

Out-Sourcing Services – Today & Future

11 May 2007

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Strategic View of Out-sourcing

IDC forecasted about 10% annual growth in out-sourcing services, and it will continue its phenomenal growth for the next few years. The out-sourcing service markets of the world's top two service centres are projected to be US\$30 Billion in India, and US\$10 Billion in China. This significant growth underscores the rising demand of many companies to accelerate the out-sourcing process to reduce their business cost.

Today, many organizations view out-sourcing service as a mere commodity. Cost is still the CIO's prime decision driver for out-sourcing. Many MNCs prefer to focus on delivering world-class core services. Decision to out-source support and IT services to reduce cost and improve efficiency to achieve higher profitability is easily made. Moreover, global trend of selective out-sourcing of various services to several service providers instead of single-contract, single-provider strategy also expedites the out-sourcing process.

However organisations should look for long-term value in out-sourcing partners that can enhance their competitiveness and bottom-line results. With a strong out-sourcing partner, customers have benefited from the partner's capabilities to achieve and surpass their business objectives.

Organisations should look forward to harness the partners' values to reinforce their key objectives by:

- **Cost Reduction**
To deliver measurable quality services to support IT and operational needs at a competitive cost that allows them to derive additional productivity;
- **Competitive Advantage**
To streamline and improve the business processes so that its performance can be enhanced and business growth could be sustained. The service partner can also offer integrated infrastructure services to provide end-to-end solutions to gain greater saving & efficiency.
- **Technology Leverage**
To leverage on service partner's core competency in their services to build, manage and improve the organisation operations.

Global Markets

IDC has forecasted 9.3% growth in out-sourcing services for the manufacturing, banking and government sectors globally. The communications sector industry is looking at a compound annual growth rate of 10.7%.

The 25 most-attractive off-shore destinations identified in an A.T.Kearney study is shown below. India led the pack with its cost leadership, experience in business process out-sourcing (BPO) and a large labour force.



Source: A.T. Kearney

A McKinsey report reaffirmed India as the industry leader for out-sourcing service with 46% market share of global BPO market and 65% in IT out-sourcing market through 2010. However it will face increased competition from China, Eastern Europe, the Philippines, South America and Africa.

In India, the overall IT segment grew 31% to US\$30 Billion according to the annual survey of the National Association of Software & Services Companies (Nasscom). It added that domestic spending on software & back-office services was expected to rise to US\$7 Billion in the year ending in Mar 2007, from US\$6 Billion in the previous year. A Reuters reported that the IT business is projected to grow by 25% to \$37 Billion in the year to March 2007. The sector employs around 1.3 Million staff. Key local players are Tata Consultancy Services Ltd (TCS), Infosys Technologies and Wipro Infotech, competing with other global competitors including IBM, EDS and Accenture who are expanding their out-sourcing units in India.

The US is the largest market for Indian vendors accounting for about 70% of the total revenue. India however has to overcome the twin challenges of rising wages and weak infrastructure to maintain its lead.

A study conducted by a US-based consulting firm, Diamond Cluster International, revealed that growing labour shortage in India's major service hubs, including Bangalore, Chennai and Hyderabad, will see out-sourcers shift focus towards tier-2 cities in India and China.

In China, out-sourcing is also the fastest growing sector, with a 2004-2009 CAGR of 39%. The service market in 2004 was US\$9.3 Billion. IDC forecasted the China market will grow with a 35% (2004-2009) compound rate.

In another report published by an IT research firm (Analysys), it revealed that China's software outsourcing market concentration is relatively low. The software outsourcing service providers' market share accounted for only 19% of the total market. Japan remains the biggest contracting market to China, accounting for 59% of China's software outsourcing market. Europe and the U.S. are the second biggest

market with 22% market share, while Hong Kong accounted for 11% of the market share in China.

Malaysia is a major challenger to both countries with its well developed infrastructure and strong government support. Singapore remains a favoured choice due to its excellent education and language skills, superior infrastructure and pro-business tax and regulatory environment.

The total Asia Pacific call centre market is estimated by Datamonitor to be worth US\$650 Million. Singapore accounts for about 2.5% of the total market in 2005. According to research firm Frost & Sullivan, the out-sourcing industry in Singapore was worth US\$40.7 Million in 2005 with a growth rate of 18.4%. The study shows that the market in 2006 grew by 17% to US\$47.6 Million. The market will mature and grow at a compound rate of 9.9% to US\$80 Million till 2012. In 2005, the number of agents working in Singapore contact centres rose by 21.7% to 1,600. This is expected to hit 3,100 by 2012.

IDC predicted that the Asian BPO market will grow moderately from 2006 to 2010. BPO in 2005 is valued at US\$6 Billion, and is forecasted to grow at about 18% to US\$14 Billion by 2010.

Datamonitor measures all new outsourcing, systems integration and consultation deals, and reported that IBM Global Services remains the market leader with a 10.7 per cent share.

