystems, the local IT software, hardware and services arm, and HCL Technologies, focusing on technical product development for Western technology companies.

That year, HCL Technologies signed two of its most prominent clients, networking giant Cisco and IT services company Perot Systems, which formed the HCL Perot Systems joint venture.

HCL operates 26 offices in 15 countries, largely focused on the key markets of the USA, Europe and Japan. Around 60 per cent of HCL's revenue is generated in the USA, with Europe contributing about 25 per cent and the Asia Pacific region approximately 15 per cent.

HCL divides its activities into three main categories: Software Services, BPO Services and Infrastructure Services. BPO Services contributes around 12 per cent of total revenues, but that figure is set to grow as the company focuses on BPO services as part of its growth strategy. BPO services include: process support, contact center services and sales & marketing support.

ICICI One Source

In June 2005, BPO provider ICICI OneSource was named as one of the top five third party players by Nasscom, India's national software association. The company, which was ranked in tenth place back in 2003, has grown its business through a series of strategic acquisitions.

OneSource is majority owned by the ICICI Group, one of India largest financial services institutions. The support of its parent company, together with recent investors Temasek Holdings and Westbridge, has allowed the firm to pursue its aggressive growth strategy. However, many in the BPO industry have suggested that the ICICI Group is on the verge of selling its 60 per cent stake in OneSource, raising doubts over the long-term future of the business.

The company was founded in December 2001, as the BPO arm of Indian financial services giant the ICICI Group. The company was set up to provide contact center and transaction processing services, including inbound and outbound calls, e-mail and instant messaging services.

OneSource has 10 delivery centers with a total capacity of 5,200 seats. Nine of the centers are in India, spread across the cities of Mumbai, Chennai and Bangalore, while the tenth is located in Amherst, New York. The company also has two US sales centers in Virginia and Buffalo, New York, alongside UK offices in London and Manchester.

IBM (Daksh)

IBM recently revealed plans to triple its investment in India to $6bn over the next three years, and is pleased with the progress it has made in building up its Indian BPO subsidiary IBM Daksh, during the last two years.

IBM acquired privately owned customer contact center services vendor Daksh eServices for around $160m in April 2004, in a move that gave it 6,000 employees and contracts with clients including US telecoms giant Sprint and Citimortgage, a Citibank subsidiary.

Since then, IBM Daksh's headcount has increased to a total of 20,000. This makes Daksh the largest of IBM's divisions in India, accounting for 47 per cent of the company's total headcount in the country of 43,000. IBM does not report separate financial figures for Daksh, but prior to the acquisition, it made a reported $60m in the year ending March 2004.

Despite IBM Daksh's rapid headcount growth since the takeover, it has actually slipped in the rankings of India's largest third party BPO services from third in 2004 to sixth in 2005. In 2004 it ranked behind only Wipro and WNS, but it now also trails new market leader Genpact (which has 23,000 employees), plus HCL BPO Services and ICICI OneSource.

Since IBM took over the reins, Daksh's services portfolio has become diverse, following the broader industry trend of branching out from highly competitive, high-attrition voice services. Voice services account for roughly two thirds of Daksh's revenue, with the rest coming from human resources, finance and accounting, procurement and financial analytics services.

IBM Daksh offers services in the following BPO lines: customer care, technical support, collections, telemarketing and transaction processing.

Despite its pretensions to be a full-service BPO service provider, IBM Daksh also finds itself working alongside rival vendors on some engagements where the client has taken a multi-sourcing approach. For example, IBM Daksh won a deal in August 2005 to provide customer care services to Indian communications company Bharti TeleVentures, which it shares with Mphasis, TeleTech and HTMT.

Infosys Technologies

Infosys Technologies (Infosys) provides outsourcing services to clients worldwide through operation, Progeon. The company is headquartered in Bangalore, India and employs over 52,700 people. The company recorded revenues of $2,141.3m during the fiscal year ended March 2006, an increase of 33.5 per cent over 2005.

One of the key areas earmarked for growth is BPO services. Infosys delivers back-office processing services through its operation Progeon Ltd, which the company launched in April 2002, and it now aims to become one of the largest BPO players in India.

During 2004, Infosys expanded Progeon when it set up a customer care center in Pune, which initially housed 350 people, and can be expanded to hold some 1,300 people. The company also opened a customer care center in Chennai, which is capable of housing some 250 people, and here Infosys is in the process of developing an employee care center with 2,906 seats.

