

## INDUSTRY DEVELOPMENTS AND MODELS

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### Business Process Improvement: Transforming Management Consulting Purchasing Behaviour

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#### IDC OPINION

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A shift in buyer behaviour for management consulting services, related to satisfying customers' unquenchable demand for business process improvement efforts, is emerging. IDC predicts that the change in purchasing behaviour will profoundly change the BPO market by allowing new vendors to enter the market and provide cross-functional BPO services. These services may not replace demand for specialized, functional BPO services that are predominant in the market today, however, IDC believes some customers will begin to look to the "horizontal" or cross-functional providers to meet their outsourcing needs because they expect to receive greater benefits – including meeting strategic objectives - which are not typically part of many BPO engagements to date.

IDC believes the scenario described in this study implies the following outcomes for the BPO market:

- Lead BPO providers will emerge and alter the BPO competitive landscape.
  - Change management skills are key for horizontal BPO providers, while process consulting skills are critical for functional BPO providers.
  - The shift in BPO spending from functional to horizontal will be considerable.
  - Industry consolidation will accelerate as vendors try to remain competitive.
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## IN THIS STUDY

This IDC study explores how business process improvement has evolved from a project-based activity – as exemplified by business process reengineering initiatives – into a contract-based activity – i.e. business transformation outsourcing (BTO) engagements. IDC also sees a shift from functional outsourcing engagements to more integrated cross-functional BPO contracts. Given this evolution, IDC advocates that management consulting skills will be essential in winning horizontal BPO engagements in the future. The study provides vendors with guidance on how to capitalize on this emerging market in Canada.

## SITUATION OVERVIEW

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### CURRENT INDUSTRY DYNAMICS

#### ***BUSINESS PROCESS IMPROVEMENT WITHIN THE ORGANIZATION***

More than ever, organizations in various business sectors are facing a stunning acceleration of technological, societal and business change they can hardly keep up with. Whether one looks at the rate of breakthrough technology inventions, the effects of globalization and deregulation, or the change in consumer preferences, the notion of stability has disappeared for good. As a result, every aspect of a business must become adaptive to change. Top executives have to think harder and faster to make the organization more flexible and agile in a fast-changing and essentially unpredictable world. Currently, tough economic times and leaner profits have forced many companies to focus inward at their business processes to find ways to be more efficient, reduce costs and possibly add more money to the bottom line.

In the past, the common way to embark on changing business processes was to launch initiatives with the help of external management consultants. Consulting firms (such as Accenture and Deloitte Consulting) have been helping clients reengineer business processes for decades on a project-by-project basis. Larger scale changes to multiple business processes are commonly known as business process reengineering (BPR). BPR is defined as "the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service, and speed," according to Hammer and Champy in 1993. (For more information, see *Related Research*). In the past, companies looked at reengineering business processes periodically, but the pace of change is quickening, so the demand for process improvement is increasing and reengineering initiatives are occurring more frequently.

However, the increasing need for process improvement is leading to a change in how suppliers are meeting that demand. Today, instead of engaging with customers on a project-by-project basis, some vendors are offering engagements on a contractual basis, whereby the provider helps redesign business processes and (usually) manages them for the customer in a business process outsourcing arrangement. The combination of process improvement and outsourcing is commonly known as business transformation outsourcing in industry terms, and has been defined by Accenture – an early proponent of this service model – as "a program to transform the way a business works by using outsourcing to achieve a rapid, sustainable, radical improvement in performance across the entire enterprise".

## DEMAND FOR BUSINESS PROCESS IMPROVEMENT

The management challenge to create flexible and agile businesses is not new – those goals led to many business process reengineering efforts by Canadian companies during the 1990s. Business process reengineering became popularized when executives concluded that their firms could not react to changing market needs due to outdated and outmoded business processes. Often many of those business processes were partially, or fully manual and companies envisioned dramatic returns from automating some business processes through information technology. IDC believes the need for ongoing BPR has emerged from:

