Trends In Global Offshore Outsourcing: Growing Adoption Offers Opportunity For Some

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Agenda

- Forrester's research approach

- Developed economies buy the offshore proposition

- Russian app developers offer inshoring lessons

- Addressing the inshoring opportunity

- Successful inshoring depends on four factors

  » Funding, promotion, targeting, and education will support successful inshoring

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Forrester's research approach

Major research strands

- Market trends and sizing (including spending surveys)

- Analysis of vendor positioning and competitive behaviour

- Tracking specific services (general outsourcing, BPO, desktop services etc) and services issues (like ITIL and CMM adoption)

- End user behaviour and needs analysis

- Vendor selection and management advice

All structured by region, service type, industry etc where required -- combining both quantitative and qualitative work

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Forrester by the numbers in 2003

- 3,500 surveys of senior IT and business executives (80% >€1 billion in annual revenue)

- 260,000 consumer surveys in NA and Europe

- 3,400 vendor briefings and research interviews

- 4,200 published pieces of research

- 16,000 inquiries with clients

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Developed economies buy the offshore proposition

European offshore use spreads globally

Low-cost Western Europe
Sykes delivers call center services to clients like Mitsubishi from its facility in Shannon, Ireland.

Central and Eastern Europe
Buyers like Alcatel, Bally Shoe Factories, and Swisscom boost Russia's global annual software development revenues to nearly €300 million.

China
ALSTOM sources ERP software services from specialist China-Offshore.

North Africa
France's AIR LIQUIDE works with specialist software firm OXIA.

South America
Spanish integrator Indra Sistemas sets up an offshore facility in Argentina.

South Africa
CSC supports European clients from multiple facilities.

India
Firms like Deutsche Bank and Britannia Airways contribute to Indian offshore providers' €869 million in 2004 European revenues.

South-East Asia
HSBC creates captive offshore facilities in Malaysia.

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Which best describes your approach to offshore IT services providers?

- 58% — We are not using any and do not plan to
- 11% — We are not using them, but are actively investigating them
- 7% — We have pilots in place, but no strategy
- 18% — We have made a commitment to offshore but are still ramping up
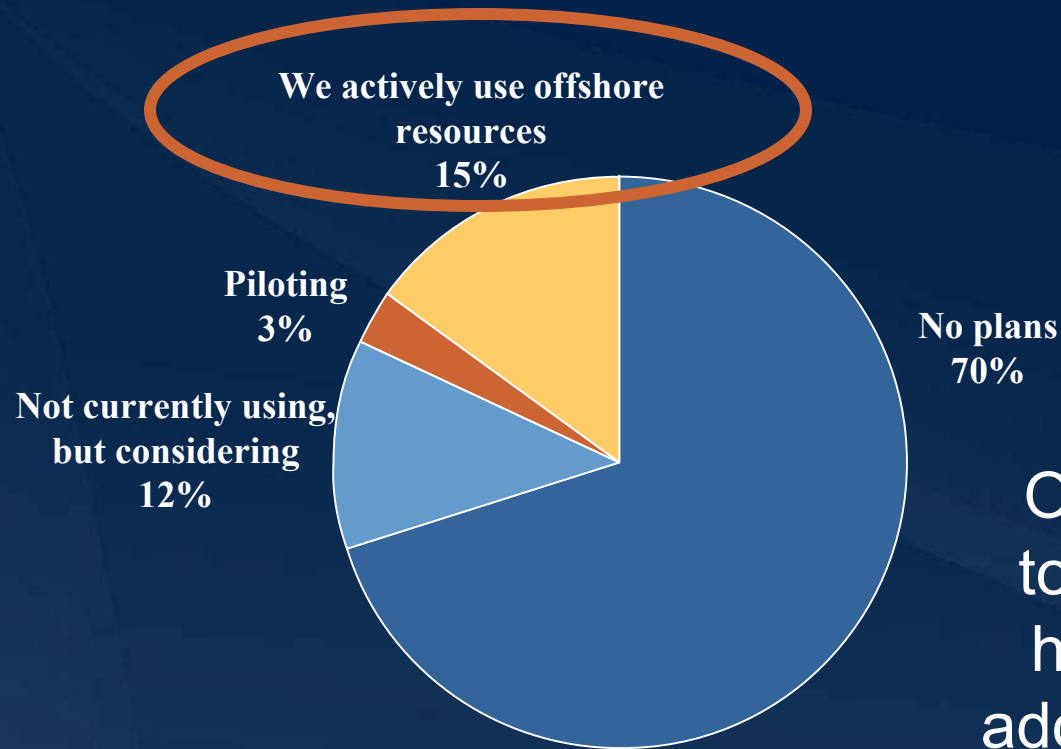- 6% — We use offshore wherever possible

139 North American IT and Business executives Jan 04

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Europe

"At what stage of adoption is your company in the use of offshore IT services?"

