Market Analysis

BPO: Climbing the Learning Curve

**Abstract:** Increased awareness and adoption of business process outsourcing should not overshadow the fact that early adopters are still seeking to understand the cost and business benefits of these services.

By Rebecca Scholl and Lisa Stone

**Strategic Market Statements**

Business process outsourcing (BPO) can only be mastered through discipline and continuous focus on the anticipated business benefits.

Established relationships should be reviewed now and evaluated in terms of progress made to date against the overall schedule and intended benefits.
The BPO Market Model

Since 1999, two forces have been at work in the BPO market. First, we have seen the emergence of aggregated service offerings — for example, a BPO offering is inclusive of all major HR processes or several specific finance and accounting processes. Second, enterprises increasingly accept BPO as a means to focus on core competencies, reduce costs of current operations and speed implementation of new technologies.

In response to these newer types of service offerings and the increased adoption of BPO by end users, Gartner has developed a new BPO market model (see Figure 1). The circular nature of the model is reflective of the increasing interactions among processes in demand and supply management, such as order to fulfillment. The new BPO market model can be used by enterprises to view and segment the totality of their internal business processes. As understanding of this grows, it facilitates analysis of what processes can be outsourced. Enterprises can then investigate what is and is not readily available from external service providers (ESPs). Figure 1 presents a few examples of processes that are good candidates for BPO.

Figure 1
Gartner BPO Model

Source: Gartner Dataquest (April 2003)
Still an Immature Market

BPO was validated in 2002. Despite the difficult economic environment, a significant number of large contracts were signed, and executive-level interest in BPO rose dramatically. Many CEOs and CFOs who had been outsourcing certain functions in a piecemeal way began taking a holistic view of the benefits of outsourcing. Furthermore, they began taking steps to adapt their organizations to the virtual enterprise — creating a stronger focus on core business and a network of specialized relationships for noncore — yet strategic — functions. Others continue to turn to outsourcing for transactional reasons: hoping to improve operational performance while simultaneously reducing costs.

Increased awareness and adoption of BPO should not overshadow the fact that BPO services are still immature and that, in many instances, early adopters of BPO are still trying to understand their cost and business benefits. Though business process services have been delivered since the 1960s, BPO has emerged as a market only in the past decade. Even today, the BPO market shows the dynamic characteristics of an "emerging" market. During the transition phase toward higher maturity in BPO, there is significant confusion on what exactly BPO is, how much process responsibility enterprises should delegate to the service provider and how the services are delivered. This confusion takes the following forms:

- **Confusion on the buyer side** — The business decision makers who are buying BPO services (CFOs, COOs, CEOs, purchasing managers and vice presidents of business or support units) frequently fail to learn from years of experience in IT outsourcing and are making similar mistakes in the basics of outsourcing. These may include carving out the wrong processes for outsourcing, selecting providers hastily, ignoring service-level agreements altogether or setting inflexible service levels.

- **Confusion on the provider side** — A number of service providers have jumped on the BPO bandwagon attracted by high growth rates and high profile contracts, but each provider brings a different set of skills and capabilities to the table. Many companies want to be in the BPO market without having any business process capabilities. With such a fragmented competitive landscape, providers are trying hard to establish a brand presence and a competitive differentiator. Some of the legacy players in BPO are now branding their services differently to stay ahead of the pack (Accenture and IBM, for example).

For more information on the emergence of BPO, see “BPO Validated: Verticalization and Aggregation Accelerate (Executive Summary)” (ITSV-WW-EX-0283).
User Adoption of BPO Is on the Rise

In June 2002, Gartner’s Griggs-Anderson division conducted a telephone survey that resulted in 150 completed responses. The objective of the survey was to assess demand for various types of BPO services.

