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Research

Gartner on Outsourcing, 2008-2009

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This is Gartner's fifth annual publication of Gartner on Outsourcing — the authoritative source to help you understand the outsourcing market today, what the future looks like, and what you need to know to make better outsourcing decisions in 2009. Sourcing service providers and buyers at all levels of management should read this report.

Key Findings

- Gartner has never seen such tumultuous economic times. Global economic uncertainty has become so widespread, and the path to economic recovery so obscured, that "cautiously optimistic" is the most hopeful position most organizations can muster.

- Price competition for outsourcing deals, particularly for standardized IT outsourcing (ITO) services, will be fierce. Some buyers will be lured by low prices from providers trying to make quarterly revenue goals or build market share.

- Although things look gloomy for the larger economy, the potential for outsourcing to address immediate cost pressures and long-term recovery goals will be unprecedented. Organizations that understand and avoid the pitfalls of cost-focused outsourcing and apply business-outcome-focused outsourcing will be successful.

Recommendations

Providers and buyer organizations:

- Structure outsourcing contracts to ensure the proverbial win-win relationship, where both parties arrive at contract terms that include fair pricing and promise long-term sustainable value. Contracts that leave the provider with only marginal profit or limited revenue growth will result in service quality issues.

- Structure contracts that include the ability to shift focus toward enhancement and innovation. Shifts in the economy will inevitably occur in a multiyear outsourcing deal, but as the economy recovers, flexibility will be important.

- Buyer organizations should use a structured, strategic approach to calculate the true costs of outsourcing, taking into account the risks and opportunities. If cost is a concern, then a clear knowledge of performance baselines before entering an outsourcing engagement is critical.

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1.0 Introduction and Outsourcing Overview

Analytical sources: Linda Cohen and Allie Young

1.1 Market Environment and Economic Impact

During the five years that we have produced this report, we have never seen such tumultuous economic times. As we entered 2008, the signs of economic fragility in the U.S. and Europe were apparent, but the crises that hit in October in the financial services sector and credit markets have plunged the world into an even deeper level of economic uncertainty. Indeed, recent course corrections in the Wall Street bailout have shown that the global economic picture is less stable than we had hoped, and that the ability of the financial services sector to rebound quickly is doubtful.

The overarching theme of global economic uncertainty has become so widespread and the path to economic recovery so obscured that "cautiously optimistic" is the most hopeful position most organizations can muster. With a globally connected economy and intertwined market behaviors that tether multiple vertical sectors to each other, the complexity is almost unfathomable. The immediate question that hovers over the financial services sector at the end of 2008 is how quickly credit will loosen up to stimulate recovery. The pessimistic view is that the weaknesses of the U.S. and Western European economies will start a domino effect on a global scale. The outsourcing market will not escape the impact of these realities.

Although things look gloomy for the larger economy, the outsourcing market represents a dichotomy: on the downside, organizations' outsourcing strategies may negatively impact market growth, but at the same time, the upside is that outsourcing can help organizations to work through financial and competitive challenges. The potential for outsourcing to address immediate cost pressures as well as long-term recovery goals will be unprecedented. However, only organizations that are diligent about understanding and avoiding the pitfalls of cost-focused outsourcing and that apply business-outcome-focused outsourcing will be successful.

We hope that buyers of outsourcing services will use this report not only as an overview of what has happened in the past year, but also to prepare for 2009.

1.2 Outsourcing Market Dynamics: Underlying Trends and Projections

This section identifies the underlying trends and market realities shaping the broader outsourcing market, and presents our projections as we move into 2009.

1.2.1 More Outsourcing Will Be Used, Not Less, and Cost Will Trump Value Considerations

- Organizations will be under extreme pressure to cut IT costs. For most buyers, a concerted and deliberate focus will be put on cost cutting or driving predictability of costs through outsourcing. Some organizations will renegotiate outsourcing contracts, and others will sign new contracts focused on reducing costs and getting cash for assets.

- Because of this focus on low-priced IT services provisioning, some bad deals — those that have no provisions for enhancement or innovation when recovery begins — will be signed.

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- More first-time outsourcers will fall into the trap of signing long-term cost-cutting deals that will turn into bad deals for both parties within two years. Shortcuts on sourcing strategy development and provider selection will be common.

- Executive-led outsourcing mandates will often be inspired by interim management or inexperienced sourcing leadership that adopts tactical outsourcing for cost vs. strategic multisourcing — that is, the disciplined provisioning and blending of business and IT services from an optimal set of internal and external providers in the pursuit of business goals.

- To avoid unsatisfactory outsourcing relationships, organizations of all sizes must develop sourcing and vendor management competency and invest accordingly.

1.2.2 More RFPs Will Focus on Price Comparisons

- Price competition for deals, particularly for standardized IT outsourcing (ITO) services, will be fierce. In some cases, buyers will be lured by "lowball" pricing from providers trying to make quarterly revenue goals or build market share. In other cases, providers will be "forced" to accept low margins for revenue growth, and buyers will make decisions based on who will promise the lowest cost. Either scenario paints a grim future one or two years into the deal as the provider's cost to deliver exceeds revenue and service quality degrades.

- Best practices in sourcing strategy and management may get a short shrift — outsourcing best practices that have been developed by buyers and providers over the past two decades will be ignored, or cast aside.

- Providers and buyers must work together to apply sourcing discipline and craft outsourcing relationships that address near-term cost objectives and longer-term scalability and enhancement when growth rebounds.

1.2.3 Executive Scrutiny of IT Budgets and Internal Cost Controls Combined Will Focus on Outsourcing as a Means to Reduce Labor Costs

- The labor burden many companies experience in their internal IT management, and business application development and management, will drive outsourcing.

- For some organizations, survival will mean shedding employees. Outsourcing is an immediate solution to labor costs, but providers may not agree to transfer staff as part of an outsourcing deal.

- Risk avoidance will be an inhibitor for some companies to outsource, even those that could gain efficiencies from managed services and performance-based contracts with an external provider.

- Some organizations will take shortcuts, and favor onshore or offshore staff augmentation instead of managed services to control labor costs; however, this approach may prove more costly and difficult in the long run.

1.2.4 Infrastructure, Applications and Business Process Outsourcing Will Increase

- In the application area, critical application modernization and portfolio rationalization may be overlooked to avoid near-term cost.

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- In infrastructure outsourcing, pressure to standardize, virtualize and automate to gain cost-benefits and variable pricing will subtly shift the market away from highly customized environments.

- "Green" IT issues will grow in importance, and will no longer be considered discretionary — but green IT initiatives will be fully embraced only if they reduce costs.

- Remote infrastructure management (RIM) will increase as infrastructure services move toward lower-cost offshore delivery.

- Buyers will look to process management, including core business process outsourcing (BPO) and business process utility (BPU), as a remedy for short-term cost control.

- Shared-service operations for IT and back-office processes will be sold to service providers to raise cash, transfer assets and move from fixed a to variable cost structure.

- CFOs of distressed companies will view BPO more as a financial transaction, signaling to Wall Street that they are taking steps to gain control of costs. Some first-time outsourcing adopters will go directly to BPO.

- Global delivery and offshore services for labor arbitrage will be vigorously pursued for ITO and BPO. Access to labor arbitrage will be the primary driver for companies to outsource for the first time.

- Some organizations will look to alternative delivery of services through utility models, such as software as a service (SaaS) or infrastructure utilities.

1.2.5 "Survival of the Fittest" Will Define the Provider Landscape

- For several years, the proliferation of service providers has defined the competitive landscape. But in 2009, only the strong will survive. Providers that have recurring revenue from outsourcing relationships will have the staying power and competitive edge.

- Merger and acquisition activity will accelerate; targets will be other service providers of all sizes, captive centers of organizations, and Tier 2 and Tier 3 offshore providers struggling to achieve revenue growth.

- Cash-rich providers will be well-positioned to make strategic acquisitions for technical, vertical or geographic competencies. This will lead to the potential for India-based companies to take leadership positions among the top-five global service providers.

1.2.6 Demand for Strategic Business Value From Outsourcing Will Percolate Upward as the Economic Downturn Is Prolonged

- Flexibility is the operative word for outsourcing strategies and contracts because outsourcing can never be separated from business goals. To drive the desired results, outsourcing relationships must constantly evolve.

- Organizations with successful outsourcing relationships will understand where they are in the business cycle and make adjustments. In down economic cycles, cost will be paramount, but when growth returns, organizations and their service providers must be prepared to adjust their sourcing goals.

- Outsourcing is never static. Problems can be corrected, the balance of trust and control can be regained, and the pursuit of business value from outsourcing can be prioritized.

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1.3 Topics Covered in This Report

This report covers a comprehensive range of outsourcing topics in greater depth:

- Contract trends analysis for the year in review and contracting issues

- Highlights in the three primary service lines that are outsourced: infrastructure, applications and business processes

- Service delivery trends — including global delivery, emerging alternative delivery models and green IT

- Geographic issues and trends in a globalizing market for outsourcing

- Vertical market trends for outsourcing in four critical sectors: financial services, communications, government and manufacturing

Various links to related Gartner research on these topics, as well as sourcing best practices and market issues and events, are provided throughout this document. This research can help organizations develop better sourcing discipline, which will lead to better results from outsourcing.

Note: The context of outsourcing in this research is a multiyear or annuity-based contractual arrangement that an organization uses to source services. In an outsourcing contract, services are defined at a level of service and provisioned accordingly on an ongoing basis. The outsourcing arrangement is in contrast to discrete, project-specific contractual arrangements that have a predetermined scope of work to be completed within a given time period.

2.0 Contract Trends in Outsourcing

Analytical sources: Dean Blackmore and Allie Young

2.1 Market Environment and Economic Impact

In economic downturns, we closely watch contract reporting as an indicator of the health of the outsourcing market. As we look at the contracts that have been signed in 2008, many of our points of analysis — contract size, contract terms, vertical uptake, deal type and "megadeals" — show continuations of past trends. We have seen some softness in large deal signings, but no catastrophic decline. In part, this is because external forces don't change the basic drivers of outsourcing — organizations still outsource for cost, efficiency, access to skills, focus on core business, innovation, modernization and even business transformation.

2.2 What We Saw in Outsourcing Contract Trends in 2008

2.2.1 Analyzing Contract Trends

Gartner maintains a database of publicly announced IT outsourcing and BPO deals. This data includes the date of signing, client name, client industry, provider name, total contract value, contract duration, services outsourced, geographies and other details.

Any outsourcing contract analysis and review, however, has limitations:

- Not all outsourcing contracts are reported; a high percentage of deals are never made public, in accordance with the desires of the buyer, provider, or both.

- Typically, smaller deals go unreported, and smaller deals comprise most outsourcing activity. Therefore, some skewing toward higher values and longer contract terms is inevitable in analyzing trends.

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- Not all publicly released information on contracts provides the same level of detail; therefore, more granular analysis is limited to those contracts with pertinent facts reported, such as contract value and terms.

Despite these limitations, each year in the Gartner on Outsourcing report we find important insights to explain what has really happened in the market, separate from hype or fears. This contract analysis presents 2008 year-to-date (YTD) contract activity through October; we will refer to this as "2008 YTD" in all tables and figures.

2.2.2 Large Contracts Show a Global, Changing Market

The 20 largest outsourcing contracts in 2008 YTD revealed a global, diverse and changing market. Table 1 lists these contracts and reveals how diverse, in both supply and demand, the marketplace is.

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Table 1. The 20 Largest Outsourcing Contracts Signed YTD 2008

Year Signed	Primary Vendor	Secondary Vendor(s)	Customer Name	Contract Value ($ Millions)	Duration (Years)	Industry	Major Geographic Region	Service Type	Contract Status
2008	TCS		Citigroup	2,500	9.5	Financial services	Global	ITO and BPO	New
2008	AT&T		Royal Dutch Shell	1,600	5	Manufacturing: Process	Global	ITO	New
2008	T-Systems		Royal Dutch Shell	1,552	5	Manufacturing: Process	Global	ITO	New
2008	Capita		Prudential U.K.	1,500	15	Financial services	Western Europe	BPO	New
2008	CSC		Bombardier Transportation	1,200	7	Transportation	Global	ITO	Renew
2008	Lockheed Martin		Transportation Security Administration	1,200	8	National and international government	North America	BPO	New
2008	EDS		Infocomm Development Authority of Singapore	1,000	8	National and international government	Asia/Pacific	ITO	New
2008	EDS		Royal Dutch Shell	1,000	5	Manufacturing-Process	Global	ITO	New
2008	Perot Systems		Harvard Pilgrim Health Care	1,000	13	Healthcare Provider	North America	ITO and BPO	Extension
2008	Lockheed Martin	Accenture	Federal Bureau of Investigation	1,000	10	National and international government	North America	ITO and BPO	New
2008	EDS-Telindus		Flemish Government	831	7	Local and regional government	Western Europe	ITO	Renew
2008	Tech Mahindra		BT	700		Communications	Asia/Pacific	ITO	New
2008	HP		Unilever	675	7	Manufacturing: Process	Global	ITO	Extension

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Year Signed	Primary Vendor	Secondary Vendor(s)	Customer Name	Contract Value ($ Millions)	Duration (Years)	Industry	Major Geographic Region	Service Type	Contract Status
2008	HP		BT	660	8	Communications	Global	ITO	Extension
2008	BT		Procter & Gamble	650	5	Manufacturing: Process	Global	ITO	New
2008	Wipro		Aircel	600	9	Communications	Asia/Pacific	ITO	New
2008	GTL		Ericsson	591	3	Communications	Western Europe	ITO	New
2008	Cable & Wireless		Aviva Insurance Group (Norwich Union)	586	6	Financial services	Global	ITO	New
2008	Stanley		U.S. Department of State, Bureau of Consular Affairs/Passport Services Directorate	570	5	National and international government	North America	BPO	Extension
2008	ACS		Ingersoll Rand	551	10	Manufacturing: Discrete	Global	ITO	Extension

Note: 2008 contracts represent publicly reported contracts signed through October 2008.
ACS = Affiliated Computer Services; TCS = Tata Consultancy Services

Source: Gartner (October 2008)

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Our top-level observations of the largest outsourcing contracts in 2008 include:

- Of the 20 deals reported, several qualify as "megadeals" (greater than $1 billion in total contract value), and 16 different providers were named. The average contract value for these top 20 deals was just under $1 billion ($998 million) and the average contract term is six years, nine months.

- HP and EDS were the only providers winning more than one deal, and they have collectively won five of the largest deals. As these two companies enter 2009 as a combined entity, they have strong momentum.

- Three India-based providers — TCS, Wipro and Tech Mahindra — are in the top 20, each with one contract.

- TCS signed the largest IT outsourcing deal in 2008. It will provide process outsourcing services, application development and infrastructure support to Citigroup for a period of nine and a half years in a deal valued at $2.5 billion. (TCS also acquired the Citigroup captive center as part of this contract.)

- Noticeably absent on this list is IBM Global Services, and Accenture appears only as a secondary provider on one contract. Since 1990, IBM has been one of the leading providers for the largest outsourcing deals. IBM and Accenture have continued to perform strongly in the past 12 months, which suggests that their outsourcing deals are smaller, that they may not be aggressively pursuing some large deals that some sizable deals are sole-sourced and not reported, or that add-ons to existing outsourcing contracts are not reported.

- Large contract signings represented diversity across different vertical markets, including six in manufacturing (five of which are in the process manufacturing sector), four in communications, five in government, three in financial services, and one each in transportation and healthcare.

- From a geographic perspective, "global deals" represented 10 of the largest contracts, while the most mature markets, North America (with four) and Western Europe (with three) collectively accounted for seven deals, with the Asia/Pacific region accounting for three. The impact of globalization was clearly evident.