Tata Consultancy Services

One area where Tata Consultancy Services (TCS) is catching up with its rivals in the offshore IT services sector is BPO. TCS offers BPO services from 11 delivery centers spread across India, Europe, and the US, and also Latin America, following its takeover of Chilean financial services processing firm Comicrom for $23m in September 2005.

TCS sold its stake in former BPO joint venture Intelenet in 2004 to co-owner HDFC. However, it acquired the core of a new BPO division through the purchase of Indian vendor Phoenix Global Solutions (PGS), which provides transaction processing services as well as software to insurance companies. TCS has integrated the Phoenix operation with its two other BPO operations, Airline Financial Support Services (AFSS), and WTI Advanced Technology Ltd. The three operations now operate as part of a single practice area.

PGS is a total transaction service provider, providing insurance solutions that encompass IT, BPO, and customer care services to support business transactions. AFSS is a joint venture company that TCS set up with Swiss Air about 10 years ago, and offers a range of outsourcing services to the airline industry.

The most significant development in TCS’ BPO strategy in 2005 was undoubtedly its $838m, 12-year contract with UK-based insurance company Pearl Assurance. The two companies planned to set up a joint venture, with TCS owning the majority of the new company, and Pearl taking a “passive minority” stake of between 15 per cent and 20 per cent. The subsidiary was to provide BPO services to other companies in the life and pensions industry, beginning with Pearl’s closed-book clients. And the company planned to build a platform that would enable it to roll out similar services globally.

Approximately 950 of Pearl’s current workforce of about 1,100 transferred to the new operation, with the remainder staying at Pearl. However, all of the revenue generated by the subsidiary was to go to TCS. This deal was unique in TCS’s history because it did not depend on an offshore delivery model to ensure lower costs.

In April 2006, TCS, created a subsidiary, Diligenta, and announced that it had entered the UK Business Process Outsourcing (BPO) Life Assurance market. Diligenta will provide BPO throughout the initial 12 year period for the Pearl Group Ltd, in processing and administration. The company will use TCS' IT expertise and consolidate 11 of Pearl’s financial and administrative systems into a single platform.

Horizontal BPO services include:

- *Finance & accounting* (accounts payable, accounts receivable, cash management, fixed asset accounting, general ledger reconciliation).
- *Customer care* (inbound/outbound call center, Web and e-mail support, technical helpdesk).
- *Human resources* (payroll processing and benefits administration); and supply chain (procure to pay outsourcing, vendor management, spend data management, purchase analytics).

Vertical BPO services include:

- *Financial services* (payment processing, loan/mortgage processing, credit card operations, securities back office processing).
- *Telecoms* (revenue assurance, order provisioning).
- *Healthcare* (clinical data management, statistical analysis).
- *Travel and hospitality* (revenue accounting, loyalty program admin, fare filing).
- *Insurance* (policy serving, claims and third party admin).
- *Retail* (customer analytics, merchandising).
- *Legal* (document management, patent management, legal research and claims management).

Transworks Information Services

In June 2006, Indian vendor Transworks, the BPO arm of Aditya Birla Nuvo Group, acquired Canadian contact center BPO services company Minacs Worldwide in a deal valued at approximately $125m. Transworks and Minacs' combined revenues will be around $300m, and will increase Transworks' presence as one of the largest Indian BPO vendors.

Minacs is one of the leading providers of contact center services in North America, and derived 55 per cent of its annual sales in 2005 from work with automotive manufacturers Ford and General Motors. However, from early 2006, the future of Minacs has been uncertain.

TransWorks is a wholly owned subsidiary of Aditya Birla Nuvo, which is itself a division of one of India's largest business houses, the Aditya Birla Group. TransWorks has approximately 4,200 employees spread across India, the UK, and Canada. Nasscom ranks TransWorks as the country's 15th largest third part BPO vendor, but the acquisition will elevate the company's rankings.

Wipro Technologies

Parent firm Wipro Technologies' BPO division, known as Wipro Spectramind, contributes around 10 per cent to Wipro's total revenues.

In January 2003, Wipro acquired the remaining 8 per cent it did not already own of Spectramind Services Private for $5.5m, from investment firm Housing Development Finance Corporation. Wipro Spectramind is now the third largest third party BPO provider in India, second only to Genpact and WNS Global Services. Its division employs approximately 13,000 people.

