The ever-changing global service-provider industry

pwc

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 Charts with this symbol are interactive.

When a Figure is referenced in the text but appears on the next page, you can go to the Figure by clicking on the **bold** Figure number.

About the Research—the history, the scope, and the demographics

The history. The Duke Offshoring Research Network (ORN) has been tracking the development of the global service-provider industry annually since 2007. This multi-year Service Provider Survey encompasses academic research informed by, and informing, managerial practices. PwC served as lead collaborator for the survey.
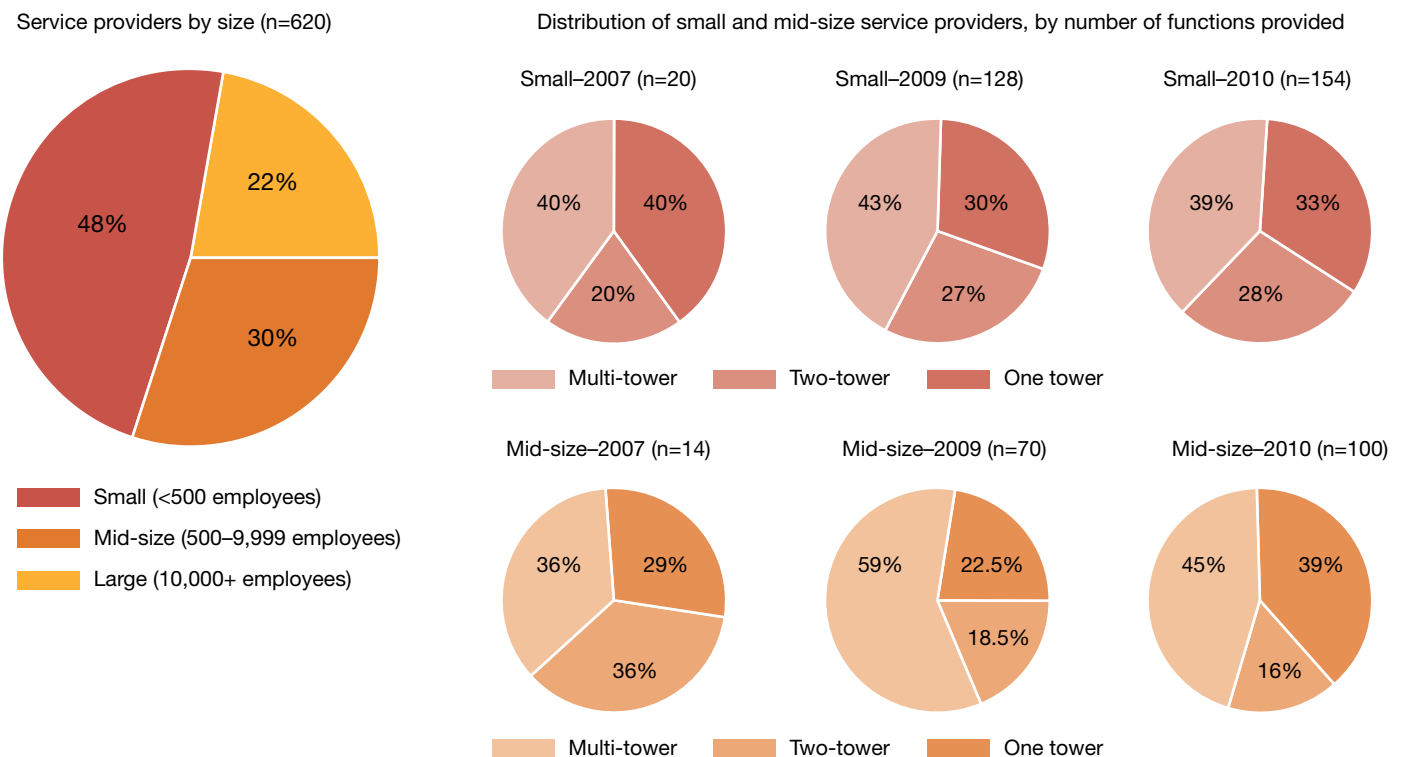
The scope. The research was designed and led by a team from the Center for International Business Education and Research (CIBER), Fuqua School of Business at Duke University. The Service Provider Survey complements the Global Corporate-Client Survey that tracks the evolution of global sourcing practices. This report highlights the key findings from the 2010 Service Provider Survey. In 2010, the ORN database encompassed over 620 service providers and 1,850 companies. The cumulative database now comprises large multinational, mid-size and small companies with headquarters located around the globe.

The demographics. The survey population comprises 137 large, 183 mid-size and 301 small providers. As evidenced in Figure 1, the distribution of the ORN sample by size suggests that small service providers account for almost half (48 percent) of the population—up from 43 percent in 2009.[1] The proportion of mid-size providers has remained relatively stable at 30 percent, while the percentage of large service providers has dropped from 27 percent in 2009 to 22 percent in 2010. As we see it, much of this is due to the growth of small service providers, up from 96 in 2009 to 154 in 2010. The findings also suggest that small and mid-size providers have been diversifying their capabilities by developing multi-pronged functional capabilities.

1 See *Is the global outsourcing industry in for a no-holds barred competition? 2009 ORN Service Provider Survey Report,* Duke University and PwC

Figure 1.

A growing number of small and mid-size service providers are reporting multi-pronged functional capabilities.

Service providers by size (n=620)

Distribution of small and mid-size service providers, by number of functions provided

- Small (<500 employees)
- Mid-size (500–9,999 employees)
- Large (10,000+ employees)

Small–2007 (n=20): Multi-tower 40%, Two-tower 40%, One tower 20%
Small–2009 (n=128): Multi-tower 43%, Two-tower 30%, One tower 27%
Small–2010 (n=154): Multi-tower 39%, Two-tower 33%, One tower 28%

Multi-tower · Two-tower · One tower

Mid-size–2007 (n=14): Multi-tower 36%, Two-tower 29%, One tower 36%
Mid-size–2009 (n=70): Multi-tower 59%, Two-tower 22.5%, One tower 18.5%
Mid-size–2010 (n=100): Multi-tower 45%, Two-tower 39%, One tower 16%

Multi-tower · Two-tower · One tower

Key takeaways emerging from the Survey

As the outsourcing industry continues to mature, driving the commoditisation of services, service providers are taking steps to diversify their service offerings.

This is a new day, and we are witnessing a changing dynamic. Certain geographies—particularly China, Latin America, and Eastern Europe—are emerging as new magnets for outsourcing firms looking to diversify. While these geographies have been immature until now, they're quickly climbing up the curve and attracting service providers looking to increase the scope, scale, and footprint of their outsourcing operations.

Using a multi-pronged approach, today's competitors are entering new markets with both low-end, commoditised services with few market-entry barriers, and also with high-end, value-added services that drive higher margins but where market entry is more challenging. This shift is having an impact on incumbent India-based and US firms that are caught in the "perfect storm." They are getting squeezed at one end by the new market entrants from other parts of the world who are grabbing market share from them, and at the other end by existing clients who are being forced by the recent economic plunge to demand price reductions for services. This challenge is driving down service provider margins. Incumbents are being increasingly pressured by this escalating margin decline—particularly in India.

Concurrently, there is a driving trend toward nearshoring, with service providers expanding their global footprint to move closer to their clients. The areas where most large buyers are located—the US, Western Europe and Japan—are especially attractive nearshoring target locations.

But beyond just moving *physically* closer to their clients, service providers are recognising the need to get closer to their client's *core business*—looking to differentiate themselves by growing beyond being third-party providers to become more like value-added business partners. To that end, providers are focusing on ramping up internal training as a means of imbuing key talent with a deeper knowledge of client-specific issues and potential solutions.

As providers seek new ways to increase the scope and scale of their service offerings and expand their global footprint, we are seeing both organic growth and growth by acquisition. We expect the M&A trend to continue over the next few years.

Our findings in a nutshell

Ongoing diversification of capabilities and service offerings. Driven by intense competition and changing market conditions, service providers are developing multi-pronged functional capabilities with an eye toward becoming more like business partners as opposed to merely third-party providers of commoditising services.

Increasing pressure on service providers to improve operational efficiency and time to achieve target service goals. This escalation is being driven by the ongoing decline in margins. India-based providers are those most affected by this trend.

Expansion of near-shore service delivery centres. This strong near-shore trend stems from both competitor moves and escalating client pressures. It is consistent across all service providers and regions—with the exception of US-based providers, whose delivery centres have remained clustered in far-shore locations such as India and other Asian countries.

Investment in internal development of client-specific capabilities. Research suggests that this new strategic approach serves to position providers to contribute to value creation that goes beyond just labour arbitrage. By making aggressive investments in training centres for internal staff—especially in functions involving a high level of client-specific knowledge and frequent interaction with clients, such as R&D and design services—providers can get closer to the client's core. Respondents uniformly identified specific skill and domain knowledge as a common theme of training centres, followed by management and language skills.

Organic and inorganic growth— on the menu for service providers. Survey participants expect to organically grow their service offerings—in terms of both scale and scope—over the next 18 to 36 months. They cite legal services, engineering services, and application development and maintenance (ADM) to be the fastest-growing areas. New entrants from countries such as China and Latin America cite aggressive strategic plans for entering high-value-added markets for ADM, R&D and design services in order to grab market share from incumbent providers (those in India and, to a large degree, the US). Mergers and acquisitions are seen as another route for growth, with some providers citing plans to become acquisitive and others saying they are looking to become an acquisition target. This suggests that providers anticipate some modest opportunities for consolidation of the industry over the next three years.

The global offshoring and outsourcing industry—A new level of maturity

Three key major service areas targeted for expansion. Our 2009 Service Provider Survey report noted that over 40 percent of providers indicated plans to aggressively expand and offer new services in two areas— **ADM** (Application Development & Maintenance) and **IT infrastructure**. This is repeated in the 2010 survey findings, along with a third area—**contact centres**.

In terms of growth of staffing, these three areas are now by far the largest services outsourced, as measured by average of full-time employees (FTEs). (See Figure 2.) The largest headcount growth in 2010 has been in ADM services

offered by large providers that, on average, increased from 2,691 in 2009 to 13,749 FTEs per company in 2010—up a whopping 410 percent. (See Figure 3.). On the other hand, the increase in the average number of FTEs for mid-size and small providers has been relatively small across functions compared to the growth for large providers—perhaps suggesting that small and mid-size providers have been more conservative about their prospects in 2010.

Knowledge and Innovation services are also areas of focus. Beyond the growth in staffing of these three major functions, large service providers have also aggressively

Figure 2.

On a relative basis, application development and maintenance (ADM) FTE headcounts are continuing to increase, while IT infrastructure and contact centres are declining.

Proportion of FTE, by function across years

Legend:
- 2010
- 2009
- 2007
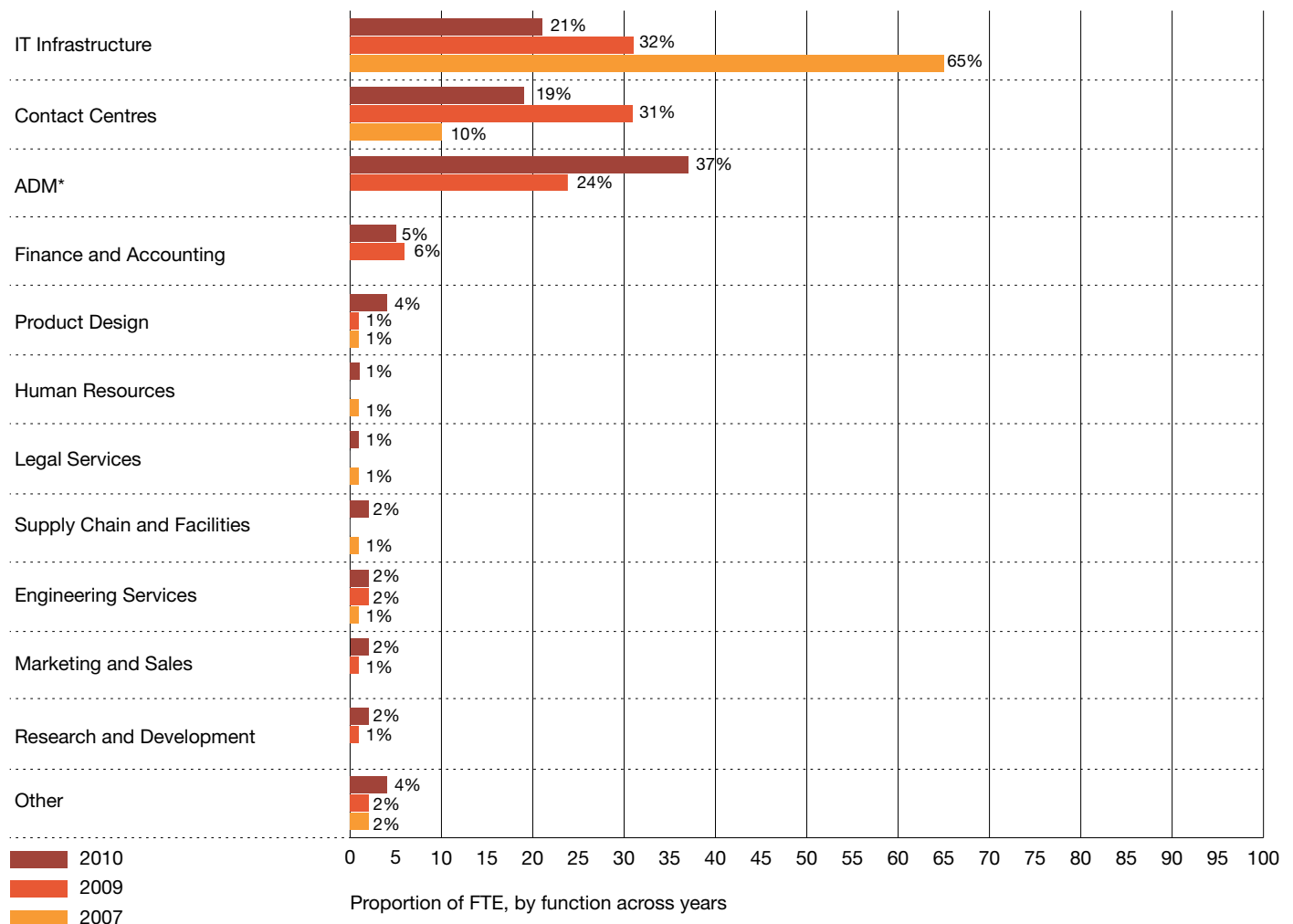
* ADM = Application Development and Maintenance
ADM was included as part of IT Infrastructure in the 2007 survey.

increased their capabilities involving the fast-growing market for R&D and analytical and knowledge services, areas dominated by small and mid-size providers in prior years. Specifically, large service providers have increased the average headcount in analytical and knowledge services from

213 to 1,583 FTEs per company over the past year. (See Figure 4.) In contrast, small and mid-size providers, who tend to be more cautious about hiring, showed a relatively small increase in the average number of FTEs involved in knowledge and innovation services.