Following are some of the key findings of this report:

- For all respondents, today’s most highly outsourced BPO services — by far — are for HR, followed by finance and accounting. Of respondents who currently outsource, the greatest increase in outsourcing is for HR services.
- Demand for outsourced HR services is concentrated in payroll and benefits outsourcing, but several companies expect to increase their level of outsourcing for education and training.
- In finance and accounting, demand is concentrated in tax management, followed by management accounting and general ledger.
- Other processes that are commonly outsourced across organizations include logistics, warehouse/inventory management, campaign design/communication planning, market segmentation, customer data analytics and telesales/telemarketing.
- In the state and local government sector, most commonly outsourced processes are claims processing, credit card processing and ticket collections.
- The greatest sources of pain for companies before outsourcing across all processes were the time spent on daily operations, the lack of integration across processes and the high cost of transaction processing.
- Across all processes, the primary drivers of BPO are the need to focus on core business, improve service levels and shorten implementation time, before reducing transaction costs.
- Some 96 percent of respondents are either very satisfied or satisfied with their BPO relationships.
- Overall, the level of customer service, process expertise, financial stability and low cost per transaction are the primary selection criteria for BPO providers.

Figure 2 presents the top drivers and obstacles to outsourcing identified by users.
Aggregated Deal Signings Will Continue in 2003

One of the key developments in the BPO market is the trend toward comprehensive multiprocess outsourcing. In the early years of BPO, contracts were focused on a single process, such as accounts payable, payroll processing or claims processing. Over the past three years, a number of BPO contracts have been highly aggregated and have extended to enterprise-level service support. In these types of arrangements, a single service provider takes responsibility for the people, processes and technology associated with a broad support category. An example would be outsourcing HR, including not only simple payroll processing but also benefits administration, personnel administration, hiring and recruiting, and training and education. Table 1 represents a sample list of comprehensive HR outsourcing contracts signed over the past 24 months.
Table 1
Sample List of Comprehensive HR Outsourcing Contracts

<table>
<thead>
<tr>
<th>Client</th>
<th>Provider</th>
<th>Geography — Number of Employees</th>
<th>Date — Contract Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMO Financial Group</td>
<td>Exult</td>
<td>Canada and United States</td>
<td>April 2003 — 10 years</td>
</tr>
<tr>
<td>Accenture</td>
<td>Borden Chemicals</td>
<td>United States</td>
<td>January 2003 — 5 years</td>
</tr>
<tr>
<td>Motorola</td>
<td>ACS</td>
<td>Worldwide — 100,000</td>
<td>December 2002 — $650M — 10 years</td>
</tr>
<tr>
<td>Sony Electronics</td>
<td>Hewitt</td>
<td>United States — 14,000</td>
<td>October 2002</td>
</tr>
<tr>
<td>State of Florida</td>
<td>Convergys</td>
<td>United States — 189,000</td>
<td>August 2002 — $280M</td>
</tr>
<tr>
<td>AT&amp;T</td>
<td>Aon</td>
<td>United States — 70,000</td>
<td>June 2002</td>
</tr>
<tr>
<td>Cable &amp; Wireless</td>
<td>Accenture</td>
<td>United Kingdom and United States</td>
<td>December 2001 — &lt;$100M — 5 years</td>
</tr>
<tr>
<td>Celanese</td>
<td>Arinso</td>
<td>United States — 5,500</td>
<td>January 2002 — 7 years</td>
</tr>
<tr>
<td>CIBC</td>
<td>EDS</td>
<td>Canada — 40,000</td>
<td>June 2001</td>
</tr>
<tr>
<td>British Telecom</td>
<td>Accenture</td>
<td>Global</td>
<td>August 2000 — 5 years</td>
</tr>
<tr>
<td>International Paper</td>
<td>Exult</td>
<td>United States — 70,000</td>
<td>October 2001 — $600M — 10 years</td>
</tr>
<tr>
<td>Bank of America</td>
<td>Exult</td>
<td>Global — 144,000</td>
<td>November 2000 — $1.1B — 10 years</td>
</tr>
<tr>
<td>Prudential Financial</td>
<td>Exult</td>
<td>Global</td>
<td>January 2002 — 10 years</td>
</tr>
<tr>
<td>IBM</td>
<td>Fidelity</td>
<td>United States</td>
<td>July 2002</td>
</tr>
<tr>
<td>Amex</td>
<td>Mellon HR Solutions</td>
<td>Global — 80,000</td>
<td>April 2002</td>
</tr>
<tr>
<td>BAE Systems</td>
<td>Xchanging</td>
<td>Global</td>
<td>July 2000</td>
</tr>
</tbody>
</table>