- In terms of service focus, ITO accounts for 14 deals, BPO for three, and combined ITO and BPO for three.

- Of the total 20 deals, 13 are new contracts and the remaining are renewals or extensions, indicating that long-term partnerships make up a healthy source of follow-up business.

- The trend to multisource (one organization using multiple providers) was exemplified by Royal Dutch Shell signing three megadeals in 2008 with three different providers: AT&T, T-Systems and EDS.

- Although not reported in Table 1, the risk of megadeals to providers was illustrated again in 2008 when the U.K.'s National Health Service canceled its $1.75 billion contract with Fujitsu because the parties failed to reach an agreement on contract reset negotiations.

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2.2.3 2008 Megadeal Signings Were Flat From 2007

The number of megadeals signed in 2008 YTD matched the number signed in 2007 at 10. The total contract value (TCV) for 2008 megadeals, however, was marginally down at a combined valuation of $13.6 billion, against $14.1 billion in 2007. Thus, there was only a slight softening at the very high end of outsourcing in 2008 compared to 2007.

Over the longer term, 2003 represented the high point of megadeal signings at 15 contracts. Fewer megadeal signings are a factor of market maturity, but big deals entail longer sales cycles, complex contract terms and management arrangements, and present a higher risk to the client and the provider. The movement away from megadeals is partially explainable by both parties wanting to lower their risk, and by buyers seeking more flexibility and less "lock-in."

2.2.4 Contract Value Trends

The TCV for outsourcing contracts from 2003 through 2008 shows volatility. During this period, the market showed a steady rise in TCV per year, but in 2007 we saw a considerable drop, to under $30 billion, and 2008 YTD shows only a minimal rise. This can be deceiving, however, because relatively few deals have reported contract value; so even in 2003 with the highest number of megadeals signed, the TCV was not higher than in later years. Furthermore, providers reported increases in IT and process management revenue, the core of all outsourcing, have steadily increased.

After peaking at more than $350 million in 2003, average contract value (ACV) dropped off to around $200 million in 2004 and 2005, and then surged back to around $275 million in 2006 before dropping off again in 2007. In 2008, ACV was at a six-year low, at $189 million. This is was only marginally down from the 2007 figure of $204 million, nevertheless it indicates changes in deal size. Although this may seem a negative market indicator, it is just a symptom of a changing market as buyers increasingly shift to selective outsourcing and smaller deals that give greater flexibility.

2.2.5 Average Contract Length Is Five Years

From 2003 through 2008, average contract length showed a fairly stable range of between five years and six years. Considering that larger deals are likelier to have deal specifics reported, the average contract length is skewed to reflect larger deals. However, outsourcing contracts reflect long-term commitments, and this has not changed dramatically over the years — even though TCV and ACV have been more volatile.

2.2.6 ITO Dominated the Outsourcing Market

ITO continued to represent most outsourcing contracts in 2008, with roughly 70% of all contracts reported being for IT infrastructure, applications and network services. BPO represented about 30%. Nevertheless, BPO is an important growth area for the outsourcing market. In 2007 and 2008, signings of combined ITO and BPO deals increased, and while the percentage is minimal, these typically represent fairly significant deals in size and scope (see Table 1). This is an important trend, since it validates provider strategies for full-service coverage and buyer desire for end-to-end accountability in some situations.

2.2.7 Uptake of Outsourcing in Vertical Markets

Figure 1 shows the percentage of contracts signed, by vertical market, in 2007 and 2008. Comparing the two years, some drop is evident in the most visible and highly outsourced sectors, that is, government, financial services and manufacturing. But, uptake in key vertical markets is undergoing tremendous change, and in these areas — communications, healthcare, and wholesale/retail —competitive activity is high. Figure 2 shows that despite fewer deals reported

as a percentage of total contracts, the TCV for government and manufacturing increased by a healthy amount, and financial services' TCV remained constant.

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Figure 1. Percentage of Outsourcing Contracts Signed, by Vertical Market, 2007-2008 YTD
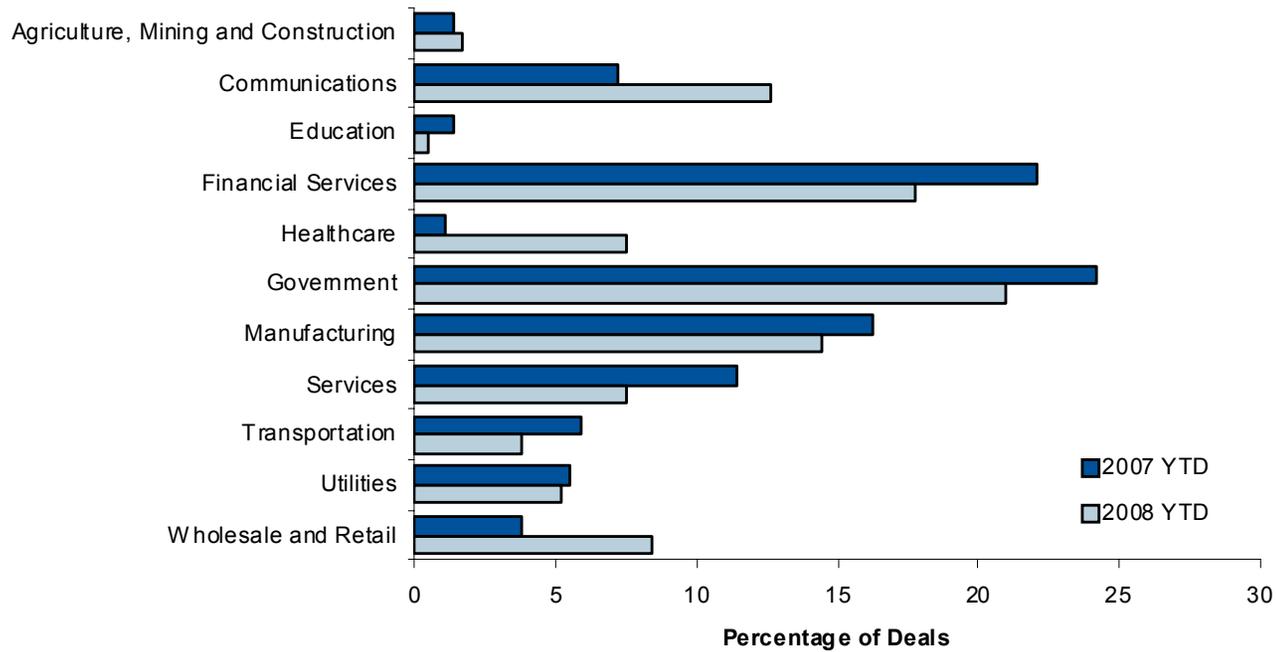
Note: 2008 contracts represent contracts signed through October 2008; only publicly reported outsourcing contracts are included in this analysis.

Source: Gartner (October 2008)

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Figure 2. Total Contract Value of Contracts Signed by Vertical Market, 2007 and 2008 YTD (Billions of Dollars)
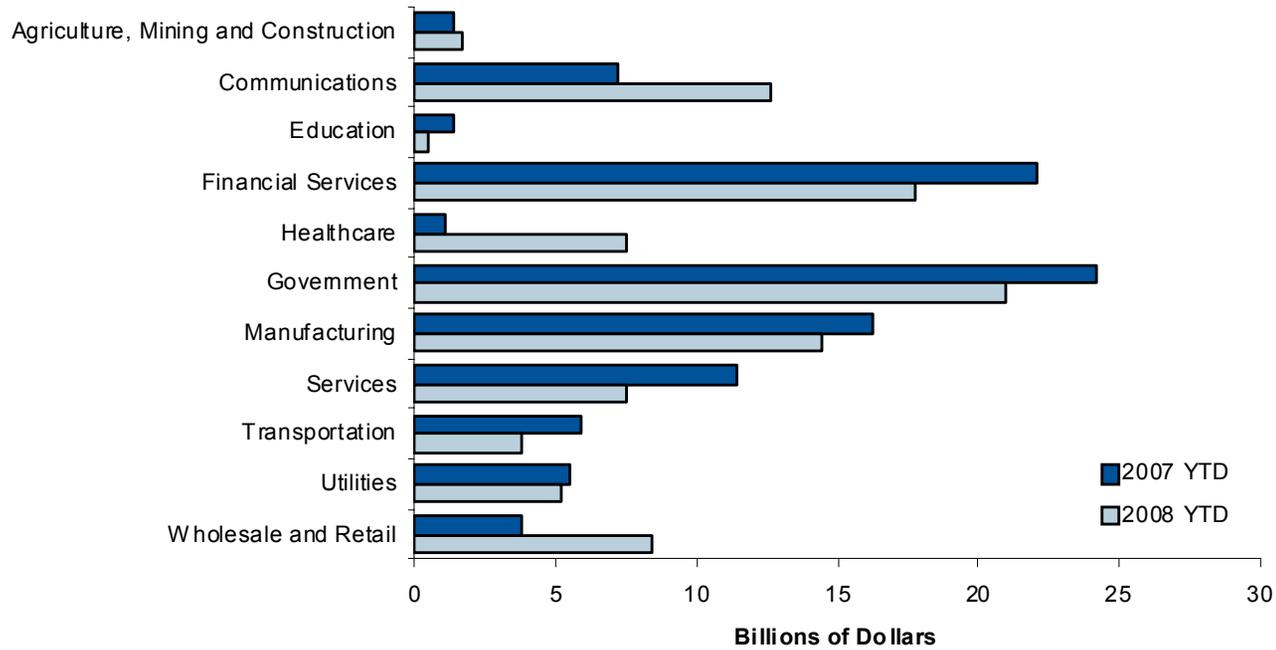
Note: 2008 contracts represent contracts signed through October 2008; only publicly reported outsourcing contracts are included in this analysis.
Source: Gartner (October 2008)

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2.2.8 Contract Extensions and Renewals Indicated Client Loyalty

In 2008, about 76% of announced outsourcing contracts represented new deals; the remaining 24% were a combination of contract extensions (14%), expansions (3.5%) or renewals (6.3%).

Almost one-quarter of contracts were a continuation of outsourcing with an incumbent provider. With the continued uptake in selective outsourcing, a provider can remain a key supplier of services to a particular client, yet potentially lose a portion of its historic contract value. Key providers are betting their future on forming enduring, long-lasting client relationships. In uncertain economic times, outsourcing relationships can prove (and test) the durability of relationships and the outsourcing value proposition.

2.3 What We Expect to See in Contract Trends for 2009

- A growing trend to provide more detailed service requirements, penalties, terms and conditions in outsourcing contracts. This is partly because of market maturity and buyer knowledge, and partly because outsourcing can signal to Wall Street active steps to control costs, improve processes and reduce head count.

- Companies looking to outsource as a way to ensure quality and service levels through performance-based terms because all vertical sectors look for cost takeout and predictability in pricing and performance.

- Some buyers consolidating their number of service providers to reduce overhead and to control spending; more work will therefore flow to trusted providers that are viewed as long-term partners.

- Fewer megadeals because of their high profile, perceived high risk and long sales cycles, and as a result of a more cautious attitude toward IT spending. Cautious buyers and providers will more easily digest smaller deals.

- More small deals, including by many first-time buyers looking for cost takeout. Consequently, average contract value and term lengths may decline. Also, we'll likely have smaller deals signed by companies outsourcing because it will be easier for buyers to get funding for smaller deals.

- Greater diversity among outsourcing service providers; some less-well-known providers will pursue and win some large deals.

- Increased standardization, with end-users buying standard, nonmodifiable terms and conditions.

- An increase in contracting for prime contractor services, as organizations struggle to get investment for internal skills to manage providers.

2.4 Recommended Reading

- "Market Optimization for IT Services: How IT Services Providers Can Survive, Even Thrive, in an Economic Downturn."

3.0 Contract Issues in Outsourcing

Analytical source: Helen Huntley

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3.1 A Definition of Outsourcing Contract Issues

Outsourcing contracts for IT infrastructure and business process services, as well as consulting and system integration, must contain terms and conditions that reflect not only the legal aspects of a contract between companies, but also how the relationship will be governed, what value will accrue from the deal, how that value will be measured, and the operational working characteristics between the parties.

3.2 Market Environment and Economic Impact

The global economic slump has meant that outsourcing clients are re-evaluating their contracts to improve efficiency and costs. This is affecting provider selection and retention, how services are or will be delivered, delivery location and contract pricing. Beyond the drivers of efficiency and cost, however, many organizations will also experience business change as a result of repercussions of the economic crisis, which will impact current or plans for outsourcing. For organizations that are outsourcing, contract terms may be altered in response to corporate change: some will downsize, others will expand, acquisition and divestiture will impact others, and still others will cease to exist. Many not outsourcing will consider or move aggressively to outsource their IT or business processes to focus on their core business. More than ever, buyers and providers must be attentive to contract issues to ensure a certain level of flexibility, since business change is almost certain.

3.3 What We Saw in Outsourcing Contract Issues in 2008

- Outsourcing contract terms got shorter in length as clients tried to gain more control and build more flexible deals that better met their business needs. Deal lengths are now typically two to three years for application outsourcing contracts and five years (three years plus two one-year options) for infrastructure agreements. Infrastructure utility (IU) contracts are even shorter, with one- to two-year lengths being common. Buyers that pursue term lengths beyond these will need strong benchmarking provisions to ensure that the pricing given today will be in line with market pricing during the extended contract term.

- Outsourcing contract renegotiations happened more often. More than 50% of deals are being renegotiated preterm, often just past the one-year anniversary of the contract. This is not necessarily bad news, and could be a positive sign to make needed adjustments. For some, renegotiation was a factor of cost or business change. Organizations that have more sophistication regarding outsourcing and a clearer insight into the changing needs of the business will use renegotiations to help preserve the continuity of the contract through midterm adjustments.

- Some procurement organizations began to better understand the nature of outsourcing contracts as largely people-intensive, service-oriented relationships, and thus not at all similar to negotiating purchasing products. However, when it comes to negotiating terms, the cost of service is still the most important selection factor.

- Pricing options were more varied. Buyers still wanted the safety of a fixed price, but providers are increasingly moving toward output- and outcome-based pricing models in outsourcing contracts where services support a process with measurable outcomes. Providers that can demonstrate cost takeout have a clear value proposition, but providers that are willing to assume more accountability for business outcomes have more influence with the business buyer. Linking outsourcing outcomes with business objectives has been a direction some mature outsourcing clients have taken, but this

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typically involves an evolved pricing model developed after relationships and trust have been established.

- Indian providers again won some very large (greater than $250 million) outsourcing contracts previously awarded to large traditional providers. Indian pure-play momentum is ongoing: these providers are not only developing key sales, marketing and delivery strategies, they have gained confidence with buyers who now consider them for large global awards.

- Small or midsize deals got the attention of large traditional and offshore service providers. Recently, many large service provider firms, whether domestic or offshore, would have overlooked small and midsize contracts. However, smaller deals are now making up a considerable part of their revenue base. This change in supplier attention benefits the small- to midsize-deal buyers, as well as large buyers that are segmenting work using a multiprovider sourcing strategy. Buyers are cautioned, however — smaller deals may be better suited to niche providers.

- Buyers asked for innovation in outsourcing contracts, but weren't defining what innovation means. Outsourcing buyers are eager to add innovation clauses in their contracts, but are often not adequately defining what innovation means to them, or how it will be priced, controlled and measured. Many feel their deals fail to deliver the anticipated innovation. A formal process for innovation, including specific contractual terms and conditions, needs to be part of contract best practices.