Market Trends

Over the last one year, out-sourcing companies such as EDS, HP and IBM have opened massive centres in China, India and the Philippines, largely for servicing the US and Europe.

IDC envisioned that two major trends will happen in the market. First, out-sourcing companies will have to strengthen their capabilities, possibly through another wave of consolidation. Second, service providers must differentiate themselves with services and functions geared toward specific industries.

Datamonitor analysed that the clients are increasingly adopting selective out-sourcing model when they out-source specific functions to various vendors rather than hand over their entire IT services to a single supplier. Mega-deals will decline with a corresponding rise in the number of mid-size out-sourcing contracts. The number of multi-billion dollar deals dropped from 29 in 2003 to 25 in 2004.

Moreover, a McKinsey report (June 2006) highlighted a rising demand of many CIOs to out-source both IT and communications infrastructure to gain greater saving and better coordination. Vendors shall acquire new skills or work with complementary partners to provide and manage end-to-end integrated services.

IBM, in its study report "Banking 2015: Defining the future of banking" published in 2005, forecasted that the five major trends that determine market success are:

- Customers only be interested in service providers meeting their individual needs;
- Specialised niche competitors will arise;
- A new workforce for increased productivity and efficiency;
- Regulatory transparency to comply with global standards;
- Operational flexibility to meet customer needs.

Market Segments

Key business processes to be out-sourced include customer support and back-office functions. Highest growth rates are expected by IDC for:

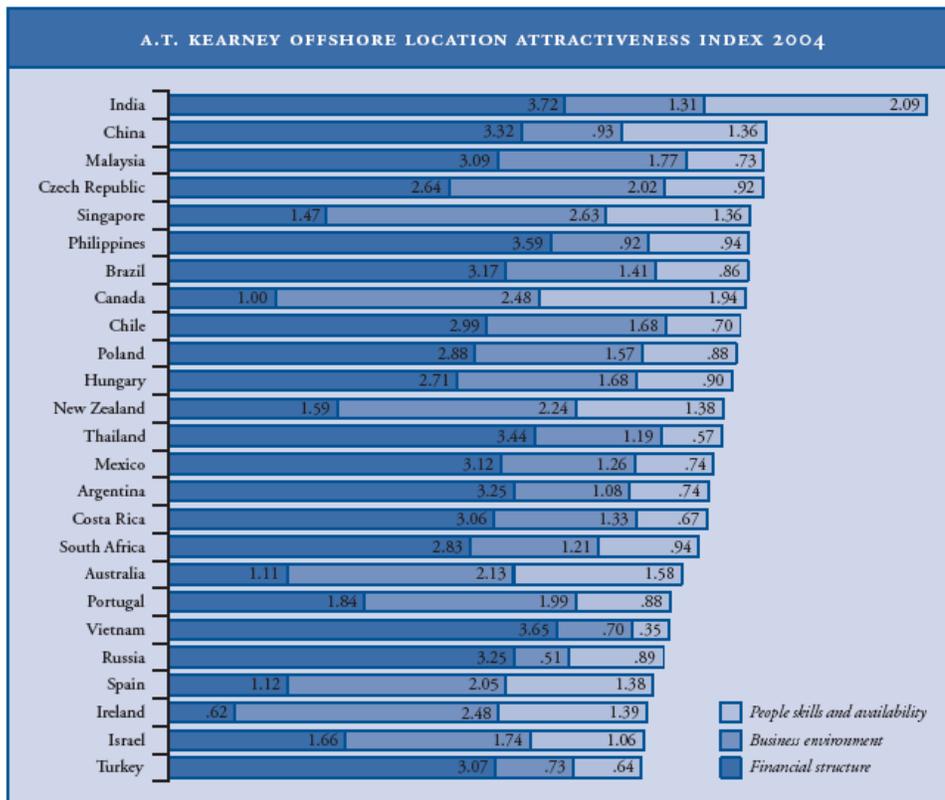
- Banking
- Government
- Healthcare
- Financial Services

Another research firm segmented the major out-sourcing markets as follows:

- Telecoms
- Financial Services
- Manufacturing
- IT

Value Propositions

In AT Kearney's 2004 Offshore Location Attractiveness Index, India was ranked top due to its strong mix of low costs and significant depth in human resources. China's vast labour pool and low costs secured it second place. However it lags behind India in terms of experience, IT & management education, language skills and intellectual property rights concerns.