WNS Global Services

Mumbai-based WNS Global Services has developed rapidly, from its foundation as the offshore passenger revenue accounting arm of British Airways, to its current position as the second-ranked BPO company in India.

Keeping ahead of its competitors has proven to be a daunting task as WNS' major competitors include such giants as Wipro, HCL Technologies and IBM. The continued backing of Warburg Pincus, one of the largest private equity investment firms in the world, is vital if WNS is to match the spending power of its better-known rivals.

WNS was founded in 1996, when British Airways set up a wholly owned Indian subsidiary in Mumbai, originally named Speedwing World Network Services. The operation was initially focused on an airline-specific process known as passenger revenue accounting, but BA quickly realized the potential advantages of offshoring certain back office processes. The airline gradually began to offshore more and more operations, including specific frequent flier activities and a number of finance and accounting processes.

However, as the operation grew it became more difficult to maintain as a part of British Airways. A lack of independence and available capital was hampering Speedwing's ability to attract third party business. These considerations led to BA selling its majority stake in Speedwing to private equity investor Warburg Pincus LLC.

The company now has over 90 clients and divides its services into six areas: finance and accounting; business administration, marketing program management, HR and benefits; customer interaction management and knowledge services.

Xansa

After a turbulent few years, UK-based Xansa has been reborn and the focus of the company has shifted onto its offshore operation. Xansa now has three facilities in India, and plans to reach the maximum headcount of 10,000 by 2007. While its operations on the subcontinent are continuously expanding, Xansa has pulled out of all its other geographical segments, with all revenue now generated from businesses based in the UK. In the short term, this has allowed Xansa to cut out loss-making divisions, However, the company may struggle in coming years, should it attempt to re-establish itself in continental Europe and North America.

In January 2004, the company announced that it was merging its IT services and BPO divisions. It was one of the first Western companies to acquire an Indian offshore provider in 1998 when it bought ISS Infotech. Since then, the operation has been the focus for the company's BPO operations, and it has pioneered the use of offshore delivery in the European IT services market, and more than half of its total workforce of 8,070 is based in India.

The other major area of activity for Xansa has been in FAO. The company now provides back office finance services to clients such as BT, O2, MyTravel and the Department of Health, and Xansa has laid claim to being the leading FAO provider in the UK. The work generated by these contracts is shared between service centers in the UK and India.

Recommendations and offshore BPO best practice

Vendor selection

One of the most hotly debated issues with offshore outsourcing is how to find the best – or most suitable – vendor. There are many conflicting opinions, as outlined below:

Pick the Country First

The mantra "Pick the Country First" is perhaps the most widely known and commonly used method for selecting an offshore vendor. In this model, the buyer uses some form of a "scorecard" approach to select the country most appropriate for their purposes. After selecting the country, the buyer then selects the vendor(s) most likely to be able to handle their needs out of the top vendors from the selected country. When using this route, there are a number of issues to consider:

- Does the country's legal framework adequately protect your IP?
- Some countries offer greater financial exposure.
- Some countries are less 'stable' then others.
- Some countries have been involved with outsourcing longer than others and this experience translates into a higher probability for success.

Generally, however, this method results in a less than 50% success rate – although there are instances where selecting the country(ies) first is a sound option specifically when there are significant cultural, language or legal issues relating to a project.

Recommendation

Either formally or informally, a relatively large percentage of customers buy on the advice of their peers and contacts. In this model, a buyer will poll their counterpart in other business groups (or other companies) and will use the information gathered to select the vendor. If the buyer merely hires the vendor with the best recommendation, success rates are low. However, if the buyer uses a strong recommendation from peers as the entry criteria in a tender process and thoroughly investigates each recommended vendor aggressively, the success rate jumps significantly.

Domain & Technical Filtering

There is a growing trend in the market where buyers will use specific industry domain and technical skills as the entry criteria for a tender process. In this model, buyers will identify the combination of specific industry knowledge with their technical needs and will search (usually regardless of country) for all appropriate vendors. Of all the models listed above, this is probably the best method for selecting a vendor.

Preparation and execution

Client preparation and execution is one of the main causes of offshore outsourcing failure. Both the outsourcing organization and the offshore provider need to perform extensive preparation and planning, including setting high standards of benchmarks in terms of performance and detail. Every detail should be recorded, reviewed and planned. As a rule of thumb, the ‘outsourcee’ should be the one pushing this agenda, rather than leaving it to the vendor.