- ☒ **Continual blurring of technology and business.** With the lines between business and IT continually crossing, it is difficult to find an example of a BPR engagement that has not leveraged IT to some degree. IDC research shows that gaining access to technology through BPR engagements is one of the strongest drivers behind many companies' decisions to work with technology providers. In other words, clients assume that technology is an inherent aspect of any BPR engagement. Providers also realize the potential cost savings that technology can offer to help increase profit margins.
- ☒ **Continued evolution of applications that automate processes.** With the continued evolution and expansion of packaged enterprise applications (e.g. suites from SAP, Oracle, Siebel) that automate business processes, companies are often required to redesign their business processes as the application change.
- ☒ **Continual change in business environment and technology.** Business process reengineering does not happen overnight and some engagements, depending on the scale, could take years to complete. Then, of course, the world changes and technology improves and best practices need to be revisited. Repeating large-scale BPR engagements over time could cost companies millions of dollars, while simultaneously making millions of dollars for the consulting firms. Customers are now realizing that the need to improve upon business processes is more of an on-going process, not a once-off situation.
- ☒ **Renewed customer focus on cost cutting and gaining market share.** Although many BPR engagements are generated out of a need to decrease costs, Canadian businesses are also assessing business functions to determine whether they can provide a meaningful and profitable point of competitive differentiation. If the assessed level of differentiation is minimal, companies may turn to third-party providers to assume operations, improve the service over time, reduce costs and headcount, while removing obstacles to business change. If this trend continues, business and IT consultants will require access to those skills, either in-house or through partnerships.

## SUPPLY FOR BUSINESS PROCESS IMPROVEMENT SERVICES

During BPR's heyday in the 1990s, management consulting firms offered services that assisted customers in their BPR initiatives. Services were typically provided on a time-and-materials basis in separate or multiphase projects. Consulting firms like Accenture, Cap Gemini Ernst & Young and the former PwC Consulting were known for their deep business process and application expertise and acted as trusted advisors for many top tier clients to navigate them through the BPR change process.

Today, BPR still occurs but IDC believes customers are looking for new ways to engage with suppliers for the BPR-related services. IDC's research indicates that there is an increasing shift toward ongoing improvement, wrapped into the form of long-term contractual business process outsourcing (BPO) arrangements. This

renewed inward focus of companies may explain some of the popularity of BPO in the marketplace as of late, as companies strive for ways to become more profitable.

#### **COMING OF AGE – BUSINESS PROCESS OUTSOURCING**

Business process outsourcing appears to be a concept whose time has come in Canada, at least in certain business functions. Business process outsourcing as a business concept is not new, however. The use of external specialists in areas such as finance, accounting and law goes back to the mid-19<sup>th</sup> century, when the Industrial Revolution triggered the concept of labor specialization and companies servicing each other. With the growth of a services economy on top of the industrial economy in recent decades, the number of specialist business service providers has grown dramatically, as has the array of services they provide. Examples include the marketing, accounting, business consulting, IT services and professional training industries.

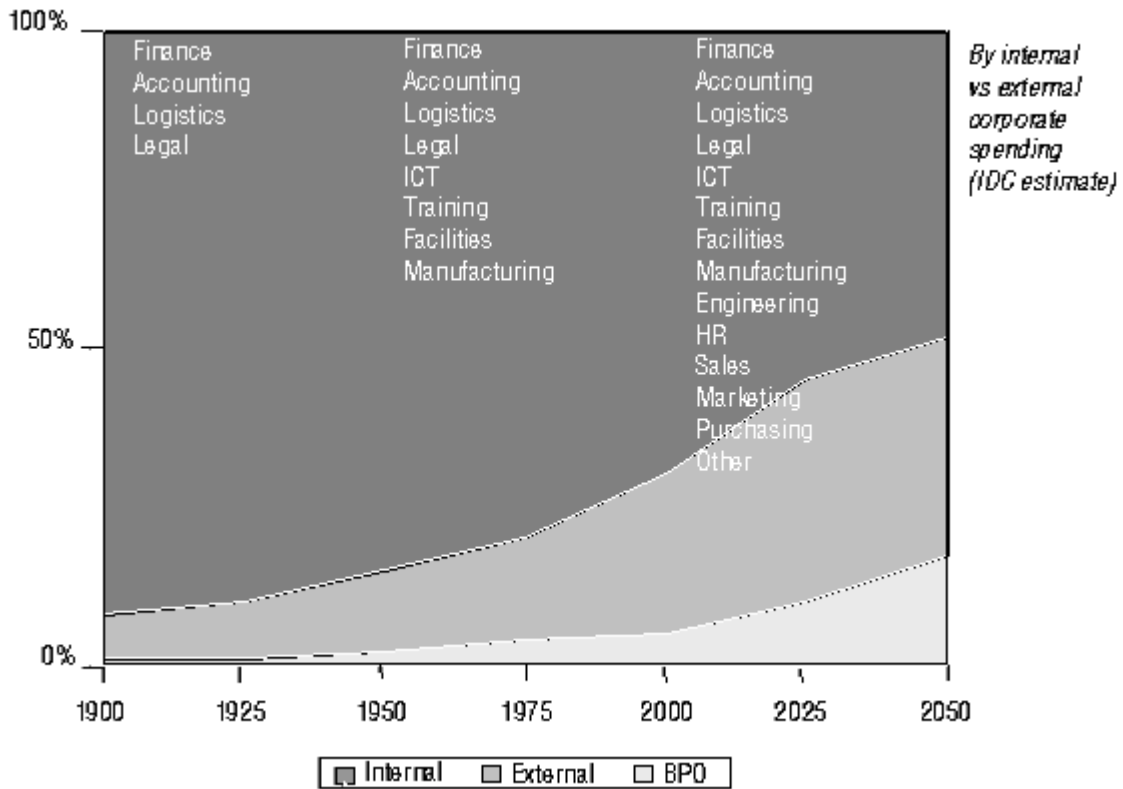
Today, there are specialists that can support companies in almost any corporate function. Many companies in various industries are currently turning to external specialists to help support one or more of their corporate tasks and activities. And companies are becoming wiser in contracting for those services. Nowadays customers are seeking contractual arrangements in which a service provider takes ownership of and responsibility for managing a range of business processes and/or business operational activities. IDC believes this trend to hand over operational responsibility to a service provider will increase due to two common schools of thought present in companies today.

