

EquaSiis Market Assessment

Data, Research and Analysis on the Global Business and IT Services Markets

The Findings

Market Pulse Update: The Impact of the Economy on Demand for Outsourcing – Causing a Lull or Bursting a Bubble?

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The recently completed 4Q08 EquaTerra Pulse survey found that current global economic conditions are slowing buyer outsourcing efforts and, in some cases, bringing them to a grinding halt. This is not surprising. Customers struggling to simply stay in business may not have the resources or time to undertake major outsourcing efforts.

Service providers, however, have a larger concern beyond this short-term decline in demand – is buyers' appetite for outsourcing actually diminishing? Are customers reevaluating their use of information technology and business process outsourcing (ITO/BPO) in light of the recession and other troubling global events, such as terrorism in Mumbai and financial fraud at Satyam? Are the global business and IT services markets bubbles that have burst like those of the housing and financial markets? While some may hope so, EquaSiis projects that market realities will ultimately disappoint them.

The global services markets are undeniably changing. Though disruptions to deal flow will continue throughout 2009, the long-term projection for the growth of outsourcing and other forms of third-party service delivery remains very positive. The speed and degree of recovery for the markets, however, are as much in the hands of service providers as buyers.

The Details

The nature of buyer demand for outsourcing and other major third-party business and IT services investments is evolving. Service providers must adapt strategically and alter their tactical practices to ride out near-term market disruptions.

Figure 1 from the 4Q08 EquaTerra Pulse survey illustrates the impact of the economy on buyer demand for outsourcing over the past four quarters.

Economic conditions are causing customers to slow down or reassess their outsourcing efforts, according to 54 percent of the EquaTerra advisors and leading

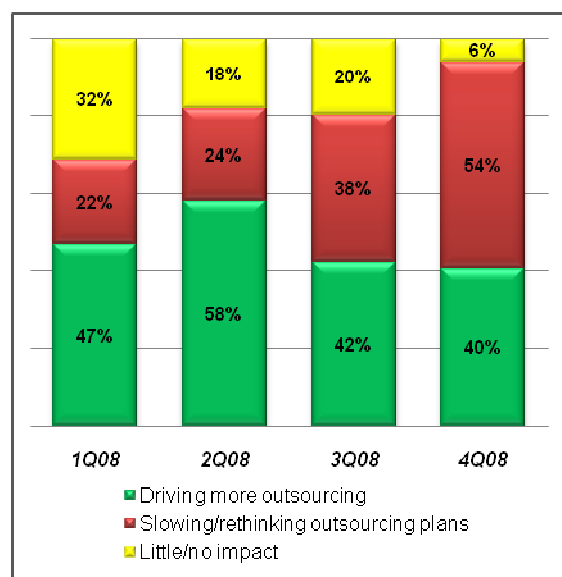


Figure 1 – Economy's Impact on Outsourcing

business and IT services providers polled. This is the highest percentage recorded over the past year and the fourth straight quarterly increase. On the other hand, 40 percent of those surveyed indicated that economic market conditions are driving up demand for outsourcing. This is down from 42 percent in the third quarter and the lowest level for the year. Only a small handful of advisors and service providers believed that the economy is not impacting outsourcing decisions.

How should outsourcers interpret these results? Is there a contradiction between over one-half of respondents maintaining that the economy is adversely affecting outsourcing efforts and 40 percent claiming this is not the case? The answer is no. Further analysis confirms that economic conditions are both increasing demand for outsourcing and holding up new deals in the services markets.

Sluggish deal flow does not necessarily mean that demand is decreasing. It is often an indicator that customers are rethinking their outsourcing plans in the context of scope, terms and conditions, and goals, not determining whether to move forward or not. Many buyers have deferred deals, but few have cancelled them. The deferrals are, in most cases, a result of other events that occurred in their organizations and impacted the sourcing process – not a sign that they changed their minds about ITO/BPO.

While there are early indications that deal flow has begun to pick up pace in the first quarter of 2009, service providers must still do their part to continue to accelerate this process. The nature of buyer outsourcing demand is changing. Broad transformational outsourcing efforts – those with questionable or long-term results or that require larger investments up front – are out. Efforts with short-term, realistic and measurable return on investment (ROI) models and those that deliver quick cost savings are in and often moving forward. Successful outsourcers will quickly adapt and respond to these changes in customer demand characteristics.