- Service providers experienced longer pursuit cycles for outsourcing contracts, which means cost of sales increased, and many noted delays in contracts signings due to economic concerns. Clients have options, which mean they are spending longer evaluating and selecting providers and service and delivery models. Service providers are reporting healthy pipelines for contracts, but are noting longer pursuit cycles for relatively small deals.

3.4 What We Expect to See in Outsourcing Contract Issues in 2009

- A growing use of third-party advisors will build and negotiate contracts. As deal complexities increase, buyers will more heavily rely on third-party consultants (including legal) to help structure and negotiate outsourcing terms and conditions, service levels and pricing, including international issues. Benchmarking provisions will become more sophisticated as buyers fully articulate the benchmarking process and link it to direct contract changes — for example, bringing delivery pricing in line with current market rates.

- Carbon and emission standards and energy-efficiency requirements will increase as evaluation criteria for outsourcing contracts. Only 25% of buyers have green IT requirements in their RFPs, but IT organizations and providers report that green IT issues are increasingly being discussed. This should translate, over time, into greater adoption of green IT as a standard contract criterion.

- Contract change of control provisions will strengthen. Outsourcing providers are acquiring, divesting and merging at an accelerated rate. To terminate IT services contracts due to provider change of ownership, buyers are increasingly creating change-of-control clauses that enable them to exit all or part of the outsourcing deal.

- Outsourcing buyers will categorize providers more methodically. Rationalizing the number of providers used is an important element for buyers to gain control and lower provider management costs. Buyers are beginning to categorize providers to build the

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most effective contracts and the right governance structure for different provider relationships.

- Use of scorecards to measure provider-client relationships will increase. Outsourcing contracts will incorporate measurement criteria on the relationship as well as standard service-level agreements (SLAs) on performance.

3.5 What You Need to Know About Outsourcing Contract Issues

- The best outsourcing contracts ensure the proverbial win-win relationship, where both parties arrive at terms and pricing that is fair and promises long-term sustainable value. Contracts that leave the provider with only marginal profit or limited revenue growth will ultimately result in service quality issues.

- Small or midsize organizations that are moving forward with outsourcing have more and more options from hungry competitors —from large providers going "downstream" and emerging providers seeking to build market share. Nevertheless, buyers should evaluate providers carefully to determine which ones best suit their needs and which will have a sustained interest in the client's business. If the market shifts again to bigger deals, some providers may not value certain clients as much as when they were signed, especially in the case of small contracts.

- More competition and more outsourcing are likely to lead to longer sales and decision cycles. This trend can be as harmful to buyers as it is to providers because it ultimately adds to the deal's cost or cause well-qualified providers to lose interest. Although heavy competition is still the norm, buyers must be prepared to execute quickly.

- The use of third-party advisors does not necessarily ensure good deals. Some third-party-led outsourcing deals drive for low prices in the RFP and final provider selection phases, resulting in providers winning deals that have very slim margins. This inevitably gets a potentially strong outsourcing endeavor off to a bad start and ultimately results in delivery problems.

- Cost may not be the best criterion for evaluating contracts. Buyers that sign deals based solely on cost are often dissatisfied with delivery, even though it is exactly what they signed up for. If cost is the paramount consideration, buyer organizations must prepare for possible degradation of service levels. Know what you are buying, how it will be delivered, the provider's reputation and how delivery will impact your business. In a slumping economy, buyers may be tempted to use cost as the predominant evaluation criterion when selecting a service provider. Be aware of what you may be giving up.

- Given that consolidation will likely occur more frequently in the provider market with economic uncertainty, buyer organizations should include contract termination clauses in the event of acquisition impacting their service provider.

3.6 Recommended Reading

- "A Guide for Building and Understanding Outsourcing Contracts: The 19 Distinct Articles in a Master Services Agreement"

- "Outsourcing Contracts: Guidelines for Master Service Agreements and Schedules"

- "Best Practices for Renegotiating Outsourcing Contracts"

- "Assess Four Factors Before Renegotiating Outsourcing Contracts"

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- "Tata Consultancy Services Acquires Citigroup Captive: Expands Offerings, Helps Citi in Tough Economic Times"

4.0 Infrastructure Outsourcing

Analytical sources: Dane Anderson, Claudio Da Rold, Richard Matlus and Gianluca Tramacere

4.1 Definition of Infrastructure Outsourcing

Gartner defines infrastructure outsourcing as the outsourcing of data centers, desktop services, help desks and networks. This involves some transfer of management responsibility for the ongoing delivery of IT services to an external provider, with performance tied to service levels or outcomes. Services can include any or all product support and professional services as they relate to the management of IT infrastructure. As part of an IT infrastructure outsourcing agreement, the service provider may acquire the physical assets or the employees of the client organization. Services may be provided at the client site or remotely from a provider-owned site.

4.2 Market Environment and Economic Impact

The current challenging economic climate makes the enterprise infrastructure a key target for outsourcing as buyers seek both cost reduction and rationalization of the IT environment. While the financial services sector is likely to go through a period of transition in the near term, government, manufacturing and, to some extent, retail remain key growth markets for infrastructure outsourcing to achieve cost reduction or to modernize platforms. Cost reduction will, however, remain linked to other objectives, notably, support for change, speed-to-solution and flexibility. Leading offshore providers are seeking greater growth in North America and in Europe, and their cash availability will enable them to consider acquisitions as a means to grow and establish a stronger infrastructure presence in key markets. Although the numbers of clients and resources managed will continue to grow, continued price pressure will hinder the overall growth of the infrastructure outsourcing market. Market consolidation will also be driven by alternative delivery models such as the infrastructure utility, cloud computing and remote management services.

4.3 What We Saw in Infrastructure Outsourcing in 2008

- Despite increasing margin pressures, the infrastructure outsourcing market continued to attract a variety of service providers. At the same time, providers continued with mergers, divestures and acquisitions to expand their markets, focus on successful businesses or geographic areas, and in general protect profitability. A notable acquisition during the year was the purchase of EDS by HP.

- To benefit from service delivery specialization, buyers continued to evaluate engaging multiple providers for broad infrastructure initiatives. Although the division normally happens by tower (for example, network, desktop and centralized/data center), buyers often fail to identify the challenges related to defining their services and fail to specify the requirements needed to manage a complex environment. The IT Infrastructure Library (ITIL) and the creation of operating-level agreements aimed at defining the responsibilities of each provider toward the others are key components to guarantee an efficient integration of end-to-end service.

- Provider focus on profitability was confirmed by strong discipline in bid selection, use of subcontractors for noncore services, standardizing service delivery via methodologies, automation where possible and the ongoing process of physical and logical consolidation, and of delivery capabilities through global delivery models.

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- Remote infrastructure services delivered from "nearshore" or offshore locations are rapidly gaining buyer interest and are being deployed by organizations looking at centralizing the delivery of specific services such as network monitoring or server management, while reducing cost through labor arbitrage (many tasks are not yet automated).

- Buyers had more choices for providers in infrastructure outsourcing, particularly the offshore providers that relied on their experience and continued focus on automation, tools efficiency and global process homogeneity. However, offshore providers faced two challenges: some lacked the experience of managing complex enterprise infrastructure environments, and some customers decided to shift from a contract based solely on remote infrastructure services to a more traditional full IT outsourcing model.

- Buyers' attention to cost meant that providers found themselves facing continued pressure to produce cost savings, with many contract renegotiations aligning the cost of the services over the lifetime of the deal. Other contract renegotiation drivers included redefinition of SLAs and redefining the scope of the deal.

- During 2008 we saw an emerging focus on green IT, particularly as it related to infrastructure outsourcing and the carbon footprint of data centers. Although buyers are just beginning to explore the impact of green IT relative to their outsourcing strategies, Gartner finds that in up to half of RFPs there are references to reducing energy consumption and the IT organization's carbon footprint. Cost will be a top driver for green IT initiatives.

- Market growth in 2008 will again be in the mid-single digits. Through 2012, Gartner expects the worldwide IT management segment overall to grow at a 7.3% compound annual growth rate (CAGR), from $202,056 million in 2007 to $292,266 million in 2012.

- Gartner forecasts that IT operation management's five-year CAGR through 2012 will be 7.3%, while help desk service will grow at a CAGR of 6.2% (see "IT Services Market Metrics Worldwide: Forecast Database"). In view of the uncertain economy, Gartner has also produced a worst-case market forecast. User transition and caution will have a minor impact on the 2007 to 2012 growth rate, reducing it to 6.3%; from $202 billion in 2007 to $274 billion in 2012 (see "Forecast: IT Services, Worldwide, 2008-2012 Update and Worst-Case Scenario").

4.4 What We Expect to See in Infrastructure Outsourcing in 2009

- The challenging economic environment will continue to drive buyers to make cost containment a priority in infrastructure outsourcing, while objectives such as business enhancement will temporarily lose their attractiveness. Providers will press for standardization, but buyers' focus on flexibility will continue to grow as a requirement. These efforts are not necessarily mutually exclusive, and we will see flexibility addressed through pricing strategies and delivery options.

- Infrastructure services delivered from nearshore and offshore locations will continue to gain interest and acceptance based on cost-benefits. To address demand and enhance their own efficiency, providers will continue to invest in their global delivery networks in areas such as Eastern Europe. Proximity will remain key for many European buyers to enable more control of service delivery management.

- Offshore providers looking for growth opportunities in infrastructure management services will continue to shift their focus from the U.S. to also include Europe. Given the cash reserves of many leading Indian players, interest in acquisitions will increase,

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especially in the European market. This will enable India-based providers to address European customer concerns about geographic proximity.

- Buyers will remain challenged to find mainframe skills such as COBOL. This will drive remote delivery, even though such skills are also hard to find in India.

- Green IT will gain momentum, with green requirements appearing in an increasing number of RFPs. However, in the near term, green IT initiatives will focus on cost/power optimization and service resilience, especially in the data center.

- Focus on deploying infrastructure-outsourcing solutions based on alternative delivery models will be renewed. Beyond remote infrastructure services, the focus will be on solutions such as the infrastructure as utility, as a service, or in cloud computing. In general, industrialized offerings will start to show a higher growth rate.

- As new offerings emerge from unconventional players (Google and Amazon, for example), deploying IT utility solutions will increasingly be seen as a viable option for organizations. This will start to impact the desktop environment, as organizations will be more willing to accept standardized desktop solutions.

- Server optimization and data center consolidation will continue to drive data center outsourcing. Legacy migration and modernization (including moving legacy systems to new platforms) will continue to be a motivator for new and renewed outsourcing contracts. The real cost-benefits of virtualization will remain under scrutiny.

- Despite the supposed maturity of infrastructure outsourcing, first-generation buyers' satisfaction will continue to be challenged by relatively low maturity, misaligned expectations, delayed focus on governance, design of the retained organization, and SLA and operating-level agreement (OLA) definition.

- Organizations will increase investment in network outsourcing because of pent-up demand for network services and the need for reliable and predictable access and availability. More providers will see network services as critical to connecting with buyers and third parties. Security will remain a key buyer concern.

4.5 What You Need to Know About Infrastructure Outsourcing

- As providers continue to evaluate their service and geographic portfolios, they will quickly divest unprofitable service and business lines to protect profitability and market reputation. This means buyer organizations must focus on exit strategies from the beginning of their outsourcing journey and must also leverage short-term contracts. Ensuring exit clauses in contracts is important for both parties.

- Buyers must design their own consolidation strategy and seek alignment with their providers. Service providers are seeking economies of scale from consolidation of data centers and service centers. This allows them to keep up with price pressures and position themselves for continued exploitation of the appropriate combinations of global delivery models and IT utility services.

- As part of the evaluation and selection process for an infrastructure outsourcer, buyer organizations must know the provider's strategic road map to ensure that the provider plans to continue investing in areas of importance to the buyer. For example, not every provider has the capability to provide network outsourcing services, nor does every provider of infrastructure services deliver network services well or directly. By the same

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token, not all network service providers have the capabilities to deliver data center, desktop or help desk services.

- Contract renegotiations are common, to the point that they occur on average almost every two years. Buyers and providers must accept this as a sign of a healthy relationship and build renegotiation milestones into established and future contracts.

- Although buyers expect service delivery performance to match what has been contractually agreed on, as the focus shifts increasingly to cost reduction, providers and clients must be able to manage the relationship and the expectations, not just the contract. Over the lifetime of the deal, if the economy has recovered, then the focus is likely to shift rapidly toward improvement and innovation. The challenge will be in managing change while maintaining realistic expectations among the key deal stakeholders within the context of the deal.

- Although buyer organizations remain keen to explore the potential of engaging multiple providers, only a minority of buyers master end-to-end service integration. Clarity of deal scope, ITIL and OLAs remain key tools to achieve it.

- Contract length is stabilizing at three to five years, with frequent smaller revenue due to deals being broken down and allocated to multiple providers. Staff and asset transfer are becoming less common as second- and third-generation deals and deals with offshore components become more common.

- The need to achieve physical and logical rationalization and consolidation is causing IT consulting and system integration to be bundled inside infrastructure outsourcing deals. As a consequence, many deals are being structured as "transition, transform and run." In some cases, pressure is even higher, with transition and transformation happening in parallel.

- With a few exceptions, market growth for leading providers remains slow. Provider focus on restructuring continues, with a focus on themes such as global delivery, portfolio standardization, customer intimacy, green IT, and virtualization and automation. At the same time, providers are rediscovering the benefit of the traditional "defend and attack" strategy. To protect their presence in specific crucial accounts, organic growth is not aimed at moving up the value chain only, but also to address the tactical needs of buyers.

- To gain advantage from the major trends driving the rapid evolution of infrastructure outsourcing, buyers must accept — and when possible seek — opportunities for consolidation, industrialization and global delivery.

4.6 Recommended Reading

- "MarketScope for Remote Support Services (Global)"

- "MarketScope for Remote Monitor Services (Global)"

- "User Survey Analysis: IT Outsourcing in Europe, the Evolution Is Ongoing"

- "What Buyers Need to Know About the Changing Global Outsourcing Competitive Landscape"

- "Vendor Survey Analysis: Investments in Alternative Delivery Models, Part 2, Global, 2008"

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5.0 Application Outsourcing

Analytical sources: Dane Anderson, Ben Pring and Allie Young

5.1 Definition of Application Outsourcing

Gartner defines application outsourcing (AO) as a multiyear or annuity contract or relationship involving the purchase of ongoing application services for managing, enhancing and maintaining custom or packaged software in server/host or desktop/client platforms. Most organizations' first steps to externalize application service work occur via staff augmentation and application project work to supplement internal capabilities. Although these forms of engaging service providers are widespread, the movement toward true AO — which entails turning over management responsibility to a service provider for performance-based outcomes in a multiyear relationship — is increasing. AO promises the added benefits of long-term relationships, performance-based contracting and comprehensive support of business applications across the entire life cycle.

5.2 Market Environment and Economic Impact

The global economic crisis and attendant uncertainty in many sectors will cause organizations to scrutinize IT budgets for cost takeout opportunities in their AO practices and contracts. Applications will likely be a target for savings in many organizations because of the following factors:

- Application services support work is labor-intensive.

- Organizations have not rationalized their application portfolio.

- Legacy applications are in need of modernization, a costly undertaking.

- Testing services are needed and software engineering processes are often immature.

- Production-level applications are costly to maintain.

- Because infrastructure outsourcing has already been addressed in many organizations, application consolidation and optimization is seen as the "new frontier" for cost containment.

Each of these factors will drive organizations to outsource business applications to gain not only cost savings, but business agility, greater efficiency and greater focus on core competencies.