- ☒ First is the rationale of transaction-cost whereby a company weighs the cost of performing a task or activity in-house versus the cost of purchasing it as a service. If the company can lower its costs by sourcing the task externally, then it should do so. Since service providers have the potential to achieve greater economies of scale than individual companies, they should be able to provide a service at a lower cost than an individual company.
- ☒ Second is the rationale of core competencies of the firm whereby a company considers which activities it can yield the greatest value from and impacts the firm's business performance most. Through prioritizing those activities, a company can identify its core competencies, and focus its scarce resources on them, leaving non-core activities to be performed by an external service provider.

IDC believes the combined impact of these two rationales will keep outsourcing high on Canadian corporations' priority lists for years to come (See Figure 1).

**FIGURE 1**

BPO AS PART OF EXTERNAL BUSINESS SERVICES SPENDING ON CORPORATE FUNCTIONS (%)

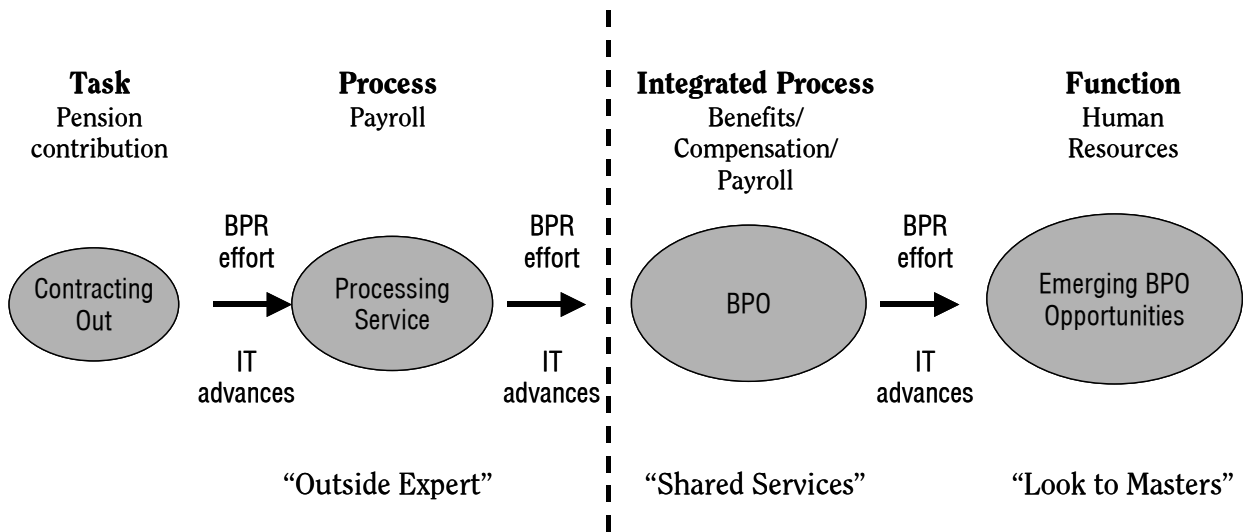


Source: IDC, 2003

Companies have now realized that they do not need to reengineer all business processes or activities. Some activities that were components of business processes being reengineered were outsourced to external providers. In some instances, some common business processes were also outsourced. At each stage, IT facilitated a company's outsourcing initiatives because IT made the coordination and control of outsourced activities and processes simpler. Figure 2 highlights how business process outsourcing evolved to accommodate and support BPR efforts.

