

EquaSiis Market Assessment

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

The Findings

Market Pulse Update: Outsourcing Demand Comes Back – Are Service Providers Ready?

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The recently completed 1Q09 EquaTerra Pulse survey found that buyer demand for outsourcing rebounded in the first quarter of this year. Pent-up demand from the second half of 2008 – along with entirely new business – began to flow into the market. This recovery will result in an increase in signed deals in the third and fourth quarters of 2009.

The following list summarizes the key findings of the 1Q09 EquaTerra Pulse survey:

- Forty-nine percent of EquaTerra advisors indicated that overall customer demand for third-party business and information technology (IT) services was up in the quarter. This is an increase of 11 percent over last quarter but a 3 percent decrease from the first quarter of 2008.
- Just 10 percent of advisors felt that demand declined during the quarter, above the survey average of 6 percent but down 3 percent from last quarter.
- Advisors supporting work in Europe were somewhat less positive about overall buyer demand growth than those in the Americas. Advisors supporting global deals were the most optimistic.
- Fifty-nine percent of advisors cited information technology outsourcing (ITO) as the strongest area of demand across the four service delivery categories, followed by business process outsourcing (BPO) at 22 percent.
- Fifty-seven percent of service providers polled noticed pipeline growth during the quarter. This level is up 26 percent quarter over quarter and 14 percent year over year and in line with the survey average. Only 5 percent observed a decline.
- Sixty-two percent of service providers polled expect buyer demand to grow next quarter, up 9 percent from last quarter and 12 percent from the first quarter of 2008. None expect it to decline.

The reason behind this increase in demand is that buyers can no longer wait to respond to bad economic conditions. Change, often of a radical nature, is required to realign costs and operating models with market realities. EquaTerra is increasingly seeing customers use the current recession as a motivator to pursue aggressive transformation efforts that they were too timid or distracted to undertake when times were good. They have a strong desire to make deep cuts and major service delivery model adjustments in order to better compete with increasingly intense

global competition. As one advisor noted, “I see outsourcing plans being investigated under the current cost pressure that would never have even been discussed in a normal economic climate.”

This is obviously good news for outsourcers. However, there are also less positive findings to report. EquaTerra polled its advisors to find out how well third-party business and IT services providers are currently responding overall to the changing needs of buyers in areas such as pricing levels and models, the mix of onshore and offshore work, and flexibility and creativity in the sourcing process and deal structuring. Advisors ranked them on a scale of one to five, with one being those that are doing a poor job and not responding at all and five being those that are doing a good job and very responsively reacting. On average, providers scored near the middle (2.99). No advisors felt that they are being very responsive.

The Advice

A major challenge for outsourcers is addressing buyer needs that have changed – often dramatically – over the past 12 months. What worked and appealed to customers last year often will not fly today. EquaTerra polled both advisors and service providers in the 1Q09 EquaTerra Pulse survey to determine how market conditions are impacting new deals coming into the market (see Figure 1). It is critical that providers adapt their go-to-market strategies and offerings appropriately.