5.3 What We Saw in Application Outsourcing in 2008

- In 2008, organizations' willingness to use external providers for AO continued to grow worldwide. Drivers for external sourcing of application services are business- and technology-related, including cost savings, capacity (ability to scale), skills shortages, lack of IT budget to hire more staff, access to better processes, past successes in AO and business mandates to outsource.

- Concerns continued around security and compliance, high costs associated with using external providers, and loss of internal core application competencies.

- Global economic uncertainty meant that many organizations continued to make cost-based AO decisions vs. value-based decisions for enhancement. Many failed to invest in governance and management frameworks, or to undertake portfolio rationalization, making their AO decisions less effective than they could have been with a more disciplined, strategic approach.

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- Buyers still wanted options. Stand-alone AO engagements often focused on application management for applications in production, but buyers were increasingly investigating and contracting for bundled outsourcing deals, with full life cycle application services, infrastructure and/or business processes, and follow-on maintenance, management and support services. Buyers expect more options from their providers, and many seek a single provider that is focused on implementation work and management work versus sourcing services separately.

- Growing acceptance and adoption of offshore delivery continued. Service providers responded with more focus on improving offshore processes, but continued to face rising competitive pressure, higher pursuit costs, and investment demands for global delivery options.

- India's prominence as an offshore location for application skills was challenged due to the impact of higher labor rates and attrition in India in 2007. These rates moderated in 2008, but were nevertheless a signpost of change. Buyers became more open and willing to consider countries other than India to take advantage of other labor sources at more competitive rates.

- Using global sourcing for cost-benefit alone in AO was no longer sufficient. Nearly all organizations seek cost reduction in their globally sourced application outsourcing. However, buyers and providers realize that while replacing one labor source with a less expensive one may provide near-term relief, it does not provide sustained benefits unless the service provider delivers quality services and improves processes. "Cost + quality" is the new mantra when it comes to offshore application services delivery.

- Centralized AO decision making was the norm. The AO decision process tends to be centralized in most client organizations, with a variety of decision makers involved. Our research shows that even with more business leaders involved, the CIO and the IT managers are not out of the game. But the business is getting more involved in decision making and is becoming more demanding in expecting results from AO.

- Business involvement in AO decision making increased. AO decisions involved more than just the IT department. The business user — the true user — must be engaged early to structure successful outsourcing relationships that support true business needs and establish business buy-in for the outsourcing model and provider. If the business is ignored, then it will make its own AO decisions and bypass IT to buy its own AO services, or perhaps even attempt to create its own IT "group" to provide the required services.

- Multiple service providers were the norm across the typical organization's portfolio of application outsourcing. Although a multiprovider environment is the norm in application services to ensure the provider competitiveness in terms of service quality, rates and resourcing, organizations continue to be challenged to manage in this environment. Many enterprises had difficulty with the most-basic sourcing competencies, such as managing requirements, defining roles and responsibilities, and estimating project and support costs. Many organizations continued to use staff augmentation models, but found that the high costs of this model did not necessarily produce the needed outcomes. Still, to move to performance-based outcomes of the outsourced model was a big hurdle for organizations that did not have solid control of their internal application portfolio, processes or demand management, or the appetite to give up control of their applications.

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- There were more multitower deals. The number of AO stand-alone deals publicly reported appears to be slightly down from 2007, with more multitower deals, including infrastructure outsourcing or BPO bundled with application outsourcing in hybrid contracts. Bundling of services and provider selection methods vary by client, but appear to be of greater interest to organizations considering AO; providers aggressively sell other services with AO.

- Renegotiation of AO contracts occurred for a variety of reasons. In some cases, renegotiation was initiated by the buyer and in other cases by the provider. A 2008 Gartner survey showed that 45% of organizations renegotiated their application outsourcing contracts, up from 37% in 2005. For buyers, renegotiations may be driven by pressure from the CFO/CIO for IT budget reductions, in which case adjustments in service levels could help achieve lower rates. (In general, we heard a firmer position from providers to maintain profits, so rate concessions for equivalent service levels were not common.)

- Buyers still wanted the predictability of fixed price, but pricing options were more varied in AO, since providers offered alternative pricing for improved performance. Outcome-based pricing for applications with close linkage to business performance was one option. Incentive-based pricing for improved cost was another option.

- Interest in hosting and SaaS grew. More large and midsize enterprises are beginning to explore, and at times use, new delivery and management models such as application hosting and SaaS. Buyers invested in large ERP products are increasingly looking to hosting arrangements to offload the ongoing investment requirements (such as for software upgrades or new supporting infrastructures) and management burden that running this type of software necessitates. Also, a small but growing number are looking to source functionality through SaaS models rather than through traditional on-premises approaches.

- As an offshoot of the SaaS adoption trend, new tech-savvy buyers challenged traditional AO purchasing. Application managers reported increasing evidence that business end-users are occasionally bypassing the IT organization in the procurement of new applications from SaaS providers. This has potential risks for the enterprise and at some stage, probably sooner rather than later, responsibility for these SaaS arrangements will revert to them.

- First-time buyers of AO were bold. Many organizations embarking on AO initiatives for the first time had the confidence (or mandate from senior leadership) to move decisively. Because this means moving from managing resources to managing outcomes, outputs and service levels, organizations often find themselves lacking in supply and demand management competencies. Some organizations will begin to tackle the basics of sourcing competency at this critical point.

- High levels of competition in AO continued. Although users have an array of service providers to choose from, competition has meant that these choices are often confusing, which lengthens the selection process and adds cost. Although some provider options are well-known, still others are unknown; buyers should therefore become educated on the market options and be well prepared as to their own needs.

5.4 What We Expect to See in Application Outsourcing in 2009

- Looking ahead, the watchword for success in AO will be "collaboration": User organizations and providers will need to work more collaboratively to understand users'

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needs, and share performance metrics to create greater efficiencies and achieve better business outcomes from AO relationships and offshore delivery plans.

- Gartner forecasts the AO market will grow from an estimated $70.9 billion (2008) to $76.9 billion (2009), a 7.8% annual growth rate. Between 2007 and 2012, our forecast indicates growth from $64 billion in 2007 to $97.9 billion in 2012, representing a five-year CAGR of 8.9%.

- Cost-based decision making by buyers will continue to increase for the near future, driven by economic uncertainty and corporate cost containment initiatives. First-time outsourcers of applications will be particularly focused on cost savings and will need to commit to sourcing best practices to avoid the common mistakes of tactical outsourcing.

- Organizations that have experience in AO relationships will use AO as a means to revisit, refine and rebalance application strategies, portfolios and providers. For many, rationalizing the number of application providers to reduce overhead may mean consolidating work with fewer providers; it is likely that proven AO providers will benefit from this rationalization.

- Alternative delivery models and SaaS will increase their impact on AO in 2009 if compelling evidence can be shown for cost-benefit and satisfactory performance. Sourcing and application managers will begin to plan with greater confidence for these new models in their sourcing strategies. However, as these models gain more traction, many organizations will remain in a reactive mode, often because they have yet to determine what to do about internal organization and integration issues.

- Views on SaaS and hosting will also increasingly have to be addressed within the context of the adoption of service-oriented architecture (SOA). Application managers and architects will have to think through what role SaaS applications will play for their business and how they will be integrated with internally managed applications. SOA will play a critical role in integration.

- Providers and users will continue striving for the achievement of business outcomes. Although a variety of approaches and methods are emerging, there are no guarantees that AO will demonstrate a direct and measurable link to business outcomes without close collaboration. Only when organizations and providers attain the ability to measure and monitor operational metrics will enterprises unleash the true value of AO.

5.5 What You Need to Know About Application Outsourcing

- Prospective AO buyers must have a clear sourcing strategy, plans and management competencies before outsourcing: evaluate if your organization is truly ready for AO (vs. staff augmentation or project work). In AO, you give up control to the service provider as to 'how' work is done, you must have demand management skills, and optimally know current performance metrics.

- In AO, relinquishing management control of the day-to-day care and feeding of the business applications outsourced does not obviate responsibility for governance and management of the operational usability and business relevance of the application, which still resides with the IT organization.

- Although cost concerns will likely be a critical issue, organizations should use a structured, strategic approach to consider the true costs of AO as well as the risks and opportunities. A clear knowledge of performance baselines before going into an AO

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engagement is the most critical step to success in structuring meaningful SLAs and knowing what you need in an AO relationship.

- Don't just "chase rates" in a global delivery model. Although labor arbitrage appears attractive, avoid chasing the latest low-cost labor location. Going global will always involve cost considerations, but a cost optimization strategy — asking where you can reduce so you can reinvest — will be more sustainable.

- Demonstrate how AO can deliver value back to the business: As performance pressures on the business continue to increase, IT must not only involve the business in AO decisions, but must also report on metrics that demonstrate real business value.

- Develop expertise in demand management and performance management within the application portfolio. This means creating cost and performance baselines for the application portfolio to begin the alignment process and setting expectations for outcomes with the business that can then be planned for, monitored and measured. This is not only imperative to successful AO; it's a requirement to get to the next level of value of application outsourcing. Use third-party assistance if needed.

- Application modernization is an initiative that organizations may consider to optimize the business value from their legacy applications; this major initiative will likely include the use of third-party service providers. Because of the magnitude of this initiative, organizations will likely consider modernization in the context of AO; they will look at modernization as a journey for sustaining the enterprise and not merely as a refresh of systems.

- Write service levels and penalties into contracts to obligate a minimum level of performance and create incentives to encourage providers to innovate in ways that will result in measurable business outcomes. Write OLAs to optimize how providers work together and across your organization.

- Although AO buyers continue to gain maturity and competency, the application departments that actually use the services are maturing at a much slower pace. This gap must be addressed by instructing application managers about the risks and opportunities of outsourcing, involving them in transition planning, providing nonduplicated roles during operations, and communicating with them about successes and challenges in the multisourced environment.

5.6 Recommended Reading

- "10 Ways Application Outsourcing Can Reduce the Cost of Quality"

- "Maturity Assessment for Application Organizations: Financial Analysis and Budgets"

- "How to Develop and Apply SLAs in Outsourcing"

- "Drivers and Inhibitors in Application Services, North America and Western Europe, 2008"

- "User Survey Analysis: Application Services, Contracting Considerations in North America and Western Europe, 2008"

- "User Survey Analysis: Application Services, Performance, Measurement and Satisfaction, North America and Western Europe, 2008"

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6.0 Business Process Outsourcing

Analytical sources: Robert Brown, Matthew Goldman, Ben Pring, T.J. Singh and Cathy Tornbohm

6.1 Definition of BPO

BPO is the delegation of one or more IT-intensive business processes to an external provider that manages the processes. Providers generally offer BPO services via four approaches: discrete BPO, comprehensive BPO, multidomain BPO and BPU (see "Understand Your Sourcing Choices and Risks With This BPO Primer").

6.2 Market Environment and Economic Impact

Economic challenges will lead organizations to look to nearshore and offshore delivery to help cut costs in back-office processes through the use of lower labor costs and improved process automation. Organizations will also seek savings on industry-specific processes such as telecommunications and healthcare billing. Some organizations that have been unhappy with their ERP implementations, because they feel those implementations haven't added enough value to business processes, may use economic conditions as an excuse to rationalize activities through BPO.

6.3 What We Saw in BPO in 2008

- New providers were still entering the BPO market. Buyers are still prepared to give unknown, inexperienced BPO providers a chance because those providers are often prepared to keep the buyer's process done as it is in-house. Buyers may think they are getting greater flexibility, but this is rarely the case, since more-customized solutions usually can't be leveraged across multiple clients. Hence, the buyer may be disillusioned by a lack of continuous provider investment.

- Established BPO providers aimed for "sole source" deals with existing clients. Many prospective buyers wondered why BPO providers were not bidding on their deals. Providers that already have a stable of clients rarely want to enter a bidding war and would rather pursue deals with clients that already buy one service to negate bidding costs and increase profitability.

- There were new signings, but fewer megadeals or multidomain BPO deals. Large BPO contract signings continued to be limited, but there were more announcements of small and regional deals. Clients are becoming more willing to publicize such deals as process outsourcing becomes a more-accepted strategy. Indian BPO providers still struggled to name clients. Providers were acquiring new low-cost delivery centers, as well as onshore process outsourcers that could be moved to lower-cost locations. Providers also sought to service new industries beyond banking.

- Savings weakened with the weaker dollar. Needs for greater cost savings, especially when servicing non-English-speaking locations, led providers to continue to establish additional delivery centers. Traditional and Indian providers set up delivery centers in Eastern Europe to respond to European demand for nearshore support, and in the Philippines and Latin America to service North American clients. Labor rates increased in 2008 due to the strength of the rupee, Canadian dollar and euro against the U.S. dollar. This has caused many BPO providers to refocus their sales attentions on the U.K. and government. Few clients saw the savings that providers promised, causing widespread dissatisfaction. Client organizations are seeing other benefits, but not enough to negate cost concerns.

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- To move away from growth related directly to head count, many BPO providers started investing in business process management (BPM) tools. Many Indian providers have coupled this focus with an increasing emphasis on Six Sigma and Lean methodologies, which has started to be reflected in North American and European BPO providers' delivery operations. Certain types of BPO have already moved away from labor-based pricing to more transaction-based approaches. However, many other types of BPO, such as finance and accounting, are still priced per full-time employee, and there is a move to take these to transaction-based pricing.

- Competition from alternative delivery models and shared-service center operations continued to grow. In-house shared-service center operations remain the BPO market's primary competition, but new SaaS models will also increasingly fuel BPO offerings, especially in payroll and voice-based services. BPO growth is expected to remain robust as organizations continue to outsource internally provisioned services.

- The BPO market was the fastest-growing IT services segment and is expected to grow by 10% year over year in 2008. The five-year CAGR is expected to be 9% from 2008 through 2012. Highlights of major areas of BPO growth from 2008 through 2012 on a CAGR basis include demand management services (10.8%), finance and accounting (12%), human resources (8%) and vertical operations services (8.9%). The worldwide BPO market is expected to grow from $171 billion in 2008 to $239 billion by 2012 (see "Outsourcing Worldwide: Forecast Database").

6.4 BPO Market Maturity Varies by Geography

6.4.1 Europe, the Middle East and Africa

BPO in Europe has been adopted mainly by U.K. organizations or by North American organizations to support European operations. In 2008, this trend continued, but there were more deals from continental European organizations, especially in Sweden, the Netherlands and Switzerland, to supplement or replace shared-service-center operations. Industry sectors looking at BPO in Europe included pharmaceuticals, media and financial services. France and Germany had a few BPO deals outside of the more popular areas of CRM and payroll in 2008; Gartner expects this growth to be slow, but BPO adoption may well be accelerated by the difficult economic environment. BPO providers have expanded their services and increased nearshore delivery capabilities. Poland, the Czech Republic, Romania, Ireland and North African countries are popular delivery locations for European BPO.

6.4.2 Asia/Pacific

The Asia/Pacific region has experienced rapid BPO growth, albeit from a lower base, with key markets in Australia, India and China. Most industry watchers would argue that this region, though a great supply base for services delivery, is still an underdeveloped market. Market momentum has put BPO on the minds of most Asia/Pacific corporate-level executives, who continue to wrestle with five key growth issues: scalability, acquisition of best-of-breed processes and technology, service quality, skills access and cost management. Most BPO services in this region are bought by first-generation buyers, and this can lead to poor deal structures and unsatisfactory outcomes.