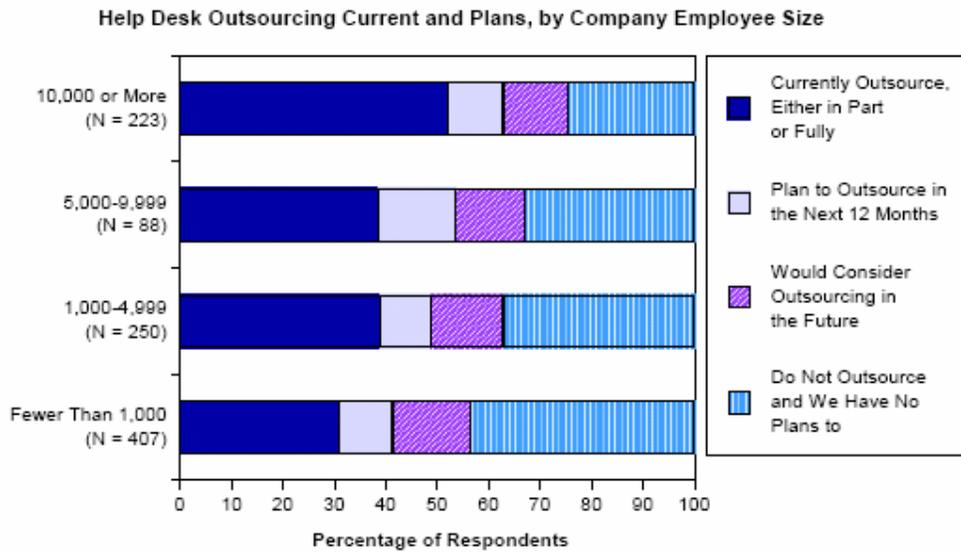
For the AT Kearney's 2004 index, the key drivers for out-sourcing considerations are listed below:

- Labour cost
- Infrastructure cost
- Tax & regulatory cost
- Business process & skills
- Labour force availability & attrition rate
- Education & language
- Security of intellectual property

Though cost competitiveness remains a critical factor, concerns about intellectual property rights and security are fast becoming an issue. Moreover, financial institutions also focus on customer satisfaction and customer services as key evaluation criteria in tomorrow's out-sourcing deals. Organisations will like to work with partners which have best practices in place.

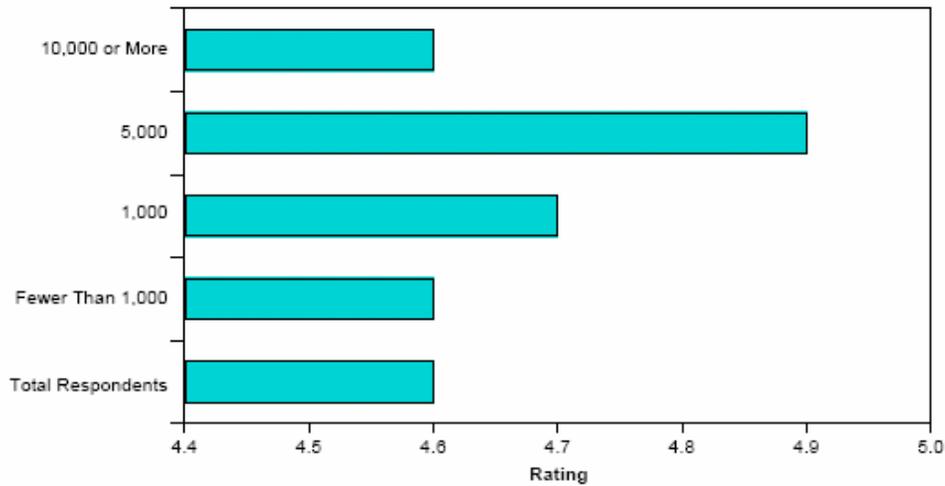
User Satisfaction

According to a Gartner (2006) study, there is a greater tendency for large organizations to out-source, at 52%, compared to smaller companies, at about 30%.



In general, organizations are satisfied with the out-sourcing services, at 4.6 on a scale of 1 to 7. Surprisingly the larger organizations encountered bigger problems possibly due to their process and system complexity.

Help Desk Outsourcing Satisfaction by Company Employee Size



Note: Mean satisfaction rating based on a 1-7 scale, with 1 = not at all satisfied and 7 = very satisfied. This question was asked only of respondents currently outsourcing this service.

Source: Gartner (March 2006)

One example is the Standard Chartered Bank (StanChart) which ended up tripling its operating cost, and decided to bring out-sourced services back in house in 2006. The bank has its shared service centres (SSC) in several countries including China, India, and Malaysia. Eleven percents of StanChart's employee count globally is located at Chennai, India.

Challenges

With organizations constantly looking for ways to cut costs and enhance competitiveness, out-sourcing as an option will always be on the radar screen of the decision makers.

There is low entry barrier for both niche and major players to enter into this out-sourcing market. Coupled with the increasing demands from customers on both cost competitive services and excellent customer satisfaction, the out-sourcing partner must strive to offer quality services supported by best practices and processes.

The writer is currently the Executive Director of an IT solutions and services company in Singapore. He has extensive business development experience in the IT and financial industries in the region. He can be contacted at kahkhuen@singnet.com.sg