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Market Research and Analysis

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Introduction

What is BPO?

Business Process outsourcing (BPO) can be defined as the transfer of an organization's entire non-core but critical business process/function to an external vendor who uses IT based service delivery. BPO aims to raise a Client company's shareholder value because it is about delivering outcomes—that is, higher-performing business processes.

Companies essentially have three kinds of processes: core processes (which give strategic advantage), critical, non-core processes (which are important but are not competitive differentiators), and non-core, non-critical processes (which are needed to make the environment work). No one suggests outsourcing core processes; they recommend investing in them. But many do recommend outsourcing critical, non-core processes to providers who specialize in those processes because they will invest in them and aim to make them world-class. And most advisors recommend outsourcing all non-core, non-critical processes.

Outsourcing does not mean handing over an entire process. Generally, it means turning over to a BPO provider the "how" aspects of a process—the systems, infrastructure, administration, execution, and some of the design of non-core processes. But retain the "what" aspects of the process—the governance, policy-setting, decision making, and strategy of these processes. The intent is to outsource the work (the boring part) while retaining the direction-setting part.

Outsourcing is not a one-time event; it is continuous. Companies that outsource one process later outsource another, then another—as their strategies change and new outsourcing options open up. The outsourcing field is thus not slowing down. At the moment, BPO is the driving force, and it is developing fast.

Why BPO has become so important?

BPO is important because it links to shareholder value. As customers have become more sophisticated, they have come to realize that the goal is to link business performance to shareholder value. BPO has gained prominence because people have asked, "When do I get the business result?" BPO is about optimizing business performance to drive value creation.

Executives want shareholder value from investments. This is an important shift in management thinking with respect to IT and shared services. They want to know how your shared services and world-class processes are creating shareholder value for the firm. They are likely to ask, "What about partnering with a supplier to sell our capabilities to the outside?"

BPO has emerged as a repeatable model for reducing costs while increasing service quality. Businesses have worked for decades to use alliances to combine and leverage their unique skills and access to markets. The building of core functions, while outsourcing non-core functions, has moved from theory to practice. This trend has become increasingly important as globalization expands the range of competitors and innovation rapidly raises the bar in many non-core areas.

BPO is often the next step after shared services. Companies that have centralized services and created a shared services organization have already handled some of the change management issues that arise from BPO. They also often see the next step as BPO.

Some functions, such as procurement, are no longer buried in the back office. What once was considered a necessary evil – procurement – is now laden with big expectations. But CEOs do not want to know how you do it, they just want you to do it. Outsourcing procurement is particularly appealing to corporations with large decentralized spend, where corporate controls little or nothing.

You can now make a business case for BPO outsourcing. Companies generally outsource processes to shift accountability and control costs. Management can then focus on core areas, and not have its attention diverted to other areas. Outsourcing also allows companies to avoid capital expenditures, which is especially important in non-core areas that may need new systems. Generally, companies only want to spend money on core areas.