Another leading cause of failure in offshore outsourcing engagements are problems relating to the extent and quality of the client-vendor planning sessions prior to commencing the engagement. Often, offshore outsourcing vendors steamroll the initial engagement process, trying to get signed contracts as fast as possible, and the client does not demand clarity in roles, responsibilities, expectations, joint operations, deliverables, short-term team plans and performance metrics. If these are not clarified from the outset, it can lead to misperceptions and differences in expectations between the two parties.

It may also be that the offshore outsourcing route is simply the “wrong answer” for a specific business problem. This relates back to the commonly made mistake of viewing outsourcing as a way to “wash your hands” of a particular IT problem or headache. It may also be that there are better options, and that offshoring does not solve the root problem.

There is also a significant issue with maintaining the support of the internal team during an offshore outsourcing engagement. It is a fact that offshore strategies are difficult and will require employees to be active participants, willing to help address issues as the offshore strategy is implemented. Without in-house support, successfully adopting an offshore fulfilment model will be particularly challenging.

Competition between onshore and offshore teams is another problem, with onshore teams keen to prove that they are still required by the organization. Organizations need to take an active approach to mitigating this problem in order to avoid a dysfunctional global team. Finally, the reason for failure could fall squarely on the shoulders of the offshore vendor, so choice of vendor and location should be one of the first considerations of any organization tempted by the offshore outsourcing route.

Engagement issues

Difficulty in communicating with the outsourcer is usually cited by organizations that are considering offshore outsourcing as the most significant barrier or challenge. Communication with, for example, Indian vendors is only in part a linguistic issue, and in fact also a logistical and cultural hurdle. However, many offshore providers have been aware of this challenge for some years, and have been taking steps to overcome it. Many offshore providers will, depending on the project, now routinely have offices in Western cities, in which their employees regularly spend months at a time, absorbing the culture, and language, of Western organizations. Likewise, senior onshore employees of the company that is outsourcing a project may spend time at the offshore vendor building relationships, as well as bridges across the culture gap. Lack of control is another commonly cited concern. Interestingly, this is a more common issue amongst certain verticals than others, indicating a more conservative attitude towards outsourcing and a greater historical focus on internal IT development in some organizations or sectors, such as financial services, compared to others.

Organizations are also apprehensive about a possible lack of understanding of business requirements on the part of the outsourcer, and that management personnel would need to spend more time overseeing the vendor relationship. This is something that can be linked to concerns over communication and the failure of vendors to establish business-level credibility. As offshore vendors aim to penetrate the business process outsourcing (BPO) services market, it will become especially vital to demonstrate increased business understanding and line of business focus.

The need for offshore outsourcing providers to have local operations within an organization's home market is seen as a minor concern amongst a minority of organizations. But while this model of operation will continue to work in the applications market, it is clear that for BPO services, a closer and more responsive relationship is required. Other issues commonly cited include: security, quality of service, onshore employee concerns, lack of customer support, lack of business driver and better onshore options.

In fact, it will be key for the outsourcing industry to tackle the issues and barriers to offshore outsourcing over the next couple of years if long term demand is to be sustained. As strategic IT drivers increasingly shift back towards growth enablement, the outsourcing imperative will be driven increasingly by fulfilment excellence and operational efficiency rather than straight cost considerations. Vendors must therefore create a clear and robust communication structure with an element of onshore service to match the nature of the services they are looking to provide.

CHAPTER 7

Best practice BPO

Chapter 7 Best practice BPO

Summary

- Outsourcing business processes can bring significant benefits to companies looking to cut costs and improve overall business performance.
- There are three underlying strategies that BPO value propositions are based upon: the *cost reduction* argument, the *core competency* argument and the *transformation* argument.
- Transformation lies at the heart of most BPO. However, the fact that most parts of the vertical BPO market are still relatively immature means that there is still much variety in the transformation elements to be found in individual deals.
- The strategic nature of some vertical processes has been underestimated, and makes proven vendor capabilities the highest priority for organisations.
- BPO cannot actually be looked at as a mere service offering at all, but should be considered as a continuous journey towards the commoditization of individual business processes.
- Outsourcing agreements can be extremely complex depending on the nature of the process being outsourced, the level of skills required, the extent to which the process is outsourced and the desired results.
- The best way to procure BPO and maintain a focus on adding value is to drive the transaction from a strategic level and facilitate an interactive process with the potential service providers.
- Value-based pricing is becoming increasingly common – value-based transactions are structured around strategic outcomes and business profitability. In many cases, performance incentives and gain sharing are put in place if these objectives are met or exceeded.

