

Full-service Outsourcing

Full-service outsourcing is growing four to five times faster than the single-process market. Who are the early adopters, how should such deals be structured and what are the implications of this trend?

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SOURCING WITHIN THE THREE functional areas of General and Administrative (G&A) — Human Resources (HR), Finance and Accounting (F&A) and procurement — has historically been dominated by single-process deals. But the emerging trend in the G&A marketplace is of full-service outsourcing. While a single-process HR outsourcing (HRO) deal may be that of payroll-process outsourcing, a full-service HRO deal would be structured to include multiple processes, such as payroll processing, benefits administration, time/labor management, regulatory compliance and/or recruiting. Similarly, a full-service F&A outsourcing (FAO) deal might include a combination of general accounting, accounts receivable, tax and management reporting.

We define full-service transactions as those that have multiple (usually three or more) processes in scope, a term of three or more years and a size of more than \$1 million in annual contract value (ACV). The size definition is adjusted for each functional area, given their unique characteristics. HR, for example, is segmented by the number of employees served; F&A by contract size; and procurement by annual expenditure on management outsourced.

We estimate the current full-service market as a \$6.4 billion market segment with approximately eight percent market share. This market is growing four to five times faster than the single-process market, and should achieve a market share of approximately 24% by 2010. Given its large contribution to the overall outsourcing market, it is an extremely important area for the industry to begin to understand and develop best-practice solutions around. To facilitate this process, we will provide in this article an overview of the outsourcing occurring today across each of these areas. The questions that we will address are:

- Who are the adopters of full-service HR, F&A and Procurement outsourcing (PO)?
- Who are the key service providers?
- Should customers source the individual functions together or separately?

- What, if any, impact can full-service outsourcing have on other outsourcing markets?
- Why should full-service outsourcing become a C-level strategic priority?

Adopters of Full-service HRO, FAO and PO

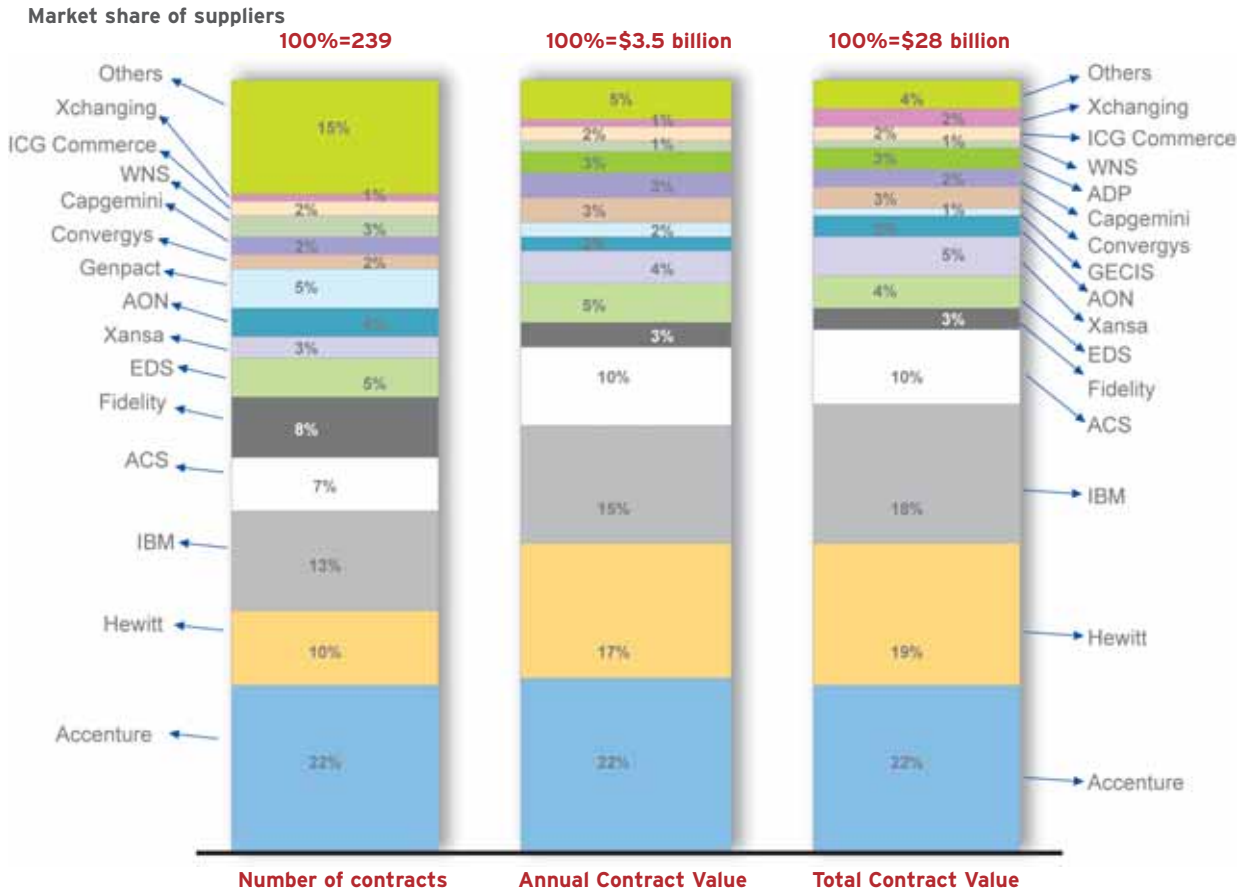
In terms of full-service transactions, HRO has matured the most, followed by FAO. Both these functions have entered the “emerging-rapid-growth” stage of market development. This stage is characterized by three key market characteristics: The emergence of operating standards, a robust set of suppliers and sufficient depth of buyer adoption. PO is still in the first stage of market maturity — pioneer stage — as it has limited emergence of standards, provider and/or customer adoption. In terms of customer adoption, the three key dimensions along which we evaluate adoption are by industry, company size and geography.