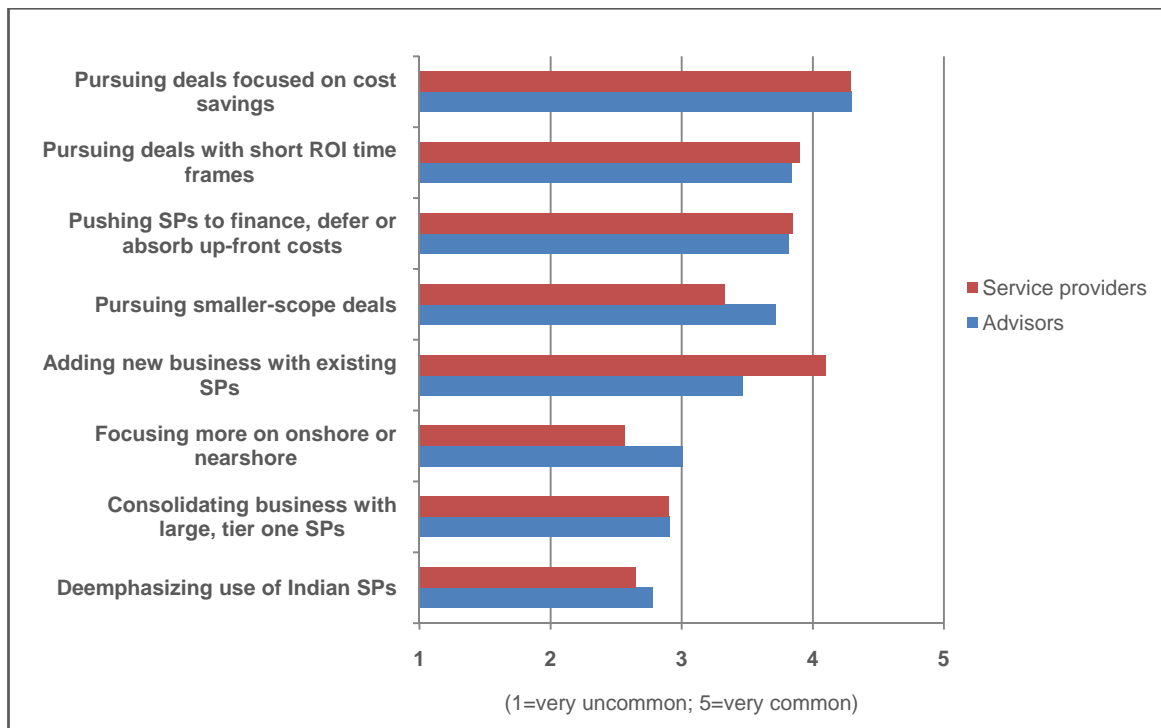


Figure 1 – Impact of Market Conditions on New Deals

- **Pursuing deals focused on cost savings:** This is nothing new, and the need is obvious under current market conditions. This presents two challenges for outsourcers. One is to still provide measurable value while simultaneously lowering buyers' costs. The second is to defend themselves against overly aggressive pricing pressure from some customers – a lowball deal does neither a service provider nor a buyer much good in the long run. Providers need to excel at haggling. For example, they can offer more favorable pricing in the short term to help a customer meet its cost savings goals in exchange for a longer term or greater scope in a deal.
- **Pursuing deals with short return on investment (ROI) time frames:** Customers need immediate costs savings. To win business, service providers must show that they can deliver significant benefits in an accelerated time frame. Exploiting labor arbitrage opportunities, taking over buyer assets, back-end loading some costs, and deferring more expensive process improvement efforts are all ways to achieve this goal.
- **Pushing service providers to finance, defer or absorb up-front costs:** Providers in a position to innovatively structure and finance deals have an advantage in today's market. However, they need to guard against getting too creative and reserve the best deals for top customers that are in acceptable financial positions.
- **Pursuing smaller-scope deals:** The trend towards deals that are smaller in scope has existed for the past three or four years. Buyers are outsourcing more work but in smaller increments. This makes good sense, especially given the current state of the economy. Providers must suitably package their offerings.
- **Adding new business with existing service providers/Consolidating business with large, tier one service providers:** It is more expedient and cost-effective to add business with existing, tested and proven providers. This is leading to market consolidation and more business for top-tier providers, which creates challenges for niche and tier two and lower providers that they must proactively and aggressively address. However, even top-tier providers must guard against losing business to competitors as buyers consolidate their business.
- **Focusing more on onshore or nearshore:** While there are some instances of existing offshore work being brought back onshore, this remains much more the exception than the norm. When pursuing new deals, providers must define the value proposition of their delivery models and locations more clearly than ever. This means reassessing nearshore and onshore delivery options for their customers that truly need them. Given the current emphasis on cost reduction among buyers, however, labor arbitrage in lower-cost offshore markets will remain a high priority.
- **Deemphasizing use of Indian service providers:** This has mostly occurred with smaller and niche providers or for obvious reasons stemming from Satyam's financial difficulties. New business has moved away from larger outsourcers more as a result of general cutbacks in

certain types of services (for example, discretionary application work) than a pullback from Indian firms in general.

Conclusion

Pent-up buyer demand from the second half of 2008 is now making it to market. According to the EquaTerra advisors and third-party business and IT services providers polled, BPO and ITO demand improved in the first quarter of 2009. Signs indicate that this trend will continue through the rest of the year. However, uncertain market conditions and turmoil within individual buyer accounts will still continue to slow or stop some sourcing efforts – albeit less frequently.

Market conditions overall are driving more demand for outsourcing, but the nature of the demand continues to change. Customers are putting more pressure on providers and insisting on up-front and clearly defined cost savings, smaller deal sizes, and a strong focus on cost savings and cost avoidance. The extent of this pressure, however, varies based on the quality and desirability of both the buyer and the service provider.

Additional Resources

[Full 1Q09 EquaTerra Pulse Survey Results](#)

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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