There are three main segments of BPO buyers in the Asia/Pacific region: local buyers focused on one country, regional buyers that require multilanguage and multicountry services, and multinational North American or European buyers that have operations in the Asia/Pacific region, and that are typically looking to outsource at a regional level. Most providers in this region don't understand the level of investment that they need to make to be able to deliver profitable BPO services. BPO service providers are rapidly increasing their Asia/Pacific presence, especially with

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the U.S. and European economic downturn, with service offerings for new markets/countries in Asia/Pacific. They aim to improve their geographical concentration in key Asia/Pacific growth markets, as they redeploy surplus assets within the region.

6.4.3 The Americas

BPO market leaders continued to see double-digit growth fueled by mature, standardized offerings and impressive delivery. Payroll providers and some of the India-headquartered players experienced the highest growth. Financial services, a dominant sector for BPO in North America, will be both negatively and positively impacted due to economic uncertainty. Deals predicated on cost reduction will grow. These types of deals, while appearing positive in the short term, typically are negative in the long term, so clients will need to exercise caution and understand risks and benefits. There will be an increase in deals based on using lower-labor-cost locations. BPO firms in North America without significant offshore presence will find capturing market share more difficult than some of their Indian competition.

6.4.4 BPO Service Line Trends

6.4.4.1 Human Resources BPO

The number of large, comprehensive HR BPO deals slowed significantly during 2008. Most of the growth through 2012 will be based on smaller, more-incremental purchasing of discrete HR BPO deals. We may see more buyers buying specific subprocesses in HR BPO due to the high level of complexity of comprehensive, end-to-end deals. Buyers are sticking with single-provider strategies and appear to be investing appropriately in HR BPO sourcing management activities. Buyers will notice that experienced providers of comprehensive HR BPO will likely continue to be more selective about the deals they will be willing to bid on. New avenues of growth are opening up in the U.S., such as the midmarket, which continue to fuel market size.

Payroll services and benefits administration services make up most of the HR BPO market. However, the recessionary environment will see HR deals targeted for short-term, cost-reduction-driven BPO contracts. Benefits administration will experience the biggest growth, as companies look to trim their exposure to the rise in benefits costs, and at the same time move to consumer-directed, employee-driven benefits like health savings accounts and flexible spending accounts.

6.4.4.2 Finance and Accounting BPO

Fewer comprehensive finance and accounting (F&A) BPO deals were signed in 2008 than in 2007. However, some major global deals were signed in the media and manufacturing sectors. Gartner anticipates growing interest in F&A BPO from other industries hit by the credit crunch, such as financial services and government, as they look to rationalize costs. However, F&A BPO payback can be two to three years under current deal structures.

Experienced providers of comprehensive F&A BPO are becoming more selective about the deals they are willing to bid on because they want to work on deals that are not simply based on the lowest price per employee. Transitioning F&A shared-service centers to BPO providers is also a continuing trend: examples include Philips engaging Infosys, Unilever Latin America engaging Capgemini, and Cummins engaging KPIT to run F&A operations.

The provider landscape has evolved to produce specialist firms supporting single processes, such as collections or accounts payable, and multiprocess providers supporting multiple F&A activities for one client.

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6.4.4.3 Vertical-Industry Operations

Vertical-specific BPO offerings, such as retail banking back-office operations and health insurance claims processing, tend to include regular cycles of business process enhancement to respond to competitive dynamics, regulation or other market forces. The resulting business process then tends to become the standard, which is yet again subject to another cycle of transformation.

Mortgage process outsourcing continues to develop and grow despite recent industry concerns over subprime mortgages. The maturity of offerings has accelerated recently because of the entrance of Indian providers with high-end mortgage origination, underwriting and servicing offerings, and companies with document imaging, archiving and management capabilities. In addition, the adoption of BPM and SOA contribute to the increasing automation of processes between the wide range of participants in the mortgage process outsourcing area.

6.4.4.4 CRM and Demand Management

Demand management dominates CRM BPO. Rates per hour, per transaction are rising in India and the Philippines — a combination of high demand outstripping the supply of skilled labor, along with inflationary pressures. This wage inflation narrows the price gap between low-cost India and the Philippines locations and lower-cost locations such as Latin America and Ireland, making closer-to-home more interesting to buyers.

Performance-based contracts are gaining popularity, observed most recently as a differentiator in competitive bid situations. Such contracts require that buyer and seller invest in making the program a success, thus distributing risk. "Lift and shift" deals are continuing, but clients are focusing on cost as buyers pay more attention to cost-benefit equations. Work-at-home setups are expanding. At least four of the top-10 CRM BPO providers offer work-at-home options. CRM BPO providers have increased their focus on analytics services.

6.4.4.5 Business Process Utilities

BPU is the next step in the evolution of the outsourcing industry. BPU takes the one-to-many architecture of SaaS and applies it to externalized BPM. Entrepreneurs within traditional BPO companies and in new ventures who have spotted the unsustainability of this model are using new technologies to develop newer, more-cost-effective solutions. BPU gained more interest from providers and more importance from buyers in 2008. Some examples of BPU providers include: 170 Systems, ACS, Authorize.net, ADP, Chi-X, Equiduct, Exigen, PayPal, the BOAT consortium, Turquoise and Steria. Navitaire (an offering from Accenture) and Excellerate HRO (from EDS) are examples of how large incumbent BPO suppliers are reacting to the opportunity and threat of BPU.

6.5 What We Expect to See in BPO in 2009

- Second-generation back-office BPO deals will come to the market with more realistic expectations of what suppliers can achieve.

- There will be an increased realization that the words "transformation" and "innovation" impede both buyers' and sellers' ability to gain clarity in BPO deals. These terms will decrease in contracting for BPO deals, especially second-generation deals.

- The number of deals that use models such as SaaS as the infrastructure delivery mechanism for BPO services will increase. BPO providers may buy SaaS companies and software suppliers to improve their BPO infrastructures, as seen with WNS acquiring BizApps.

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- Comprehensive and multidomain BPO sourcing strategies will not be supplied by single megaproviders but will be supported by best-of-breed, selective outsourcing of discrete process components, with the buyer acting as sourcing service integrator.

- An estimated five to 10 of current comprehensive HR BPO contracts will be canceled and re-insourced.

- Expect further consolidation of the top-15 BPO providers in 2009.

- Growth of the market and BPO providers will come through continued sales of shared-service centers.

- More shared-service centers will be built in 2009 and continue to be considered a viable alternative to BPO.

- Indian BPO companies will continue to aggressively grow and force traditional BPO players to rethink their ability to combine hefty consulting charges with BPO deals.

6.6 What You Need to Know About BPO

- The clients that benefit most from BPO deals are the ones with the strongest internal teams, which include staff from IT, procurement and the business working together from day one.

- The more buyers accept standardized solutions, the more they can save.

- Maturity levels vary widely in BPO services.

- Standardized SLAs and contract formats are found primarily with discrete BPO-type and BPU-type offerings.

- Many of the largest BPO providers are moving to consolidate, rationalize, standardize and leverage their portfolio of clients to boost profits.

6.7 Recommended Reading

- "Hype Cycle for Business Process Outsourcing, 2008"

- "Leverage Business Process Outsourcing Lessons to Build a Successful Shared Business Service Organization"

- "How to Prepare for the Increasing Convergence of BPO, Application Outsourcing and Global Delivery"

- "Business Process Utility: The Next Wave in Business Process Outsourcing"

- "How to Create and Execute a Business Process Outsourcing Strategy"

- "Process Management Services Worldwide Market Share: Database"

7.0 Alternative Delivery and Acquisition Models

Analytical Sources: Claudio Da Rold, William Maurer and Ben Pring

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7.1 Definition of Alternative Delivery and Acquisition Models

Alternative delivery and acquisition models (ADAMs) deliver IT services through new approaches such as SaaS, BPU, IU, remote management services (RMS) and Web platform/cloud computing.

Gartner has identified 14 ADAMs that will transform the technology market during the next five years. For a full listing, see "Search Analyticals: Alternative Delivery and Acquisition Models."

7.2 Market Environment and Economic Impact

ADAMs are becoming more pervasive in many, if not all, aspects of IT development, delivery and management. Market excitement over new delivery methods is intensifying and whetting buyers' appetites for new options and services that promise greater flexibility, speed-to-solution, lowered capital investment, and pay-for-use models. during the next five to seven years, a broad set of new and alternative IT delivery models — already in use by aggressive early technology adopter organizations — will become mainstream. Furthermore, since these models have been gaining attention from enterprises in recent years in relatively benign economic market conditions, they are likely to become of far greater interest to buyers as economic conditions worsen through 2009.

7.3 What We Saw in ADAMs in 2008

- Of the 14 ADAMs named by Gartner, five stood out in 2008 for accelerated adoption and are poised to experience further growth in 2009: SaaS, BPU, IU, RMS and Web platform/cloud computing.

- The first wave of SaaS took place from 2001 through 2006 and was based on principles articulated in "The Innovators Dilemma" by Clayton Christensen — that is, disrupt incumbents from below. In the second wave (2006 to present) incumbents responded with SaaS offerings, and pure-play SaaS providers have started to move upmarket in terms of functionality and price.

- IU reached its Trough of Disillusionment on the Gartner Hype Cycle in 2008. Worldwide end-user spending on IT IU services reached $4 billion in 2007 — roughly 5% of the worldwide data center outsourcing market — and is expected to be $5 billion in 2008. IU is a subset of the Gartner data center outsourcing forecast, and its five-year CAGR is just 6.1%, so IU will gain more share at the expense of traditional data center outsourcing services. Roughly 80% of outsourcers are investing in IU. More investments occurred during 2008 in IU and cloud computing from major companies such as Google, Microsoft, Amazon, Yahoo and eBay. However, the risk associated with IU adoption is still uncertain and users need to consider risk mitigation approaches.

- Some traditional providers were not fully embracing the creation of IU and cloud-computing services. Instead, they used third parties for these services as they moved up the value chain, or they provided services that were more customized or were perceived to be of higher value than commodity IU services.

- Infrastructure service providers surveyed by Gartner claimed that 11% of revenue was derived from IT IU in 2007. Some position IU revenue between 20% and 30%.

- New and nontraditional infrastructure providers, such as cloud-computing providers, introduced discontinuity, hype and confusion for buyers. In particular, the emergence of very-low-cost services, often finalized to facilitate the creation of a developer's

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ecosystem, increasingly made price comparisons useless unless associated with risk analysis, and testing and certification scrutiny.

- Some providers, worried about reduced margins, de-emphasized their IU message.

- IU continued to emerge through "IU islands." Providers have addressed specific application needs to focus the solution, simplify the design and reduce the initial investment.

- Worsening economic conditions produced a major shift in the infrastructure services that are being delivered. RIM services saw increased demand as what was traditionally delivered locally was offered and delivered remotely. Many India-based service providers pushed hard into expanding their IT infrastructure services, and Gartner saw global support of these services from various remote sources (onshore, nearshore and offshore).

- For many India-based providers, growth in this area occurred through application buyers that are comfortable with an offshore delivery model, and that have built a relationship with the service provider. For infrastructure services, remote monitoring services are a growing form of delivery model for mature service areas such as data center operations management.

7.4 What We Expect to See in ADAMs in 2009

- Economic conditions will provide a net boost to the adoption of ADAMs in 2009. IU is defined as a key initiative for IT organizations during the next 12 months by 27.1% of organizations in the Asia/Pacific region, 18.3% in North America and 13.2% in Europe.

- IU will cross the Trough of Disillusionment in 2009. Providers that de-emphasized IU investment will react to the growing "everything as a service" buzz by refreshing their messages, creating new service bundles and reactivating investments.

- IU will gain more market share at the expense of traditional data center outsourcing services. This will put pressure on traditional IT outsourcing providers to deal with the pricing pressures that IU services represent and create change in their service portfolios and within their client bases.

- Hardware providers will continue to support delivery models and terms such as "utility computing" or "capacity on demand" when selling servers, tools and software stacks, as well as associated support services that constitute part of real-time, infrastructure-oriented approaches.

- Additional nontraditional infrastructure providers will add to discontinuity, hype and confusion for buyers in the cloud-computing arena. Price comparisons will be meaningless if not associated with risk analysis and testing, and certification scrutiny.

- Providers that are in position to invest in cloud computing (from marketing to delivery capability) will do so. Those who cannot invest will rebrand traditional offerings to try to reduce market and margin erosion.

- A few service providers will make their IU road maps more visible, gaining credibility and possibly achieving a better alignment of demand and supply.

- Google will continue to represent the cloud-computing trend in terms of innovation, power and influence. Nevertheless, its share of business IT services will continue to be marginal.

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- IU will continue to emerge through "IU islands." Early "killer apps" such as IU4SAP will be followed by SaaS enablement (APaaS) and e-mail (IU4 Exchange).

7.5 What You Need to Know About ADAMs

- Few, if any, organizations are likely to use an IT utility or a one-size-fits-all solution for their entire infrastructure or application needs during the next five years. Within this time frame, ADAM islands will emerge and deliver significant advantages to users. Some early examples of islands are related to optimized platforms for ERP, especially SAP, Microsoft Exchange, Web services and e-mail, CRM and procurement. However, in the longer term, ADAMs are part of the natural industrialization of IT services and will make those services more secure, faster and less expensive. Although customized services will still be available, ADAMs will affect most organizations. Because client interest and provider investments are not necessarily always aligned, this will add to the market hype and confusion during the next 18 to 36 months.

- The IT market is undergoing a period of accelerated change and innovation in how IT is applied and delivered to businesses and consumers. The full impact of ADAMs on the technology market will be significant (see "The Impact of Alternative Delivery Models on Major Hardware Providers" and "The Impact of Alternative Delivery Models on the Traditional Channel"). For example, Internet-based storage services, such as Amazon S3, charge 10 times to 100 times less than traditional providers, creating tension among traditional IT, low-cost IT (utility and/or global-delivery-based) and very-low-cost or free IT. IT utilities and SaaS will progressively provide external benchmark data points for investments in and operational budgets for internal IT, business process differentiation and sustainable competitive advantage.

- We advise our clients to understand the various models and services, such as SaaS and IU, which are already in use in their organizations or set to become viable for use in the industry. Evaluate which ones yield the best risk/reward ratio and communicate with key providers as to their ADAM offerings as a precursor to possible changes in your IT portfolio. Test and pilot ADAM-based services as the offerings become viable, then scale up according to business case, risk and user traction. Alternative delivery models are a fact of life for the future, so organizations must intelligently manage the shift toward a new multisourced IT delivery environment, which will be based on both traditional models and ADAMs.

- Indicators of the increasing impact ADAMs will have during the next three to five years include:

  - The SaaS market reaches $6.5 billion worldwide at the end of 2008 and is expected to grow to reach $15.2 billion by the end of 2012.

  - The IU services market is now worth $5 billion worldwide and is forecast to be worth $14 billion by the end of 2012.

  - Gartner recently surveyed 80 providers offering ADAMs; in aggregate, the revenue generated from these services total almost $10 billion. These providers expect to see 35% growth in these offerings during the next three years.

  - Investment by providers is running at close to $5 billion in cloud-computing capabilities, plus more than $3.3 billion in ADAMs-based offerings.

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- Leading IT outsourcers and IU providers report over 1,000 clients for IU services, which represent an average of 10% of revenue, with some reporting 20% to 30% of revenue.

- Second-tier, offshore and "cloud" providers of data center services will naturally move to price competition, which will force larger providers to innovate.

- An expected 29% CAGR could be exceeded in categories such as leading-edge small or midsize businesses and larger early adopter organizations or for "killer applications" such as IU4SAP.

- Although investments on IU and cloud computing are made, ROI and net present value are still to be proved.