The Advice

It is an imperative that service providers evolve their value propositions and operating models to reflect existing market conditions. This is not just a cyclical adjustment. The world is experiencing the worst recession since the 1930s. The impact of current events and customers' responses to them will have a much greater impact on the global sourcing markets than other more recent financial downturns. Buyers – particularly legacy Western organizations in troubled industries – must radically overhaul their operating models just to survive, much less compete. This is especially true in the case of expensive support service delivery.

The urgent need to overhaul their service delivery models under tough economic conditions means that buyers have little tolerance for failure. Service providers with questionable skills (those that are cheaper for good reason) or limited process and industry knowledge and those peddling bad business cases, faith-based outsourcing efforts and vague transformational change will find themselves increasingly shut out of opportunities. Providers on the fringe will not be the only ones that suffer this fate.

The 4Q08 EquaTerra Pulse survey identified the leading obstacles threatening buyers' ability to consummate outsourcing efforts. These are areas where service providers can improve their operations and capabilities. Where possible, they must work hard to help customers meet these challenges. However, outsourcers should guard against pursuing deals with potentially problematic buyers that could prove frivolous or even dangerous in the future.

Buyer Challenge Number One

The major challenge cited by over 40 percent of those polled was effective change management, such as the ability to successfully complete the sourcing process given turmoil in the organization, adequately staff the transition team, and prepare and execute the transition.

There are many ways that service providers can help buyers address and overcome change management challenges in an outsourcing effort.

- **Simplify.** Providers need to present clear and concise recommendations. They should limit the amount of change required initially and put off more involved improvement efforts for the future when the buyer is more able to focus.
- **Support.** Outsourcers should offer to provide change management expertise and support customers in developing their own change management plans and programs. Providers can supply templates, tools and guidelines and even connect buyers to other customers with change management expertise for additional support.
- **Speed up.** Service providers can accelerate the transition process by leveraging the two points above. They must clearly define benefits and tempt buyers to move forward with aggressive – but realistic – time lines, achieving the best result possible in the shortest viable time frame.

Buyer Challenge Number Two

Another significant challenge mentioned by over 40 percent of those surveyed was the overall cost to do the deal. While buyers must typically make an investment to enter into a new outsourcing deal, it is more difficult for them to do so under current market conditions. Providers must tailor their offerings to mitigate this limitation when possible. However, the ability and desire of an outsourcer to do this depends not only on its profile and financial strength, but also on whether the buyer in question is a premium customer or prospect account worth the extra effort.

One way to reduce costs, particularly with an existing customer, is to simplify and accelerate the sourcing process into a spend sourcing effort. Limiting process improvement work on the front end, back-end loading transition costs, and spreading costs over the life of the agreement can also help. Finally, providers with the means and resources to do so can offer to fund transition costs either directly or through more lucrative and aggressive asset transfer programs. Again, it is important to assess these options in the context of the deal and only offer them to deserving buyers.

Service providers must ensure that the business and benefits case they propose to buyers meets their current needs, which are likely to have changed recently. Even for deals in midstream, it is important that the benefits sought and the means to achieve them fit the current buyer profile.

Providers should also assess where they can rebalance their offerings or market position to reflect changing buying patterns. This could, for example, mean highlighting local delivery capabilities to counteract buyer concerns over global sourcing. Larger and more financially stable service providers should proactively and tangibly draw attention to these economic strengths when competing with – or taking business from – smaller competitors.

Conclusion

The global recession has slowed outsourcing deal flow. Even though buyers need to reduce costs and overhaul their business models now more than ever, their ability to do so via outsourcing is diminished. This is a function of being unable to successfully undertake the process to source new deals and define terms and conditions that fit into the new and more challenging business environment. Service providers must evolve and adapt their approach and repackage the bundle of benefits they can provide their customers.

The nature, quality and structure of the supply – which has not responded effectively to current market conditions – have driven part of the decline. As service providers better tailor their value propositions and offerings to the market environment, they will help to stimulate demand for their services.

About EquaSiis

EquaSiis, an EquaTerra company, provides software and services that improve the business support services lifestyle for shared services, outsourcing practitioners and service providers. The software, EquaSiis Workbench and EquaSiis Enterprise, is a framework for collaboration used during the service delivery assessment and sourcing process to assist in analysis and decision making for shared services or outsourcing. EquaSiis provides intelligence and optimization for the delivery of business support services across the entire organization. The company also offers service providers market intelligence, research, customer satisfaction and trending data through its Insights group. For more details about EquaSiis' research offerings, please contact Stan Lepeak, stan.lepeak@equasiis.com.

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