

BPO 2008: The Year Ahead

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Press release from: [ValueNotes Database Pvt. Ltd.](#)

Pune, India; 2nd January 2008 - The sub-prime mortgage crisis and the weakening of the US Dollar have rendered several rude shocks to the outsourcing industry in 2007. Indian companies were especially hit as the Rupee appreciated by 10.9% in the last 12 months (14.2% in the last 15 months) against the US Dollar. Investors, analysts and the media have been speculating about the impact of margin pressures, risk of business loss in the US, further Rupee appreciation coupled with domestic inflation, etc. This will continue through 2008, as we watch the US slowdown play out – much depends on the extent of the slowdown (will it become a full-blown recession?).

Interestingly, despite worries on the margin front, outsourcing growth expectations stand tall. In our interaction with vendors across the outsourcing spectrum (IT, BPO and KPO), optimism is the prevailing mood, especially as concerns top-line growth. As a result, companies are gearing up to face the year with aggressive plans coupled with some innovative strategies to fight margin pressures. Either way, 2008 promises to provide plenty of action for the outsourcing industry. Our analysts have put together a list of key trends that we believe will make an impact in 2008.

1. Shake-up likely as smaller un-differentiated BPOs will be badly hit

Smaller BPOs with low-end, commoditized services are worst affected by margin pressures, and the worst is far from over. These players will find it difficult to raise prices, and will be unable to pay enough to retain the best talent. Small Indian vendors will be forced to innovate with a focus on “differentiating” their services. In 2008, we believe that this will become critical not just for sustaining competitiveness but also for the very survival of smaller vendors. The vendors that succeed in differentiating their offerings and thereby climb higher up the value chain, will see new growth or exit options open up via better access to funding and M&A activity by larger players. The others, who are unable to get out of the low-price, low-cost game, will start fading away from the competitive landscape.

2. Rigorous cost cutting by vendors inevitable in 2008

The larger companies may hedge forex exposures in the near term, but cannot disregard the threat of lower competitiveness in the long run. Large global vendors and focused, niche providers may be able to raise billing rates, but this will not compensate for the entire exchange loss, and will need a parallel productivity increase to prevent margins from weakening further.

Cost rationalization will be inevitable in 2008 for Indian vendors – whether small or large! The most obvious impact will be on wage hikes and executive perks. Recruitment too is expected to slow down marginally until mid-2008, as vendors push up utilization rates aggressively. But we expect recruitment to pick up again in the latter half of the year as the slack gets wrung out. The impact on attrition rates will also be interesting to see, as poaching may not earn employees a large premium.

Apart from the obvious cost heads, companies will also look to optimize various administrative or marketing costs. Traditionally, the weak Rupee has meant that margins were never threatened for Indian IT and BPO service providers. This has led to considerable slack, in areas like transport costs, procurement, travel, telecom, etc. In the past, management attention was focused only on growth, but now, the quality of growth will matter more.

3. Smaller cities will shine brighter

The cost and talent pressures will drive vendors to smaller cities at a faster rate. Especially so or new centers of large companies already present in India. With improving attention to education across India and State governments’ recognizing the potential of the outsourcing sector, companies are finding themselves almost spoilt for fresh location choices. Proximity/connectivity to larger cities and good education infrastructure seem to be guiding the discovery of Tier III destinations like Udaipur, Bhopal, Vishakhapatnam, Nagpur, Chandigarh, Ahmedabad, Nashik, etc. The emerging hot spots are also offering:

- Competitive talent at lower wages than the preferred locations
- Infrastructure and realty advantages

- Lower attrition
- Lower operating costs

4. Vendors to aggressively diversify client base

The focus on the US market is already going down – ValueNotes analysis shows that US-based buyers made up for 56% of the total BPO & KPO contracts in 2007. Nasscom analysis shows that for IT outsourcing, the share of US-led business was about 67% in 2006-07. We believe that this will reduce further in 2008 for several reasons. First, a probable US recession is making vendors aggressively de-risk their sources of business. Secondly, growing maturity of buyers in Europe, Middle East and Asia is opening up new, untapped markets. Thirdly, vendors are maturing rapidly and have acquired the financial, managerial and operational capabilities to build and run centers at multiple locations around the world. All of this is driving the “global sourcing” movement in the industry, and 2008 will see this playing out further.

5. Domestic business will be hot and happening

The Indian domestic market for IT and BPO has typically not interested the large companies, which are traditionally export focused. All of a sudden however, they’re waking up to the potential opportunity in this hitherto neglected, but rapidly growing market within India. A few large IT deals in the past two years, especially in BFSI and telecom helped spark the interest. Ironically, many of the largest domestic deals, especially in telecom, have gone to multinational vendors. But as the Indian economy grows rapidly, new opportunities are emerging in retail, manufacturing, media & publishing, for Indian vendors to tap.

We believe that 2008 will see a lot of noise around outsourcing in the domestic market. High growth rates, Rupee denominated contracts and better utilization (day shifts) will grab the attention of small and large Indian exporters. We expect that large IT/BPO companies will look for acquisitions in the domestic space to acquire specific capabilities and client relationships.

6. Greater focus on the mid-market opportunity

The mid-market segment in the US and Europe has been traditionally underserved for a variety of reasons, including lack of knowledge of offshoring, unattractive deal sizes for the premium vendors, etc. However, rising outsourcing maturity of early buyers amongst mid-market companies is driving their propensity to deploy the more expensive services of larger vendors. At the same time, intensifying global competition is encouraging the larger vendors to look beyond Fortune lists.

Some Indian vendors have laid down strategies to enhance their mid-market coverage via select acquisitions. We believe that in 2008 many more vendors will create differentiated offerings for the mid-market segment, and target this business aggressively through defined strategies and calculated investments.

7. Software + BPO will integrate even more closely

The integration of software and business process outsourcing has been underway for a while now, as customers are moving from piecemeal contracts to transferring ownership of entire processes to their vendor “partners”. This presents a large opportunity for IT vendors, some of whom have already integrated their BPO and IT arms and also started knowledge services/ analytics practices. We expect vendors to further articulate and implement software+BPO integration strategies in 2008.

A key ingredient of the “integrated” offering will be the creation of platforms, especially for back-office and transaction processing services. Platform BPO will allow vendors to de-linearize growth through large-scale productivity payoffs and pay-per-use revenue models. Acquisitions of companies with proprietary platforms will also pick up, although acquiring cannot help vendors do away with investments in capabilities for customization and backward integration.

8. The knowledge services industry will scale the maturity curve further

We have seen credible evidence of the knowledge services industry’s climb up the maturity curve this year. VC interest in the sector is rising and investor concerns about a less than rewarding exit have been put to rest by the valuations of KPO firms like Marketics and marketRx. Entry of large (IT & BPO) outsourcing vendors into the KPO business, the slow but steady emergence of end-to-end service providers, rapid ramp-up of some of the smaller, niche players and other such factors point to more evidence that growth in the knowledge services space is set to gain further traction in 2008.

We believe that in 2008 KPO will rise to the “next” level of maturity – and move from the staff augmentation model to a

value-added role, in which the service provider partners, and even consults the service user, and services provided have the potential to directly impact the buyer's business objectives.

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About ValueNotes Outsourcing Practice

The ValueNotes Outsourcing Practice is one of the largest information providers on the outsourcing industry. Our Outsourcing Practice uses a comprehensive, analytical framework providing fresh insights into the fast emerging and yet, complex outsourcing space. We extensively track the outsourcing space in-depth through a regular analysis of news and events and continuous primary research and contact with the industry.

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