7.6 Recommended Reading

- "The Impact of Alternative Delivery Models on Major Hardware Providers"

- "The Impact of Alternative Delivery Models on the Traditional Channel"

- "Alternative Delivery Models: 14 New Ways to Deliver IT"

- "Hype Cycle for Software as a Service, 2008"

8.0 Global Delivery Models

Analytical sources: Ian Marriott, Rich Matlus and Allie Young

8.1 Definition of Global Delivery Models

Gartner defines global delivery as the ability of an organization's service provider (internal or external) to source skills from several global locations. These resources must come together seamlessly, with high process maturity, and must operate in a secure and scalable global infrastructure supported by significant investments to mitigate or manage risk. In the context of Gartner's research, and in this section, we use the term "global delivery" interchangeably with "offshore services," since the latter term is still widely used in the marketplace by buyers and providers.

Offshore services is an overarching term to describe the incorporation of globally dispersed creation and consumption of IT-enabled services, including applications, infrastructure and business processes. Service delivery in a globally sourced model includes a combination of domestic and nondomestic resources. The location of resources and a mode of delivery are implied in the term "offshore services." Offshore services denotes any type of IT-enabled service that involves nondomestic creation of services for domestic consumption.

Four specific service delivery options exist: on-site, onshore, nearshore and offshore. Each of these denotes different physical locations for the source of labor. To better explain the differences, we group these four models into domestic service delivery or nondomestic service delivery:

- Domestic service delivery means delivery of resources on-site (at the buyer's premises) or onshore (at a location beyond the buyer's premises but in the same country).

- Terms for nondomestic service delivery include nearshore (from countries in close geographic proximity) or offshore (from remote geographic locations).

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The terms "global delivery" or "global delivery model" — and more recently, "global delivery networks" — have become more common as offshore services move beyond traditional geographic-centric delivery. Although the term "offshore services" focuses on the location of service resources, the terms "global delivery" and "global delivery model" focus on the technical skills, process rigor, tools, methodologies, overall structure and strategies for seamlessly delivering IT-enabled services from global locations.

For further discussion of these definitions, see "Tutorial for Defining Key Offshore Services and Global Delivery Terms."

8.2 Market Environment and Economic Impact

Amid the mounting economic difficulties of 2008, more organizations looked at global delivery of services for their applications, infrastructure, and business processes as a way to reduce costs while optimizing resources and resource scale. As 2009 begins and uncertainty continues, buyers of IT services will add cost reduction to cost containment (which is a constant), as well as placing greater emphasis on productivity. In this environment, buyers will consider offshore services mostly as a mechanism to move labor to lower-cost locations. Use of global delivery across industries and geographies will vary based on the impact level of economic problems. Countries that are hardest hit will be looking most keenly at cost reduction. However, geographies that are least affected will present growth opportunities for services in general when global delivery options can be included. This extreme focus on cost reduction will have an interim negative impact for organizations that strive for added value beyond labor arbitrage in offshore services delivery.

8.3 What We Saw in Global Delivery in 2008

- Offshore services delivery in outsourcing continued to be successful, with high levels of repeat business, high revenue growth among providers with offshore delivery models, and increased options for buyers to leverage global delivery of services.

- Continued strong adoption of the offshore global delivery model by buyers in both North American and European Union markets further validated the "globalization" of services delivery and underscored the maturity of the global delivery model. The North America market remained the dominant one for offshore services and continues to be critical. However, the European market for offshore services grew significantly during 2008.

- Although the U.K. was the dominant purchaser of globally delivered application services in Europe, enterprises from a growing number of regions — including the Nordic and Benelux countries, Germany, and France — took advantage of globally delivered services. In addition, as Western European buyers tried to find the best providers for their organizations' needs, many nearshore countries emerged as alternative locations for European buyers.

- Competition levels were high. Just as globalization had an increasing impact on commerce and economic activity worldwide, globalization also changed the IT services market. In 2008, competition in the services market for offshore delivery accelerated, validating the central role that offshore services now play in the IT services market.

- For buyers of services, evaluating a service provider's global delivery capabilities and processes became an essential element of their sourcing strategies. Many buyers are in second- and third-generation global sourcing, but some are just beginning to consider or use offshore services.

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- Providers that relied on past successes in offshore delivery strategies, or that did not invest in and evolve their global delivery processes, strategies, quality, and marketing messages, lost traction. Providers that aggressively developed their offshore competencies were most likely to gain more mind share and market share.

- The largest global providers established global delivery networks via globally integrated and consistent processes and tools, and continued to invest in and enhance their global delivery networks to enable a more integrated multicountry delivery model. Buyers with globally dispersed needs had to look carefully at providers' processes to make comparisons.

- Currency fluctuations and rising wage rates in India caused some renegotiation of contracts. Some buyers shared in currency impact on pricing. Anecdotal evidence suggested 10% to 15% charge rate increases for staff augmentation or project-based work delivered out of India. Long-term, annuity-based contracts experienced a lower charge-rate increase (in some contracts, this is estimated to be in the 3% to 5% range, based on scope and size of deal). Providers absorbed some wage increases through enhanced efficiency, automation, and tools.

- RIM demand increased. Global delivery of remote support and monitoring services gained widespread acceptance and client demand increased. This was driven by two major objectives. First, buyers aimed at centralizing a specific function and delivering it in a one-to-many model, focusing on rationalization and service delivery standardization. Second, since many support and monitoring functions still require human intervention (the potential of automation remains unfulfilled), buyers saw global delivery capabilities as necessary for their IT infrastructure — in the same way as for applications — to gain cost advantages through labor arbitrage.

- RIM delivery locations became more globally dispersed and varied. Many service providers invested to enhance or create delivery hubs (often described as "control towers") in nearshore or offshore locations. These centers are normally focused either globally or in a specific region and function as multilingual support centers delivering services to multiple geographies. Because of the approach toward risk mitigation and "hands-on" service delivery management of many buyers (especially those with sizeable European operations) providers increasingly invested beyond India to offer location choice and proximity. For example, Eastern Europe has emerged as a prime location to support European operations.

8.4 What We Expect to See in Global Delivery in 2009

- Based on the current economic uncertainty, IT budgets will be carefully scrutinized; buyers will be looking for ways to reduce cost and or supplement their IT staff, which will open more opportunities to consider global sourcing.

- Many organizations that have successfully used offshore sourcing for cost-benefits will be looking for the next level of benefit. This opens opportunities for service providers to introduce higher levels of operational effectiveness that incrementally add value through globally delivered service relationships.

- Offshore/global delivery will be considered by more organizations that have never outsourced before. Those using offshore/global delivery are likely to increase the levels and types of services work being done offshore. Countries that have not used offshore heavily in the past will start.

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- European growth rates for globally delivered services will continue to outpace North America's, and nearshore options in Eastern Europe will be favored.

- Strong competition among global service providers will continue. Buyers will have a broader selection of provider options, and with options will come more challenges to select the right provider. The lowest-cost provider options will not necessarily be the best choice, challenging the traditional views of offshoring as primarily an India-centric labor arbitrage move.

- Providers will need to concentrate investments on strong marketing plans that demonstrate how their global delivery can satisfy clients' changing requirements in an economic downturn. These messages must closely align to delivery capabilities and sales strategies to convert prospective buyers.

- More countries will appear on buyers' radar and buyers will seek proof of quality resources, predictable scale, provider stability and new countries (see "Gartner's 30 Leading Locations for Offshore Services").

- More providers will seek acquisitions to achieve growth and scale. In particular, India-based providers will seek strategic acquisitions in Europe. The constrained economies globally will make it more difficult for Tier 2 providers to compete, and some good companies will be up for sale. Cash-rich providers could gain in this market, enhancing their own growth and providing greater skills to their own client base.

- Organizations will bundle more services in offshore delivery models. As organizations move from a project-based approach to a truly outsourced model, they will consider bundling more types of services, with potentially more work being performed offshore. Based on current economic conditions, clients will be looking for more ways to reduce costs; this means that some buyers will consolidate providers to lower management overhead costs. This will open more opportunities for providers to be more of a one-stop shop.

- RIM services will show more maturity in the coming year. Once the level of automation In RIM has been fully exploited, the focus on location will increasingly lose traction. In the meantime, buyers will need to continue their evaluation of a provider's ability to underpin globally delivered remote infrastructure services through common tools, processes and methodologies.

- To be responsive to customer needs, providers will need to balance the deployment of repeatable approaches with continued demands for flexibility and customization.

8.5 What You Need to Know About Global Delivery

- In difficult economic times, global delivery options will increase in importance for buyers' sourcing and services strategies as a means to reduce labor costs. However, more-experienced organizations will seek higher value of process optimization in a global delivery model as a means to impact top-line and bottom-line revenue goals.

- As global delivery of services gains acceptance and convergence occurs among providers — that is, traditional providers ramp up their global delivery models and offshore providers evolve to higher value services to their portfolio of offerings — buyers will face greater complexity in provider choices.

- Service options in a global delivery model will be more abundant, and provider selection will become more complicated.

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- The likelihood of more complexity and change in the competitive landscape through acquisitions and expanding country options underscores the need for buyers of IT services to carefully evaluate the benefits their businesses can gain from a broader choice of service providers.

- Acceptance of the offshore delivery of services materially affects provider evaluation/selection decisions; buyers need to understand which evaluation criteria combine to determine the right provider for your organization for the type of service and relationship you desire.

- Buyers must evaluate whether offshore services can support cost containment or cost reduction goals in different platform areas: infrastructure, applications or business processes. The impact will not be in one area alone — all areas of services will be considered for global delivery options.

- Although cost issues are a critical consideration, providers should not be evaluated on labor rates alone. Key criteria for provider selection for outsourcing must include whether the service provider has the scale, skills, global resources and geographic locations, as well as the tools, methodologies and processes that elevate the offering from simple offshore services to a true global delivery model.

- Careful planning is required to achieve the full benefit of global delivery; in particular, new skills and competencies are required for first-time users to incorporate the offshore delivery model in their sourcing strategies. Buyers will need to need to build internal experience in a globally sourced model, and adopt repeatable best practices for finding the right provider that offers the right resources, at the right price, from the right place.

- Buyers must carefully assess the sophistication and maturity of a service provider's global delivery model. Benefits can be delivered by working with a provider that can offer multicountry options to minimize risks through a broader base of country delivery options, and that has the maturity to increase reliability, predictability and effectiveness in delivery.

- RIM services must address business continuity and disaster recovery. Infrastructure availability is crucial to the delivery of business products or services; before clients turn over the infrastructure, they need to ensure that the provider makes certain that systems are protected against failures.

- Buyers need to ensure their RIM provider has the right technical skills and knowledge to support their particular environment.

- Buyers must evaluate a service provider's financial health and anticipate whether any major acquisition or divestiture for that provider is likely.

- Buyers should expect to see continuing change in country options available. Buyers will need to beef up their country evaluation capabilities: as some emerging offshore country options mature, it's likely that these options will become more appealing and less risky, but labor rates may increase and scale issues may arise.

- With more choice available in terms of global/offshore strategies, types of service, and country locations, buyers must focus more internal sourcing efforts on evaluation approaches.

- Buyers will need to reassess pricing options (fixed-price, time-and-materials or performance-based) and contracting models (staff augmentation, project, outsourced).

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Some buyers may opt to retrench in uncertain times, to have a pay-for-use strategy that favors staff augmentation.

- Some organizations that have relied on captive centers in the past to access global delivery services may re-evaluate their strategy. Some possible scenarios are converting fixed costs to variable costs by shifting from captive centers to outsourcing or monetizing investments (such as TCS's acquisition of Citigroup's offshore business processing unit) if these are cost-effective.

- Don't get caught in market hype, or make fear-based decisions in your choice of country. Start now to systematically evaluate a provider's processes for optimizing and integrating multicountry strategies in a global delivery model, including:

    - Seamless delivery and handoffs

    - Consistent processes in each location

    - Integrated workflows and communication systems

    - Specific and consistent methodologies to ensure quality

    - Consistent use of toolsets in each location

    - Global workforce management

    - Dynamic movement of work to alternative locations

    - Tracking and reporting of services status

    - Performance metrics

    - Critical infrastructure investment for consistency as well as latency, security, redundancy and disaster recovery

8.6 Recommended Reading

- "Gartner's 30 Leading Locations for Offshore Services"

- "Six Best Practices for Offshore Outsourcing"

- "Tutorial for Defining Key Offshore Services and Global Delivery Terms"

- "What Buyers Need to Know About the Changing Global Outsourcing Competitive Landscape"

- "Offshoring IT Services Can Cut Costs: Options for a Potential Economic Downturn"

- "Key Comparisons of Pure-Play Offshore and Traditional Service Providers"

- "Market Scope for Remote Monitor Services (Global)"

- "'India-3' Are the Emerging Megaproviders"

- "Hype Cycle for Consulting and System Integration, 2008"

- "Hype Cycle for IT Outsourcing, 2008"

- "Magic Quadrant for European Offshore Application Services, 2008"

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- "Magic Quadrant for North American Offshore Application Services, 2008"

9.0 Green IT in Outsourcing

Analytical sources: Richard Matlus and Gianluca Tramacere

9.1 Definition of Green IT

"Green IT" is a broad term encompassing the movement in the public and private sectors to lessen the impact of IT on the environment. It includes the full life cycle environmental impact of the equipment and supporting services.

9.2 Market Environment and Economic Impact

In uncertain economic conditions, the logical concern is that green IT initiatives will be forgotten as more pressing economic and cost-cutting initiatives take top priority. Nevertheless, Gartner research finds that most green IT investments in buyer organizations are motivated by and justified by saving money, usually through energy savings and extending the life of the data center. Furthermore, these are low-risk, quick payback investments, and thus ideal for cost cutting or even more extreme recessionary times.

We will continue to see enterprises that have set a greenhouse gas (GHG) reduction goal looking at investments that will cut emissions, which in some cases may come at a premium. For example, procurement of renewable energy or investment in local generation may not be immediately cost-effective, but over the long term it may prove not only cost-efficient but also ecologically responsible. We expect enterprises with no public GHG reduction target will focus on investments with a positive ROI.

Our bottom-line prediction is that organizations will increase investment in mainstream green IT initiatives, but when long-term initiatives come at a premium or the ROI is not so clear they will not invest.

9.3 What We Saw in Green IT Outsourcing in 2008

- Interest in green IT continues to grow. Gartner's interviews with service providers in 2008 indicated that this interest was being driven primarily by cost reduction, especially energy use.

- The data center was the primary target of green IT initiatives. However, in about 25% of cases, we believe that requests for proposal (RFPs) are asking for plans to reduce the organization's carbon footprint over time.

- To achieve greener hardware and software operations, service providers consolidated the number of data centers and remodeled or replaced them with new more energy-efficient facilities. These facilities are designed with the latest heating and cooling techniques, all focused on supporting higher-density processors while reducing the energy requirements. Many of the service providers are equipping their new data centers with specific tools that are designed to manage cooling in the data center and offer real-time thermal mapping aimed at quickly identifying areas that are under critical temperature pressure.

- Semiconductor manufacturers, server providers, data center infrastructure providers and management software providers were all working on improvements to help address the power crisis in the data center, but this may take a few years to achieve as newer energy-efficient systems are replaced. Although these trends existed before green IT

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became a concern in the data center, many providers have identified the potential of virtualized solutions to increase hardware use and reduce the carbon footprint of data center operations. They are developing offerings in which virtual machines run on fewer boxes, creating a shared, standardized and virtualized infrastructure with reduced power and cooling consumption.

- For their data centers, service providers looked at the adoption of more energy-efficient servers to replace higher energy systems. Service providers pursued management software that will enable them to automatically restart servers as required, offering the possibility of creating an architecture similar to that in the power-generation industry, where base load is addressed with technologies such as load-following resources and peaking units that are brought online with varying degrees of delay as demand peaks. This allows service providers to be more flexible.