Figure 3.

ADM, IT infrastructure and contact centres represent a large proportion of activities for large and mid-size providers in terms of FTE employed.

Changes in average number of FTEs per provider of top four functions, by provider size across years

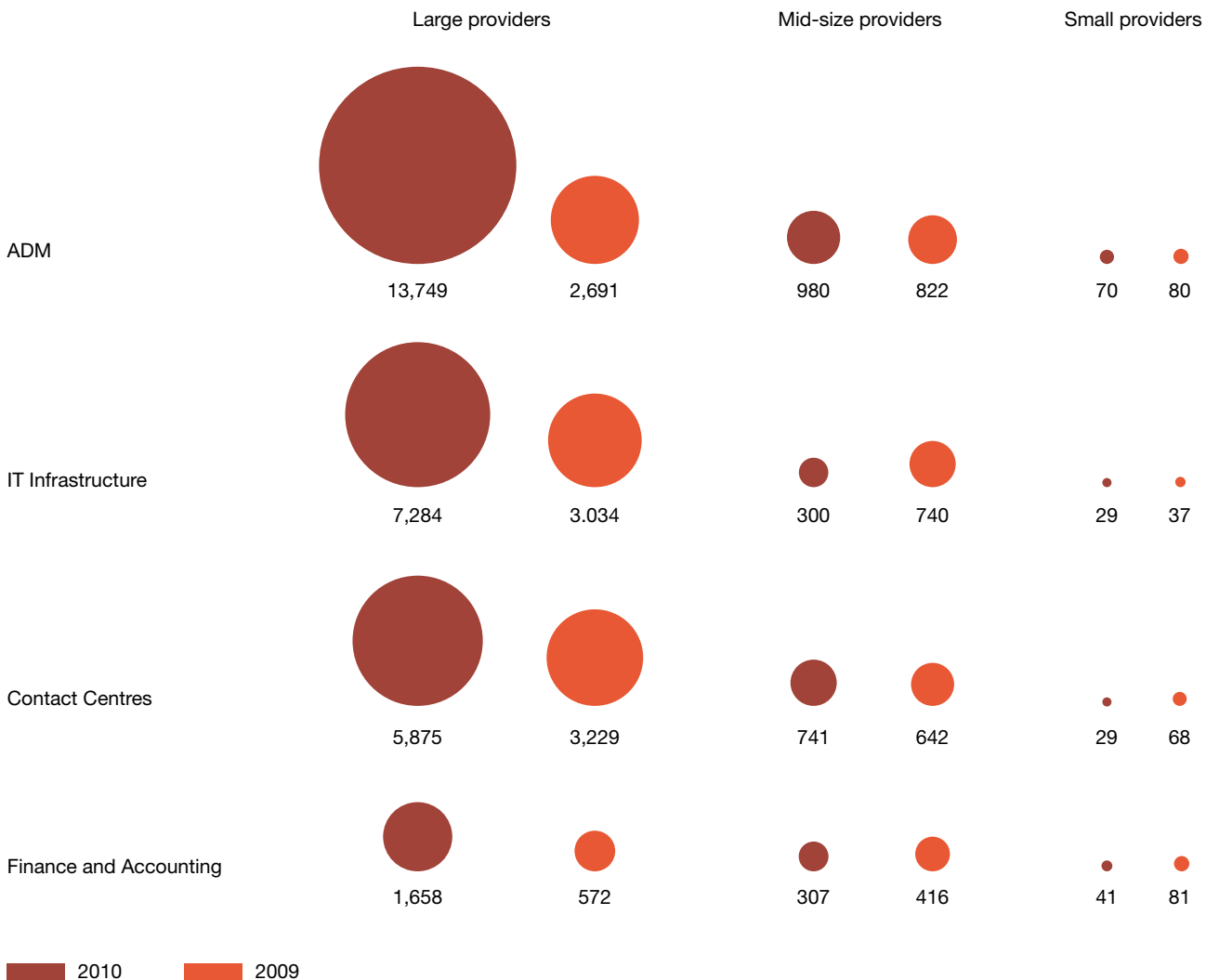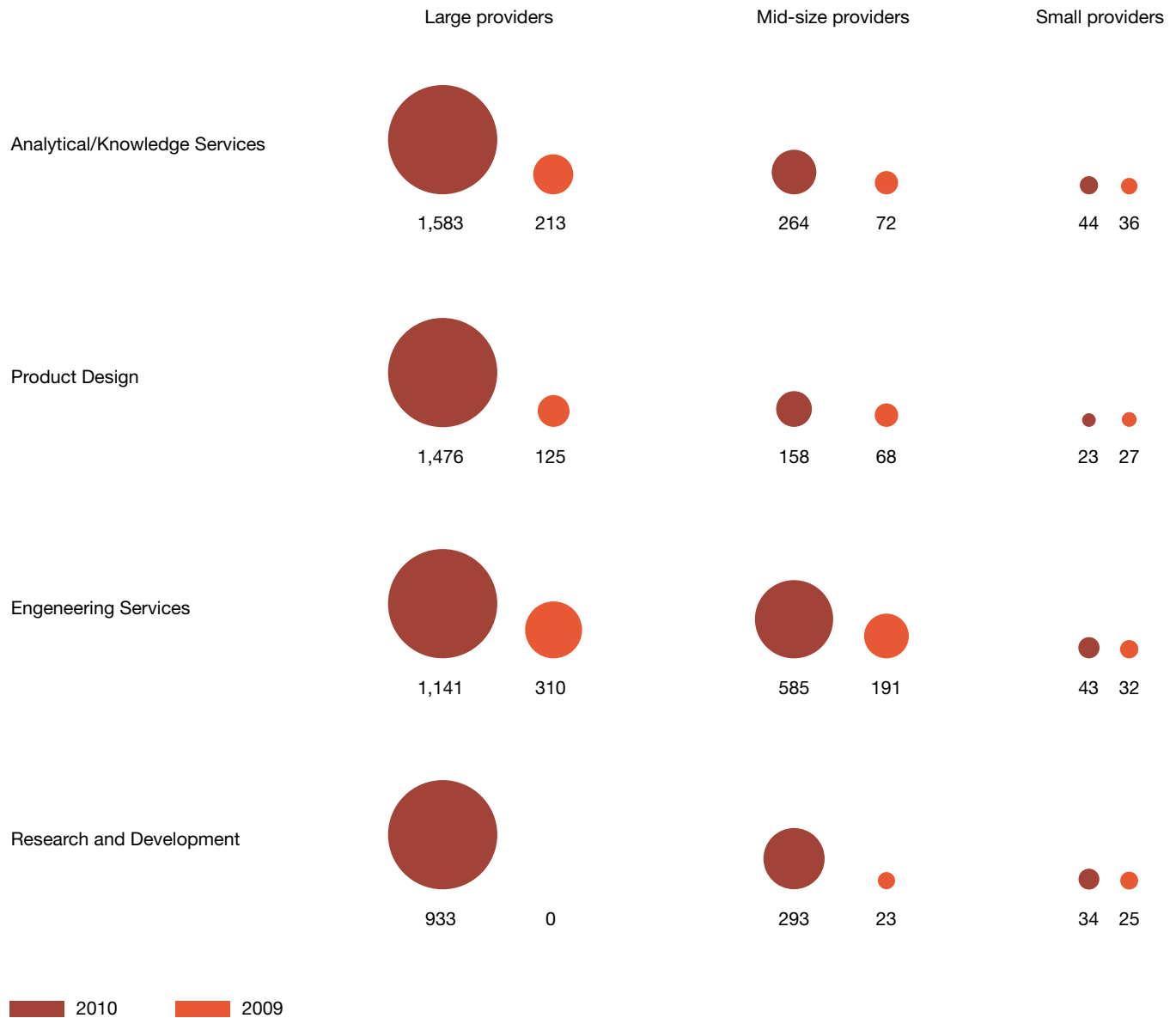|	Large providers		Mid-size providers		Small providers	
ADM	13,749	2,691	980	822	70	80
IT Infrastructure	7,284	3.034	300	740	29	37
Contact Centres	5,875	3,229	741	642	29	68
Finance and Accounting	1,658	572	307	416	41	81

■ 2010   ■ 2009

Figure 4.

Between 2009 and 2010 large providers aggressively increased FTEs involved in analytical and knowledge services.

Changes in average number of FTEs per provider for KPO and innovation services, by provider size across years

	Large providers	Mid-size providers	Small providers

Analytical/Knowledge Services
1,583   213   264   72   44   36

Product Design
1,476   125   158   68   23   27

Engeneering Services
1,141   310   585   191   43   32

Research and Development
933   0   293   23   34   25
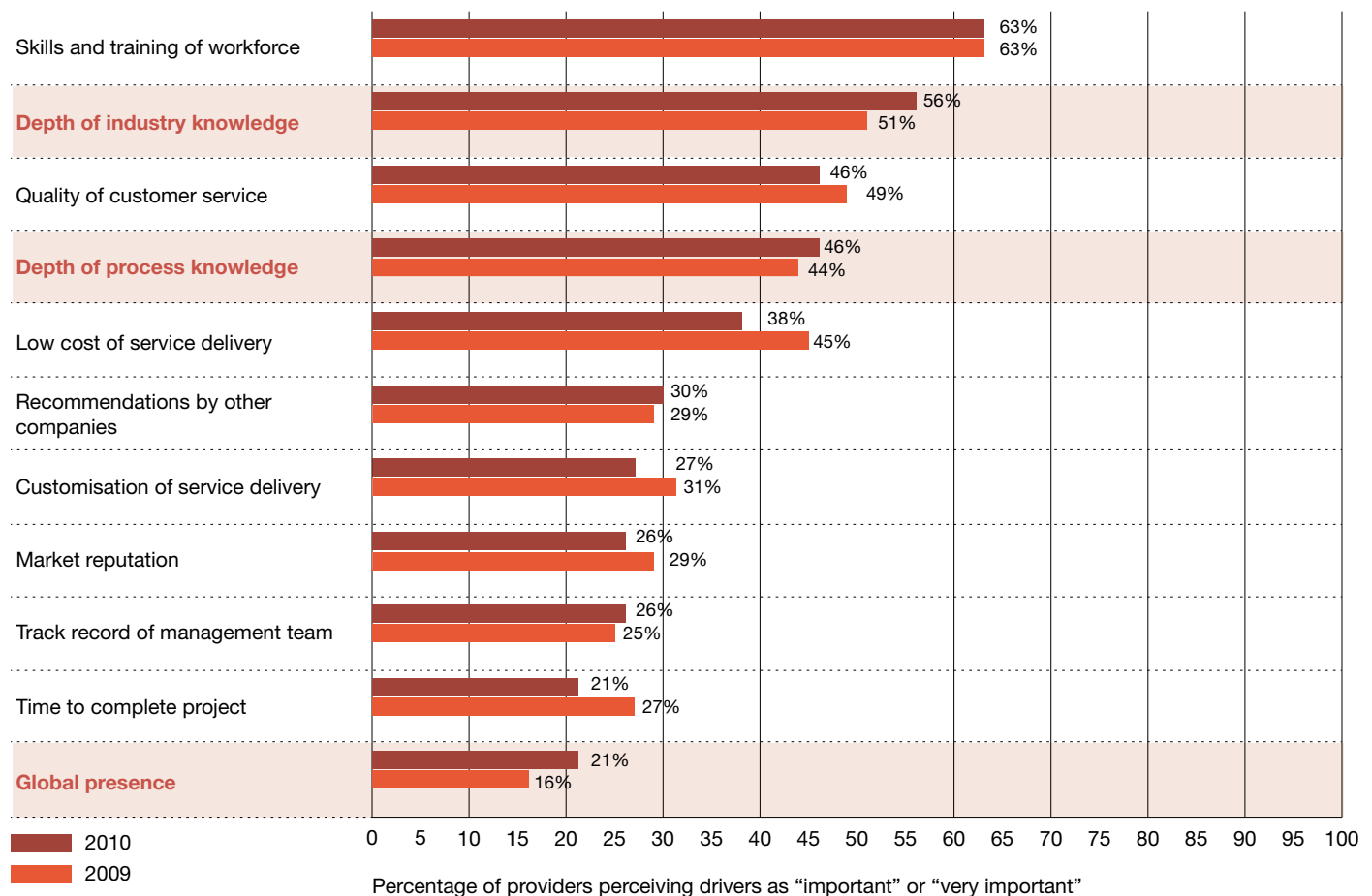
■ 2010   ■ 2009

Five strategic differentiators seen as key to attracting new clients

When asked which factors are most important for attracting new clients, most service providers focused on five key factors, two of which— **workforce skill levels and training of the workforce**—have increased in importance since 2009 to become the most vital criteria in the client's decision-making around selection of service providers. Now, three new key factors—**industry expertise, in-depth process knowledge**, and **global presence**—have also emerged as key strategic differentiators. The growing importance of these new factors is consistent with clients' expectations that providers should be more aligned with their business objectives in order to create value that goes beyond just labour arbitrage. While that continues to be an important underlying driver, survey results indicate that low cost of service in and of itself has continued to decline in relative significance, dropping from 45 percent in 2009 to just 38 percent in 2010. (See Figure 5.)