As can be expected, adoption is quite prevalent across all industry segments given the universal nature of HR, F&A and procurement. The four leading sectors are manufacturing, energy and utilities, financial services, high-tech and telecom, whose combined market share is approximately 70% in terms of number of transactions, total contract value and cumulative ACV.

In terms of company size, adoption is still a “large buyer” phenomenon, with most adopters being companies with annual revenues of greater than \$5 billion. The market, however, is rapidly maturing to include smaller buyers. For example, the market share of companies with revenues below \$5 billion has almost doubled in 2000, from 9% of ACV to approximately 16% in 2004. In terms of number of transactions, the smaller buyers’ market share has grown from 20% in 2000, to 24% in 2004.

Along the geography dimension, adoption is still primarily a North American phenomenon with North America (including both the U.S.A. and Canada) contributing 63% of the market share. Europe holds 30% market share (U.K. has 13%, Continental Europe another 17%) and the rest of the world has approximately a seven percent share.

SUPPLIER MARKET SHARE ACCROSS HRO, FAO AND PO



Based on an analysis of 27 suppliers across HRO, FAO and PO deals, across a sample of 239 transactions until March 2005

SOURCE: EVEREST RESEARCH INSTITUTE

Key Service Providers

As of March 2005, Everest Research Institute transaction database indicates that Accenture and IBM have signed the most full-service contracts. Their overall market-share position is driven by their presence in all three functional areas of HRO, FAO and PO. Hewitt also has a strong overall showing, although a key difference is that Hewitt's share is based on only the company's strong presence in the HRO segment.

Interestingly, market-share numbers suggest that this emerging full-service market is being dominated by a long list of players that are not key leaders in the traditional IT outsourcing (ITO) market. Given this market is growing quickly, the resulting new market transactions and M&A activity could alter the supplier landscape.

Sourcing Functions Together or Separately

An important adoption pattern is that more than 90%

of full-service transactions are currently limited to multiple processes within a single function, HR, F&A, or procurement. In other words, while we see strong growth in BPO deals bundling multiple "processes" together (for example: multiple HR processes being placed into a single outsourcing deal), we are not witnessing a widespread trend towards bundling HR, F&A and procurement "functions" together.

Our belief is that there is currently a limited value for customers to bundle processes across the three primary functions within the GAO market. While suppliers suggest that there could be value in bundling cross-functional BPO services with the same supplier, fundamental value drivers, both early and late stage, suggest that these functions require different kinds of focus and capabilities for success.

The absence of a clear trend favoring the bundling of multiple functions is likely a disappointment to companies

like Accenture and IBM. These suppliers would be ideally positioned in an environment requiring deep business-process expertise across multiple functions, not to mention frequent deals also requiring a combination with ITO services.