Source: Gartner Dataquest (April 2003)

The degrees of process ownership vary from deal to deal. Therefore, it is not possible to compare one relationship with another. A common theme of many of the early aggregated BPO deals is their "newness" and immaturity, which is manifested in several ways. Sometimes, it is the first time an ESP has offered this type of service or such a complex offering. In some instances, it is the first time that an industry or a particular enterprise has outsourced such a broad set of processes. This level of immaturity, coupled with the complexity of the various service offerings, can lead to a significant misalignment of expectations. Many current aggregated BPO deals resemble early IT outsourcing deals, because enterprises are transferring assets to ESPs.

For more information on aggregated BPO, see "Aggregated BPO Deal Signings Will Continue in 2003" (COM-18-7320).

Offshore BPO Accelerates

Another significant trend in the BPO market is the move toward a global delivery model for BPO services. Over the past six months, Gartner Dataquest has been following the acceleration of offshore BPO activity. Most of the early initiatives for offshore BPO took place in India, but new locations are emerging for offshore BPO, namely, the Philippines, Latin America, the Caribbean, Eastern Europe and the Republic of Ireland.

Several years before offshore BPO emerged, a handful of large global companies (GE, Amex, British Airways and Procter & Gamble) set up
internal shared service centers in India or the Philippines as a low-cost alternative to domestic operations in the United States and Western Europe for a number of transactional voice-based activities (data entry, transaction processing or call centers). With the opportunity for third-party services becoming apparent, the Indian BPO industry has seen a stampede of offshore companies and individual entrepreneurs rushing to grab the opportunity. Indian IT services companies largely stayed out of the initial rush, but in recent years, Gartner Dataquest observes that a growing number of IT services companies are charting BPO plans. Most of the offshore BPO market remains very focused on out-tasking activities, rather than true end-to-end BPO.

In addition, about one-third of the U.S. and European BPO providers interviewed in this year's survey indicate they have concrete plans for rolling out offshore delivery capabilities.

Offshore-based service providers and Western-based service providers need to learn about each other's capabilities to better compete in the global BPO marketplace and possibly partner when it is not cost-effective to roll out a global delivery platform in-house. Nevertheless there are still significant hurdles and risks in the offshore delivery model.

For more information on offshore BPO, see "IT Services Providers in India Are Getting Into the BPO Game" (ITSV-WW-DP-0313).

The BPO Competitive Landscape

The BPO market is highly segmented with few larger players that have comprehensive offerings and many smaller players with process-specific offerings. The market is also very dynamic and is characterized by consolidations, new entries and exits. The main categories of players in this market are:

- **IT outsourcers** — A significant number of BPO service providers come from an IT outsourcing background. Most of the players in this category offer a variety of processes but have often concentrated in one or two specific vertical industries. For most, their interest in the BPO market has been an outgrowth of years of experience in the outsourcing of IT skills, services and solutions. Thus, BPO has become a natural extension of their services portfolio.

- **Consultants** — Of all the segments of BPO providers, this has been one of the most dramatic changes in the past two years. For example, PricewaterhouseCoopers Consulting (PWCC) has merged with IBM Global Services and the BPO unit of Andersen has been acquired by ACS. The providers that are still active in this segment are Accenture, Deloitte Consulting, Cap Gemini Ernst & Young (CGE&Y), PricewaterhouseCoopers and BearingPoint.

- **Pure-play BPO vendors** — Pure-play BPO providers are companies that generate the entirety of their revenue from BPO, for example Exult. This is in contrast to a host of IT services companies that may have some
measure of BPO competency as a part of their services portfolio (for example, Accenture, CSC and EDS) but do not solely focus on process outsourcing.