Figure 5.

When participants were asked to rate drivers as "important" or "very important," skills and training of workforce and depth of industry knowledge came out on top.

Driver	2010	2009
Skills and training of workforce	63%	63%
Depth of industry knowledge	56%	51%
Quality of customer service	46%	49%
Depth of process knowledge	46%	44%
Low cost of service delivery	38%	45%
Recommendations by other companies	30%	29%
Customisation of service delivery	27%	31%
Market reputation	26%	29%
Track record of management team	26%	25%
Time to complete project	21%	27%
Global presence	21%	16%

■ 2010
■ 2009

Percentage of providers perceiving drivers as "important" or "very important"

Optimising operational efficiency and time to achieve target service levels continue to be key focus areas

Over time, client organisations have consistently reported that a service provider's operational efficiency and time to achieve target service levels are important performance indicators that they monitor and consider. Participants in the 2010 service provider survey once again report a focus on optimising both resources and time required to achieve target service levels, in addition to cost reduction.

Figure 6 shows that mid-size providers have made the most significant improvement in their service transition processes. This is evidenced by the decrease in time to achieve target

service levels over the past year, which fell from an average of 6.3 months to just 4.6 months. In contrast, large service providers are reporting an increase in time to achieve target service levels. This may indicate that large providers have been struggling to execute improvements in operational efficiency— possibly because of diseconomies of scale and scope stemming from the aggressive expansion of new delivery centres. Most service providers agree that the ability to deliver transformational and reliable incremental process improvement is highly critical to their ability to differentiate themselves. (See Figure 7.)

Figure 6.

Mid-size providers are making significant improvements in their transition processes, as indicated by time required to achieve target service levels.
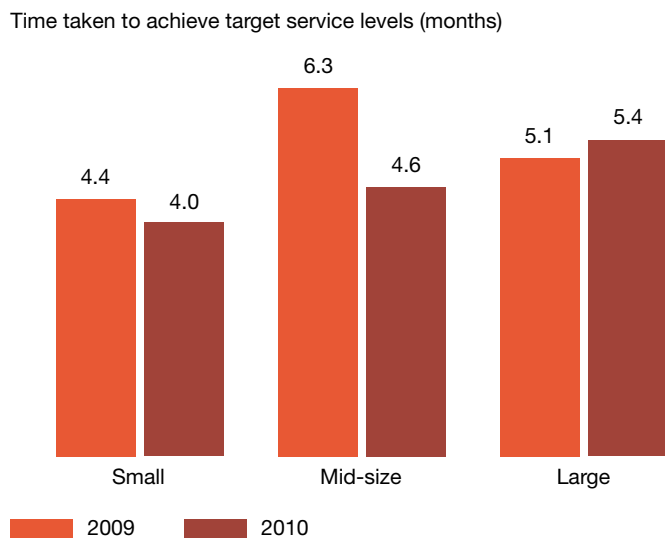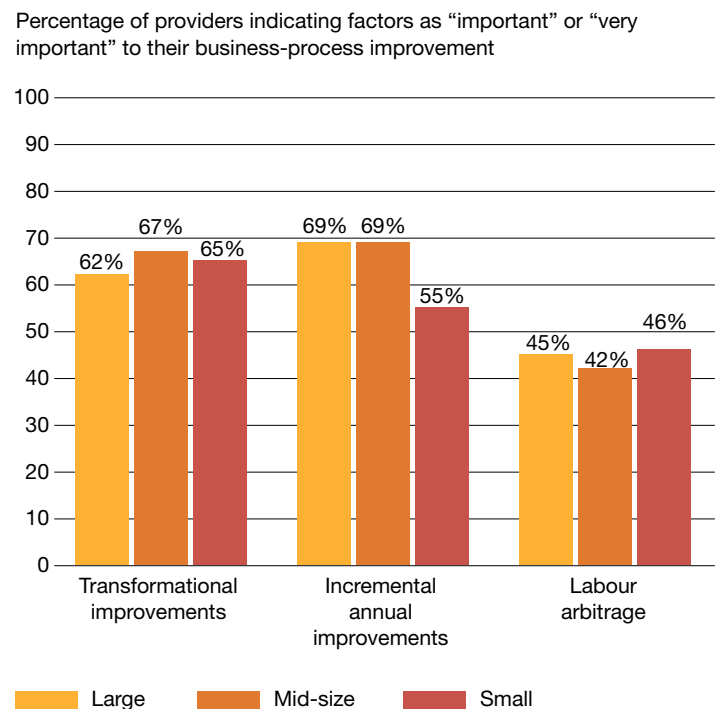
Time taken to achieve target service levels (months)

2009   2010

Figure 7.

The ability to deliver incremental and transformational process improvements is a critical strategic differentiator.

Percentage of providers indicating factors as "important" or "very important" to their business-process improvement

Large   Mid-size   Small

Generating top-line growth and high margins

Both top-line growth and the generation of high margins are strategically important for achieving and retaining a competitive edge and driving innovation. However, most service providers participating in the survey say that they found it extremely challenging to maintain margins in the current economic environment. Figure 8 indicates that all providers, regardless of size, reported a decline in actual achieved margins between 2009 and 2010. Large providers experienced the largest decline, dropping from 23 percent in 2009 to 18 percent in 2010. This could be partially explained by the increasingly intense competition in offshoring service areas—including the significant volume of contract rene-gotiation that challenged large providers, accounting for 75 percent of reported contract changes during 2009 and 2010, as well as the time lag associated with reaping the full benefits of executing their own business efficiency initiatives to make up for lost margins.
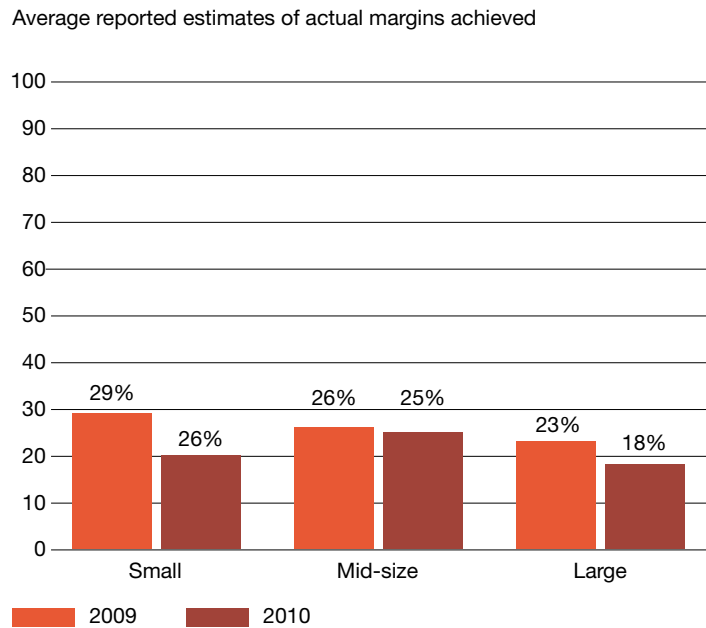
As seen in Figure 9, a comparative analysis of average achieved margins shows that India-based providers have been struggling with a steady decline in their average achieved margins over the past three years. We saw a drop from 25 percent in 2007 to 17 percent in 2010—the same period during which large international service providers were able to raise their profit margins from 20 percent in 2007 to 30 percent in 2010.

This interesting finding adds to a growing body of evidence that the "old" business model—originated by most India-based providers who at that time enjoyed a comparative advantage from favorable factor endowments such as the availability of cheap and skilled labour—has now run its course. To gain a competitive edge in this increasingly global marketplace, today's providers must go beyond offering cost savings alone. Rather, it is imperative that they build out their service capabilities to deliver more value to their clients' business processes.

A look at today's service-provider contracts and their impact

The 2010 survey was designed to capture the type and mix of provider contracts. (See Figure 10.) Most contracts signed by small and mid-size service providers are either fixed-price or time-and-materials contracts, while large service providers have the advantage of diverse pricing options, including transaction- and outcome-based contracts. Overall, time-and-material and fixed- price contracts are the most common contract terms seen in the outsourcing market. Surprisingly, it does not appear that contract type determines profitability, average achieved margins, or time to achieve target service levels.

Figure 8.

Average reported estimates of actual margins achieved, by firm size. Large providers saw the largest decline.

Average reported estimates of actual margins achieved

Legend: 2009, 2010

Figure 9.

India-based providers have been struggling to maintain high margins while large international providers have been successful in increasing theirs.
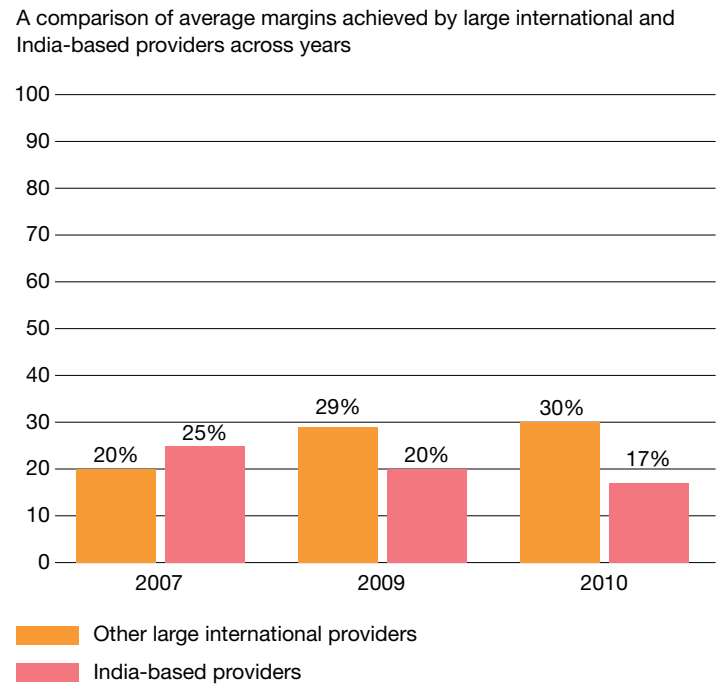
A comparison of average margins achieved by large international and India-based providers across years
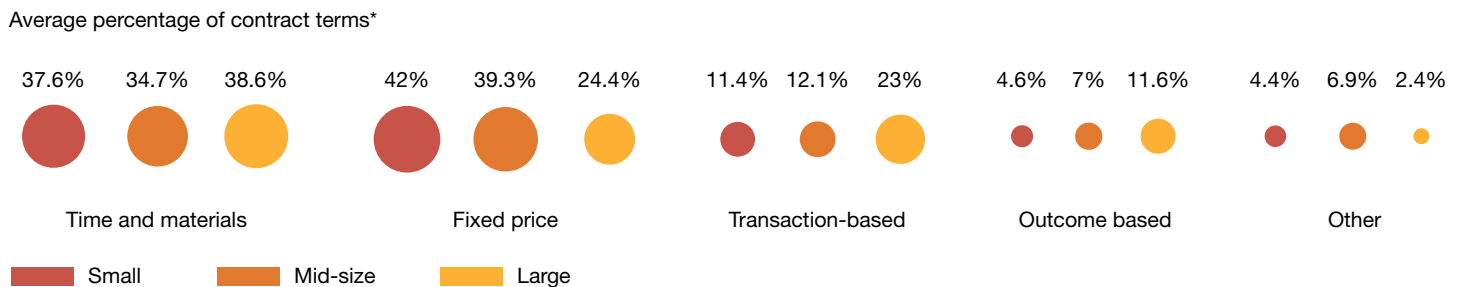

Legend: Other large international providers, India-based providers

Figure 10.

Average percentage of contract terms, by firm size. Fixed-price and time- and-materials lead

Average percentage of contract terms*

Legend: Small, Mid-size, Large

* These numbers are average percentages across years and may not add up to 100%.
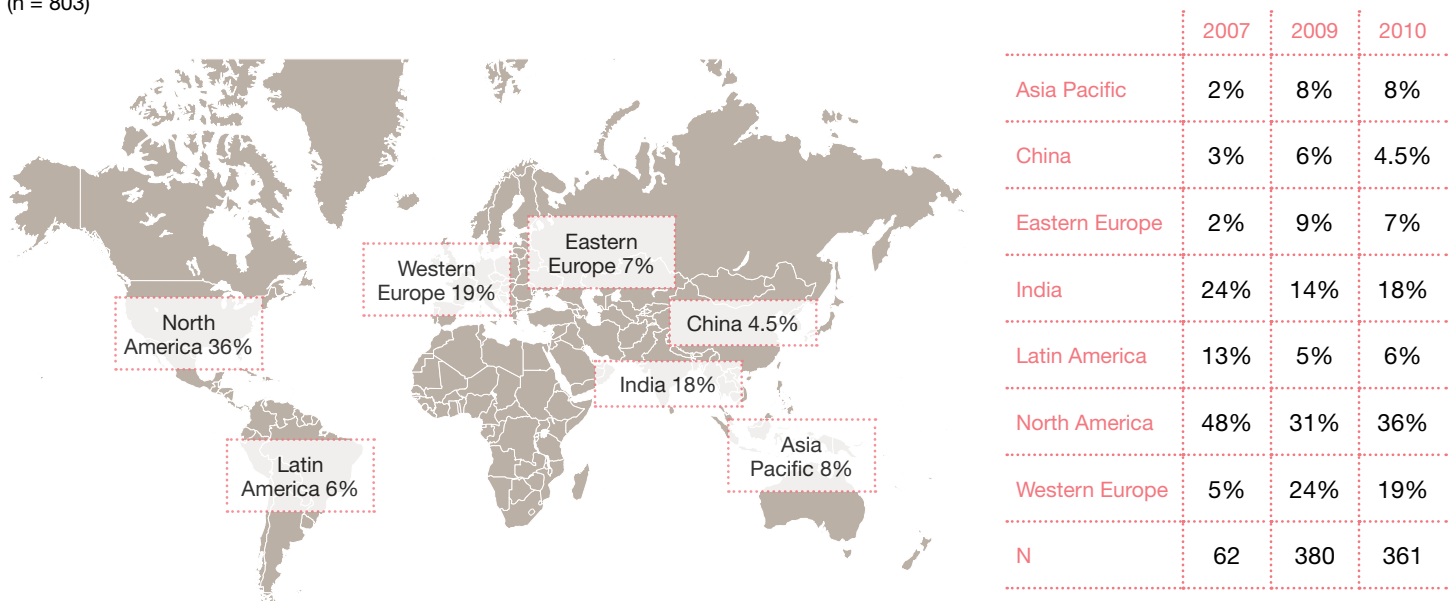
Today's service providers—on the move, getting closer to their clients

With competition becoming increasingly intense, service providers have found it necessary to have a presence close to their clients. This is clearly reflected in the survey results as depicted in Figure 11. Over the past three years, service providers have been emerging and expanding around the globe. Due to the density of customer sites, North America and Europe are the most popular locations for near-shore headquarters. Thirty-six percent of respondents say they have headquarters located in North America, while 26 percent report headquarters in Western and Eastern Europe.