We actively use offshore resources
15%

Piloting
3%

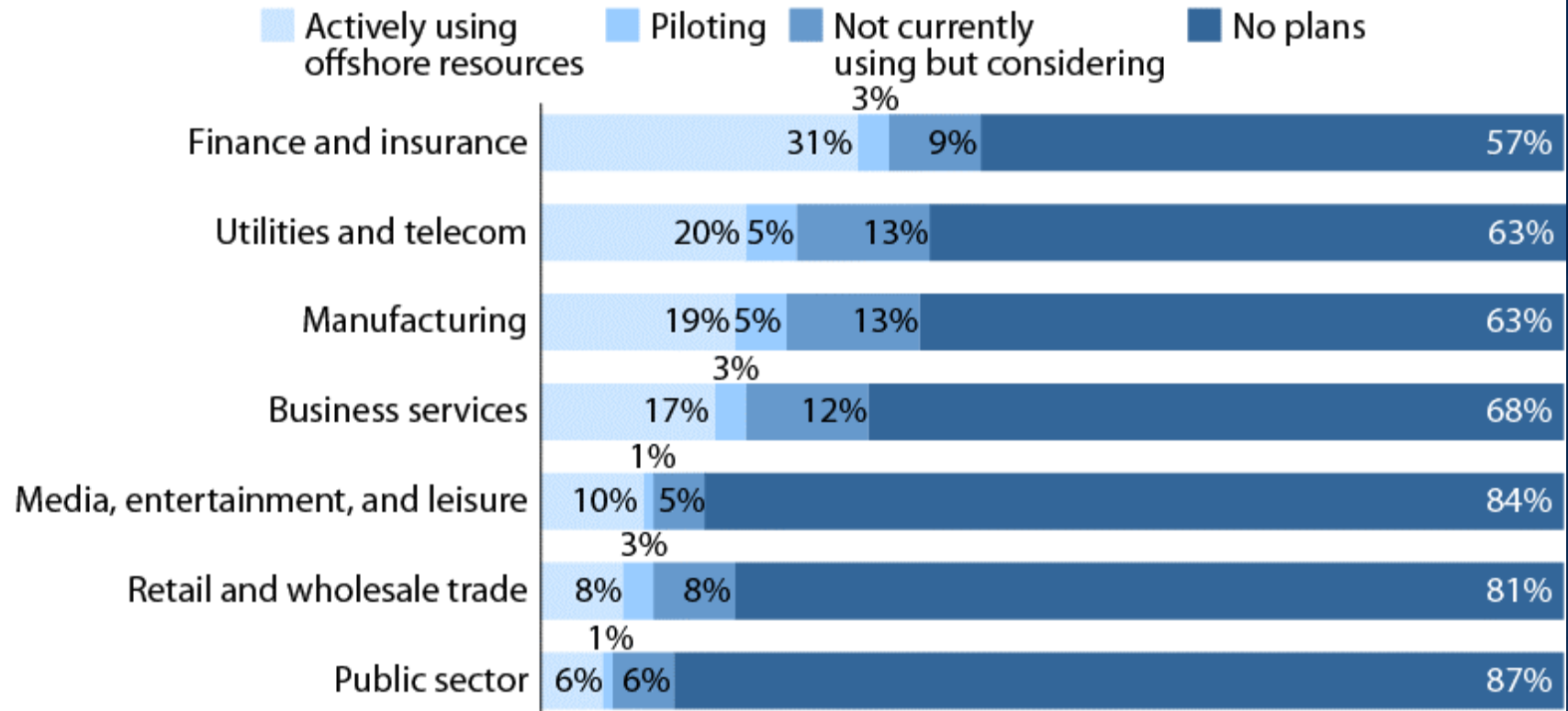Not currently using, but considering
12%

No plans
70%

Overall, Europe today has about half the level of adoption of the US – judged by company numbers

Source: European Business Technographics, August 2004
Base: 504 European enterprises

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How does offshore adoption look today?

"At what stage of adoption is your company in the use of offshore IT services (for example, in places like India, Russia, and China)?"

Legend: Actively using offshore resources | Piloting | Not currently using but considering | No plans

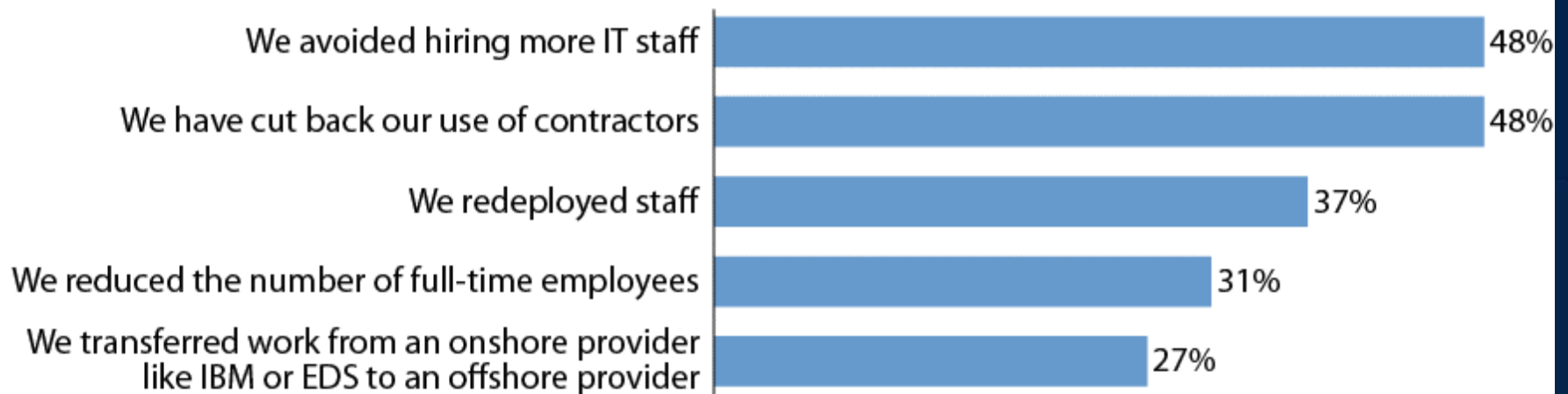| Industry	Actively using offshore resources	Piloting	Not currently using but considering	No plans
Finance and insurance	31%	3%	9%	57%
Utilities and telecom	20%	5%	13%	63%
Manufacturing	19%	5%	13%	63%
Business services	17%	3%	12%	68%
Media, entertainment, and leisure	10%	1%	5%	84%
Retail and wholesale trade	8%	3%	8%	81%
Public sector	6%	1%	6%	87%

Base: 1,346 technology decision-makers at North American and European enterprises
(percentages may not total 100 because of rounding)

Source: Forrester's Business Technographics® June 2004 North American And European Benchmark Study

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Firms make concrete changes when they move offshore

"What have been the implications of sending IT work offshore?"

