

The Outsourcing Study

Emerging Opportunities in non-BRIC countries

The Global offshore outsourcing market for IT and business services has exceeded \$55 billion USD in 2008 and some estimates suggest an annual growth rate of 20% over the next five years. In 2008, India exported \$40 billion of ITO and BPO services, while China, Russia and Brazil managed \$5 billion, \$3.65 billion and \$800 million respectively. However, there also were 120 other active offshore locations offering IT and business process services. All were looking for new business. Moreover, the BRIC countries are not without their problems, with Brazil and China hardly leveraging their potential, Russia lacks of government support and is being led into high-value but niche work, while India and China may even be seen turning to Non-BRIC locations for some of the solutions. All this points to the fact that relative attractiveness of BRIC and non-BRIC countries as offshore, outsourcing and business locations is highly dynamic.

Major Trends for IT Outsourcing Industry by LSE

Specific Research was undertaken by the Outsourcing Unit at the London School of Economics and Political Science (LSE) to identify major global trends for outsourcing market that will develop over next five years. The analysis points to 11 major trends shaping global sourcing, and so impacting non-BRIC activity over the next five years. Also, the report provides with the most recent research and details as to how the economic downturn will have mixed and impacts on this trends. The implications of each trend are identified for non-BRIC countries along with their attractiveness and possible responses over the next five years.

Trend 1: *the rising spend on outsourcing markets - BPO will overtake ITO within 5 years*

According to the study the global BPO market grew at a faster rate than ITO market in last years. In 2008, the global ITO market was estimated to be worth between \$220 and \$250 billion, while the BPO market was less. The estimate for ITO market, over next five years shows that it will grow by 6-9% per annum while BPO expenditures is likely to grow by 10-15% a year, from \$140 billion in 2005 to potentially \$230 billion by 2013.

Trend 2: *the growth of multi-sourcing*

Although the spending on ITO and BPO services is increasing, the average size of individual contracts and the duration of contracts is decreasing. The study claims that client organizations are actively perusing more multi-sourcing. Multi-sourcing has always been the dominant model and the overall growth driven by client organizations signing more contracts with more suppliers. However, while multi-sourcing allows client to access most fitted suppliers and mitigates the

risks of reliance on a single suppliers, it also increases transition costs as suppliers must bid more frequently because contracts are shorter and suppliers face more competition.

Trend 3: *India's changing role*

There is an evidence that US and EU clients initially used Indian suppliers to provide technical services, such as programming and platform upgrades. As the relationships matured, clients assigned more challenging work to Indian suppliers, including development and support task for critical business applications. The suppliers from three leading Indian suppliers mentioned their wish to assume higher-value tasks, such as research and development, and knowledge process outsourcing.

However Indian, and to a lesser extent China, Brazil and Russia are already experiencing upward pressure on wages, combined with rising, sometimes high, labor turnover rates. Also, both India and China are increasing their own offshoring of IT and BPO work to other countries.

Trend 4: *China Promise*

In 2006, China invested \$142,3 Billion in its ITO and BPO markets, specifically in information and communication technologies, to secure its global position in offshore/outsourcing services. China's long term ITO/BPO future is seen to be strong. The Everest Group estimated that Chinese offshore services market was only \$2 Billion in 2006, but it predicts a growing of 38% annually to reach \$7 Billion by 2010.

Despite the optimism, many client organizations are wary of China's ITO and BPO services. Language and cultural barriers along with fears to lose intellectual property remain significant obstacles for many companies in US and Europe.

Trend 5: *emerging country competition*

In addition to India and China, suppliers from all continents will develop centers of excellence. In US and Western Europe, organizations will increasingly outsource IT and business services to providers located in closer proximity with less time zone differences and lower transition costs than Asian alternatives. By the end of 2008, the Central and Eastern European ITO market exceeded \$3.5 billion, with Russia also exporting over \$3.6 billion of IT and business services.

