Research Brief

How to Grow a BPO Business in 2003

Viewpoint: Many companies that outsourced business functions in a piecemeal way are now adopting more comprehensive forms of business process outsourcing, but the market is still immature, and trends are emerging.

By Rebecca Scholl

Analysis

■ Buying trends: Most business process outsourcing (BPO) activity in 2002 was in HR, BPO adoption is occurring on a global basis and midmarket companies are getting more attention from providers.

■ Top challenges in 2003 included slow decision making by end users, moving beyond landmark (foundation) clients, competing for talent, delivering successfully to clients, running good business operations, and differentiating and measuring the business value of BPO.

■ The provider BPO pipeline is growing, but contracts are not always signed. The BPO sales cycle is, on average, 12 to 18 months and has been decreasing, but some deals have been delayed because of the uncertain environment. Nevertheless, service providers have high growth expectations for their BPO service lines in 2003.

■ Providing offshore BPO services in low-cost, high-quality regions is a key competitive factor to consider.

Recommendations

■ Develop a consultative, CEO-level sales strategy. An ideal BPO salesperson will have consultative skills and benchmarking skills will be able to address top-level management in a user organization.

■ Choose the right offshore strategy. Reducing delivery costs through offshore service centers soon will be a requirement for BPO providers but requires discipline.

■ Benchmark to justify the BPO value proposition and to ensure continued process improvements.
Viewpoint

BPO Gains Ground
The practice of outsourcing business processes was validated in 2002. Despite the difficult economic environment, a significant number of large contracts were signed, and executive-level interest rose dramatically. Many CEOs and CFOs who had outsourced functions in a piecemeal fashion began 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 outsource for transactional reasons, hoping to improve operational performance while reducing costs.

But BPO services are still immature, and, in many instances, early adopters are still trying to understand their cost and benefits. Significant confusion still exists about what exactly BPO is, how much process responsibility enterprises should delegate to service providers and how the services are delivered.

Confusion Affects Both Sides
- **On the buyers side** — The business decision makers buying BPO services haven’t learned from years of IT outsourcing experience and are making similar mistakes in the basics of outsourcing. They are choosing the wrong processes to outsource, selecting providers hastily, ignoring service-level agreements (SLAs) altogether or setting inflexible service levels.
- **On the providers side** — A number of service providers have jumped on the BPO bandwagon, attracted by high-growth rates and high-profile contracts, but each provider offers a different set of skills and capabilities. Many companies want to be in the BPO market without having any business process capabilities at all. With such an uneven competitive landscape, providers are trying hard to establish a brand presence and a competitive differentiator. Some of the legacy players are branding their services differently to stay ahead of the pack — for instance, IBM and Accenture are now referring to business transformation outsourcing (BTO) instead of BPO.

Analysis

The Vendors’ Perspective on the BPO Services Market
From July to September 2002, Gartner Dataquest conducted an online survey with 43 marketing directors of BPO to assess the maturity of the BPO service provider landscape across a broad range of processes and target segments. After the online survey was completed, Gartner Dataquest conducted 29 qualitative phone follow-up interviews with BPO service line executives.
Gartner Dataquest attempted to cover the diversity of the BPO competitive landscape by interviewing companies from different backgrounds: IT consulting, IT outsourcing, process transaction specialists, pure-play BPO providers, offshore providers, business service providers and software vendors. IT services providers and process specialists accounted for about half of the sample.

**Major Survey Findings**

- **The provider BPO pipeline is growing, but contracts are not always signed.** Most providers interviewed in 2002 claim that their pipeline of BPO business is larger than ever. But a big gap definitely exists between the level of interest in discussing outsourcing opportunities and the realization of these opportunities. Many of the 2003 respondents claim that only a small percentage of the leads actually materialize into a real contract. The BPO sales cycle is, on average, 12 to 18 months and has been getting shorter over the past few years, but in 2002, several deals were put on hold because of the uncertain economic and political environment. However, service providers have high growth expectations for their BPO service lines and were optimistic about their growth for 2002 and 2003. More than 50 percent of our sample indicated they expected more than 15 percent revenue growth in 2002 compared with 2001. In reality, the top 50 BPO vendors in Gartner Dataquest’s database achieved a 10 percent growth rate in 2002, which is lower than expectations but significantly higher than other IT service lines.