Introduction

BPO has attracted a lot of attention since the turn of the century, with large IT services players such as IBM, EDS and Accenture having promoted BPO in the hope that its rapid growth would become a phenomenon within the outsourcing market. However, while we have seen some parts of the market developing at a breathtaking pace over the past two to three years, the BPO market we see now only vaguely resembles the homogeneous picture that vendors, end-users and analysts would have expected to see by now.

In contrast to the broad idea of BPO becoming a generic and adaptable service that is offered by large vendors to clients in order to relieve them of non-core activities, the market still shows great variety along several lines:

- Significant variation in maturity of vertical offerings.
- Uneven acceptance of BPO across the financial services sector, depending on geography, vertical as well as institution tiers.
- A fragmented vendor landscape that still features large outsourcing giants, specialist niche players, FSI (Financial Services Institution) in-sourcers as well as upstarts.
- A multitude of value propositions and go-to-market strategies across the vendor landscape.

The three basic value propositions of BPO

There are three underlying strategies that BPO value propositions are based upon: the *cost reduction* argument, the *core competency* argument and the *transformation* argument. However, these are not entirely separate but are inextricably linked with each other, as the following sections will demonstrate:

Cost reduction

The argument of cost reduction is possibly the oldest and most basic value proposition associated with most forms of outsourcing. In all cases, the promise of cost savings is based on the outsourcer's position to offer improved economies of scale either in parts or across the entire value chain. However, economies of scale do not automatically arise by outsourcing any process and, with the number of recent failures of outsourcing deals across the industry, FSIs must become more proactive in assessing an outsourcer's real ability to deliver on these promises in the long term. Two factors are most fundamental in any outsourcer's ability to achieve economies of scale:

- *More than one client*. Clearly, if an outsourcer takes on the proprietary and deeply entangled business process of a single client only, the scale of the operation will remain the same before and after the hand-over. Consequently, any outsourcer that claims to achieve scale will have to do this by taking on similar processes of several clients – be it across the full value chain or by identifying sub-processes with synergy potential (e.g. call center operations, IT support).

- *Migration platform*. When taking on several client operations with sufficient synergies to achieve greater scale, outsourcers must have a framework in place to migrate these processes on to a single platform. Vendors without a strategy to realize such synergies are in danger of undermining their margins and endangering the long-term viability of their business. Especially in less mature segments of the BPO market, vendors still primarily concentrate on establishing market share by aggressively targeting clients offering contracts based on significant and instant cost-savings, without a mature migration framework yet in place.

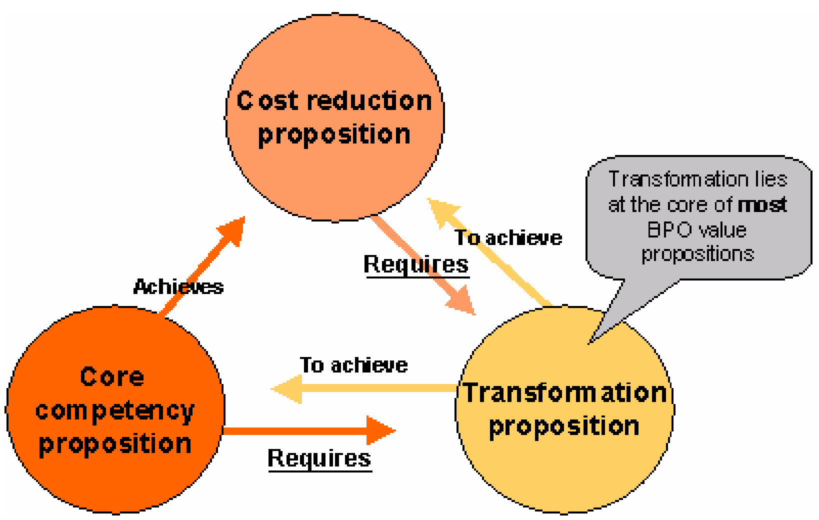
Core competency

Increasingly competitive environment and pressure to improve operational efficiency in recent years has forced companies to focus on areas that deliver competitive differentiation. As a result, these companies are looking for opportunities to pass on responsibility for supporting or administrative functions that are not considered strategic to the business. Since its inception, the outsourcing market has been targeting this specific area across all client segments, with a strong focus on providing clients with 'utilities' offering supporting and administrative operations.