- Process specialists — These vendors are recognized in the marketplace for their expertise in a particular process (for example, ADP for payroll processing and Ryder for logistics). While some of these companies heavily exploit IT to serve their customers, others are more asset- or labor-based. None are IT companies by design. Rather, they find themselves turning more often to IT-based tools and services to enhance the speed and efficiency of the processes they support. Depending on the process, the competitive landscape is more or less consolidated. For instance, in payroll, there are just a few players, whereas there are several hundred in recruiting. As the market matures, relationships need to be more dynamic.

In addition to these four established categories of players, there are several new entrants into the BPO market. The following trends were observed in the BPO competitive landscape in 2002:

- Consolidation — Several providers merged with each other or acquired part or all of other BPO providers to enhance their service offerings.

- Entrance into new vertical markets by vertical specialists — Several vertical specialists have ventured into industries outside their traditional domain. Companies that were focused on financial services industries are offering cross-industry services or are expanding their focus to include new vertical industries.

- Entrance of offshore providers — Several new providers have entered the offshore BPO market as early as 2000, but most of them have accelerated their BPO initiatives in 2002. Most offerings are out-tasking and operational-focused, rather than full end-to-end BPO.

- Emergence of BSP offerings — As the ASP model began to decline, providers tried to stay in the game by adding business services to their existing ASP platforms (such as process inquiry, call centers, transaction processing capabilities or even full process management). At the same time some BPO providers are investing in platforms and technologies (Web services, business process management software and workflow) to standardize their BPO services and offer them in a one-to-many delivery model. This model is still emerging, but the first signs of its success can be seen in some narrowly defined, easily automated process offerings (credit ratings, benefits enrollment, travel and expense, and so on).

Figure 3 shows a sample list of BPO providers and their core competencies.
Figure 3
A Sample of the BPO Competitive Landscape

Recommendations for Enterprises

Gartner developed the following recommendations for companies investigating BPO opportunities:

- **Formalize your BPO strategy.** Because of the comprehensive nature of a BPO arrangement, these relationships can only be mastered through continuous focus on anticipated business benefits. Users need to employ a project management team, particularly in the transition and implementation phase of the arrangement. Along with the transition of the process from an internally delivered service to an externally delivered service, the relationship itself must be implemented as roles and responsibilities of the service recipient and the service provider become exposed and refined.

- **Benchmark your internal business processes.** Contracts must be built on the realization of the business goals, with SLAs that measure the entire business process. Process is at the core of BPO offerings. Unlike IT outsourcing (ITO) offerings, where metrics often involve items such as systems availability, or response time within a specific application, the metrics that truly measure the effectiveness of a BPO offering measure the effectiveness — in terms of cost, quality and timeliness — of the entire business process. Enterprises must have a baseline of their current operational, cost and business performance before they make the insource vs. outsource decision, and they must keep benchmarking the performance of the external provider after the contract is in place.
- Develop cross-company sourcing teams. There are a wide variety of
decision makers in a BPO relationship, including the CEO, CFO, CIO,
procurement manager and business unit vice president. Each one of
these decision makers has different priorities and different agendas.
Very few companies have developed cross-company sourcing teams.
Research shows that users consistently underestimate the management
effort needed to ensure success in a BPO relationship. We expect that a
majority of contracts will be staffed inadequately not only in terms of
project personnel but additionally in terms of management personnel.
The situation derives from a lack of understanding of the boundaries of
the relationship, no clear definition of responsibilities between user and
vendor, and the natural desire to reduce project costs by reducing the
overhead allocated to it.

- Design your "post-outsourcing" operational model before you
outsource. When entering into a BPO relationship in 2003, enterprises
must comprehensively map their current processes against the proposed
service offerings to identify gaps in functionality that have to be
addressed outside of the offerings. Additionally, enterprises and ESPs
must use a roles and responsibilities matrix to ensure that all activities
are being resourced.