- **Most BPO activity in 2002 was in HR.** Demand for aggregated HR outsourcing services is becoming more mainstream, for instance, aggregating several HR processes into one contract, such as payroll, benefits and records management. Demand for finance and accounting outsourcing is not as high, judging by user research conducted in the fall of 2001 and the spring of 2002, as well as by the level of inquiries Gartner Dataquest receives from end-user clients. Most of the finance and accounting demand is fragmented, focused on the transactional components of accounting: accounts receivable and accounts payable. Other areas of high activity in BPO include payment processing and vertical-specific services in financial services, healthcare, manufacturing, and energy and utilities.

- **BPO target markets became more diversified in 2002.** While BPO providers almost unanimously targeted Global 500 companies in the financial services sector in 2001, they expanded their opportunities in 2002. This indicates demand is emanating from new buying centers (new vertical markets, new geographies and new market segments). Financial services and large corporations are often among the first to try new business models. Now, other vertical markets are formally adopting outsourcing — in particular, life sciences, high tech, telecommunications and the public sector. Several BPO providers are adapting to the "verticalization" of BPO demand. However, vendors must be cautious in targeting new opportunities and not aim for every one that comes along. Verticalizing BPO solutions requires focus and investment.
Focus on midmarket companies is increasing. In 2002, 64 percent of respondents’ BPO revenue came from large clients (more than $500 million in revenue) compared with 75 percent in the 2001 survey. Another 36 percent of the 2002 sample targeted companies with less than $500 million in revenue, compared with 25 percent in the 2001 sample. Small and midsize businesses (SMBs) are good targets for BPO lines of business, because they want affordable access to technology and process expertise and desperately need to reduce their administrative burden. But they are also a challenging market segment because of their inexperience with business process re-engineering and the level of customization they require compared with the size of the contract opportunity. BPO providers should develop targeted vertical-specific offerings for SMBs and define a channel strategy for entering this segment.

BPO adoption is occurring on a global basis. Demand emanating from Europe and Asia/Pacific remains fragmented and requires a strong local presence, but these regions are accelerating their adoption of BPO. The United Kingdom has been one of the leading countries in taking up BPO, even compared with the United States (or any other country), but the adoption of BPO in continental Europe is still limited by several cultural and legislative factors. Demand in Asia/Pacific remains concentrated in a small number of countries (Australia, New Zealand, Singapore and Malaysia), but early signs indicate that 2003 might be the true kickoff year for BPO in Asia/Pacific.

Providing offshore BPO services in low-cost, high-quality regions is a key competitive factor. New competitors are emerging from offshore regions, and U.S. companies are also making new investments offshore. Customers are demanding that their services be delivered locally and sourced globally. BPO service providers must develop a global delivery model for their transaction-intensive services to be successful. The key issues in developing an offshore BPO delivery model are the following: determining what portions of BPO can be “offshored,” calculating the price point that will be competitive and still ensure profitability, designing a successful transition model from onshore to offshore, and developing effective communication plans with offshore resources.

In 2002, service providers focused on hiring new leadership, increasing marketing awareness, making technology investments and expanding their delivery capabilities. The change in leadership at many of the top BPO firms might create unrest in the user community if providers cannot demonstrate consistency in delivery and customer service. Branding initiatives must focus on the key selection criteria identified by BPO users: customer service, process expertise, industry expertise and technology expertise.
Fixed fee and per-transaction fee are still the most common pricing models. Neither vendors nor end users venture much out of the traditional pricing methodologies, as can be seen by the relatively small percentage of equity payments, pay-as-you-grow and joint venture types of engagements. This is a reflection of the large proportion of piecemeal contracts that we see in BPO today. However contracting models are becoming more innovative and often include equity participation by users in the BPO ventures with their providers.

The primary types of alliances are with clients. Some 45 percent of the BPO providers recently surveyed indicated they had a cooperative business arrangement with their clients, and the mean number of alliances is 25 for companies in the sample of BPO providers, which is much lower than most other IT services firms. These cooperative business arrangements are of various natures, including marketing alliances, joint ventures, exchange of services and equity participation in the provider by the client.

The top challenges in 2003 are slow decision making by end users, moving beyond landmark (foundation) clients, competing for talent, delivering successfully to clients, running good business operations, and differentiating and measuring the business value of BPO.

Recommendations

Short Term: What Should You Do on Monday?

Develop a consultative, CEO-level sales strategy. An ideal BPO salesperson will have consultative skills, benchmarking skills and the ability to address top-level management within a user organization. Successful BPO providers have a small number of senior BPO sales executives, who are also involved in the service delivery and also develop training programs for their other lines of business sales teams to identify upselling and cross-selling opportunities in BPO.