We avoided hiring more IT staff	48%
We have cut back our use of contractors	48%
We redeployed staff	37%
We reduced the number of full-time employees	31%
We transferred work from an onshore provider like IBM or EDS to an offshore provider	27%

Base: 263 technology decision-makers at North American and European enterprises that are piloting or actively using offshore resources (multiple responses accepted)

Source: Forrester's Business Technographics® June 2004 North American And European Benchmark Study

From **Offshore's Impact On IT And Service Providers,** August 2004
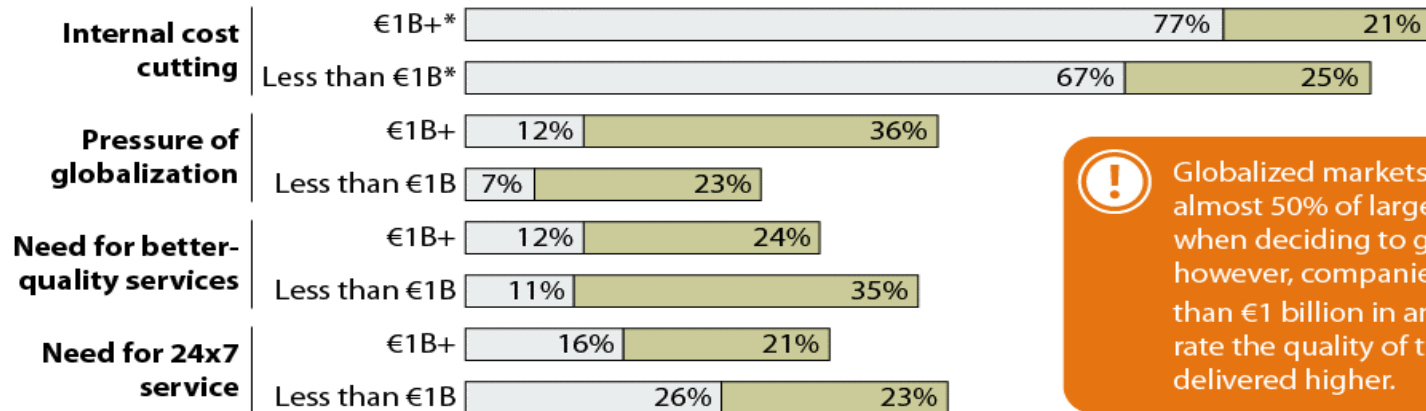
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In Europe, internal cost cutting pushes firms to turn to offshore service providers

"How important are the following factors in your company's decision to use offshore providers?"
(1 [not important at all] to 4 [very important])

☐ 4 [very important]   ☐ 3 [important]

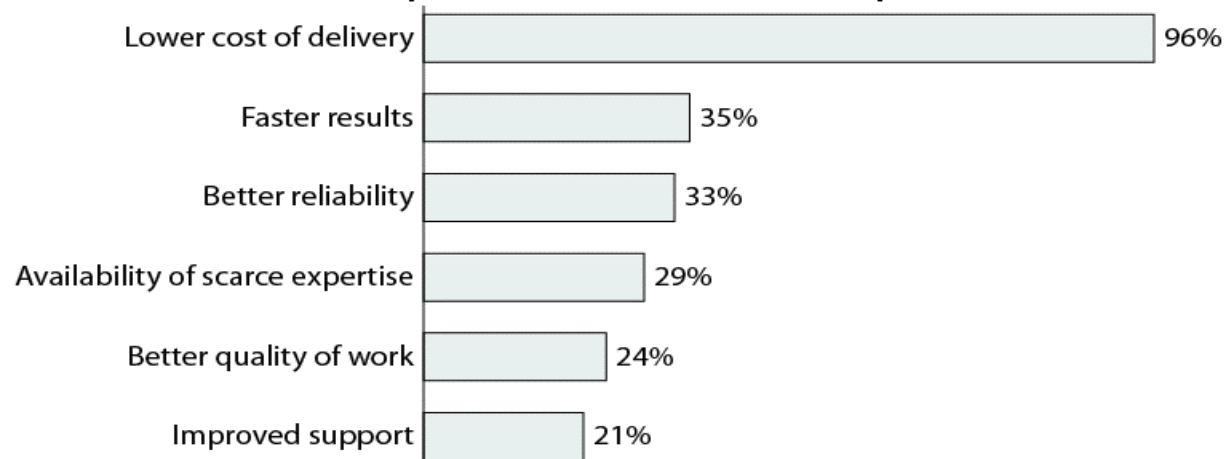|		4 [very important]	3 [important]
Internal cost cutting	€1B+*	77%	21%
	Less than €1B*	67%	25%
Pressure of globalization	€1B+	12%	36%
	Less than €1B	7%	23%
Need for better-quality services	€1B+	12%	24%
	Less than €1B	11%	35%
Need for 24x7 service	€1B+	16%	21%
	Less than €1B	26%	23%

Globalized markets impact almost 50% of large firms when deciding to go offshore; however, companies with less than €1 billion in annual revenues rate the quality of the services delivered higher.

Base: 243 IT and business decision-makers at large European companies

* €1B+: firms with revenues of more than €1 billion; Less than €1B: firms with revenues of less than €1 billion.

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European buyers firmly believe the low-cost offshore message

"Which of the following attributes of offshore services strongly influenced your company's decision to use an offshore service provider instead of an in-house operation or a local services firm?"

Attribute	Percentage
Lower cost of delivery	96%
Faster results	35%
Better reliability	33%
Availability of scarce expertise	29%
Better quality of work	24%
Improved support	21%