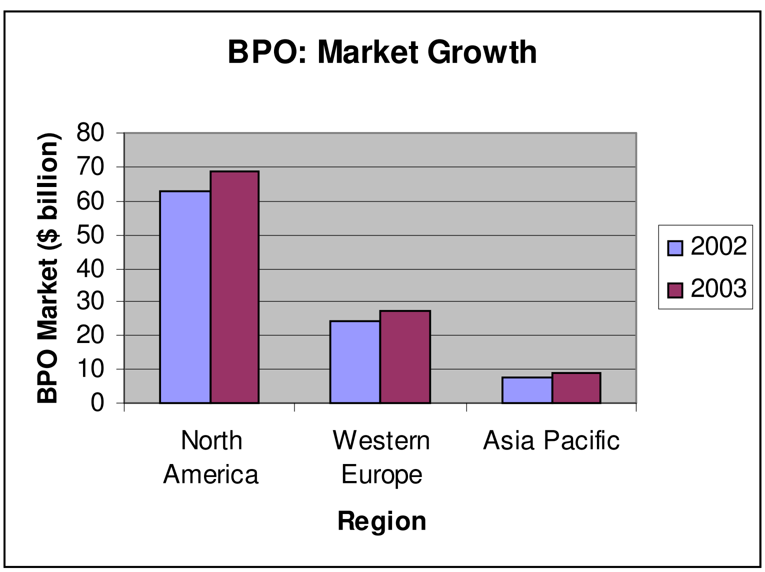
Market Performance

Market Growth

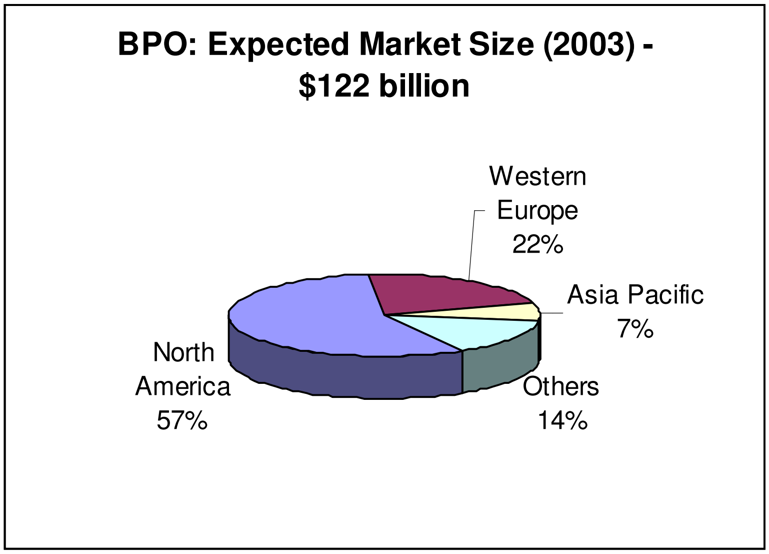
In 2003, the worldwide business process outsourcing (BPO) market is expected to grow 10.5 percent — to $122 billion — up from $110 billion in 2002, according to Gartner Inc., and the Aberdeen Group predicts 13 percent annual growth until 2005 when the market will reach $248 billion.

BPO allows organizations to form strategic partnerships that focus on core competencies, thereby reducing corporate costs and increasing productivity. The centralized buying power of these BPO service providers, coupled with the fact that they represent a major new low-cost channel of distribution, can create a unified block of purchasing strength.

"Although several large BPO deals of over $1 billion will be signed in 2003, there will be a decrease in growth linked to a period of disillusionment starting in 2004", according to Rebecca Scholl, principal analyst for Gartner's sourcing group. 2004 corresponds to the five-year mark after the signature of several early BPO 'megadeals'. These deals will be renegotiated, in some instances recompeted, while other late adopters take on a 'wait-and-see attitude'.



Source: Gartner



Source: Gartner

North America is expected to represent 57 percent of the total BPO market in 2003 — to $69 billion — with growth in other regions eventually outpacing North America. Gartner analysts say that after several years of double-digit growth, delays in contract signings and lower negotiated rates for large BPO deals have led to moderate growth in 2002 and 2003.

The Western European BPO market is forecast to grow 10.9 percent in 2003, to $27 billion, according to Gartner. In Europe, outsourcing of financial services processes are widely used, however, other industries are growing in respect for different types of BPO. Customer interaction for demand-management BPO is proving popular in the utilities and telecommunications sectors. Supply-management BPO is gaining popularity in local governments, and enterprise services are growing in telecommunications for human resources, finance and accounting.

Starting off slowly, the Asia Pacific BPO market is expected to grow 7.8 percent in 2003, to $8.7 billion, but it is then forecast to have double-digit growth during the next few years. META Group, Inc. found that nearly all Asia Pacific IT organizations will outsource at least one mission-critical technology operation by 2005.