Transformation

The way BPO has developed in recent years, and the fact that no clear distinction between BPO and BTO (Business Transformation Outsourcing) deals in the market has emerged, makes it increasingly hard to isolate the element of transformation from the concept of BPO in general. As Figure 7.8 demonstrates, transformation – in its widest sense – can be seen at the core of most BPO value propositions.

Figure 7.8: The three underlying value propositions of BPO



Source: Business Insights

Business Insights Ltd

There are three types of activity that are part of the wider concept of transformation:

- *Gradual business process transformation*. BPO vendors entering into lift-out deals (mainly in parts of the BPO market that are not yet fully established/commoditized) largely rely on their ability to implement long-term efficiency gains through gradual business process transformation and the realization of process synergies. Vendors entering such deals are often strongly incentivised to execute transformation through aggressive pricing of the deals they enter into, making transformation a necessity for the sake of securing their own profit margins in the long-term.

- *Large-scale migration*. In areas where vendors have some established BPO competency already, transformation may involve the immediate migration of a client's operations on to an existing migration platform once the deal is in effect. This kind of transformation will require a significant and dedicated migration effort at the beginning of the BPO relationship, and tends to deliver more instant efficiency gains and cost-savings once the migration is complete;

- *Plug-and-play*. In areas that are already well-established as utilities, taking on new clients will typically require relatively limited transformation effort on the vendor's side but will require clients to put the necessary structures in place to be able to 'plug' their operations into the established utility.

Key business and technological issues in BPO

Transformation: who, how and when?

There is now a clear realization that transformation lies at the heart of most BPO. However, the fact that most parts of the vertical BPO market are still relatively immature means that there is still much variety in the transformation elements to be found in individual deals. There are two fundamental questions to consider: How does application infrastructure need to evolve to enable BPO? And who should execute the transformation?

How does application infrastructure need to evolve to enable BPO?

There are two key operational priorities to ensure the success of BPO from both the customer's and vendor's perspective:

- *The need to de-couple individual business processes to maximize potential realization of synergies*. Vendors must ensure that individual business processes can be converged with similar operations they run for other clients in order to achieve scale and cost savings. In particular, with BPO arrangements that include a significant proprietary element to individual clients, it is of utmost importance to identify the sub-processes that could be established as shared services across the vendor's wider BPO business. The challenge of disentangling such processes has been somewhat underestimated in the early days of BPO and has in many cases, such as cross-border payments processing, held back vertical BPO activity so far.

- *The need to enable smooth information/process flow between internal and vendor operations*. Naturally, any BPO deal introduces a new interface to an external vendor, breaking up processes that would have been considered entirely internal to the customer before. While certain segments of the BPO market have already relatively mature frameworks and tools in place to deal with this challenge, these are much less developed in newer parts of the vertical BPO market. As a rule of thumb, the more strategic and closer to the core business the outsourced operation is, the more challenging the problem of workflow and integration of information becomes.

The vertical credibility challenge

The issue of specific experience in running vertical operations has proved a significant force in the development of the vertical BPO market in recent years. Contrary to the widely held expectation that large generalist outsourcing vendors would capture the majority of the market for themselves, there have been a number of unexpected entrants to the market as well as the continuing strong position of smaller niche players. The key factors contributing to this development are:

- *The strategic nature of some vertical processes has been underestimated*, and makes proven capabilities the highest priority for organizations. The early days of BPO were driven by an over-simplified concept of a clear distinction between strategic (i.e. not ‘outsourceable’) and commoditized (i.e. ‘outsourceable’) processes. While this view has proved fairly accurate in the horizontal BPO market, it failed to recognize the more ambiguous distinction in the vertical-specific domain. Consequently, the more strategic nature and perceived risk associated with vertical processes is causing organizations to put trust, credibility and proven capabilities at the top of priorities when choosing BPO vendors for such processes.