Base: 105 IT and business decision-makers at large European companies already using offshore providers
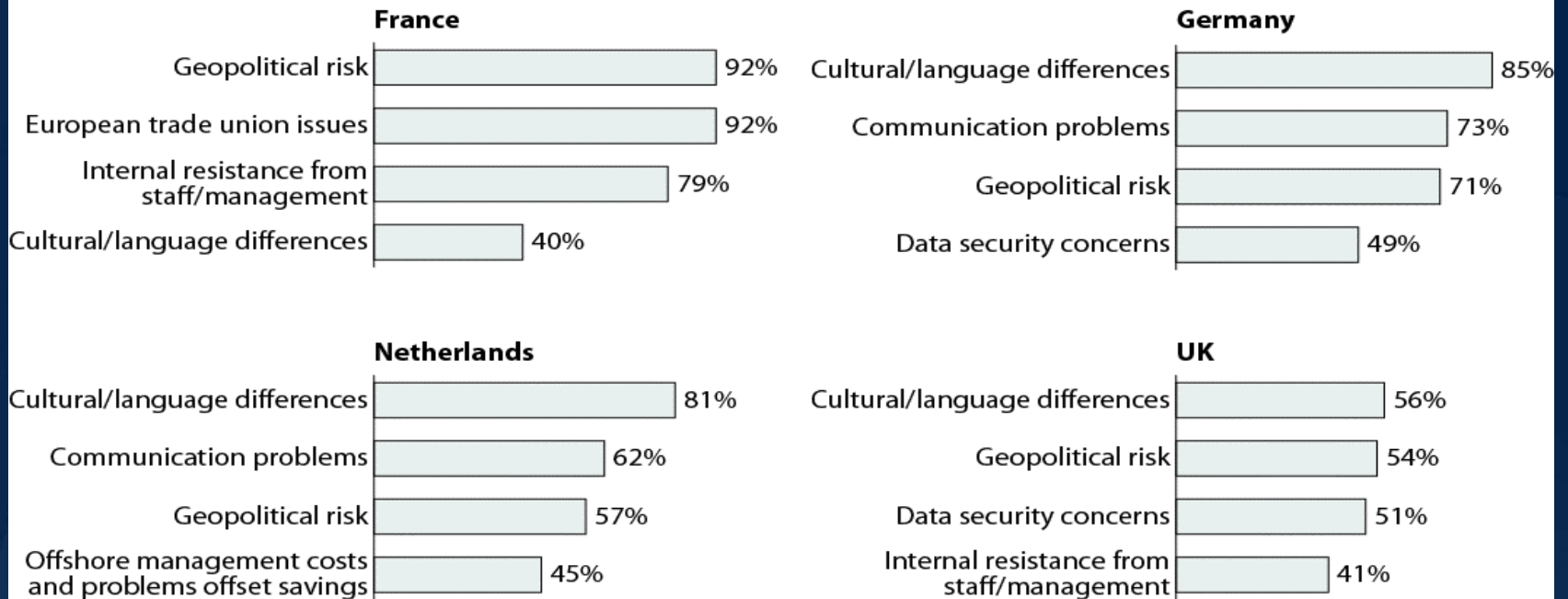(multiple responses accepted)

✓ **ACTION**

Companies should also assess their internal IT and business readiness when deciding to use offshore providers. Elements like effective project management, process change control, or past experience with outsourcing contracts will define firms' readiness to go offshore.[5]

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Continental firms hesitate more over offshore hurdles

"Which of the following factors have a negative impact on your company's plans for using offshore service providers?"

France

Geopolitical risk	92%
European trade union issues	92%
Internal resistance from staff/management	79%
Cultural/language differences	40%

Germany

Cultural/language differences	85%
Communication problems	73%
Geopolitical risk	71%
Data security concerns	49%

Netherlands

Cultural/language differences	81%
Communication problems	62%
Geopolitical risk	57%
Offshore management costs and problems offset savings	45%

UK

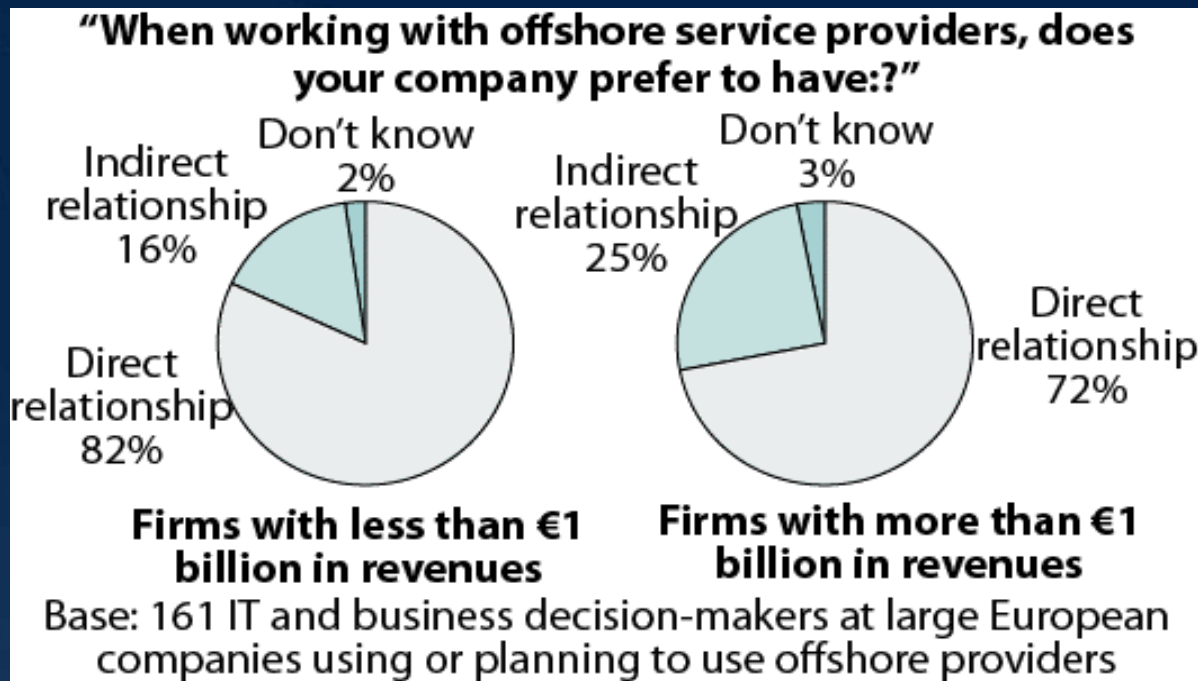|	
Cultural/language differences	56%
Geopolitical risk	54%
Data security concerns	51%
Internal resistance from staff/management	41%

Base: 161 IT and business decision-makers at large European companies using or planning to use offshore providers (multiple responses accepted)