McKinsey' s research found that Australia and New Zealand are the most mature economies in terms of acceptance of BPO services, followed by Singapore. In most other countries there is almost no history of outsourcing other than product support, education and training and some application development. The Indian market is largely export oriented with exports of IT services and BPO services far outstripping the domestic market size, which is still largely immature. BPO markets in China, Taiwan and Malaysia have a large contract-manufacturing base, but outsourcing of other business processes has yet to take off.

According to Gartner’s Scholl, enterprises around the world are attempting to focus their investments on their core business processes and are increasingly looking at outsourcing non-core business processes. Early adopters of BPO services, primarily large organizations, continue to expand their relationships to include new process areas, and new technology and media are creating opportunities for outsourcing entire lines of products and services, such as online payroll, online benefits administration, online order management and online transaction processing.

Key Drivers of Growth

¬ **Attempt to focus on Core Competencies**. The number one driver behind the growth in the BPO market today is an increase in the number of enterprises that are reviewing their internal operations in an attempt to more fully understand their true core competencies, and focus on only those competencies. All other internally provided services then become candidates for examination in terms of how efficiently and effectively those services are being delivered compared to what is available from an external service provider. This decisioning process often includes an evaluation of the cost of owning technology – with its associated support costs, that are not core to the enterprise (HR applications as an example). This is leading to an increased willingness to outsource processes considered non-core, yet critical – activities such as claims administration, HR services and payment services.

¬ **Desire to Improve Service Levels.** A secondary driver of growth in this market is a desire by enterprises to improve their current service levels. BPO offers enterprises an opportunity to do so in many cases, and at the same time removes the requirement for the capital expenditure that would be necessary if the enterprise sought to improve those service levels internally. Service providers who can best communicate their ability to deliver significant process improvement (as opposed to simply taking on an existing process in a status quo manner) are likely to emerge as the market leaders who will change the way in which business has traditionally been done.

¬ **Aim of reducing internal costs.** The third most prominent driver of growth in this market – not surprising given the current economic environment – is a desire by enterprises to extract all possible costs from within their internal operations. Any chance of decreasing transaction-processing costs frees up precious capital that can then be applied to more strategic initiatives.

Market Trends

The BPO market is expanding

Successful providers have best practices, methodologies, and industry standards that allow deals to get done quickly. The entire BPO field has learned from past deals, so we now see bigger deals with better foundations. As a result, BPO is continuing to be used in new functional areas, new industries, and across the world.

BPO has come a long way in the past three years

Three years ago, BPO meant payroll processing and benefits administration – not exciting enough to talk about at a conference. Mainly the big consulting firms were talking about it, said Scholl of Gartner Dataquest. Since then the mega-deals have become very important in shaping the new form of BPO. The field has become much more segmented, complicated, and sophisticated. It will fundamentally change how businesses work.

The BPO market is growing, but not as fast as expected

BPO is still the top growth market for IT services, but several factors – the economy, the BPO adoption curve, and the technology innovation downturn – have slowed its growth. BPO is driving growth in system integration and IT services. Every single BPO engagement includes sub-components of IT consulting, application development, IT outsourcing, and process management.

The key drivers of BPO have changed

Cost savings and variable cost structures are more important. Information security, the ability to execute, and business continuity have also become more important. But strategy and transformation are less important. As are innovative financial and tax structures.

Technology management – including IT outsourcing – is moving into the hands of process-based management organizations

Of 50 CIOs surveyed, on average, they outsourced 28 percent of their IT budget, said Bobby Cameron, Principal Analyst at Forrester Research. And they are looking to outsource 34 percent. One company has out-sourced 76 percent of its IT. This is just the tip of the iceberg. The ITO paradigm is being restructured. IT organizations used to build everything. Now an increasing amount of their work is below ground. The emerging business model is collaborative and operates at a process level. Firms specialize in their core competencies and collaborate with other specialists for the balance of the work. The technology to operate these outsourced processes – which used to be supplied by internal IT – is now provided by the process outsourcer.