Cultivate BPO vendors as your newest, best customers. Some IT services vendors have smartly realized that their fortunes and core competencies lie outside BPO area. They’ve realized they have a critical and sometimes symbiotic role to play with BPO providers, and that direct contact with end-user customers is not always necessary or desirable.

Ensure a smooth transition. A solid employee transition plan for clients’ internal business process department is required. By sharing and communicating this plan to clients, you can dramatically reduce the risk of client dissatisfaction during the transition stage.

Build tight relationships with customers. In BPO relationships, end-user clients become attached to their primary points of contact because the engagement is relationship-intensive (more so, the more processes involved). Vendors should develop solid transition planning in regard to replacing the primary point of contact for their clients. These transitions can take an entire year.
Communicate success. Demand for BPO is becoming more mainstream in some areas (for instance, payroll or call center services), but demand is still immature in other areas (procurement and integrated CRM). Good communication strategy, using real-life client references, is key to educating clients on BPO competence.

Midterm: What Should You Do One Year From Now?

Select targeted opportunities. Don’t try to be all things to all people, which is impossible even for the largest BPO vendors. Select the appropriate process mix, scope of services, countries and industries to target for BPO. Opportunism may lead to client disillusionment and unprofitable engagements.

Modularize your offerings. "Megadeals" get a lot of press attention but are the exception, not the rule. Successful vendors will have a set of modular offerings that can be packaged into a full, multiprocess BPO offering or in an a-la-carte fashion (single processes and service bureaus), depending on customers’ needs.

Build best-in-class delivery capabilities. The choice of a "killer" technology platform is a key success factor for BPO, but don’t forget to build the human element of your delivery model: shared service centers, call centers, change management teams and so on. Customer service remains one of the primary selection criteria for BPO users.

Develop selective alliances. Complement your established capabilities through alliances to provide a comprehensive scope of process expertise and service lines. Even niche specialists must be prepared to refer clients to alliance partners for services beyond their capabilities.

Choose the right offshore strategy. Reducing delivery costs through offshore service centers soon will be a requirement for BPO providers. Decide whether you want to establish your own offshore facilities or partner with local offshore providers to serve local clients.

Benchmark. To justify the BPO value proposition and to ensure continued process improvements, you must be able to benchmark clients’ internal business process costs and performance and compare them to your own, throughout the life cycle of the outsourcing engagement. Partnerships or acquisitions of benchmarking firms can be a winning strategy.

Long Term: What Should You Do in Two or Three Years?

Go vertical in a focused manner. As horizontal BPO offerings become more mature, consider expanding into a carefully selected number of vertical-specific BPO services, especially in industries that already have extensive experience with BPO. For an average BPO provider, specialization in two or three vertical markets is a winning strategy. It is important, even for providers specializing in one or two vertical markets, to also develop a cross-industry process expertise that they can showcase to new clients.
Standardize for profitability. Developing repeatable solutions is a key success factor for all IT services vendors, but standardization is often difficult as it relates to business processes instead of pure technology. BPO vendors must find ways to streamline and standardize components of their service delivery, to drive profitability. These components include infrastructure, application, transition methodologies, imaging, workflow and rules-based processing.

Beware of commodity. In the near term, specific processes, such as payroll and transaction processing, are becoming commoditized. However, certain vendors’ abilities to craft multiprocess, mass-customized BPO contracts to the requirements of a singular customer will keep certain services from commoditizing.

Plan for global BPO. The next step for many BPO engagements is to include new geographies in the scope of an established contract. BPO providers should think ahead of their clients and develop global BPO sales, marketing and delivery strategies.

Ensure financial stability. To ensure a long-term partnership model between clients and vendors of BPO services, vendors need the financial stability to make significant investments in their delivery capabilities (enterprise resource planning, shared service centers, process experts) and continuously enhance or expand their process expertise.

Related Research

Methodology
From July through September 2002, Gartner Dataquest conducted an online survey with BPO providers that resulted in 43 completed responses. The objective of the survey was to assess the maturity of the BPO service provider landscape across a broad range of processes and target segments. After the online survey was completed, Gartner Dataquest conducted 29 qualitative phone follow-up interviews.


Key Issue
What service models, customer or market segments offer growth opportunities for my services business and how should I address them?
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