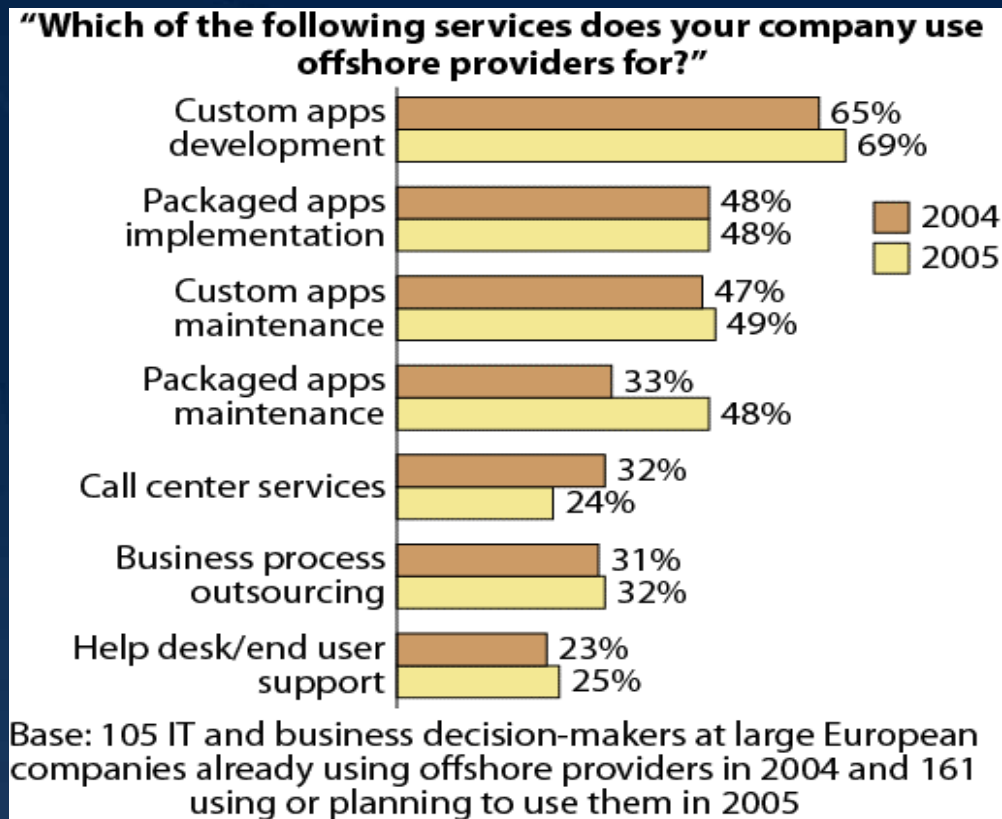From **Europe's Offshore Outsourcing Plans,** June 2004

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Firms prefer direct relationships with offshore providers

"When working with offshore service providers, does your company prefer to have:?"

Don't know 2%
Indirect relationship 16%
Direct relationship 82%

Firms with less than €1 billion in revenues

Don't know 3%
Indirect relationship 25%
Direct relationship 72%

Firms with more than €1 billion in revenues

Base: 161 IT and business decision-makers at large European companies using or planning to use offshore providers

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Apps work dominates offshore demand

"Which of the following services does your company use offshore providers for?"

	2004	2005
Custom apps development	65%	69%
Packaged apps implementation	48%	48%
Custom apps maintenance	47%	49%
Packaged apps maintenance	33%	48%
Call center services	32%	24%
Business process outsourcing	31%	32%
Help desk/end user support	23%	25%

Base: 105 IT and business decision-makers at large European companies already using offshore providers in 2004 and 161 using or planning to use them in 2005

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# Offshore services spending trends up across Europe

"What percentage of your total third-party IT and business services and outsourcing spend will go offshore?"

Firms with less than €1 billion in revenues

2004	2005	2008
15%	21%	26%
21%	21%	26%
4%	4%	21%
11%	11%	7%
50%	30%	16%
	14%	5%

Legend:
- Don't know
- More than 30%
- 21% to 30%
- 11% to 20%
- 1% to 10%
- None