**FIGURE 2**

EVOLUTION OF BPO – HUMAN RESOURCE FUNCTION EXAMPLE



Source: IDC Canada, 2003

Using human resources as an example, the earliest examples of outsourcing of business activities typically involved sourcing a well-defined, specialized task to a service provider. Companies questioned whether a task, e.g. calculating pension contributions, cost less performing it in-house or sourcing it externally from a service firm. Since some tasks involved specialized skills, companies routinely determined that purchasing the outcome of the task was cheaper than performing it. This situation was commonly called "contracting out". Outsourcing practitioners and observers consider it to be a form of "in-sourcing" because the responsibility for the business process remained with the company.

Next came examples of business processes being outsourced in the form of processing services. However, the outsourced business processes were narrowly defined and often common across companies. They often also required substantial IT investment that companies preferred to avoid making. Payroll and pension administration are common human resource examples of outsourced business processes. Companies that opted to outsource considered their service providers as the "outside experts", who were able to increase the efficiency of their business processes and lend functional expertise. The decision to outsource was often not only based on lower transaction costs but also based on focusing on core business activities.

Now BPO is evolving further. Canadian businesses are outsourcing integrated business processes and/or complete corporate functional areas. Some customers are outsourcing a collection of integrated business processes, such as employee management that includes payroll, employee benefits administration and pension administration. Other companies are outsourcing complete corporate functions. Customers taking BPO further along its evolution are doing so gain greater benefits from the outsourcing relationship. Customers are recognizing that they can benefit from not only economies of scale but also economies of scope in many areas of their businesses. Many companies have organized into internal shared service models that consolidate various staff departments – those areas whose primary task is provide

advice or service to lines of business – to gain those economies they are seeking. Alternatively, some companies are beginning to look at outsourcing to gain similar benefits, before or after creating internal shared service groups.

Companies choosing BPO as it commonly appears today because providers are willing to provide cost-effective services while accepting accountability and sharing risk in ensuring that its services are delivering measured benefits to customers. Often there is a level of technological investment required that is beyond the means of the customer but the provider has made that can be leveraged. Companies choosing BPO in this form are still considering BPO in tactical terms – i.e. the benefits of using an external provider are greater than performing the tasks internally.

However, some leading companies are choosing to consider BPO strategically and often involves, but does not require, the complete corporate function. Those customers are seeing BPO as a means of achieving competitive advantage through partnering with the best service providers. Instead of worrying about purchasing services, the customer "looks to masters" and partners for the services it needs. The relationship changes from a customer/supplier relationship to one that sees the partner as an extension of the customer's organization. BPO engagements of this ilk help align the goals of the partners because payment is often structured such that most, or all, of the provider's compensation is variable and tied to various business metrics the customer measures.

In BPO or function outsourcing, there are various examples of structuring and governing the outsourcing relationship and, currently, there is no clear model that identifies whether the relationship is tactical or strategic. And the lines are finely drawn between tactical and strategic, depending if the customer's or the provider's viewpoint of the relationship is taken. Ultimately, IDC considers the intent behind the customer's decision.

#### BUSINESS TRANSFORMATION OUTSOURCING: FACILITATING EMERGING FORMS OF BPO

Customer adoption of emerging forms of BPO (highlighted in Figure 2) is being spurred in part by business transformation outsourcing (BTO) discussed earlier in this study. Customers are adopting services at various points in the evolutionary spectrum, but often customers considering outsourcing integrated processes or corporate functions are unable to do so because their systems infrastructure, application portfolios and business processes are cobbled together in a manner that prevents outsourcing. In those circumstances, providers experienced in BPR initiatives have an opportunity to offer BTO services to lead customers to their desired state. In these situations, firms with management consulting expertise, like IBM Global Services and CGE&Y, enter into engagements with the plan of managing the customer's business processes after reengineering and improving them. (Referring back to Figure 2, BTO impacts the BPO spectrum to the right of the dashed line.)