Figure 11.

Overall distribution of ORN service providers*, by headquarters location (N=803)

(n = 803)

	2007	2009	2010
Asia Pacific	2%	8%	8%
China	3%	6%	4.5%
Eastern Europe	2%	9%	7%
India	24%	14%	18%
Latin America	13%	5%	6%
North America	48%	31%	36%
Western Europe	5%	24%	19%
N	62	380	361

* The distribution is based on service providers participating in ORN surveys and may not be representative of overall population.
Percentages do not add up to 100% because there is an "other" category of 1.5%.

An analysis of providers by function, as depicted in Figure 12, shows several interesting strategic directions taken by service providers in each region. In China, for example, the growth in number of providers offering ADM services is the highest relative to other functions, followed by IT infrastructure and engineering services. In other Asian countries, the number of providers offering contact centre services has doubled between 2009 and 2010. In addition, an increasing number of Asian service providers have entered both the IT infrastructure and the marketing and sales services markets. Although India-based providers continue to dominate the offshoring market, the growth of providers in other Asian countries has created a credible threat to these incumbents.

Figure 12.

ADM services continue to grow in China. Other Asian providers are gaining share in the contact-centres market. India-based provider experience is growing as a competitor for marketing and sales business.

Top offshoring functions provided, by headquarters region (Changes in number of providers from 2009–2010)
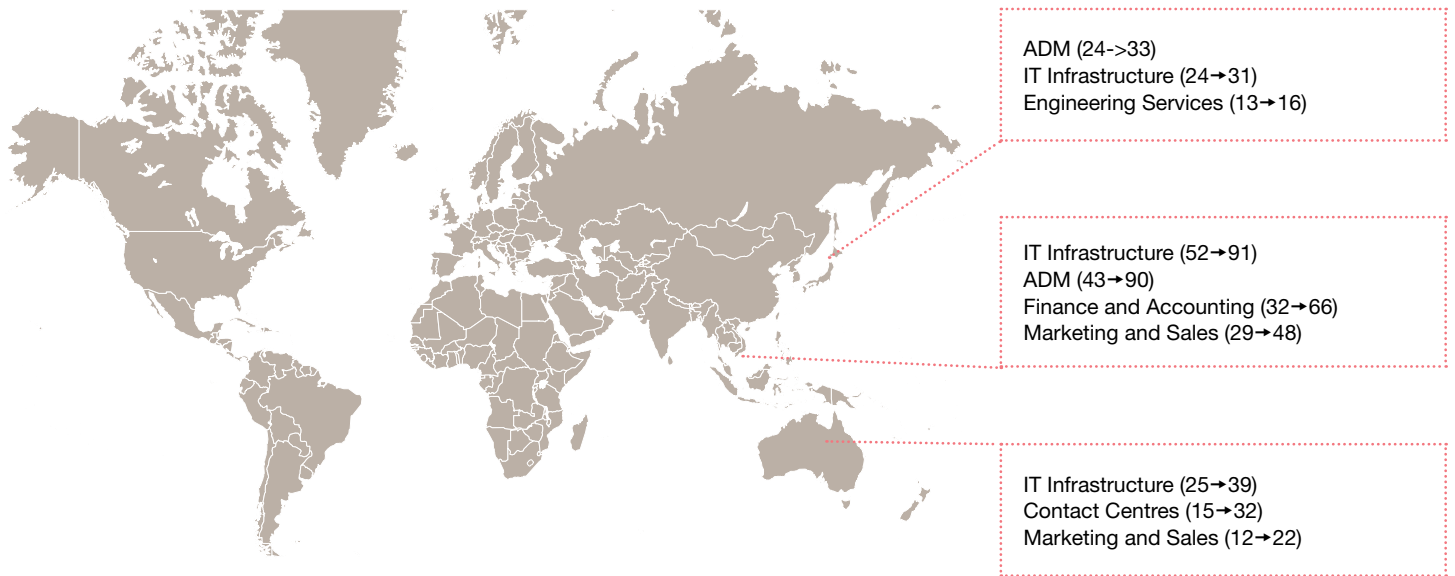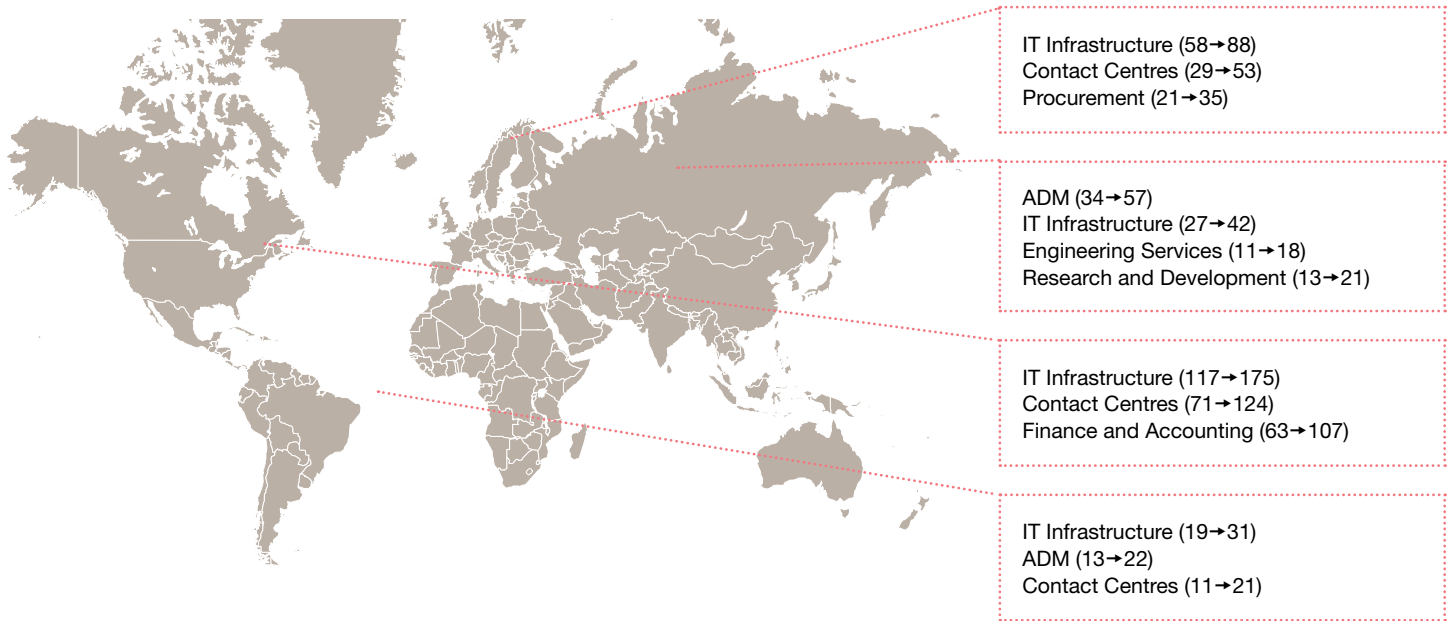

ADM (24->33)
IT Infrastructure (24➜31)
Engineering Services (13➜16)

IT Infrastructure (52➜91)
ADM (43➜90)
Finance and Accounting (32➜66)
Marketing and Sales (29➜48)

IT Infrastructure (25➜39)
Contact Centres (15➜32)
Marketing and Sales (12➜22)

Figure 13.

Latin American providers emerge as a main destination for IT infrastructure and contact centres serving mainly Latin American and US clients. Eastern European providers are progressively expanding their engineering and R&D services.

Top offshoring functions provided, by HQ region (Changes in number of providers from 2009–2010)

IT Infrastructure (58→88)
Contact Centres (29→53)
Procurement (21→35)

ADM (34→57)
IT Infrastructure (27→42)
Engineering Services (11→18)
Research and Development (13→21)

IT Infrastructure (117→175)
Contact Centres (71→124)
Finance and Accounting (63→107)

IT Infrastructure (19→31)
ADM (13→22)
Contact Centres (11→21)

North America continues to be the region with the largest number of service providers, especially in IT infrastructure, contact centres, and finance and accounting. (See Figure 13.) That said, Latin America is rapidly emerging as a key destination for these three services. Latin American providers are not only serving their domestic clients but are also increasingly serving those in North America. (See Figure 14.) In the European marketplace, a majority of IT and contact-centre providers are located in Western European countries, while ADM providers are clustering in Eastern Europe. This is most likely due to the availability of software engineers in those countries.

Figure 14.

Latin American providers not only serve their domestic clients in Latin America but are increasingly serving clients in North America as well.

Latin American service provider ranking of top 3 client headquarter locations

Canada 18%
Latin America 95%
US 45%
Western Europe 23%
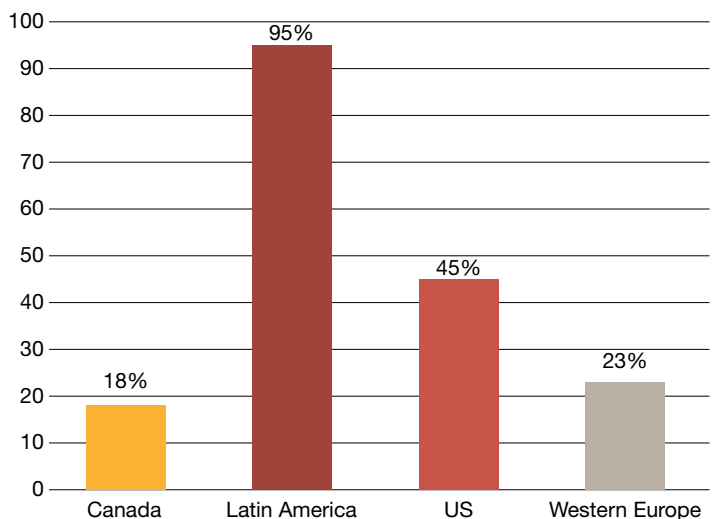
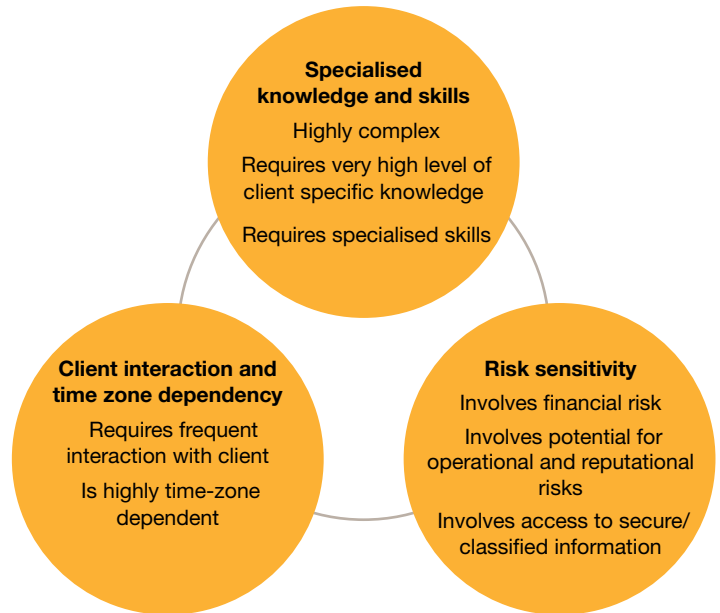# *Determining fitness of processes for offshoring*

To understand the degree to which activities are "fit" for offshoring, and the rationale behind that "fitness," respondents were asked to provide information about the degree to which certain activities were offshored—time zone requirements being one example. We analysed the results using Factor Analysis.[2]

As shown on Figure 15, three key factors emerged from that analysis: **specialised knowledge and skills, client interaction and time zone dependency** and **risk sensitivity**.

1. **Specialised knowledge and skill** characterises offshoring tasks involving high complexity, requiring a very high level of client- or domain-specific knowledge.

2. **Client interaction and time zone sensitivity** describes offshoring activities that require frequent, real-time interaction with clients.

3. **Risk sensitivity** identifies offshoring tasks that involve potential for financial, operational and reputational risks as well as access to secure and/or confidential information.

2 Factor analysis is a statistical method used to describe a complex variability among a large number of observed variables in terms of a potentially lower number of unobserved variables, called factors.

Figure 15.

Classification of business services task characteristics according to three dominant factors 1) specialised knowledge and skills, 2) high interaction and time zone dependency, and 3) risk sensitivity.

Specialised knowledge and skills
Highly complex
Requires very high level of client specific knowledge
Requires specialised skills

Client interaction and time zone dependency
Requires frequent interaction with client
Is highly time-zone dependent

Risk sensitivity
Involves financial risk
Involves potential for operational and reputational risks
Involves access to secure/ classified information

Based on these three key factors, 77 percent of service providers rated innovation services as being highly sensitive to **specialised knowledge and skills**, while only 57 percent cited **time zone dependency**. **Risk sensitivity**, cited by 52 percent, trailed. (See Figure 16.)