Firms with more than €1 billion in revenues

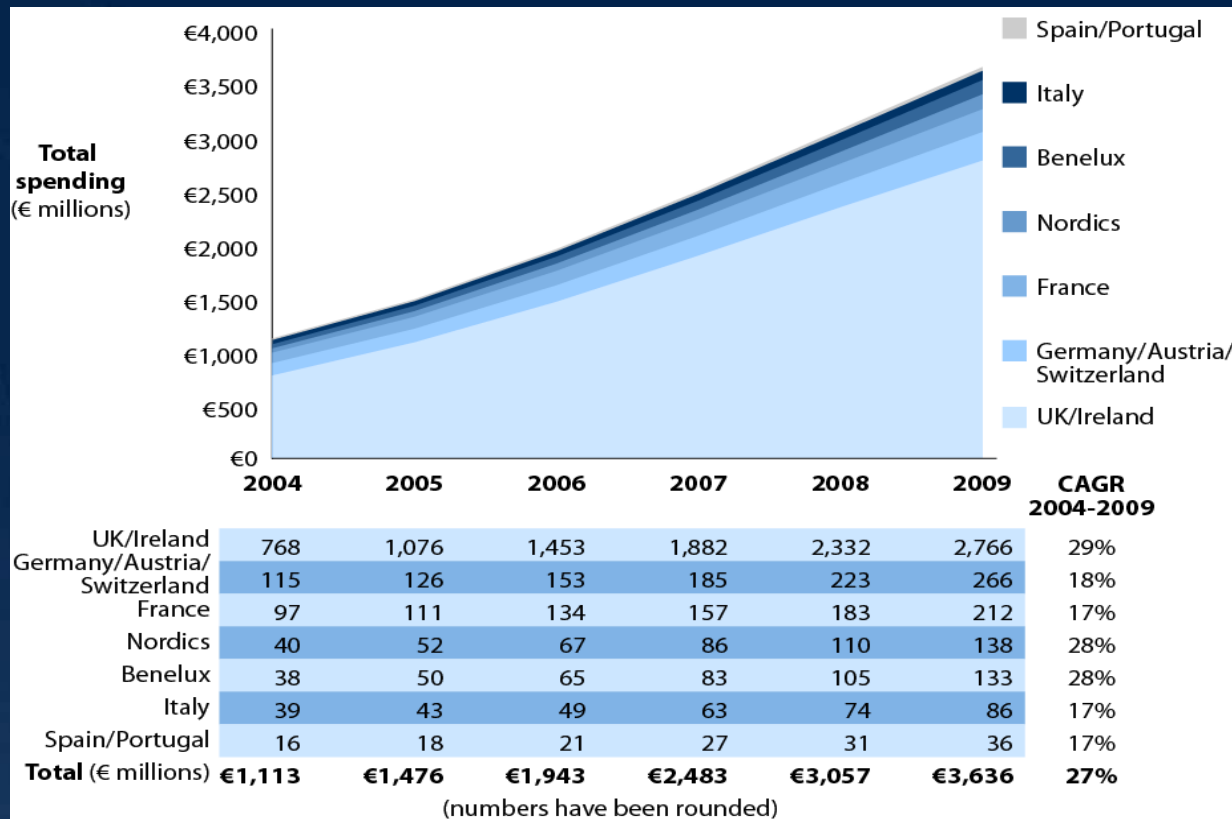| 2004	2005	2008
17%	25%	42%
2%	3%	10%
49%	8%	6%
	46%	12%
29%	16%	29%
		2%
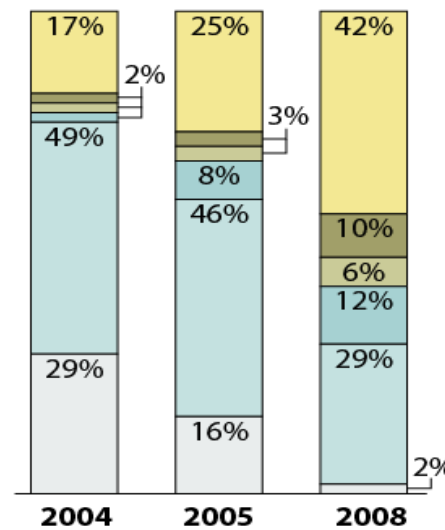
Did you know?
In 2004, 21% of North American firms will dedicate more than 20% of their total external IT services spending to offshore vendors; 40% of them will spend between 6% and 10% of their total.[6]

Base: 242 IT and business decision-makers at large European companies

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The UK dominates offshore spending in Europe

	2004	2005	2006	2007	2008	2009	CAGR 2004-2009
UK/Ireland	768	1,076	1,453	1,882	2,332	2,766	29%
Germany/Austria/Switzerland	115	126	153	185	223	266	18%
France	97	111	134	157	183	212	17%
Nordics	40	52	67	86	110	138	28%
Benelux	38	50	65	83	105	133	28%
Italy	39	43	49	63	74	86	17%
Spain/Portugal	16	18	21	27	31	36	17%
Total (€ millions)	**€1,113**	**€1,476**	**€1,943**	**€2,483**	**€3,057**	**€3,636**	**27%**

(numbers have been rounded)

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India remains the most important offshore location

	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**CAGR 2004-2009**
India	869	1,171	1,548	1,983	2,443	2,905	27%
Low-cost Western Europe	179	224	285	357	433	514	24%
Central and Eastern Europe	41	49	61	75	89	106	21%
China	13	17	23	28	35	41	25%
South-East Asia	3	4	5	7	8	10	25%
South America	3	3	4	6	7	8	26%
South Africa	2	2	3	4	5	5	28%
North Africa	0	1	1	1	1	1	18%
Other	3	4	5	7	8	10	28%
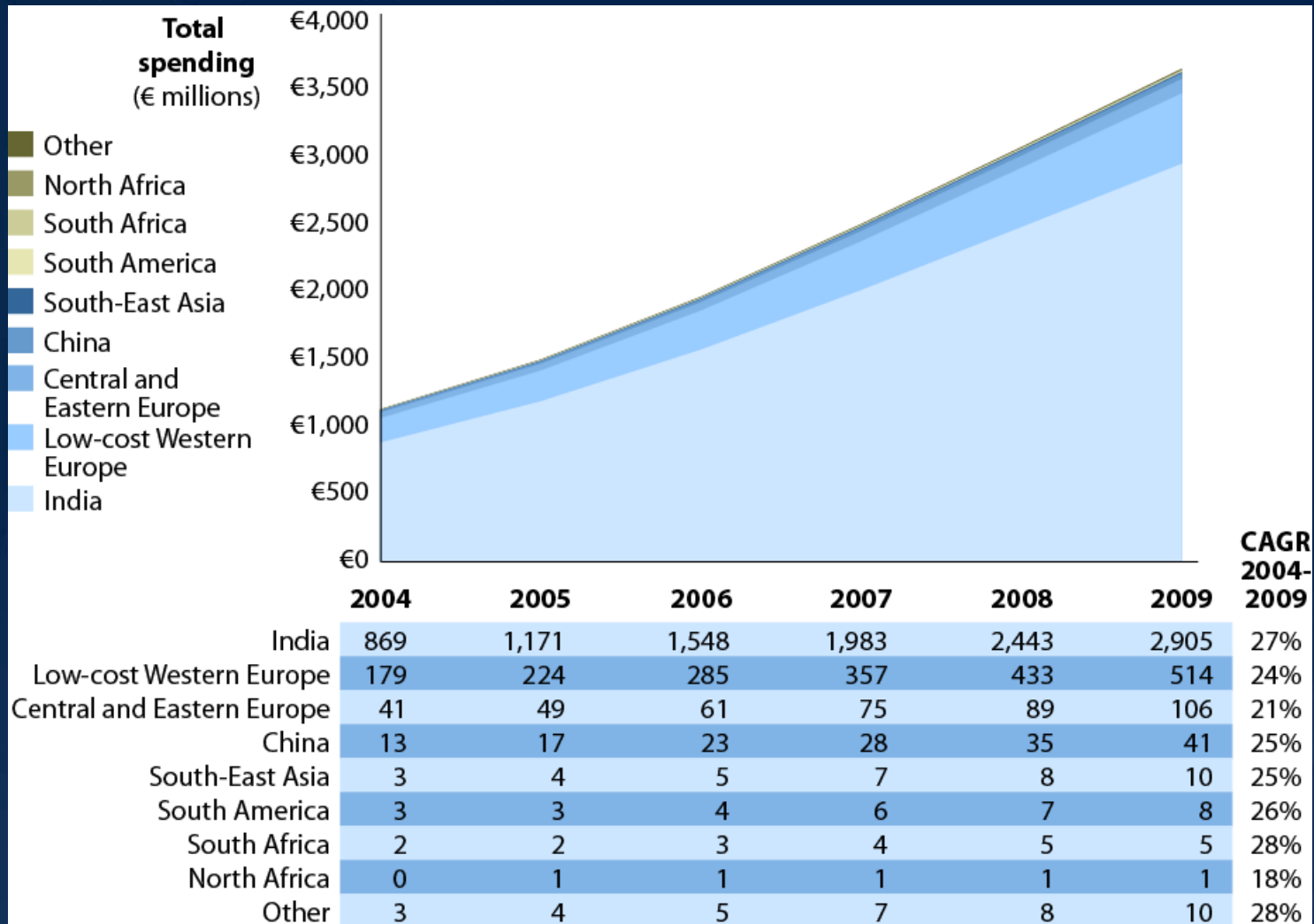
(€ millions)
(numbers have been rounded)