- *The similarity between BPO and ITO, as well as the potential to cross-sell vertical BPO into existing ITO contracts, has been overestimated*. The factor of credibility as discussed above has somewhat undermined the original hope of generalist vendors to capitalize on existing outsourcing relationships. With few exceptions, organizations should treat individual vertical BPO activity as separate from each other, and separately look for vendors that best fit the specific requirements at hand.

- *Niche vendors and new in-sourcing providers have taken advantage of their position as vertical specialists*. The strong focus on proven operational capabilities (as opposed to pure technology expertise) in vertical-specific processes has provided specialist niche players that concentrate on specific vertical BPO segments with an advantage in pitching for some contracts.

The BPO maturity model

Given the great variety of approaches, underlying drivers and players that can be observed in the context of BPO, it becomes clear that it is virtually impossible to identify a single common denominator to define BPO as a discreet and ready-made service offering. This becomes particularly apparent when looking at the highly fragmented state and varying levels of maturity in the vertical-specific BPO market as discussed above.

This perspective suggests that BPO cannot actually be looked at as a mere service offering at all, but should be considered as a continuous journey towards the commoditization of individual business processes. For the purpose of clarifying this 'evolutionary' view of BPO, there are four stages that make up this journey from Non-utility to Utility, termed the BPO maturity model.

Pre-BPO

This stage represents the state of any business process that is situated within an organisation. Processes that no longer contribute to strategic differentiation, combined with the need to improve their efficiency (e.g. due to declining margins), are identified and 'sent' on a journey with the final aim of turning them into Utilities.

Lift-out stage

This represents the first and most 'immature' stage of an existing vertical BPO market. It is driven by vendors' willingness to turn a certain process into a BPO offering without yet having sufficient vertical in-house capabilities in place. Vendors will typically take over entire operations from companies to establish operations with the long-term view of taking on additional clients, utilizing the newly acquired skill sets.

Shared services stage

A vertical BPO segment has reached the 'shared services stage' once vendors have sufficient operations in place to benefit from instant efficiency gains when taking on additional clients. BPO deals in this category will often include some lift-out elements, but vendors will already have established shared services that the newly acquired operation can take advantage of (e.g. certain IT infrastructure and support, existing call center capabilities).

Utility stage

This final stage represents the point when vendors have fully established capabilities, platforms and frameworks in place to allow for immediate and complete migration. At this stage, the notion of 'transformation' as discussed above becomes a mere case of 'plug-and-play', allowing organisations to switch and choose suppliers with relative ease. As a final consequence, this stage causes the difference between BPO and other services eventually to blur.

BPO contracts

Outsourcing agreements can be extremely complex depending on the nature of the process being outsourced, the level of skills required, the extent to which the process is outsourced and the desired results. The various structures of outsourcing agreements vary depending on the individual company, but generally fall within two distinct areas:

- *Partially outsource the process*. One option available is to partially outsource a process. In this way, the outsourcing provider is only responsible for an element of an overall function. An example of this may be the application of best practice in human resource management, providing access to expertise while the customer still retains direct control of the function and resource or,

- *Outsource the entire process*. In some cases, it may make more sense to completely outsource a process. In this case, the outsourcing provider undertakes full control and responsibility for an entire process. An example might be the provider taking responsibility for HR or finance and accounting functions. The company would enter a contract outlining its requirements and desired results. The provider would then perform this task using its existing technology and sourcing platform to provide a better result than the outsourcer could provide, at a lower cost, while minimizing risk through the use of SLAs.

The actual location of the provider's staff also varies according to the individual manufacturing company and the contract in place. Sometimes, the providers work on-site, generally working with the customer's company extensively. Alternatively, the provider's staff may reside off-site, within their own offices, and provide services remotely via electronic means. A combination of the two is quite common, and once again depends purely on the agreement reached. Due to the uniqueness of each company’s corporate structure, internal culture and processes themselves, every BPO agreement will differ.

BPO benefits

Outsourcing business processes can bring significant benefits to companies looking to cut costs and improve overall business performance. Because external providers focus on key processes as their core competency, companies are able to effectively leverage their knowledge and experience for their own benefit. The core benefits can be categorized into four separate areas:

- *Lower costs*. Because BPO providers focus purely on the processes that they provide, they are able to offer a lower cost to organizations than they might otherwise be able to get themselves. For many of the processes outsourced such as contact centers, the startup costs are significant, and for many are hard to justify given the alternative of a BPO service. Similarly, the BPO provider will often guarantee that it is using the most appropriate and up-to-date technology, allowing the user to avoid issues such as sourcing and upgrading.