Providers rated analytical and knowledge services as a task requiring a high level of **specialised knowledge and skills**, suggesting the importance of recruiting and retaining qualified staff, as well as implementing training and development programs for key staff in those areas. Surprisingly, despite a well-developed concept of modularity in software engineering, ADM remains a task that requires the highest level of **interaction with clients**. It was also cited as having **sensitivity to overlapping time zone requirements**. Similarly, contact centres involve a high level of **client interaction and time zone dependency**.

Due to the nature of the task and the information involved, emerging services (such as legal services) are viewed as being **highly sensitive to financial, operational** and **reputational risks**. Combined with strong internal resistance, this may explain the slow takeoff of legal services in offshoring relative to other functions, despite rapid growth in the availability of legal process providers offshore. Interestingly, the results depicted in Figure 16 suggest the evolution of locating offshoring services to near-shore locations. In particular, the requirement for a high degree of **interaction with clients** and **time zone dependency** elevates contact centres and innovation services to the top of the candidates' list for nearshoring.

Figure 16.

77 % of service providers rated innovation services as being highly sensitive to specialised knowledge and skills, while only 57% cited time zone dependency.

Percentage of providers rating task characteristics* as "high" or "very high" for each function

	Specialised knowledge and skills	High interaction and time zone dependency	Risk sensitivity
ADM	68%	62%	45%
Analytical/ Knowledge Services	69%	47%	49%
Contact Centres	38%	57%	38%
Finance and Accounting	46%	41%	40%
Human Resources	42%	46%	30%
Innovation	77%	57%	52%
IT Infrastructure	52%	50%	47%
Legal Services	62%	50%	66%
Marketing and Sales	50%	49%	38%
Supply Chain and Facilities	48%	45%	46%

* The percentage is an average percentage of detailed task characteristics describing each representative factor as defined from Factor Analysis
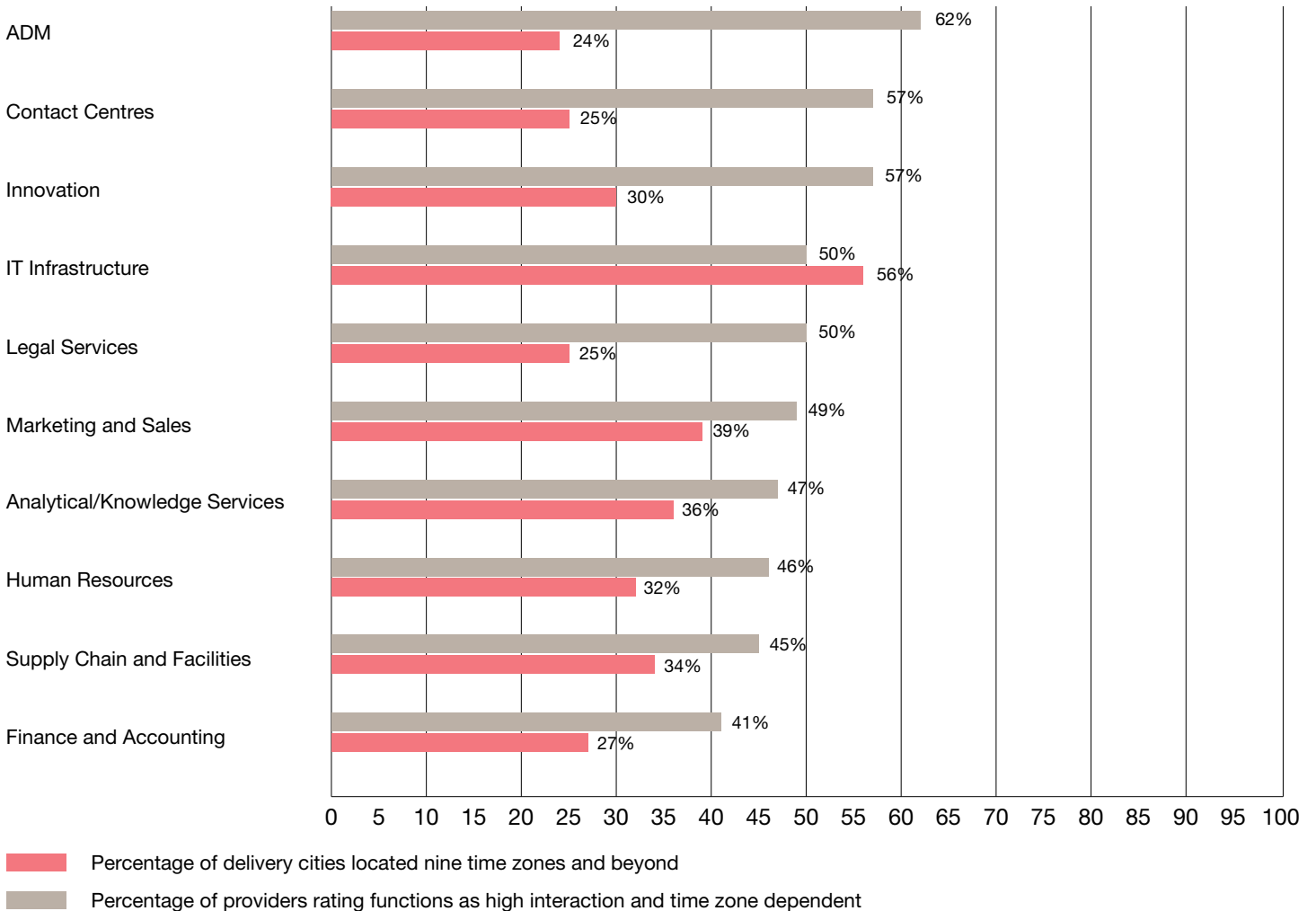
Another surprise shows up in Figure 17. Despite a well-recognised need for frequent **client interaction** and **time zone dependency**, the latest survey reveals a contradictory pattern, suggesting that delivery centres are often located more than nine time zones away from the client, with IT infrastructure services accounting for the highest proportion of far-shore locations (nine time zones and beyond). This could be due to several factors, among them: the legacy effect of early locations in India; the high switching costs of relocating to another geographic location; and a depth of capability in recruiting and the retention of talent and skilled staff.

Figure 17.

Despite availability of near-shore delivery centres and a need for client interaction, delivery centres are frequently located more than nine time zones away. IT infrastructure delivery centres have the highest proportion of locations nine time zones and beyond.

Legend:
- Percentage of delivery cities located nine time zones and beyond
- Percentage of providers rating functions as high interaction and time zone dependent

| Function	Percentage of delivery cities located nine time zones and beyond	Percentage of providers rating functions as high interaction and time zone dependent
ADM	24%	62%
Contact Centres	25%	57%
Innovation	30%	57%
IT Infrastructure	56%	50%
Legal Services	25%	50%
Marketing and Sales	39%	49%
Analytical/Knowledge Services	36%	47%
Human Resources	32%	46%
Supply Chain and Facilities	34%	45%
Finance and Accounting	27%	41%

Determining fitness of processes for offshoring

For American companies, delivery centres within the five-time zone range are limited to Latin American countries, which are relatively new offshoring locations.

As early movers, many American companies established their ITO and BPO facilities in India and other Asian countries *before* the maturation of service providers in Latin America. As shown in Figure 18, findings from the 2010 ORN Corporate Client Survey provide a consistent message, showing that the majority of American companies offshore their business services to locations beyond five time zones.

Figure 18.

Most US companies offshore their activities to locations beyond five time zones.

Percentage of offshoring implementations to a location within five time zones
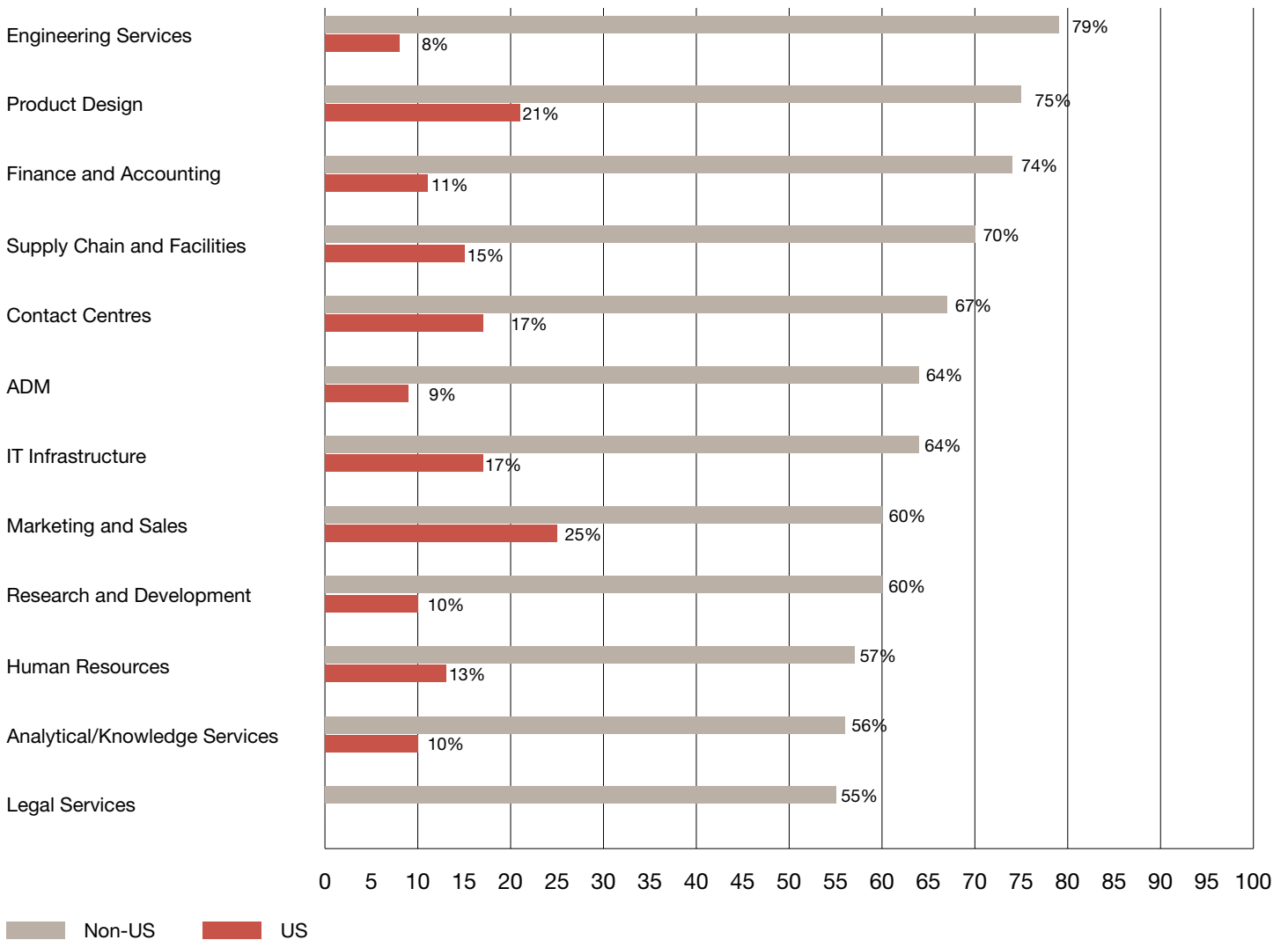
India-based industry leaders continue to invest in locating delivery centres closer to their widespread global clients. (See Figure 19.)

Similarly, Chinese providers—whose main delivery centres have traditionally been clustered in China and in a few other Asian countries—have been growing their delivery centres in both Western and Eastern European countries to get closer to their European clients. Likewise, to better serve their major North American customers, Chinese providers have doubled the number of delivery centres in Latin America. Latin America is not only close to their clients, but also offers the additional advantages of lower operating costs, availability of talent and skills, and overlapping time zones. (See Figure 20.)

The delivery centres of Eastern European providers mostly serve their major European and US clients. In particular, 36 percent of delivery centres are located in Western Europe, while North America accounts for 34 percent. Now, in an effort to get closer to their clients, a growing number of providers are jumping on the near-shore bandwagon. A growing number of Eastern European providers report the expansion of their operations and delivery centres into Latin America and Asian countries. (See Figure 21.)

Figure 19.
India-based providers have increasingly established delivery centres closer to their clients to minimise the time zone barrier.

Changes in the percentage of India-based service providers' existing delivery centres, by region (2009–2010)*

North America 56->59%

Eastern Europe 17->18%

Western Europe 46->47%

Africa 13->18%

Latin America 13->19%

Asia Pacific 85->87%
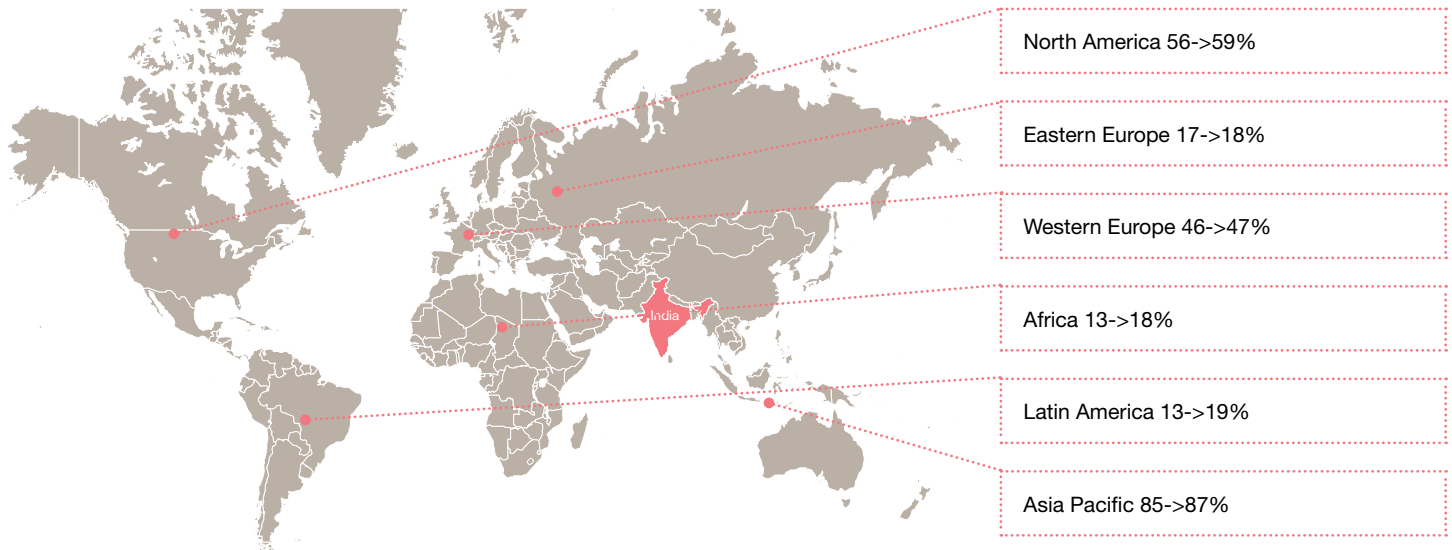
* Sample size for 2009 = 72 and sample size for 2010 = 145
Percentages do not add to 100% because service providers can have delivery centres in more than one region.