Total spending (€ millions)

Legend:
- Other
- North Africa
- South Africa
- South America
- South-East Asia
- China
- Central and Eastern Europe
- Low-cost Western Europe
- India

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Russian app developers offer inshoring lessons

Russian software firms show continuous dramatic growth

Employee numbers grow in line with revenues

Number of employees

300
250
200
150
100
50
0

1999   2000   2001   2002   2003

Base: 8 large Russian software firms

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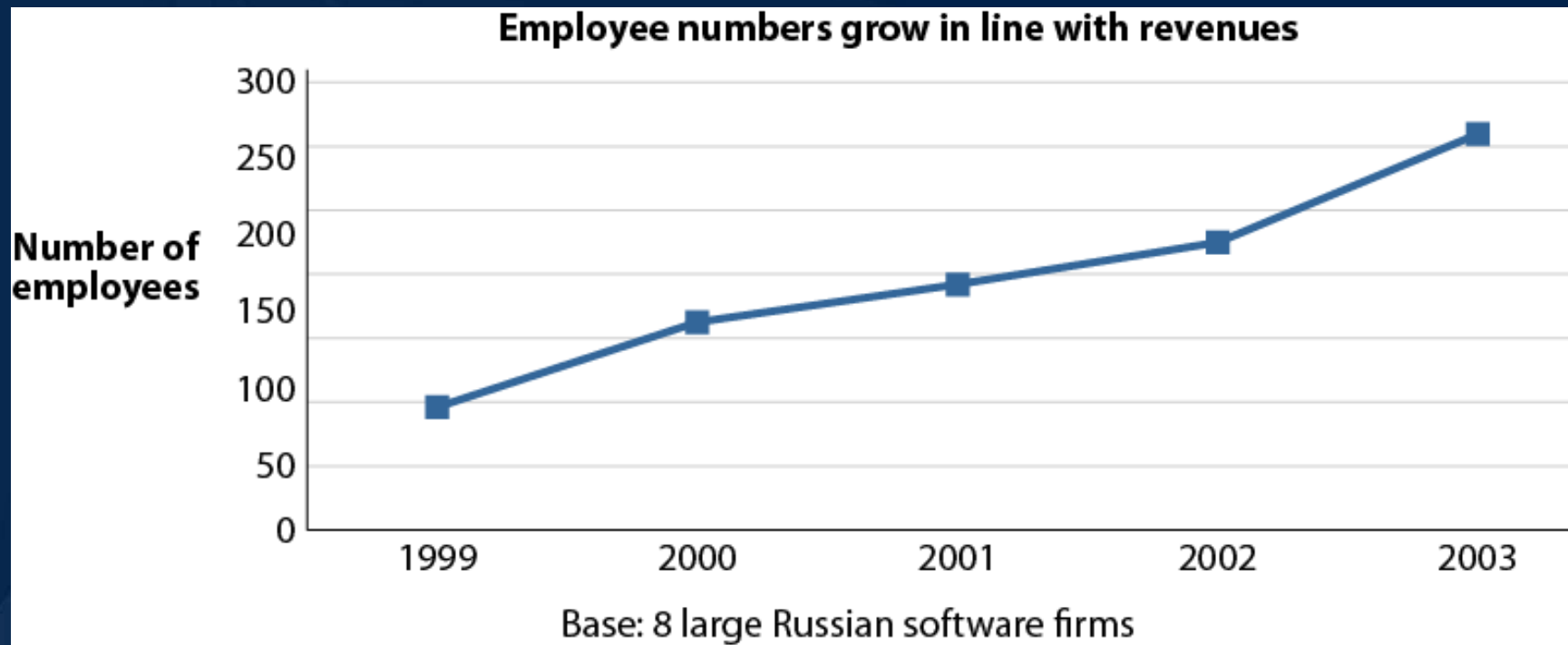
Providers build up strong overseas client lists

Firms have, on average, 25 international clients

Number of international clients
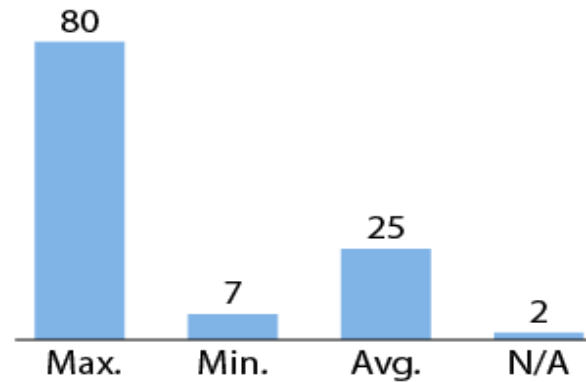
80 Max.
7 Min.
25 Avg.
2 N/A