9.4 What We Expect to See in Green IT Outsourcing in 2009

- Cost reduction will continue to dominate as a green IT driver, especially if the economic downturn continues or worsens.

- Reference to green IT will continue to gain momentum, appearing in an increasing number of RFPs.

- Governments will likely be slower to enforce green regulations during 2009, but service providers and client organizations must be prepared for tougher regulations when the economy improves.

9.5 What You Need to Know About Green IT Outsourcing

- Consumers are asking that their service providers be more in tune with the environment and to address the social aspects of green IT. With the recent interest in global warming, people are becoming more concerned about the environment and what everyone can do to help. However, in addition to these environmental concerns, the real driver for green IT initiatives is cost, and this is what motivates both clients and service providers.

- Many questions about green IT center around not only the carbon footprint but also around the company's actual carbon emissions and how effectively they can be controlled. The public wants businesses to be morally responsible and companies are willing to adopt green IT.

- Energy consumption is obviously a major issue for enterprises with big data centers, which draw a lot of energy to run and to cool hardware. Energy consumption must be addressed both at the physical level (such as servers) and the workload level, based on the business transaction. IT organizations are trying to identify what hardware or business process is hurting energy efficiency and what can be done to improve the situation.

- Pressure from both the public and government agencies will continue, and enterprises and service providers will need to address the many environment issues associated with conducting business and plan for the future. Many standards exist for environmental protection, but none yet provide a comprehensive assessment of the organization's IT operations.

- Beyond the lack of a comprehensive standard, other challenges exist. Old facilities do not allow easy or cost-effective implementation of environmentally friendly technologies. Software licensing restrictions often reduce energy savings achievable through

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consolidation. Green improvements are often opportunistic and rarely anticipated in contracts. Most organizations expect green IT to be a source of savings, not additional cost.

- Gartner urges organizations to develop green IT policies around sourcing strategy and selection. Best practices include evaluating a provider's ability to increase use through consolidation and virtualization of servers, printers and storage based on green IT considerations and not overprovisioning processing power in the data center. Other helpful practices are more obvious, such as turning equipment off when it isn't being used and using recycled and recyclable paper and printer cartridges.

9.6 Recommended Reading

- "Green IT: The New Industry Shock Wave"

- "IT Vendors, Service Providers and Users Can Lighten IT's Environmental Footprint"

- "How IT Management Can 'Green' the Data Center"

10.0 Vertical-Market Issues and Trends: Communications

Analytical source: Venecia Liu

10.1 Market Environment and Economic Impact

- The communications industry has adopted ITO and BPO services for many years, especially after the dot-com crash in 2001 and during the years of cost containment that followed through 2004. Incumbent carriers looked to predictable cost structures and examined additional areas to outsource, such as legacy application maintenance, packaged application integration, infrastructure services and testing services. In some cases they outsourced their core network. At the same time, emerging carriers such as mobile virtual network operators entered the competitive landscape and quickly outsourced many business support systems and operations support systems processes while leveraging another carriers' network infrastructure.

  - The uncertain economy means that CFO scrutiny over budgets in the communications industry will continue. Carrier average revenue per user will decline in some markets, with consumers facing tighter restrictions on discretionary spending. Carriers will need to revisit strategies to achieve greater cost savings.

10.2 What We Saw in Communications Outsourcing in 2008

- Achieving cost savings and greater cost predictability was a major driver for outsourcing in the communications sector.

- Additional IT responsibility shifted to providers. Carriers are migrating to an all-IP network backbone, IP multimedia subsystems, service delivery platforms, new-generation operations software and systems architecture and SOA-based frameworks. At the same time, they are deploying new services such as WiMAX service, Internet Protocol television (IPTV) service, mobile television, mobile payments, mobile remittance and rich-media services on new devices such as iPhone. These demand additional testing capabilities and infrastructure management.

- Delivering services quickly to the market spurred outsourcing for application development and testing services.

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- Improving IT service to end users was another outsourcing driver. For example, Bharti Airtel extended its outsourced contact center contract with Nortel to leverage additional features of automated interactive voice and video response.

- Carriers in the Asia/Pacific region and Latin America were more open to outsourcing their core networks, which had been inconceivable to incumbent North American carriers. Network outsourcing in North America made some inroads.

- New spectrum licenses were granted in Canada and the U.S., with emerging carriers such as Cox Wireless and Globalive looking to compete in wireless.

10.3 What We Expect to See in Communications Outsourcing in 2009

- Carriers will re-examine contracts for re-evaluation and renegotiation, while at the same time scrutinize additional areas for global sourcing practices with the goal of saving money.

- A resurgence of ITO and BPO contracts will occur around the world, and an increase in network outsourcing contracts.

- Delivery of rich media and entertainment services will increase demand for new storage requirements, help desk support, application development and maintenance, and infrastructure services.

- Delivery of video such as mobile video, enterprise-managed video and IPTV will require storage management, business continuity and content management services.

- Carriers such as Telstra will move into SaaS models. Carriers will further expand into IT services and will require support for IT services.

- Mobile remittance and micropayments with billing and call center support representing areas of potential outsourcing expansion.

- Parts of Africa and the Middle East allowing foreign direct investment and new licenses, which will help outsourcing market uptake.

- Eastern Europe will become an area of opportunity, because penetration is low. Russian carriers have not adopted outsourcing activity, and this is an area of opportunity.

- Mobile remittance laws being enacted in countries such as India and Brazil, which will spur demand for outsourcing solutions.

- Given the recent global economic slowdown, Gartner predicts additional ITO and BPO contract deals, especially in Europe, the Middle East and Africa, where penetration has been significantly lower and where inefficiencies remain.

10.4 What You Need to Know About Communications Outsourcing

Communications companies should:

- Review operations cost structure and benchmark against similar carrier characteristics to examine optimum cost performance and potential additional outsourcing areas.

- Re-examine existing contracts to assess provider cost/performance benefits. At the same time, investigate other processes, operations, and new service delivery areas where global sourcing could improve time-to-market and reduce cost.

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- Perform due diligence on the technology provider's industry certifications, involvement in standards and qualifications to ensure capability beyond lead consultants. When shifting the IT problem to the provider, it is important to ensure that the technology provider has a solid track record.

- Technology and service providers should:

- Review the carrier's operations cost structure and benchmark it against similar carriers. For years, Gartner has emphasized the importance of having ROI-backed projects and justifiable metrics to assist team leaders with board and executive-level presentations.

- Extend value into the outer touchpoints of the ITO or BPO contract as well as into the ecosystem of the telecom landscape. If you are providing call center support, identify a process to turn call complaints into sales opportunities. If you are providing application development with the carrier, and application development and support to the handset manufacturer, then ensure interoperability of handset applications with carrier operations. Deliver end-to-end value.

11.0 Vertical-Market Issues and Trends: Financial Services

Analytical source: Susan Cournoyer

11.1 Market Environment and Economic Impact

The global economic crisis worsened during the last months of 2008. At first, national governments were slow to respond, but now they are aggressively applying remedies at the macroeconomic level in addition to direct investment, guarantees and stepped-up regulations.

Financial services and insurers heavily impacted by the crisis will seek cost containment and increased transparency of costs in the near term. Heavily impacted firms will seek quick sources of credit and liquidity through selling assets. Financial services and insurers with moderate impact appear to view the near- to midterm as a window of opportunity to invest in technology for competitive advantage. A minority of large firms will skirt the crisis and aggressively seek market share through mergers, acquisitions and restructuring. For many firms, however, the emphasis will be on survival.

11.2 What We Saw in Financial Services Outsourcing in 2008

- The deterioration of the financial services industry accelerated in 2008, initially driven by the subprime lending collapse, followed by global restrictions on credit. In late 2008, the credit crisis spread to many large banks, investment firms and insurers.

- Early focus was put on captive centers as a source of liquidity for financial services firms.

- Uncertainty around new outsourcing initiatives occurred, given the credit crisis and involvement of government resources to stabilize financial services firms.

11.3 What We Expect to See in Financial Services Outsourcing in 2009

- A shift toward "A-team" players will favor the emergence of a handful of dominant global outsourcing firms, along with about a dozen financial services niche and specialist firms.

- North America will be hit hardest in the near term, but the speed of response indicates a brief trough in early 2009 followed by dramatic upswing in outsourcing momentum.

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- The European market will follow the same pattern as the U.S.; however, the slowdown is likely to last longer, at least through mid-to-late 2009.

- A moderate delayed impact will occur in the Asia/Pacific region and emerging regions, causing a slowdown in growth through mid-2009, followed by resumption of growth in late 2009.

- Financial services firms will seek to gain greater control and visibility over costs, which can be achieved through outsourcing.

- Sales of captive centers will become attractive to generate liquidity for heavily impacted financial services firms.

- Regulatory and business process expertise will become crucial determinants of success.

- The impact of global ownership is likely to quickly outweigh government stakeholders, unleashing immense competitive momentum and innovation.

- Business process areas with low outsourcing maturity, such as mortgage, claims and trade settlement, are likely to accelerate as midterm targets by financial services firms and outsourcers.

11.4 What You Need to Know About Financial Services Outsourcing

Financial services companies should:

- Negotiate for A-team resources with key outsourcing providers, as opposed to price breaks, to ensure the right people are available to help with projects.

- Maintain relationships with preferred service providers by considering payment models that roll back cost savings into upcoming process improvements or IT enhancement when recovery begins.

- Select service providers with domain expertise, but avoid niche players, since regulations will change so fast that every outsourcing provider will need to learn on the job.

Technology and service providers should:

- Lead with your best teams in e-accounts deemed most likely to thrive.

- Keep a presence in acquired firms to capture upcoming integration opportunities.

- Ramp up business and regulatory skill sets.

- Maintain a flexible global presence, including sufficient onshore and nearshore resources, to address government stakeholder concerns.

- Emphasize models of reinvestment with near-term cost savings to fund transformation for future growth.

12.0 Vertical-Market Issues and Trends: Government

Analytical source: Rishi Sood

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12.1 Market Environment and Economic Impact

- The U.S. presidential election cycle dampened large-scale transformation activities across the federal government as well as in states with gubernatorial elections. Continuing budget pressures have also limited the ability for federal agency CIOs to plan for multiyear technology management changes. Increased procurement oversight and contractor scrutiny have placed large-scale technology programs under the spotlight.

- Governments traditionally face a lag time associated with an economic slowdown and can often have different approaches to help manage the slowdown. Although federal governments often provide countercyclical resistance (that is, increased spending) in response to an economic slowdown, state and local government usually enact spending cuts within six to 12 months after an economic slowdown occurs. In the current slowdown, the impact has been felt faster than during other periods. State and local governments have already started budgetary cuts, workforce reductions, tapping rainy day funds and increasing service fees. Although there has been dramatic federal government spending to help correct market conditions, there does not appear to be the same level of spending on government technology spending.

  - From a modernization perspective, four types of technology projects — cost containment, cost avoidance, revenue maximization and revenue generation — continue to be prioritized and have spurred new initiatives for tax collection, fraud detection, and cost recovery. Program accountability, agency efficiency and customer satisfaction continue to drive new investments and technology decisions, but transformation has taken a back seat to more immediate budgetary issues.

12.2 What We Saw in Government Outsourcing in 2008

- An aging workforce and need to attract greater technical skill sets drove consideration of alternative management practices; furthermore, increased executive sponsorship of new technology management practices occurred, including shifts to greater outsourcing use.

- Increasing recognition that government cannot maintain the status quo and needs new levels of technology transformation to improve process efficiency.

- Traditional obstacles such as unions, sunk infrastructure costs, financial models/liability and ownership often tied the hands of IT outsourcing partners and remained roadblocks to greater outsourcing use.

- Process efficiency and greater technology penetration drove expansion of BPO services.

- Major government outsourcing contracts included the U.K. Ministry of Defense (EDS-led team, estimated at $500 million for eight years), the Flemish Government (EDS-led team, estimated at $800 million for seven years) and the Australian Department of Defense (Unisys-led team, estimated at $225 million for five years).

- Shared service initiatives provided a pathway for increased future outsourcing.

- Major geographic variation for IT outsourcing services by region and country occurred, with Europe in general, and the U.K. government in particular, at the head of the pack.

- Additional IT outsourcing initiatives were implemented in the Asia/Pacific region, with specific adoption and evolution in the Australia and New Zealand markets.

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- U.S. ITO adoption continued to progress, but at a different pace than European and Asian markets.

- Government BPO adoption spanned diverse process areas and represented a higher level of maturity.

12.3 What We Expect to See in Government Outsourcing in 2009

- Changes in U.S. political party control may slow outsourcing momentum over the short term. However, the impact of workforce changes, budgets, pensions and entitlements may move some governments to greater outsourcing use.

- Leading public-sector success stories will drive increased receptiveness by governments to outsourcing, providing innovative public/private models, and improved contract and provider oversight.

- Government BPO adoption will continue to progress, and cost and efficiency gains will be realized across a greater array of process areas.

- Application outsourcing and SaaS adoption will represent key areas of new interest through 2012.

- BPO expansion will remain a key area of growth, as new domains and services are covered and evolution of areas such as eligibility, congestion pricing and payroll continues.

- Initiatives supported by external funding measures, such as technology modernization related to Medicaid, human services, and transportation will likely see stabilized growth in a moderated budgetary environment.

- Impact of new regulations, executive mandates and legislative orders may enable greater outsourcing use.

12.4 What You Need to Know About Government Outsourcing

Government agencies should:

- Fully understand the complexities and drivers of outsourcing models. Cost reduction and technology refresh cannot be the sole reasons for government outsourcing. Successful government outsourcing engagements are based on building the right business case, conducting an exhaustive gap analysis, benchmarking existing IT resources and practices, and creating the proper governance structures to manage the outsourcing initiatives.

- Build in time to manage major outsourcing milestones, particularly in the areas of transition to the new service provider and additions to the service agreements. Unreasonable time frames can doom the outsourcing relationship.

- Build innovation into your outsourcing strategies; the market is constantly evolving to reflect new realities, emerging technologies and shifting pricing models.

Technology and service providers should:

- Recognize that government outsourcing initiatives can often have different goals, service orientations, financial models and risk considerations. Use caution in these areas and look to educate government executives.

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- Focus on the continuing evolution of BPO services across the government landscape, particularly in areas where more efficient metrics, collection activities and customer satisfaction can be easily demonstrated.

13.0 Vertical-Market Issues and Trends: Manufacturing

Analytical source: Ken Brant

13.1 Market Environment and Economic Impact

- The current financial crisis and economic slowdown will negatively affect manufacturers, especially those in construction, automotive, and home furnishings and appliances. However, even within these sectors, outsourcing will be one of the most resilient market segments owing to its ability to help control costs.

- Manufacturers continue to pursue specialization to capitalize on the advantages of a focused business model and agile enterprise. Time-to-market, including the cycle times for invention and for commercialization, remains a critical business issue across the industries, especially in sectors such as pharmaceuticals, aerospace, automotive and consumer electronics. Besides reducing costs via managed services, outsourcing has allowed manufacturers to concentrate resources and develop core competencies against these strategic goals.

- Outsourcing, including ITO and BPO, remains one of the fastest-growing market segments within the manufacturing sector of our IT market forecast. Both have grown at approximately twice the rate of overall IT market expansion since 2006 and are forecast to continue to outperform the IT market as a whole through 2012.

- The economic slowdown will reinforce the tactical reasons for outsourcing during the next 24 months. As manufacturers recover and return to growth agendas in 2010, outsourcing motives will include product development in emerging markets, planning and executing sourcing close to new production capacity and local technical support and customer service in high-growth emerging markets.