Figure 20.

Over the past two years, Chinese providers have been starting to locate delivery centres in Europe to serve European clients, and in Latin America to serve US clients.

Changes in the percentage of Chinese service providers' existing delivery centres, by region (2009–2010)*

North America 42->48%

Eastern Europe 0->9%

Western Europe 8->15%

Africa 4->9%

Latin America 4->9%

Asia Pacific 83->88%

* Sample size for 2009 = 24 and sample size for 2010 = 32
Percentages do not add to 100% because service providers can have delivery centres in more than one region.

Figure 21.

Despite advantageous near-shore location to Western European clients, Eastern European providers are establishing delivery centres in North America, South America, Africa and Asia Pacific.

Changes in the percentage of Eastern European service providers' existing delivery centres, by region (2009–2010)*

North America 29->34%

Western Europe 32->36%

Africa 12->8%

Latin America 3->5%

Asia Pacific 9->12%

* Sample size for 2009 = 34 and sample size for 2010 = 59
Percentages do not add to 100% because service providers can have delivery centres in more than one region.

Tables 1 and 2 highlight major emerging cities in terms of administrative and innovation services. This supports our finding that, increasingly, service providers are expanding their operations to various locations around the globe in order to satisfy client expectations for near-shore delivery centres, as well as to maximise benefits stemming from time zone differences. For example, contact centres initially clustered in various cities in India, and later in Manila, have now been extended to Guangzhou in China, Kuala Lumpur in Malaysia, and to several major cities in Latin America. Two major cities in Romania—Bucharest and Cluj—are emerging as locations for legal services delivery centres. This not only signals the significance of language requirements, but also a need for a strategic effort on the part of providers to diversify operating locations—thereby avoiding 'hot-spot' locations such as India that are increasingly beset by the challenges of managing wage inflation and escalating turnover rates.

Table 1.
Time zone considerations are disappearing as a factor in selecting new locations for administrative services.*

	Contact Centres	Finance and Accounting	Human Resources	Procurement	Marketing and Sales	Legal Services
India		Gurgaon Noida	Chennai Noida	Mumbai Noida Delhi	Mumbai Hyderabad Delhi Gurgaon	Mumbai Bangalore
China	Guangzhou			Guangzhou Hong Kong	Beijing	Shanghai
Other Asia Pacific	Kuala Lumpur	Manila		Adelaide	Makati Kuala Lumpur Taipei	Manila
Eastern Europe (including Russia)				Cluj	Sofia	Bucharest Cluj
Latin America	Sao Paulo Mexico City Managua Medellin	Bogota Mexico City Santiago	Mexico City	Mexico City Santiago Antofagasta Campinas	Buenos Aires	

* The list is extracted from the locations of delivery centres (by function) which service providers own in each region and appear for the first time in the ORN database. It should be noted that the list does not imply the popularity of a city as an offshore destination.

Table 2.
Sourcing innovation services continues to involve managing across nine time zones.

	Design Services	Engineering	Research and Development	Analytical/ Knowledge Services	ADM	IT Infrastructure
India			Hyderabad	Bangalore Gurgaon Hyderabad	Gurgaon	Delhi
China		Guangzhou		Guangzhou	Hanhzhou	Dalian Hanhzhou
Other Asia Pacific	Kuala Lumpur		Manila Makati Colombo	Makati Manila Singapore	Sydney Tokyo	Tokyo
Eastern Europe (including Russia)	Kherson Kharkov	Kharkov	Bucharest Cluj	Moscow St Petersburg Minsk		
Latin America					Bogota Santiago	

Internal training and development of staff for client-specific capabilities

Service providers report a declining average rate of staff attrition, down from 16 percent in 2009 to 13 percent in 2010. This is consistent with the challenging economic environment and a much tighter job market. Despite the decline in average turnover during the past year, service providers expressed their strong concern about retaining existing staff; attracting new qualified staff; and developing internal capabilities, expertise and knowledge through staff training.

A new phenomenon involves introducing training and development programs designed to increase staff knowledge of client-specific needs, processes and capabilities. One possible explanation relates to client expectations that their provider partners will find opportunities to contribute to higher value-added activities. To that end, mid-size service providers in particular are making aggressive investments in establishing training centres for internal staff. As shown in Figure 22, training centres owned by mid-size companies represent almost half of all training centres, followed by small providers at 27 percent and large providers at 25 percent.

The survey findings suggest that functions involving a high level of client-specific knowledge and frequent interaction with clients are rated as the top priority for investment in training. (See Figure 23.) Design Services and R&D—which require a high level of client-specific knowledge and interdependency with processes in client organisations—are the two areas where over 50 percent of service providers have made client-specific investments in training over the past year, especially in human resources and in marketing and sales.

Figure 22.

Mid-size providers in particular are making aggressive investment to establish training centres for internal staff.

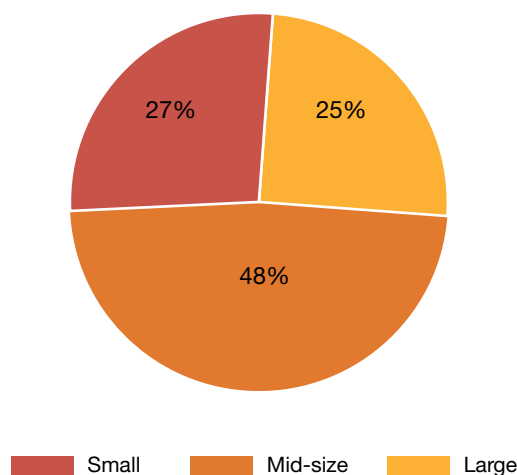Percentage of providers owning training centres for employees

- Small
- Mid-size
- Large

Internal training and development of staff for client-specific capabilities

Figure 23.

Functions involving a high level of client-specific knowledge and frequent interaction with clients (e.g., design services, R&D and contact centres) were rated as requiring extensive investment in internal staff training.

Percentage of providers making client-specific investment in training

Percentage of companies that rated characteristic "high" or "very high"

Function	Investments in training (2010)	Investments in training (2009)	Highly interdependent with process in client organisation	Require very high level of client-specific knowledge
ADM	50%	43%		
Supply Chain and Facilities	49%	41%		
Marketing and Sales	52%	43%		
Legal Services	42%	47%		
Analytical/Knowledge Services	42%	50%		
Engineering Services	44%	53%		
Research and Development	50%	54%	65%	78%
IT Infrastructure	48%	42%	58%	46%
Human Resources	59%	39%	58%	49%
Finance and Accounting	45%	52%	56%	44%
Design Services	50%	62%	67%	79%
Contact Centres	58%	56%	54%	53%

The ever-changing global service-provider industry: Key findings for 2010

22

The survey also reveals (See Figure 24.) that the specific focus on internal training centres varies across service providers. That said, specific skills and domain knowledge for tasks are common themes of training centres across regions:

- **Asia.** Training and development of project- and client-related management skills are strongly emphasised among Asian service providers, including India and China.

- **India.** Given the reality and challenge of dealing with high turnover rate, India-based service providers focus significantly on nurturing and retaining talent.

- **China.** Chinese service providers' focus on enhancing language skills reflects an attempt to improve their weakness in the English language and communication skills.

- **Latin America.** Having learned from the challenge facing India-based service providers, Latin American providers place a strong emphasis on talent management as part of their training centres.

As part of the strategic approach to enhance operational efficiency and capabilities, service providers report that they have been striving to embed innovation into their client solutions. Over half of service providers surveyed plan to invest in new areas of expertise with cloud and service-oriented architecture (SOA), as well as to set up a centre of excellence. (See Figure 25.)

As part of their innovative solutions offering to clients, Chinese providers are emphasising business process transformation capabilities as well as intellectual property solutions.
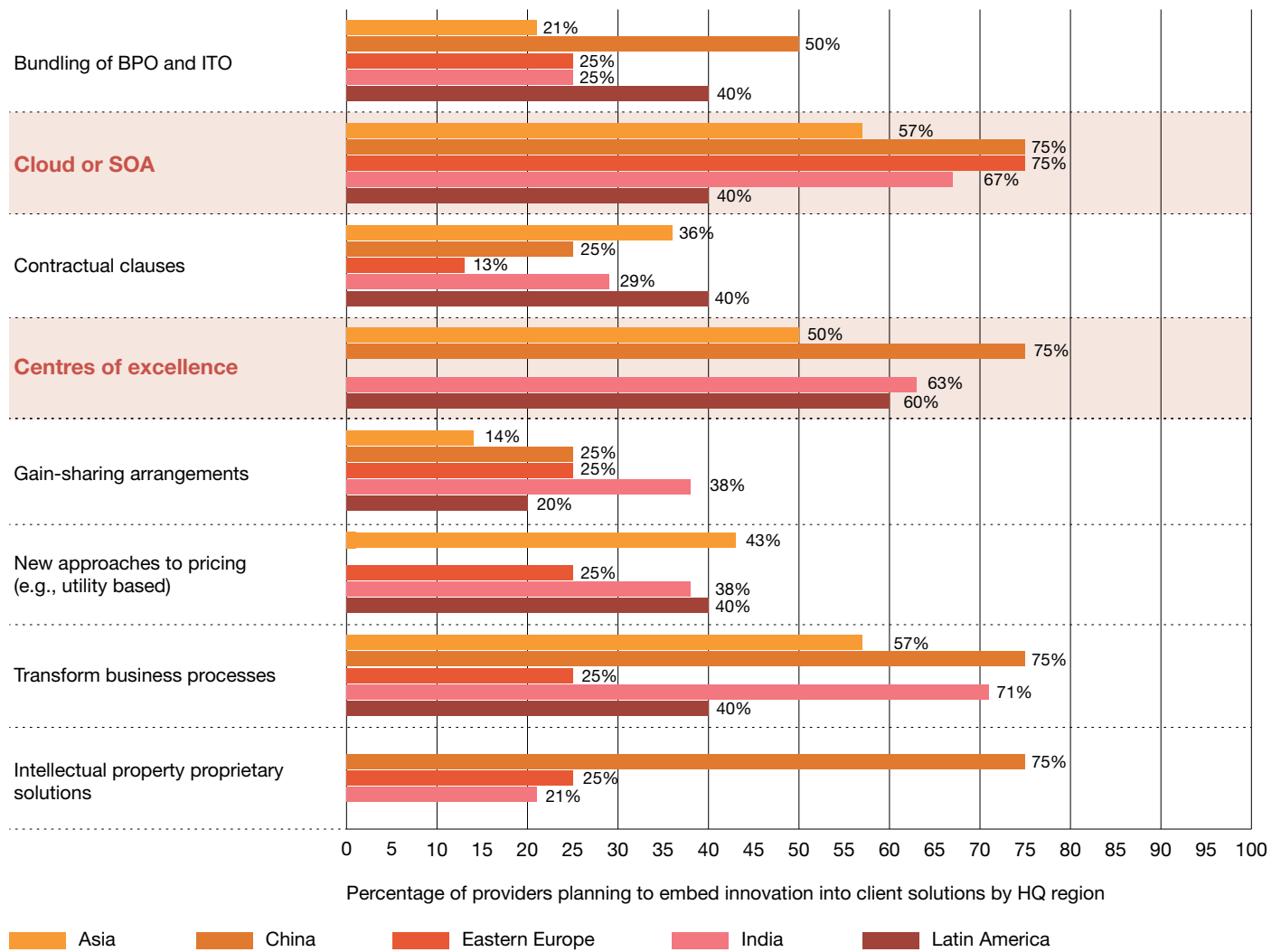
Figure 24.

Domain knowledge is a key focus of most training centres. Indian, Chinese and other Asian providers also strongly emphasise training and development of project- and client-related management skills.

Training centre focus as indicated by providers, by headquarter region

	US	Western Europe	India	China	Eastern Europe	Latin America	Asia Pacific
Specific skills or domain knowledge for the tasks	●	●	●	●	●	●	●
Has a dedicated training framework	●						
Adherence to best practices	●						
Accelerating knowledge transfer	●						
Enhance language skills	●			●			
Enhance management skills			●	●			●
Nurture talent			●			●	
Retain talent			●			●	

Figure 25.

Over 56 percent of providers plan to invest in new areas of expertise with Cloud or SOA and COEs as their main focus. Chinese providers also emphasise IP solutions and business process transformation capabilities.

Percentage of providers planning to embed innovation into client solutions by HQ region

Asia   China   Eastern Europe   India   Latin America

A look ahead: The global offshoring industry three years out

The future direction of the global business-services provider industry has seen intense interest among academic scholars, business executives and policy makers alike. Most recent studies and reports predict continued growth of the industry over the next five years.