Trend 6: *returning to "software as a service"*

According to the reports back in 2002 many large organizations were not interested in renting applications, services and infrastructure over networks. They already had ASP product offerings and expertise in-house, and they wanted customized services and to source to stable providers, not risky start-ups. Many analysts thought that ASP died with dotcom bust but there are several reasons (see below) to believe that organizations will reconsider ASP for targeted activities, not least as it evolves into software as a service

- large organizations want net-native applications that are available through ASP delivery

- organizations are ready to abandon their expensive proprietary suites for cheaper ASP alternatives
- ASP providers realize that customers want customized services, and the need of customized services increases service providers viability as they can generate profits by charging for value-added services

Trend 7: *outsourcing helps insourcing*

As organizations become smarter at outsourcing, they also become smarter at insourcing. In-house operations are facing real competition in nearly every area and can no longer assume they will retain their monopoly place with the organization. As a result, in-house operations are adopting the techniques of the market. However, insourcing will be impeded by a shortage of talent within developed countries, particularly for IT skills. Nearly every research report suggests that US and Western Europe countries will suffer a shortage of domestic IT workers within the next five to ten years. For example, the UK will experience a shortage of 714,000 IT workers by 2010, while US is projected to short of 17 million skilled workers by 2025, France, Spain and Germany each with 3 million and Italy with 2 million short.

Trend 8: *Nearshoring - a strong trend*

Nearshoring is defined as outsourcing work to supplier located in a lower-wage foreign country close in distance and time-zone. Compared with offshore outsourcing, the benefits of nearshoring include less travel costs, less time-zone differences and cultural affinity. In the Nearshoring studies experts are arguing that the distance still matters and point to customers choosing nearshore option to gain benefit from one or more of the following constructs of proximity: geographic, temporal, cultural, linguistic, economic, political and historical.

The Central and Eastern Europe is significant Nearshore destination for Western Europe. According to a 2006 Deutsche Bank Research imports of IT services from the Central and Eastern Europe to Western Europe increased an average of 13% per year between 1992 and 2004. This growth nearly comparable to the import of IT services from India, which averaged 14% per year over the same time period. Clients from Western Europe are attracted to Central and Eastern Europe European suppliers for many of the same reasons that US customers attracted to Canadian suppliers: common language, cultural understanding, minimal time zone differences, geographical proximity and low labour costs.

Trend 9: *knowledge process outsourcing is increasing*

Knowledge process outsourcing (KPO) is the outsourcing of business, market and industry research. KPO requires significant amount of domain knowledge and analytical skills. Although the KPO market was, in 2008, quite small, industry analysts expected a huge growth in this sector over the next five years. There are some estimations that the KPO market will be 17 billion by 2010-2011, employing approximately 350,00 professionals around the globe.

Trend 10: *captives - building and selling*

While it is widely recognized that Western companies are setting up sites offshore, there is an emerging trend called "The GE effect". General Electric established first captive center in India, in 1997. In 2004 GE sold off 60% of its center to two equity companies. A year later the name of the center was changed and now it is one of the top 10 ITO/BPO service providers in India. With virtual captive center, the company owns the physical operations, but the staff are employed by a third-party supplier. Presumably the captive center offers the best of both worlds - the client investor still maintains strategic control but the supplier equipped to attract, develop and retain local talent.

There are several examples of US companies selling their captive centers. The Black Book of Outsourcing 2007 survey found that selling captive centers may indeed be a significant trend. Among the survey respondents were 487 companies with captive centers in India and Philippines, and 29% of these companies were actively seeking to sell out their centers.

Trend 11: *outsourcing successes and disappointments*

According to Outsourcing Unit it is estimated that over the next five years some 70% of selective sourcing deals will be considered relatively successful. Presumably, clients will be spending anything between 15-58% of their operating budgets on outsourcing, usual to several, sometimes multiple, suppliers. In contrast, it is estimated that only 40% of large scale deals involving complex processes that represent more than 80% of operation budgets will be successful, 30% will have mixed outcomes and 30% will seen as failures.

The Outsourcing Unit at the London School of Economics and Political Science (LSE) states that economic downturn will have a deep impact on trends identified above. By early 2009 there was an evidence of client behaviors observed during previous economic downturns

- Deferring project decisions
- Consolidating vendor relationships
- Delaying making decisions to commit new contracts
- Looking for dramatic costs savings

All that means that providers will need to be clever in cost control, financial planning and innovation, both for themselves and clients. Providers will also need to be inventive with how they add value in contracts.

At the beginning of downturn, some organizations took a drastic measures to cut costs and headcount, and hold existing and new projects fire. Others continue to invest in their long-term strategy, though sometimes doing this at a slower rate. The research indicates that the offshoring and outsourcing markets will remain dynamic, both for BRIC and non-BRIC destinations.