- View your BPO relationship as a business asset — Many of the early
highly aggregated BPO deals contain some element of financial
engineering beyond the basic outsourcing arrangement. In some cases,
an enterprise will gain some cost-reduction benefit once the ESP begins
to leverage the migrated environment across a wider client base. In
others, an enterprise anticipates future revenue streams from offering its
products to the ESP’s client base. Gartner Dataquest recommends that
the viability and business case of BPO deals should be assessed only
against known costs. Deals should be attractive regardless of whether
future revenue streams materialize. If enterprises expect ESPs to
transform their environments, they must be willing to let ESPs craft
solutions that are capable of being leveraged across multiple clients.
Enterprises must be willing to accept a "good enough" solution. If they
do not, ESPs will be unable to make the investment necessary to deliver
innovation.

- Anticipate change — Enterprises may find that problems come to light
when the steady-state phase is reached. Even though ESPs may have
transformed enterprises' legacy environments, the new environments
may not fully deliver the improved functionality and increased
efficiencies that were originally envisioned. Enterprises may also begin
to realize that some functionality they thought was part of the initial
relationship was not included by the ESPs and, therefore, has to be
handled as additional services or resourced internally. Established
relationships should be reviewed now and evaluated in terms of
progress made to date against the overall schedule and intended
benefits. If benefits do not materialize as expected, enterprises should
have comprehensive discussions with their ESPs to determine how to
adapt the contract so that both parties continue to view the contract as
valuable.
Related Research

**BPO Across Industries**
The following offer more details on current trends in BPO:

- "Backlash Will Not Stop Offshore BPO Trend" (E-19-4291)
- "Business Process Outsourcing Needs Integration Services" (SPA-19-0990)
- "IBM Commits to the Business Process Outsourcing Market" (M-19-5711)
- "BPO Validated: Verticalization and Aggregation Accelerate (Executive Summary)" (ITSV-WW-EX-0283)
- "Deciding to Insource or Outsource for Human Resources" (DF-19-1071)
- "SMBs: It’s Time to Shift From Tactical to Strategic Sourcing" (COM-18-8240)
- "Aggregated BPO Deal Signings Will Continue in 2003" (COM-18-7320)
- "Users of BPO Report High Satisfaction With Existing Relationships (Executive Summary)" (ITSV-WW-EX-0228)
- "After the e-Procurement Hangover: Is BPO the Right Painkiller?" (ITSV-WW-DP-0390)
- "Offshore Contact Centers: Still a Long Road Ahead" (ITSV-WW-DP-0344)
- "Business Process Outsourcing in Europe — What You Should Know" (COM-17-2725)

**BPO in Vertical Industries and Case Studies**
The following offer more information about BPO in vertical markets:

- "Insurers Shift Focus and Approach to Outsourcing" (COM-19-4453)
- "Scalable BPO Makes Telesales Easy for Virgin Trains" (CS-19-0610)
- "Utilities: The Next Vertical Frontier of Outsourcing" (ITSV-WW-DP-0373)
- "Healthcare Payer BPO: Market Dynamics in 2002" (M-16-9824)
- Business Process Outsourcing Benefits BP and Accenture (CS-18-0145)
- BOC’s Sourcing Strategy Led to a Decision to Insource (CS-17-9641)

**Recent BPO Contracts**
The following provide more information on recent BPO contracts:
"Accenture Extends Co-Sourcing Contract With AT&T"  
(ITSV-WW-DA-0194)

BMO Financial/Exult Deal Shows Continuing Trend Toward BPO (FT-19-9148)

"$1-Billion Accenture, BC Hydro Deal Shows the Expansion of BPO"  
(FT-19-4763)

"Unisys’ Deal With Malaysian Bank Could Boost BPO in Asia"  
(E-19-0005)

"ACS and Motorola HR Outsourcing Deal Will Boost BPO Market"  
(FT-19-0750)

"State of Florida Uses Unique Deal to Outsourcing HR Services"  
(FT-18-0138)

Key Issues

What are the key trends, drivers and inhibitors of the outsourcing market?

Why do outsourcing engagements succeed or fail?

For More Information...

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