Growing organically, and/or by M&A. As shown in Figure 26, nearly 75 percent of service providers indicate plans to continue growing organically, primarily through increasing the scale and scope of their services. Mergers and acquisitions are seen as another route for growth, accounting for approximately 13 percent of service providers' plans over the next three years. Further, seven percent of service providers indicate a desire to become an acquisition target. In short, this suggests that providers anticipate some modest opportunities for consolidation of the industry over the next three years.

Figure 27 amplifies the M&A story. Further analysis of growth plans suggests that Latin American providers are planning to rapidly expand their operations, primarily through M&A activities. Over 30 percent of Latin American providers are expecting to expand their operations by acquiring shared-service centres (SSCs) from clients. By comparison, 16 percent of India-based service providers have plans to acquire client SSCs. An analysis of strategic acquisition plans

by specific functional capabilities identifies marketing and sales, cited by 18 percent of service providers, as the highest acquisition target. Other strategic functional capabilities being targeted include contact centres at 13 percent, R&D at 11 percent, and finance and accounting, also at 11 percent.

Figure 26.

Organic growth through increased scale or scope represents nearly 75% of providers' primary growth plans.

- 7.6% Acquisitions for scale
- 5.3% Acquisitions for scope
- 5.3% Other
- 7.6% Become an acquisition target
- 31% Organically via increase in scope of services
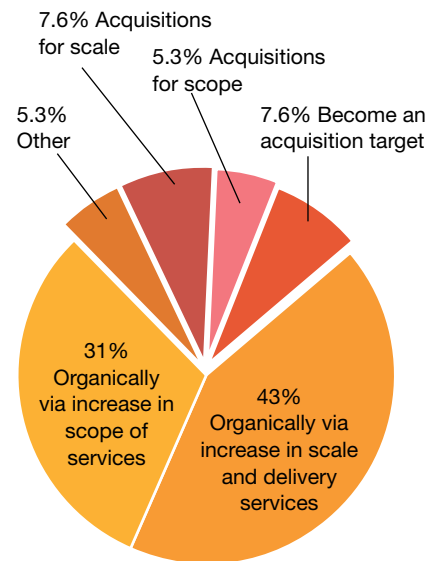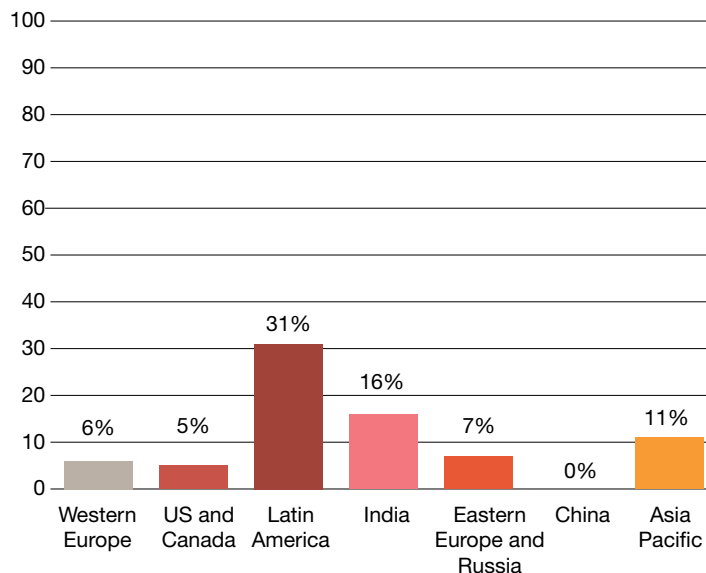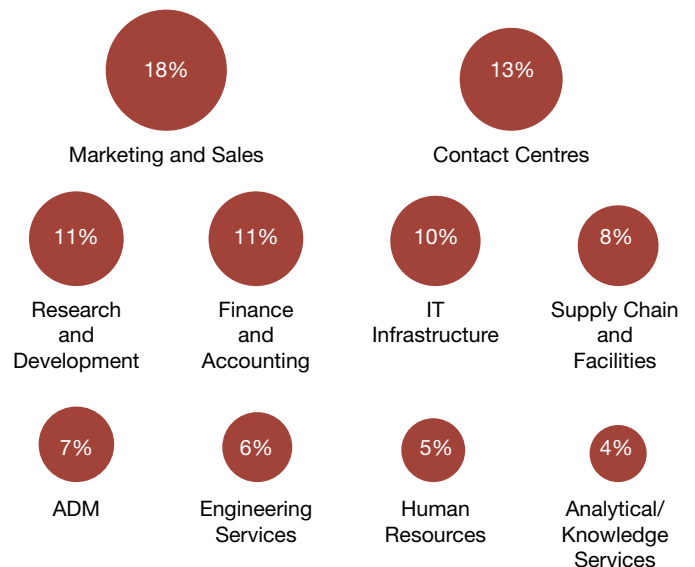- 43% Organically via increase in scale and delivery services

Figure 27.

Latin American providers are favoring mergers and acquisitions as their growth strategy.

Plan to acquire shared service centre of clients by HQ region
Over 30% of Latin-American providers are looking to expand their operations by acquiring client shared service centres

- Western Europe: 6%
- US and Canada: 5%
- Latin America: 31%
- India: 16%
- Eastern Europe and Russia: 7%
- China: 0%
- Asia Pacific: 11%

Plan to acquire shared services centre of client, by function
Contact centres and marketing and sales operations are the top two functions that providers are planning to acquire

- Marketing and Sales: 18%
- Contact Centres: 13%
- Research and Development: 11%
- Finance and Accounting: 11%
- IT Infrastructure: 10%
- Supply Chain and Facilities: 8%
- ADM: 7%
- Engineering Services: 6%
- Human Resources: 5%
- Analytical/Knowledge Services: 4%

Services in greatest demand. The outsourcing industry estimates that legal services, engineering services and ADM are expected to experience the highest increase in demand over the next 18–36 months. (See Figure 28.) All providers of legal services strongly indicate plans to expand the scale of this service in this same time frame, which is consistent with clients' estimated rapid increase in demand for the offshoring of legal services.

The estimates for future demand are not always aligned with plans to expand the scale of operations. Let's take IT infrastructure services as an example. On one hand, IT Infrastructure is rated as having the lowest increase in demand—just 20 percent over the next 18-36 months. On the other hand, more than 60 percent of service providers say they are planning to expand the scale of their IT infrastructure operations. One finding seems to contradict the other. As we see it, the slow growth of demand is due to the maturity of this capability, i.e., its already large customer base.

Figure 28.

Estimates of future demand for services and plans for expanding scale and scope of existing services are not always aligned, e.g., analytical/knowledge services, supply chain, design services and IT infrastructure.

Estimate change in demand of service

Service	%
Legal Services	49%
Engineering Services	43%
ADM	38%
Analytical/Knowledge Services	32%
Supply Chain and Facilities	32%
Human Resources	31%
Research and Development	30%
Contact Centres	24%
Finance and Accounting	22%
Marketing and Sales	21%
Design Services	20%
IT Infrastructure	20%

Plan to expand the scale of existing services

Service	%
Legal Services	100%
Engineering Services	83%
ADM	69%
Human Resources	68%
IT Infrastructure	63%
Research and Development	61%
Design Services	60%
Finance and Accounting	59%
Marketing and Sales	53%
Contact Centres	53%
Analytical/Knowledge Services	52%
Supply Chain and Facilities	46%

Relocating services to avoid the 'hot spots.' Going beyond the expansion of scale and scope, service providers continue to diversify the location of their delivery centres away from hot spots. IT Infrastructure and ADM are the main targets for such relocation initiatives, as shown in Figure 29. Previously clustered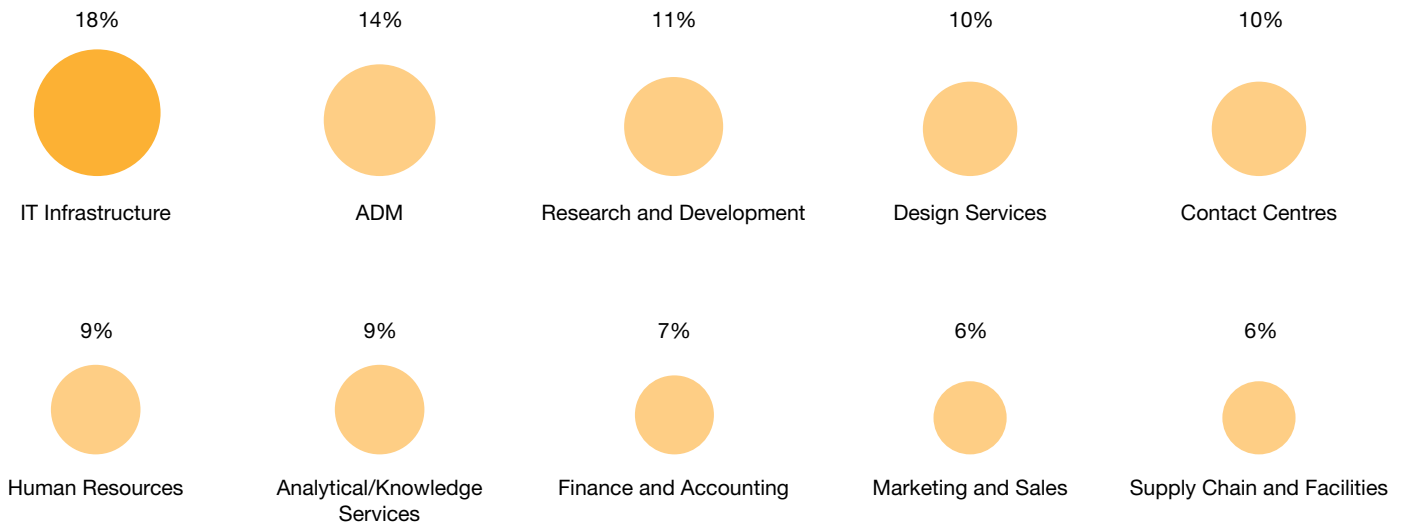 in India, providers of IT infrastructure and ADM are planning to relocate some of these centres to other locations. This is particularly true of North American and India-based service providers, 40 percent of whom—challenged by wage inflation and a high turnover rate—say they plan to relocate their processes away from hot spot locations over the next 18-36 months.

Figure 29.

Providers continue to relocate delivery centres away from hot spots. Lower margin and commoditised processes are increasingly being relocated to low-cost areas, and existing facilities are being redeployed to add higher value to clients' businesses.
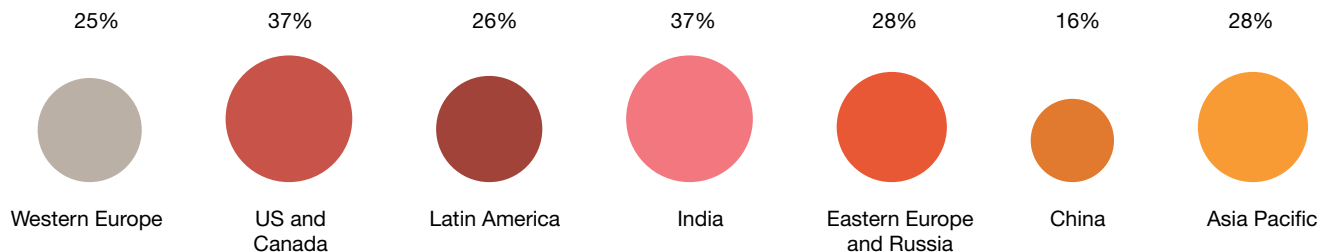
Plan to relocate processes to another location, by function
Previously clustered in India, IT and software development providers are looking to relocate their processes to other locations

18%	14%	11%	10%	10%
IT Infrastructure	ADM	Research and Development	Design Services	Contact Centres

9%	9%	7%	6%	6%
Human Resources	Analytical/Knowledge Services	Finance and Accounting	Marketing and Sales	Supply Chain and Facilities

Plan to relocate processes to another location, by HQ region
Almost 40% of India-based and American providers are planning to relocate their operations. Wage inflation and high turnover rate are among the top reasons

25%	37%	26%	37%	28%	16%	28%
Western Europe	US and Canada	Latin America	India	Eastern Europe and Russia	China	Asia Pacific

New entrants from emerging countries, such as Asia-based service providers, report aggressive plans to expand the scope of their service offerings in such areas as Administrative services for both human resources and marketing and sales—thus foreshadowing head-to-head competition with established providers in India.

(See Figure 30.) On the other hand, over 90 percent of Chinese and more than 80 percent of Eastern European service providers are targeting ADM services as their market-entry strategy, as evidenced in Figure 31. Chinese and Asian service providers are also targeting new offerings in high-value-added services such as R&D and product design.

Figure 30.

Over 35% of Asian providers plan to offer new services for HR and for marketing and sales—foreshadowing head-to-head competition with established providers in India.