Base: 8 large Russian software firms

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Overseas revenue ratios vary widely

Average ratio of international revenues to total revenues

2002	Maximum	0.91
	Average	0.66
	Minimum	0.21
2003	Maximum	0.93
	Average	0.68
	Minimum	0.43

Maximum
Average
Minimum

Base: 8 large Russian software firms
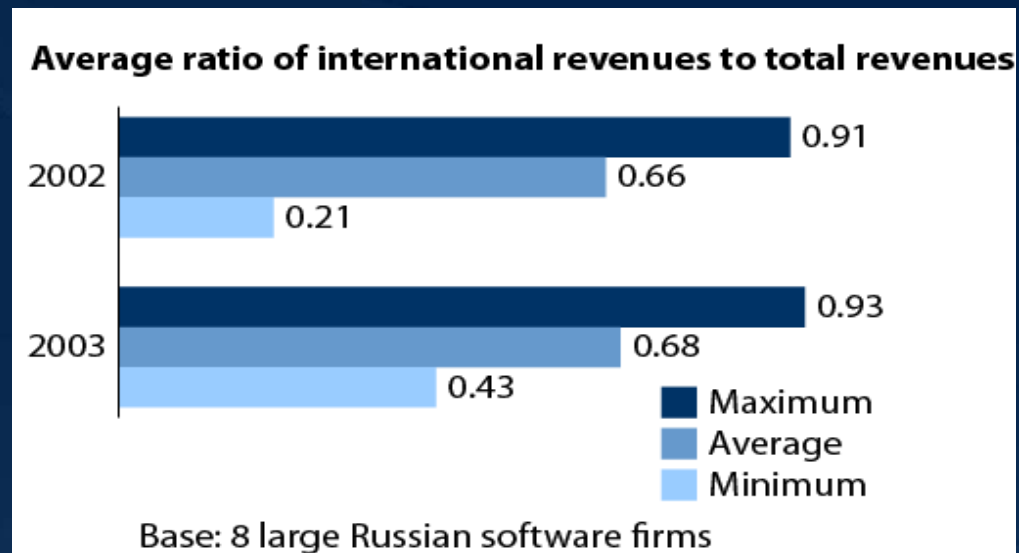
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Lessons from the Russian software developers

- Forrester studied 9 firms in detail: Aplana Software, Auriga, Digital Design, EPAM Systems, LUXOFT, Reksoft, Star Software, Telmasoft, Vested Development

- Almost all specialise: in types of company they work with, in technologies they focus on, in types of projects they handle

- Some specialise in target markets (countries) also

- Several firms have their corporate HQ in the US or Western Europe

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Addressing the inshoring opportunity

Broad conclusions

- The US and the UK will dominate offshore services buying for years to come – but Japan and South Korea will also build offshore demand

- Germany, Austria, Switzerland and the Netherlands continue the most attractive target countries in mainland Europe

- Germany, Austria, Switzerland and the Nordic countries represent the most natural market for Central and Eastern European service providers – in terms of geography, culture and established business links

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Offshore users move slowly from naivety to sophistication

- Choose your target group:
  - » New users
  - » Mature users
  - » All groups
- If you choose to supply services to new users, gear up for
  - » Providing process support
  - » Delivering education on offshore best practices
  - » Having more customer retention challenges
- Mature users will demand
  - » More sophisticated sales and account management
  - » Either more specialisation, or a broader base of services
  - » Value beyond simple low cost of delivery

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Levels of use vary by industry sector

- Don't just jump for the most active industry – financial services – everyone else wants that business too

- Know where your strengths lie – and promote them aggressively

- European and US end users criticise offshore/nearshore vendors consistently for lack of vertical industry expertise

- Demonstrating vertical industry expertise will help improve customer retention

Clients have defined goals for taking work offshore

- Most focus on cost, speed of delivery and quality

- They want to cut their local staff costs, focus on core competences or cut back their use of local (onshore) service providers

- Structure your service offerings to help these goals:
    - » Pricing
    - » Transition management
    - » Onshore support

US and European firms have reservations about using offshore service providers

- User firms worry about communication issues, cultural problems, business risk, protection of intellectual property, service providers' staff turnover problems, quality of processes and deliverables

- Providers must provide clear, effective, and believable answers to these issues – and communicate about them proactively

- Governments need to back up service providers with the right legislation and messages

- A national software vendors association or industry association for IT services will help to develop and communicate the right information – following the example of Nasscom in India and Russoft in Russia

End user firms look for evidence on quality

- Work hard to build a list of reference accounts that includes as many Western European and US large firms as possible – especially those outside the tech sector

- Use process and quality frameworks like CMMI, ISO, and Six Sigma to give a structured approach

- Stay focused on areas of strength, and show this in the types of work delivered

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User firms prefer direct relationships with offshore vendors

- Why? Mostly because they get better control, and better prices

- Offshore providers must have local account management and customer support people – and bring adequate numbers of services specialists onshore when project content demands it

- Follow the Indian example -- some vendors have as many as 60% of their staff onshore at any given time in a single project

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Maturing buyers broaden their service focus

- Don't miss opportunities to expand in scope to serve established customers – if you have the capital and staff resources to extend the scope of services offered

- Don't expect to compete with Accenture by next year

- Remaining in a specialist niche – by industry or by type of service/technology – may be the best way to grow – in reputation, in revenues, in markets served

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More on specialisation

- Young service providers need to gain a toehold in Western markets

- By focusing on a given technology, industry, or target country, service providers will improve their ability to win deals

- Using local partners, or acting as a sub-contractor to local service providers, offers good potential for building a reputation with customers in developed markets

Successful inshoring depends on four factors

Four keys to successful inshoring

- Funding

- Promotion

- Targeting

- Education

Thank you

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