13.2 What We Saw in Manufacturing Outsourcing in 2008

- Managing for cost reduction and cost certainty were the primary drivers of outsourcing among manufacturers; prior and parallel experiences in outsourcing production and contract manufacturing gave manufacturers insight into the potential economies of outsourcing in other business areas.

- Other leading drivers included gaining access to technical and business skills, improving speed and flexibility of processes, improving IT service to end users and focusing internal staff on the strategic challenges of the core business.

- A review of Gartner's outsourcing contracts database showed a clear expansion trend among process manufacturers, with the largest deals on record in 2008 including Royal Dutch Shell, Procter & Gamble, Unilever, Bristol-Myers Squibb and AstraZeneca.

- Global deals by manufacturers based in Europe and regional deals in Europe during 2008 were also up significantly compared with 2006 to 2007.

- Although represented in smaller deals during 2008, another clear trend was the growth toward product-development-oriented and manufacturing-operations-oriented outsourcing, including data management and process management in areas such as

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engineering services, regulatory process compliance and product safety validation services.

- Cost saving in the provision of infrastructure-oriented and support-oriented business functions, and the focus of internal resources on core competencies, were the primary drivers for outsourcing among manufacturers in the G7 nations (mainly North America and Western Europe, see Note 1).

- Gaining access to needed skills was a more prominent motive for outsourcing among manufacturers in the emerging nations of Latin America, the Middle East and Africa, and Asia.

13.3 What We Expect to See in Manufacturing Outsourcing in 2009

- Through 2010, cost management and risk mitigation will be the overarching concern of CEOs, CFOs, CIOs and others with responsibility in the IT and professional services buying center. However, gaining productivity and preserving core competencies during the global economic recession will cause manufacturers to consider outsourcing as a way to pare down internal IT staff while production capacity is being cut.

- Demand for ITO and BPO will be robust in 2009, with ITO and BPO markets outperforming consulting, application development and system integration.

- Unfortunately, the "defensive" and reactionary posture of many manufacturers in 2009 may delay them from embracing the key disciplines of multisourcing and managing service providers to achieve business outcomes, rather than strict adherence to transaction/cost metrics in standard SLAs.

13.4 What You Need to Know About Manufacturing Outsourcing

Manufacturing companies should:

- Include business unit leaders and more representative end users in the early phases of outsourcing strategy development to enable a more-consistent and successful transition to managing the engagement and relationship with the service provider.

- Develop new methods for sourcing knowledge process management, including more-stringent due diligence of the service provider's technical expertise, plus assessments of the qualifications of dedicated personnel and the compatibility of processes and corporate culture. Include nontraditional members from engineering, production and quality management functions, and structure deals for shorter initial engagements with extensions based on meeting business outcomes.

Technology and service providers should:

- Prepare marketing messages for manufacturers facing recession and downsizing that emphasize the provider's ability to create a more agile response to IT and business process management during turbulent times.

- For key clients that are outsourcing processes that require continuous improvement, invest in BPM tools that map business processes, model future states and simulate potential results of changes. Establish an incremental fee structure that provides for sharing savings.

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14.0 Geographic Regions

Analytical source: Cassio Dreyfuss. Contributors: Jim Longwood and Gianluca Tramacere

14.1 Global Convergence Is Shrinking Geographic Differences

Traditionally, Gartner's coverage of outsourcing trends in different geographies highlighted differences among countries and among regions. Although we continue to report on those differences, in this world of globalization we increasingly see a convergence of outsourcing behaviors among different geographies. On the supply side, the advance of global providers contributes to the convergence of portfolios; on the demand side, as enterprises mature, they tend to source along similar patterns and to follow global best practices.

Nevertheless, buyer organizations should not assume that it doesn't matter what part of the world they source IT and business process services from, or what providers they use. Understanding big or small differences among locations and providers helps buyers explore them selectively to get the most cost-effective services that are most aligned with their business objectives.

14.2 Market Environment and Economic Impact

The current environment will establish cost as the necessary competitive condition, regardless of other service characteristics such as breadth or scale, provided by global players, or differentiation, provided by local players. The combination of the restrictive economic scenario and the growing maturity of business process service providers (including BPU) will accelerate the adoption of outsourcing services on a worldwide basis. Global organizations will increasingly consider global providers to consolidate more services.

14.3 What We Saw in Different Geographies in 2008

14.3.1 Global Trends

- Global sourcing effectively advanced. Providers from many countries, including strong players from India, offer service portfolios that are increasingly similar, especially among Tier 1 global players.

- On the resource side, global providers took advantage of the availability of resources, with different costs and characteristics, to create labor pools with different profiles from which they supply their global clients.

- Providers matured their capabilities in different countries, becoming more homogeneous in the services they provided, regardless of geography. They standardized their business approaches and invested in English language skills and service best practices, thus enhancing the consistency of their service delivery and affecting the competitive edge of local providers. Nevertheless, a window of opportunity — which could be called "after India and before China" — started to open. Less-mature source countries rushed to take advantage of this window, while China accelerated its pace to challenge India's dominant position within four to five years.

- More source countries were fighting for a piece of the market, since an India-centric strategy is beginning to lose its appeal; India's high turnover, increasing salaries and increasing currency value, while moderating toward the end of 2008, has effectively opened the door for the use of other countries to lower cost and risk.

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- The Indian offshore market moved into the consolidation phase of the market life cycle, which pushes providers toward larger-scale deals. Second-tier global providers, many of them from Western Europe, rushed in to fill the void in smaller deals.

- Local providers in different geographies sought to leverage favorable cultural characteristics, local knowledge, and intense customer relationships to create unique offshore delivery offerings.

- A host of niche service providers found their way into the global market through trade associations and government export drives.

- Clients adopted a multicountry approach (mostly for project work) to reduce risks of dependence on one country, and to take advantage of different characteristics in offers from different geographies.

- In the past, providers and buyers displayed approximately the same level of maturity in each geography. Global sourcing broke that symmetry, and buyer organizations in different geographies showed very different outsourcing maturity levels. Although with big variances among individual enterprises, from the perspective of buying markets, countries can be generally classified in the following levels:

  - Mature markets: representative regions are Australia, New Zealand, the Nordic region and the U.K.

  - Consolidating markets: representative regions are Hong Kong, Malaysia, Singapore, France, Germany, Italy, the Netherlands and Spain.

  - Growing markets: representative regions are India, South Korea, Thailand, Eastern Europe, Argentina, Brazil, Chile and Mexico.

  - Emerging markets: representative regions are China and Eastern Europe.

14.3.1.1 On the Supply Side

- The global outsourcing market was driven by the supply side and evolved as providers developed their global footprints through direct build-out in different global locations or through acquisition. Truly global providers made progress in pursuing seamless global delivery, and in developing "think globally, act locally" global coordination.

- Moves to secure positions in different geographies continued, causing intense merger, acquisition and divestiture activity. Those different moves included:

  - Indian providers buying companies in sourcing countries, such as China or other parts of the Asia/Pacific region, Latin America, Eastern Europe, or in destination countries, such as the U.S. and, more intensely, in Western Europe.

  - Providers in the Asia/Pacific region and Latin America buying companies in other countries in their region and in the U.S. to achieve ubiquity and scale.

  - Global providers buying companies in India, China and Eastern Europe or selected service portfolio from other providers.

- "Best sourcing locations" began to be more than a marketing tag line, and providers intensely shuffled resources toward those best sourcing locations, including new countries, by combining different models: centers of operational excellence for large, transactional-based services, centers of expertise for project work and package-based

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services and centers of innovation, which are partly research and development, but also centers of expertise, for specific vertical markets.

- It became more important for providers to diversify their global delivery strategy and explore low-cost locations.

14.3.1.2 On the Demand Side

- The strong growth in enhancement deal types, in line with growth economies, seen in the first half of 2008, moved into hold mode, while specific consequences of the economic slump are still unclear (see "The Business Value of Services in Sourcing Initiatives"). In parallel, the modest maturity advances in multisourcing management that could be observed among buyers were also put on hold.

- Multiple-location demands from multinational companies were still not well-coordinated, except for IT outsourcing, where significant advances occurred. The perspective is different for mature multinational companies, which are seeking outcome-based contracting for offshore application services and moving away from simplistic, resource-based models.

- Enterprises in less-developed geographies demonstrated a keen interest in ADAMs, their availability, and their savings potential. These enterprises are more willing to accept standardized services with a reduced price tag. Global players, cushioned by their steady revenue streams from traditional deals, venture forward and have already closed some trend-setting deals.

- Buyers pushed providers to supply services from compatible time zones and locations with a compatible culture. At the same time, they welcomed being serviced from more than one location to mitigate the risks from a single location.

14.4 What We Expect to See in Different Geographies in 2009

14.4.1 Global Trends

Although its aftermath is still uncertain, the expected effect of the current economic slump may be to reduce the overall expansion of outsourcing in 2009 and 2010. This will alter the growth rates in the various geographies. Global trends include:

- The progressive standardization of services will strongly push local providers toward differentiation.

- The offshore market will continue to move into a consolidation phase — especially because of the actions of the Indian big players. Competing countries will accelerate their move from the emergence into the growth stage.

- The HP-EDS merger will force global providers to review their strategies, which will probably reinforce merger activity in 2009, especially among providers of IT outsourcing services in mature economies. That will create a vacuum in the midmarket that will be rapidly filled by midsize (but growing) providers, aiming at deal sizes smaller than $10 million per year.

14.4.1.1 On the Supply Side

- Small providers that ventured into different countries and failed to reach critical mass will retreat from their positions and concentrate in fewer geographies.

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- Competitive (mostly global) players will capture greater market share over small-to-midsize regional providers that fail to cope with more competitive environments, possibly leading to acquisition of those providers.

14.4.1.2 On the Demand Side

- Sourcing deals will go through two levels of scrutiny: the first will be cost-effectiveness, and the second direct business value.

- Sales cycles will be longer, as additional scrutiny over each deal — with strong intervention of the finance area — will characterize the selection and negotiation phases. Contracts will have more flexible terms and conditions to adjust services to changing scenarios.

14.5 What You Need to Know About Geographies

- "Chindia" will begin to impact service strategies. China and India are growing individually at the same time that they are growing the relationships between the countries. This scenario leads to the perception of the two countries partnering to become a global superpower that some are calling "Chindia." Chindia is a work in progress, and the outcomes are far from determined, but early signs indicate continued positive movement. In the IT services industry, the pace is quick and we can see growing cross-investments and developments. Those developments are sure to have an impact on end users and sellers of services worldwide, but how much and how soon has yet to be seen. Nevertheless, when giants take even the smallest of steps, the vibrations ripple across the world. In 2009, providers and clients throughout the world will begin to take this scenario into consideration when defining their global service strategies.

- Service growth causes resource scarcity in the Asia/Pacific region. Growth rates in many areas will continue to surpass the availability of resources, and staff shortages will continue in a number of countries, particularly India, Australia, New Zealand, Thailand and even China. Countries in the region have to cope, not only with offshore demand — which will continue to grow in 2009, albeit at more moderate rates — but also with local demand, the result of maturing sourcing practices. Local and offshore service buyers will have to enhance their screening processes and be more precise about the service levels in their deals, particularly when there are scalability expectations.

- A complex market in Europe demands a precise strategy. The European market will remain fragmented, dynamic and fiercely competitive. Mergers, acquisitions and divestitures will continue. Nearshore outsourcing from Eastern Europe will continue to grow with relatively new countries, such as Romania, playing an increasing role. This will be coupled with increased investment in areas such as North Africa, where specific availability of languages such as French exist. At the same time, major providers will continue to consolidate and standardize service delivery capabilities in a global delivery model, moving away from business on a country-by-country basis. Also, the need to make available a wide portfolio of services and the urgent need to reduce costs and improve efficiency will increase the appeal of global delivery models. European buyers will need to consider these two very different scenarios in 2009. This will be disorienting for a while, which will make decisions difficult. Service buyers must not start their selection initiatives without a well-defined sourcing strategy.

- Excessive focus on costs may harm European clients outsourcing success rates. Outsourcing with multiple providers remains a common option in Europe, and switching among providers is more frequent than in other regions. Most times, those are opportunistic choices rather than the consequence of a well-developed multisourcing

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strategy. In 2009, a serious risk exists that many deals will be signed with an excessive focus on cost cutting. This focus is likely to make many of these deals inadequate to support the evolving strategy of many customers over the lifetime of the contract. In fact, once the economic crisis is over (probably some time in 2010), it is likely that a renewed focus on operational and business efficiency will test the level of client satisfaction and will drive the need to renegotiate existing deals. As much as cost management will be critical in 2009, service buyers must not forget to include other business objectives for services (generically associated with quality, agility, flexibility and innovation) that must be balanced together with cost management.

- Latin American countries join the "offshore services" race in earnest. Many Latin American countries have discovered that the offshore services industry is a powerful lever in their economies and are increasing their efforts to become viable players. Mexico and Brazil lead the pack, followed by Argentina, Chile, Costa Rica and Panama. Other countries — Colombia, Guatemala, Peru, Puerto Rico, Uruguay and Venezuela — are following suit. They are all in very different development stages and leverage different government support programs. Nevertheless, they share important cultural characteristics and business approaches, which make them easier to evaluate than the similar group of emerging countries in the Asia/Pacific region or Europe.

- Mexico and Brazil still grow, but face different challenges in 2009. Mexico has already gained credibility as a critical country location for global services delivery. For U.S. buyers, proximity, time zone, cultural alignment and North American Free Trade Agreement membership all make Mexico an attractive nearshore services destination. Continued government support has not only developed a host of local players, but has also attracted many important global service providers. Brazil offers resources with interesting capabilities and high cultural compatibility with the Western business environment in a stable and growing country with good infrastructure and no geopolitical risks. The country is the world's 10th most-developed economy and an important user of IT and IT services. The Brazilian government strongly supports the development of the IT services export industry. Outsourcing will still grow in these two countries in 2009, but they will not respond in the same way to the current economic downturn. The Mexican economy in general, and the IT services industry in particular, are strongly tied to the U.S. and will undoubtedly suffer more than other Latin American countries. Conversely, the strong Brazilian internal economy and its broad portfolio of international trade partners will lessen the impact of the economic downturn. Brazil stands a good chance of being one of the least affected countries. Nearshore and offshore service buyers must continue to consider those two countries as viable possibilities, but must pay attention as events unfold.

Acronym Key and Glossary Terms

ACS   Affiliated Computer Services

ACV   average contract value

ADAM   alternative delivery and acquisition model

AO   application outsourcing

BPM   business process management

BPO   business process outsourcing

BPU   business process utility

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CAGR   compound annual growth rate

F&A   finance and accounting

GHG   greenhouse gas

IPTV   Internet protocol television

ITIL   Information Technology Infrastructure Library

ITO   IT outsourcing

IU   infrastructure utility

OLA   operating-level agreement

RFP   request for proposal

RIM   remote infrastructure management

RMS   remote management services

ROI   return on investment

SaaS   software as a service

SLA   service-level agreement

SOA   service-oriented architecture

TCV   total contract value

TCS   Tata Consultancy Services

YTD   year-to-date

Note 1
G7 Defined

The G7 (Group of Seven) is the meeting of finance ministers from a group of seven industrialized nations. It was formed in 1976, when Canada joined the Group of Six (France, Germany, Italy, Japan, the U.K. and the U.S.). The finance ministers meet several times a year to discuss economic policies. Their work is supported by the regular, functional meetings of officials, including the G7 finance deputies.

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