The market drivers are more practical than in the past

Gartner Dataquest conducts a BPO survey every fall. In fall 2001, the top two drivers of BPO were *focus on core business* and *reduce costs*, both of which are more practical than the previous year's top driver: *gain competitive advantage*.

Companies are either doing BPO or not even planning to do it

There's not much middle ground at the moment, said Pierre Mitchell, Vice President of Research at AMR Research. A joint survey by AMR Research and *CFO Magazine* found that those doing BPO are aggressively doing it in non-core areas to save money or gain expertise. It's not about reducing headcount or reducing capital costs. Travel and payroll are the most outsourced functions, by far, ahead of outsourcing accounts payable, asset management, expense reporting, indirect procurement, recruitment, direct procurement, and warehousing. As big suppliers become committed to procurement BPO, it is growing. The top three criteria are vendor viability, domain expertise, and price. And while 64 percent of the respondents said BPO is growing (and only 2 percent said it was shrinking), only 55 percent justified BPO on return on investment – even though they should, to show that value is delivered. CFOs are involved in 90 percent of the decisions. The average contract life is one-year (41.4 percent) and three-year (28.8 percent), but 50 percent of the contracts are three-year contracts in companies with revenues over $500 million.

BPO staff will come from numerous sources

People from industry may have process experience on a large scale, but they often do not have multi-client skills, which they need because they must serve different clients in different ways every day. Some people come from consulting, but they often lack operating experience. And IT people lack domain (process) expertise. As a result, BPO providers must mix-and-match skills from these different sources.

Integrators with outsourcing expertise are gaining ground on BPO specialists

The integrators are learning specialty areas more quickly than the specialists are learning to form outsourcing agreements and manage service delivery.

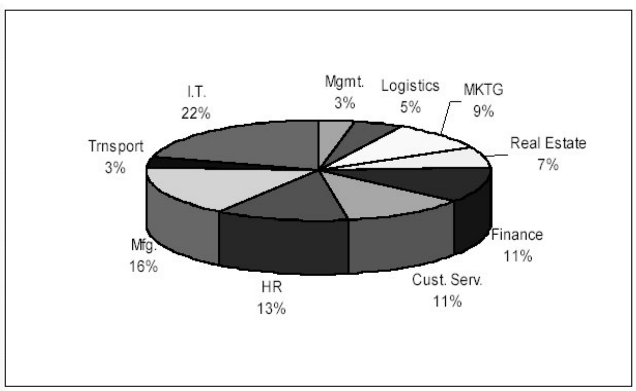
The next generation of procurement outsourcing will be procurement utilities

These are utilities that companies "plug into" to get the procurement services they need. These utilities will have standardized processes, a common infrastructure, and a menu of procurement services. Companies will select from the menu and thereby leverage the common processes and infrastructure.

BPO expansion is going to be infinite

Providers will find ways to get to this higher-margin work. In fact, the BPO marketplace is similar to the ITO marketplace in 1992-93. That's when CEOs and CFOs asked their CIOs, "Why aren't we doing this?" In the not-too-distant future, there will be a BPO deal or series of deals that galvanizes the BPO market. When that happens, this market will grow faster than the ITO market did.

Market Segmentation



Source: McKinsey

BPO Business Models

There are three business models of BPO: transactional, niche, and comprehensive. As shown in the figure below, there are several characteristics that distinguish between these three flavors of BPO.

BPO Business Model	Transactional	Niche	Comprehensive
Number of processes	Transactions only, typically for 1 process	2-4 processes	10+ processes in a function; sometimes more than one function
Invest in client assets?	No, migrate everything to their system	Yes – but modest dollars and personnel take-on	Yes – significant dollars and employee take-on
Hire client's people?	No	Yes – but usually < 50	Yes, usually > 100s and often in the 1000s
Locations	Work at provider's location; very low headcount at the client site – typically account managers and sales people	Mixed, people at both client and provider locations	Mixed, people at both client and provider locations
Geographic spread	Multi-country	Domestic (> 80% of revenue) with some international (typically Europe)	Global
Contract duration	1-2 years	3-5 years	7-10 years
Contract value per year	$1-5 million a year	$5-10 million a year	$50-$100 million a year
Business model	Offload transactions from client, use provider's software	Make processes more efficient – reduce costs, raise service levels	Make functions more effective, introduce best practices
Accountability	For the transaction processing	For process outcomes	For cost savings for the entire function plus business outcome
Risk-holder	90% of the risk is still on the client, 10% provider	50% client, 50% provider	30% client, 70% provider
Metrics	Per transaction	Based on outcome	Based on outcome