Impact of Full-service Outsourcing

Besides providing a source of growth for well-positioned outsourcing firms, full-service outsourcing transactions will cause some re-shaping of the more mature ITO market. We anticipate the BPO market growth will cannibalize some of the traditional ITO market, particularly the application-management segment, as new BPO deals will encompass certain activities that historically fell into the purview of ITO deals.

Our tracking of BPO contract signings has uncovered a meaningful amount of outsourcing arrangements involving the outsourcing of business processes in combination with IT/application services. Our research suggests these “combination BPO/ITO deals” occur in 83% of HRO deals, 35% of FAO deals and 22% of industry-specific BPO deals (for example: claims processing in the insurance industry).

This trend towards combining BPO and IT services within a single contract has important implications for vendors:

- Traditional IT outsourcers will experience some encroachment as BPO players increasingly overlap into the ITO realm
- Given the demand for “combination deals,” ITO firms that are successful in building distinctive business-process capabilities have an opportunity to carve out leading positions in targeted segments within the BPO market.

Another key trend that will have an impact on the marketplace is the emergence of proprietary technology solutions. Many HRO and PO service providers have developed proprietary technology solutions to provide end-to-end technology and process solutions for their customers. While ERP solutions still remain dominant, we have started to see increased adoption by buyers of these integrated proprietary technology and process solutions. For example, in HRO, within the small buyer segment of less than 15,000 employees, the share of proprietary technology solutions has grown from 38% of cumulative transactions in 2003 to 48% of cumulative transactions in 2005. Even in the larger buyer segment of greater than 15,000 employees, the share of proprietary technology solutions has grown from 12% to 25% over the same period. This market also continues to evolve towards hybrid (ERP + proprietary) solutions as ERP and proprietary suppliers create new value propositions to compete in the marketplace.

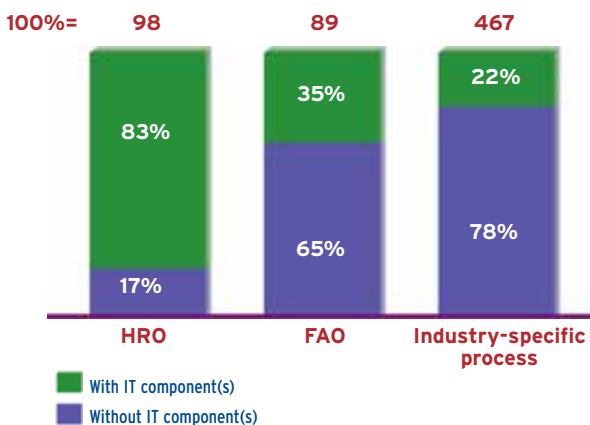
C-level Strategic Priority

Given the impact of full-service outsourcing market on the industry and individual companies, it needs to become

IMPACT OF FULL-SERVICE BPO ON THE IT MARKET

Frequency of combination of BPO with associated IT services

Number of contracts



SOURCE: EVEREST RESEARCH INSTITUTE

a C-level strategic priority. We are starting to see a strong emergence of this trend with many buyers investing in an enterprise-level sourcing strategy to maximize value capture and minimize risk.

C-level executives should focus on:

- Ensuring that enterprise-level objectives are achieved, and not just functional objectives. Given that the HR, F&A and procurement functions overlap in the areas of accounts payable and payroll, deciding how best to source across these functions needs to be done at a level above the functional areas to ensure that enterprise-level priorities and objectives are addressed. In addition, these full-service areas also encroach into the IT domain of organizations as they impact the choice of technology and the manner in which it should be sourced
- Understanding that these functions have an impact on the brand. Full-service outsourcing is more transformational in its impact on an organization than single function outsourcing. Outsourcing will have an impact on the brand of the company (as the outsourcer will now be in close contact with the key customers and suppliers), and therefore needs to be managed at a C-level to ensure that the brand is further enhanced through the outsourcing solution
- Focusing on change management. For success in full-service outsourcing, a high degree of change management is required. For example, the biggest challenges faced by buyers, who have outsourced these functions, are how best to transform their retained organizations and to build the buyer-supplier relationship into a truly transformational program. For organizations to succeed in this endeavor, C-level leadership, intervention and support are often required. ■