Percentage of providers intending to introduce new service by function
Asia Pacific

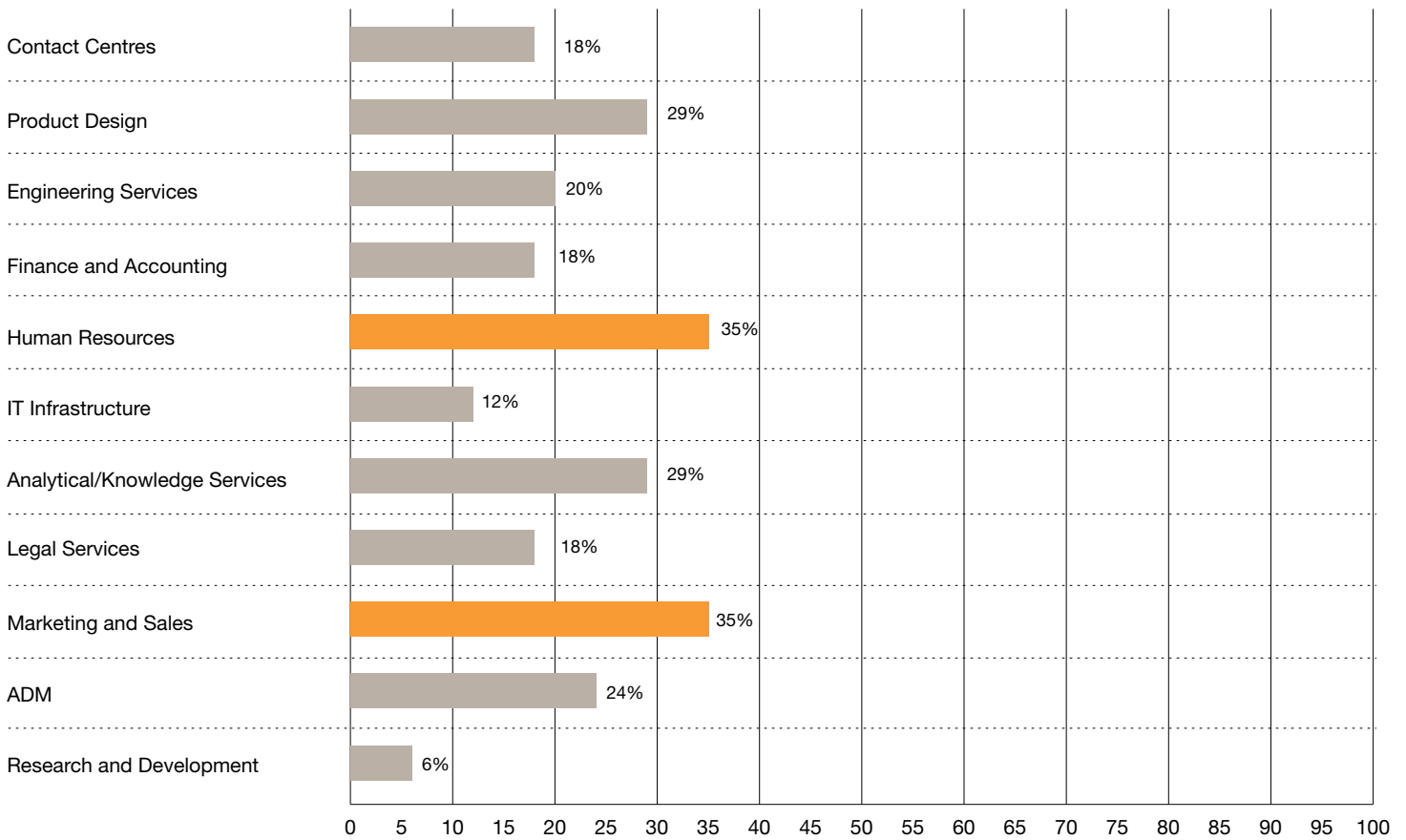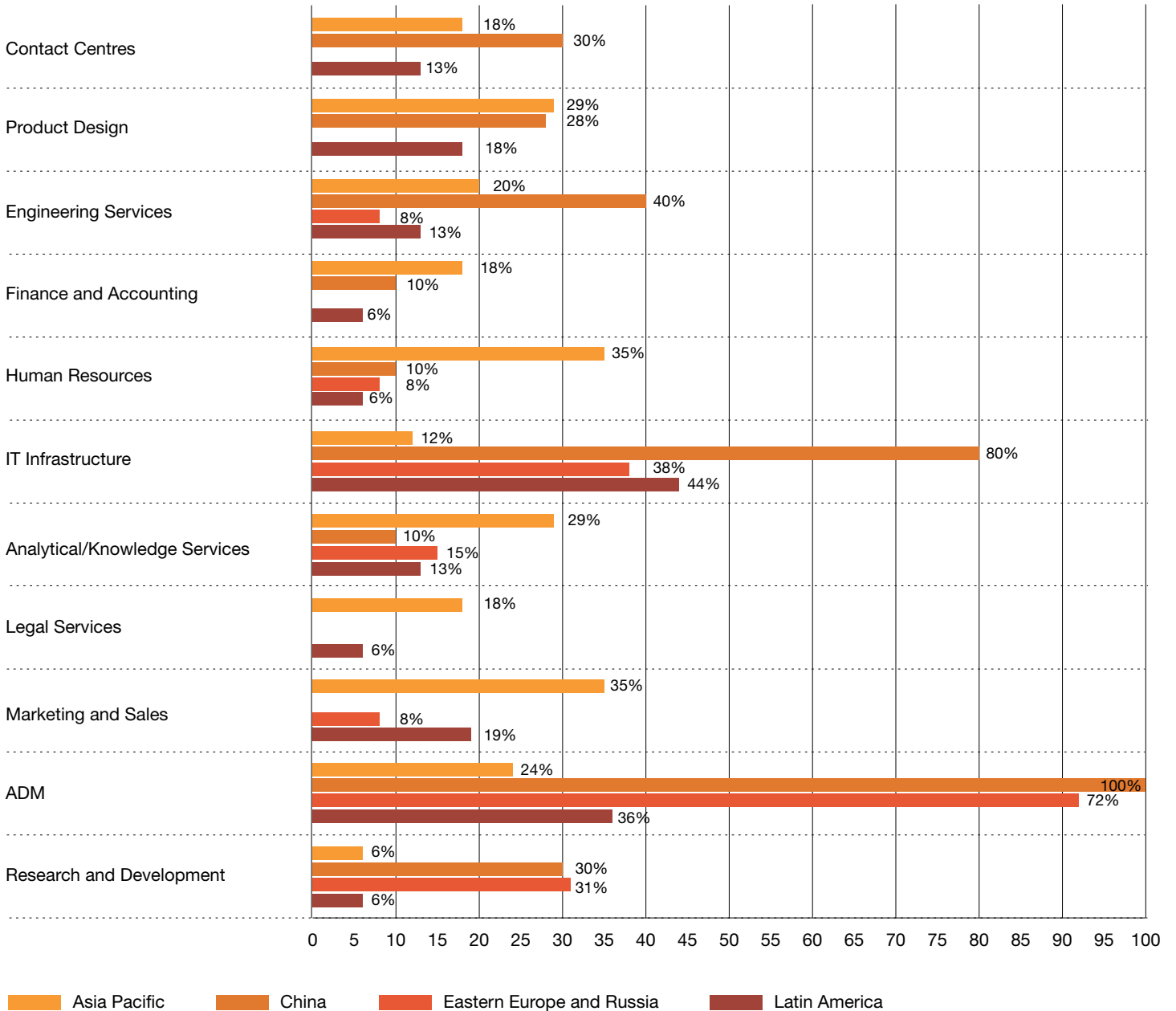| Function	Percentage
Contact Centres	18%
Product Design	29%
Engineering Services	20%
Finance and Accounting	18%
Human Resources	35%
IT Infrastructure	12%
Analytical/Knowledge Services	29%
Legal Services	18%
Marketing and Sales	35%
ADM	24%
Research and Development	6%

Figure 31.

The majority of Chinese and Eastern European providers are targeting ADM as their market-entry strategy. Chinese and Asian providers are targeting high-value-added services such as R&D and product design. Over 90 percent of providers signal their intent to offer new software-development services.

Percentage of companies that intend to introduce new services, by region

	Asia Pacific	China	Eastern Europe and Russia	Latin America
Contact Centres	18%	30%		13%
Product Design	29%	28%		18%
Engineering Services	20%	40%	8%	13%
Finance and Accounting	18%	10%		6%
Human Resources	35%	10%	8%	6%
IT Infrastructure	12%	80%	38%	44%
Analytical/Knowledge Services	29%	10%	15%	13%
Legal Services	18%			6%
Marketing and Sales	35%		8%	19%
ADM	24%	100%	72%	36%
Research and Development	6%	30%	31%	6%

Different locations—Different views on growth opportunities.

When asked to identify industries with the greatest growth opportunities over the next three years, providers offered diverse expectations, as depicted in Figure 32.

- Eastern European and Latin American based providers expect high growth in **high-tech** and **software**.

- Chinese providers anticipate substantial growth of offshoring for their clients operating in **wholesale** and **utilities**.

- Other Asian service providers said they foresee rapid growth in demand for offshore services in **healthcare, finance** and **insurance**.

Figure 32.

Eastern European and Latin American providers expect high growth in the high-tech and software sectors. Chinese providers anticipate substantial growth of offshoring in the wholesale and utilities industries. Other Asian providers anticipate growing demand in the healthcare and finance and insurance industries.

Industry growth, by HQ location
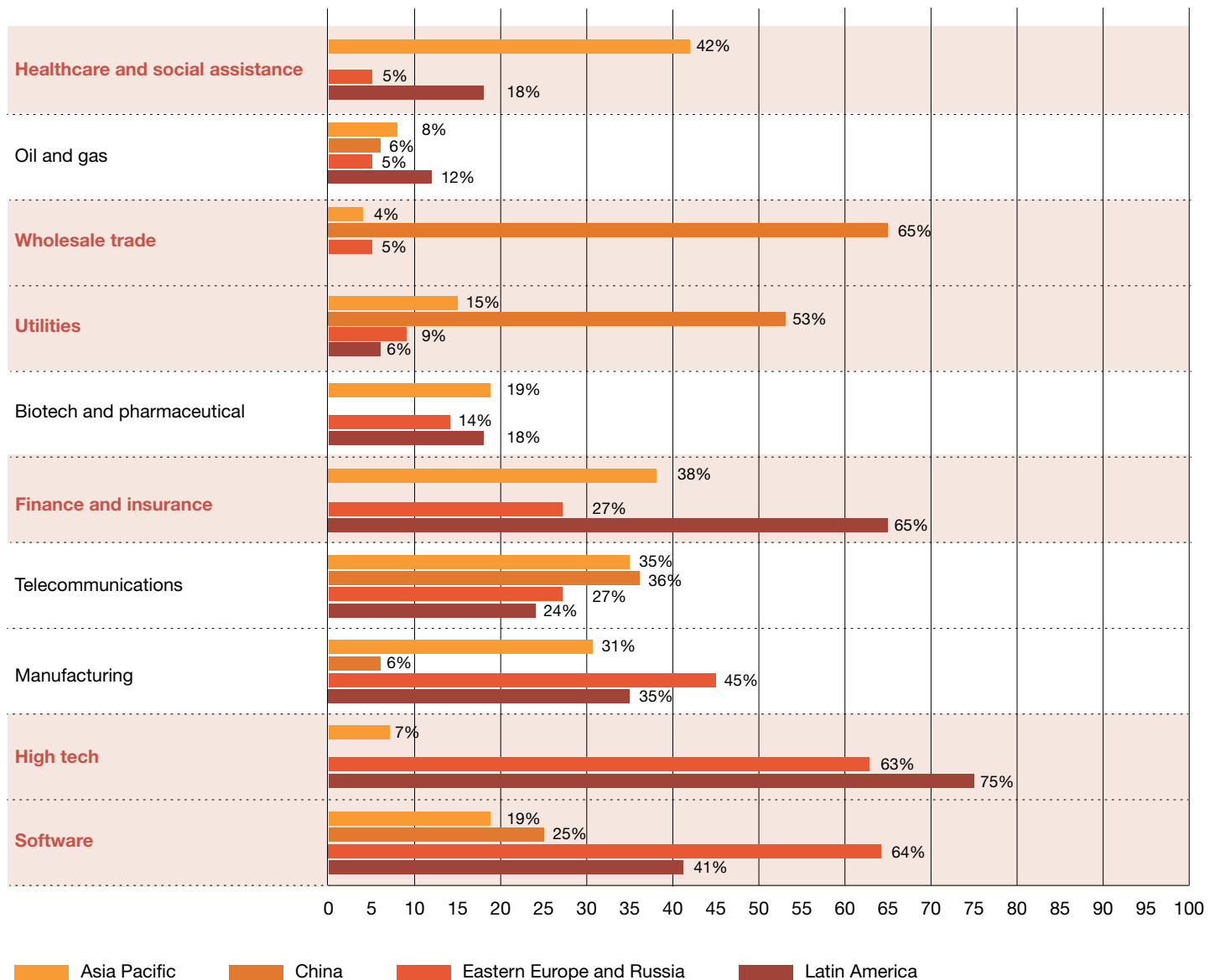
Conclusion
A new day. A new focus. A new kind of client relationship

As the global offshoring and outsourcing industry continues its moves into a more mature industry phase, service providers need to go beyond price reduction alone to differentiate themselves on value-added services and true capability. Previously, most service providers were focused on providing services at a cheaper rate, but this is a new day. Given the current market condition, relying only on low cost and labour arbitrage is no longer a successful strategy. To gain a competitive edge in today's dynamic and increasingly global marketplace, it is critical that providers go beyond the third-party service-delivery relationships of the past and find ways to become more like valued business partners. That means:

- **Improving operational efficiency and time to achieve target service levels.** One key approach is to improve transition processes and minimise time to achieve target service levels.

- **Moving closer to key clients.** Service providers need to get closer to their clients—especially in cases where high interaction and sensitivity to time zones is required. Establishing near-shore facilities not only allows service providers to strengthen their relationship with clients, but it also serves as a strategic move to increase market penetration in such regions. Nevertheless, increasing dispersed operations poses a threat to service providers in terms of monitoring and effectively coordinating among units.

- **Developing client-specific capabilities internally.** Value created from the ongoing development of specific skills and the knowledge of employees is another critical strategic action in the fierce market competition that service providers face today. To win in today's increasingly global marketplace, providers must continue to develop client-specific capabilities through investment in training centres, and to establish an environment conducive to innovation. Among the key strategies to be built into their client solutions are: moving to the cloud, bundling IT and BPO, and setting up COEs.

- **Focusing on high-growth markets:** Going forward, providers need to make a conscious decision about which markets they want to enter. To that end, they should focus on growing markets where demand for a given service is strong, and where they have superior capability and a competitive advantage over their rivals. For example, given the ample supply of software engineering graduates in emerging Eastern European economies, service providers in such a region could choose to adopt ADM services as their market-entry strategy and to set a strategic regional goal to become a leader in the ADM market.

Long story short. Leading providers are preparing today to win in the marketplace of tomorrow.

***For a deeper discussion about
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