Source: TPI

Transaction providers handle the transactions for only one process. In payroll, for instance, they do not take over your payroll department; they only cut the checks. They do not take on your people, their contracts are short (1-2 years), and the contract values are not large ($1-5 million a year). Using transaction providers has many benefits, but the more processes you outsource, the more fragmented your processes become. In essence, you still have an in-house department to manage. In transaction outsourcing, most of the operational risk stays with the client. There might be penalties for non-performance, but these are minor because the client still retains most of the function in-house.

Niche providers focus on two to four processes. Niche providers will hire your people, but only up to 50 or so. They will invest modest amounts of capital to release some of your asset value. For instance, they will invest money migrating assets to their system or they will buy your assets in their specialist process area. Niche providers are generally domestic, and their deals range from three to five years in length, with a yearly contract value of $5-10 million. Niche providers aim to make selected processes more efficient, by lowering costs and raising service levels. They are paid based on outcomes, such as lowering turnover or reducing hiring time from 120 days to 90 days. In niche outsourcing, risk is typically shared evenly between client and provider. Although the providers will hire your people and be responsible for outcomes, they only make limited investments in capital and only impact a few processes. Thus, clients continue to shoulder the other processes in a function.

Comprehensive providers handle almost all the transactional and administrative processes in a function, or even several functions, such as HR and financial accounting. For instance, there are 22 processes in HR and 33 processes in finance and accounting. Comprehensive BPO prefers global deals, which are typically 7-10 years in length, and are generally over $100 million a year. These providers will buy client assets and will take on hundreds and sometimes thousands of client staff. Comprehensive providers strive to make interrelated processes more effective, so they aim to reduce the total cost of a function by introducing best practices – such as requiring direct deposit of payroll or increasing the HR-to-employee ratio from 1:50 to 1:300. They are accountable for cost savings as well as outcomes for an entire function, so clients pay for outcomes, not inputs. Comprehensive providers shoulder 70 percent of the operational risk of the in-scope processes because they are responsible for the information technology, transactions, and administrative elements of those processes. Furthermore, they invest significant amounts of capital in the relationship, and they absorb most client personnel. The risk to clients is that comprehensive BPO is new – it's only been around for two-three years – so providers are less mature, their processes less proven, and most have very few reference-able accounts.

Competitive Positioning – Offshore BPO Destinations

Analysts predict that the market for business process outsourcing (BPO) done offshore will hit US$1.8 billion in 2003, up from US$1.3 billion in 2002. Still, the offshore BPO market will make up just 1.5 percent of the total BPO market this year.

Gartner analyst Rebecca Scholl strongly emphasized that if enterprises that have been developing offshore sourcing strategies over the last few months successfully conclude pilot projects, the growth in offshore BPO during the next couple of years will be significant, as a result of contract expansions and new adopters.

Moving work overseas has appealed to some corporations, partly because of low salaries in countries such as India, the Philippines and Mexico. U.S.-based organizations that offer information technology services, such as Electronic Data Systems and Computer Sciences, have been eager to take on BPO work as IT spending has flagged.

The overseas outsourcing push has met with some resistance in the United States, as domestic workers see their jobs shipped offshore. For example, the New Jersey state senate has approved a bill requiring that only citizens or legal residents of the United States work on certain state contracts.