- *Improve service*. Because outsourcing contracts are constructed using SLAs (Service Level Agreements), a predefined level of service is guaranteed. In most situations, this level is higher than the company itself could provide internally. For applications such as customer interaction, this is critical as poor communication with customers can affect revenues. For other processes such as HR, the customer is able to receive better staff and ensure that existing staff are managed properly, thereby leading to better internal efficiencies.

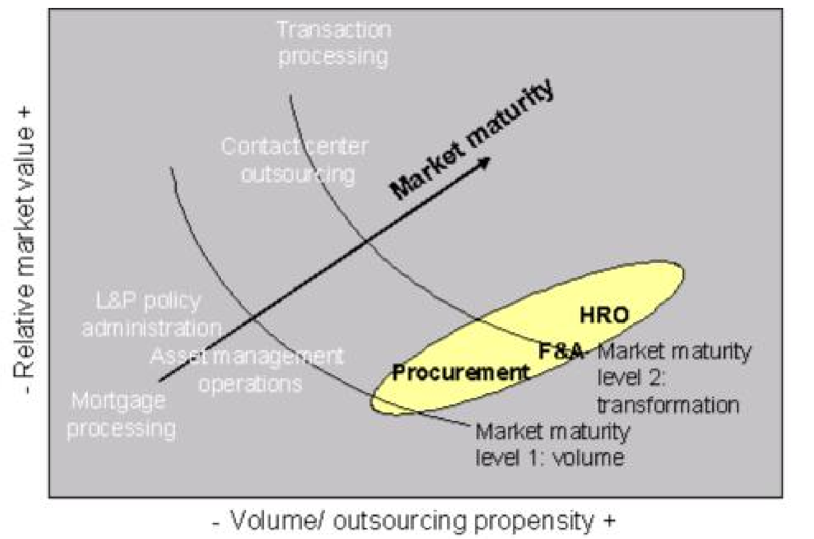
- *Gain access to expert skills*. As companies are faced with increasing regulation, the demand for appropriately skilled staff is growing. Often, it is difficult to ensure an adequate level of knowledge within internal staff to guarantee performance. Using a BPO provider for select processes, however, provides companies with staff that are experts in specific areas. This extra knowledge can help to relieve the pressure of issues such as regulation. Similarly, external experts can help optimize and streamline internal processes through the application of best practices methodology.

- *Focus on core activities*. By outsourcing non-critical elements of the business, companies are able to pay more attention to their core competencies. In this way, companies can effectively forget about managing lines of business such as HR or finance and accounting. This releases considerable resources to try and gain as much market share and revenues as possible, while at the same time maintaining or improving the level of services within the business.

BPO market segments

Horizontal BPO services are, overall, further advanced in terms of market development than the more sector-specific vertical BPO services. However, a great deal of this development has happened in a service bureau or managed service set-up, often being more third-party service than outsourcing, with few strategic BPO deals having driven past market growth.

Figure 7.9: Market maturity model for BPO



Source: Business Insights

Business Insights Ltd

As illustrated above, horizontal BPO as a whole is at a higher level of maturity and development than many vertical BPO services. However, this does not necessitate a sharp drop in overall horizontal BPO growth, but instead distinguishes between a first and second wave of horizontal services outsourcing:

- Much of the first wave of horizontal outsourcing market development was on the basis of narrowly defined areas of expertise, with the key vendors being process or function experts rather than generalist outsourcing or IT services providers.

- The second wave is/will be towards a horizontal BPO market of higher strategic importance and wider scope. Effectively this means a more complete outsourcing of the function in question, but multi-function outsourcing is also covered in this definition.

Glossary

APO	Agent Position Outsourcing
AP's	Agent Positions
BPO	Business Process Outsourcing
BTO	Business Transformation Outsourcing
CFO	Chief Financial Officer
CRM	Customer Relationship Management
CTI	Computer Telephony Integration
ERP	Enterprise Resource Planning
FAO	Finance & Accounting Outsourcing
FSI	Financial Services Institution
HRO	Human Resources Outsourcing
ICT	Information & Communications Technology
ITO	IT Outsourcing
ROI	Return on Investment
SLA	Service Level Agreement

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