India is the top country for delivery of offshore BPO services among large companies, Gartner said. India' s revenue from BPO will grow from slightly less than US$1 billion in 2002 to US$1.2 billion in 2003 and will represent 66 percent of the offshore BPO market, according to the research firm. But other countries are gunning for a share of the business.

Although India dominates the market today and for the near future, other English-speaking nations across the world are ramping up their delivery capability and putting into place aggressive investment-friendly policies to attract BPO investment.

Comparing India with other BPO Destinations

The abundant skilled manpower has made India a target destination for multinationals to back end their operations in India. India ranks high in areas such as qualifications, capabilities, quality of work, linguistic capabilities and work ethics, and thus is ahead of competitors such as China, Philippines, Ireland, Australia, Canada etc. Indian companies have unique capabilities and systems to set, measure and monitor quality targets.

In specific BPO categories, Indian centers have achieved higher productivity levels-for example, the number of transactions per hour for back office processing, than their Western counterparts. Also, India is able to offer a 24x7 service and reduction in turnaround times by leveraging time zone differences. India' s unique geographic positioning makes this possible. Many state governments in India are offering incentives and infrastructure to set up IT enabled services.

About 100,000 engineers graduate from India every year. Many of these engineers are employed with call centers for troubleshooting and providing technical support at salaries that are dramatically lower compared to the pay scales in the US. The average monthly salary in India is $400-700 compared to $2,700-2,800 in the US.

BPO	India	Philippines	China	Russia	Canada	Ireland
Government Support	High	Medium	Low	Low	Medium	High
Labor Pool	High	Medium	Low	Low	Medium	Low
Infrastructure	Medium	High	Medium	Low	High	High
Educational System	High	Medium	High	High	High	High
Cost Advantage	High	High	High	High	Medium	Low
Quality	High	High	Low	Low	High	High
Cultural Compatibility	Medium	High	Low	Low	High	High
Time/Distance Advantage	High	High	High	Medium	Low	Low
English Proficiency	High	High	Low	Low	High	High

○ - Low ● - Medium ● - High

Source: neoIT

CHINA

In the outsourcing field, China is the biggest challenge in the future and the largest threat to India. With the largest population and fastest economic growth, China has at least two strengths in the global outsourcing market: manufacturing and IT.

The main advantages of China are as follows:

¬ **Lower Manpower costs**: The Chinese workers cost about 15 percent less than equally qualified Indians.

¬ **Japan Advantage**: China is likely to grow through the Japanese outsourcing route. The advantages that China has are Japan' s proximity to China, similarity of the languages. India currently offers almost no BPO services in Japan.

¬ **Extremely low cost real estate and power**: These costs are lower than in India. This can be a very attractive to the US companies, which are looking for cost cutting due to the downturn.

¬ **Proactive Govt.**: The govt. is very friendly to this sector and has taken the following steps.
○ *English teaching and other skill sets*: Over $5.4 billion was invested in nine universities in China to promote English language and other skill sets.
○ *Increasing telecom density and PC penetration*: China scores over India in these aspects and intends to further increase the gap.

¬ **Leveraging on the manufacturing image**: Western manufacturing companies have found that outsourcing their manufacturing function to China for their companies' global operation can be profitable and also of good quality.

The main disadvantages of China are as follows:

¬ **Lack of a good Quality record in Software**: India has a better image as a quality supplier mostly due to its track record of better quality software than China.

¬ **Low English speaking population**: This is the biggest drawback of China. It has a very small proportion of the population speaking fluent English.

¬ **Less mature**: The Indian business processes are much more mature. China has only recently entered into BPO. As such, despite lower billing rates, total project costs in China would turn out be higher because of the higher overheads incurred.

PHILIPPINES

In the Philippines the manpower costs are 60 to 80 percent lower as compared to UK and US. The average salary cost is around $700-800 per month in the BPO sector. The country has a shortage of manpower mainly due to the small population as compared to India. The manpower base for BPO is only 300,000. Right now the country is getting business from nearly 70 companies employing more than 12,000 people with revenues of US$ 250 million.

The main advantages of Philippines are as follows:

¬ **Large scale technical training program**: The govt. has initiated a no. of policies by which the skills can be provided to a larger population.

¬ **Improved telecom and office infrastructure**: Philippines scores over India in this respect.

¬ **3rd largest English-speaking nation in the world**: This is a very important advantage.

¬ **Well developed IT skill set**: It is considered 2nd only to India due to performance in software.

¬ **Costs of technology workers**: This is(which represents the biggest recurring costs for, say, a B2B site) is only around 16% to 25% in the Philippines to that of comparable workers from the United States.

¬ **Former American colony**: As a former American colony, American culture and language is widely emulated here. These cultural and communications skills could prove to be so appealing to American firms that they would outweigh slightly higher labor costs in the Philippines.

The main disadvantages of Philippines are as follows:

¬ **Low graduate turnout**: Philippines has a low graduate turnout (only 400,000 per annum). This compares very unfavorably with India.

¬ **Not having a record of high quality**: India has consistently delivered very high quality in Software and has built a very high reputation in it.

¬ **Political instability**: The country has frequent elections which makes it difficult for companies to outsource as there is lack of uniformity of policies with changes in the Govt.

¬ **No disaster recovery facilities or multi-location facilities**: After the WTC bombing terrorism has become a very important issue for the US companies in particular and they want that the BPO providers should have multi location facilities which can be used in case of any terrorist attack.

¬ **Issue of scaling up**: Philippines faces the important issues of scaling up. Issues like scaling up have stunted the growth of BPO activities being outsourced to Philippines. The largest call Centre in Philippines of AOL has only 800 people. The size of the Philippines BPO industry is only $100 million, whereas India' s BPO industry is presently at $1.5 billion (2001-02).

IRELAND

It was one of the front runners in the BPO and started much earlier than India. Thus it has built good brand equity in US. It has a very conducive regulatory framework and is known for excellent quality standards. The country that has strategically pursued developing outsourcing services market and is planning to invest heavily in telecom infrastructure ($5 billion over 10 years).

But it suffers from a very big disadvantage of a lack of a large human resource pool. It has nearly 500 companies employing more than 40,000 people. Also it compares very poorly with India and China in terms of Manpower costs. Ireland is actually the biggest exporter of software services in the world today. But there is currently a shortage of programmers in Ireland and companies are forced to outsource work to India.

The other countries, which have a share in the BPO sector, are given below. These countries are not serious competitors to India mostly due to the small population base.

AUSTRALIA

It has a mature BPO industry with 4000 call centers employing 225,000 people with US$ 5.7 billion revenue. It has the advantage of large English speaking population with a favorable time zone.

CANADA

Since only five per cent of total BPO business (by year 2005) from United States would be offshore amounting to US$7.5 billion, Canada and Eastern European States could put severe pressure on India on price front, besides being sought after for their near-shore capabilities by the US.

India: A SWOT Analysis

Strengths	Weaknesses (Challenges)
• Solid history in software development • English proficiency • Government Support • Cost advantage • Strong tertiary education • Process quality focus • Skilled workforce • Expertise in new technologies • Entrepreneurship • Reasonable technical innovat9ions • Reverse brain drain • Existing long term relationships	• Positioning & Brand management • Infrastructure • Cultural differences • Sales & marketing • Leverage expertise for higher-value education • Business process experience • Distance from US • Fear/Uncertainty from Pakistan • Legal system • Poor globalization skills
Opportunities	**Threats/Risks**
• Creation of global brands • BPO & Call center offerings • Expansion of existing relationships • Chinese domestic & export market • Leverage relationships in West to access APAC/Middle East markets • Indian domestic-market growth	• Internal competition for resources • Over-promise / Under-deliver • Regional geopolitical uncertainty • Rising labor costs • Competition from other countries • Sometime blinding nationalism • Government blocking reform/deals • Corruption/piracy/trust • Political & religious instability –war