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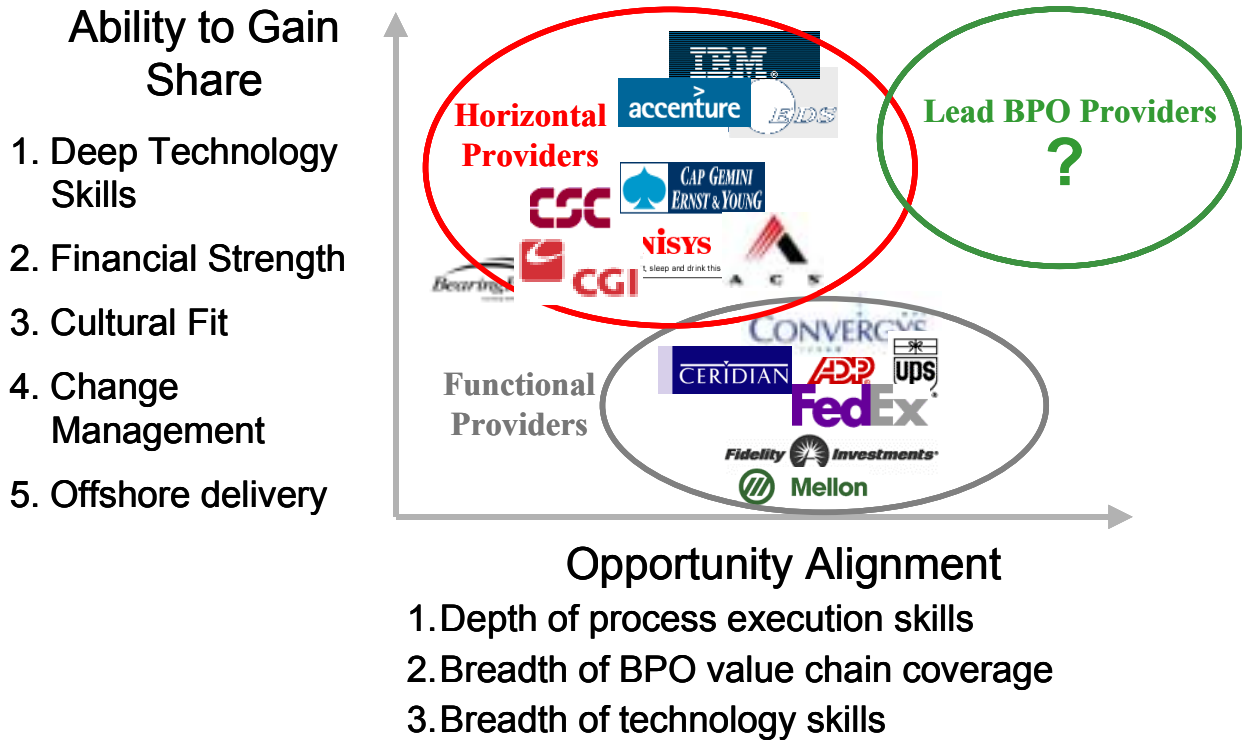
#### COMPETITIVE ASSESSMENT

There are many vendors vying to increase their revenue and profits through tapping into the growth in spending on BPO and they can generally be categorized into horizontal or functional camps. Figure 3 highlights the breadth of functional areas within corporations that are now being outsourced. Often each functional area is a separate BPO market with a different set of suppliers than other markets. Consequently there are dozens of vendors competing in the overall Canadian BPO market. Yet regardless of the market segment, most competitors can be classified as either horizontal (i.e. cross-functional) or functional based on their market positioning. Horizontal BPO suppliers approach the market by offering integrated BPO services that can span several corporate functions. These firms are fewer in number and most

of them have heritages in providing IT services. Functional BPO providers approach the market by offering specialized services aligned with a specific corporate function.

**FIGURE 3**

PRELIMINARY GLOBAL BPO LEADERSHIP GRID



Source: IDC, 2003

IDC's preliminary global BPO vendor leadership grid conveys IDC's opinion about suppliers' relative position in the global BPO industry. It also depicts how IDC classifies each vendor (horizontal or functional). IDC's leadership grid is a two-dimensional graphical tool, measuring how suppliers' offerings match the present market opportunity and projecting how suppliers are positioned to increase market share in the future.

Given the factors required to gain market share and opportunity alignment, IDC believes that business consulting skills are a seminal factor in the horizontal or functional providers' ability to compete in the BPO market. Specifically, we see change management and process consulting as key skills to possess to address this trend.

**CHANGE MANAGEMENT IS KEY FOR HORIZONTAL PROVIDERS**

Change management skills are vital for cross-functional providers offering BPO services because integrated business processes across corporate functions are typically more complex and require greater change than more narrowly scoped BPO engagements. The information flow and BPR that usually accompanies BPO

engagements are more intricate and complex when several or many business processes are being redesigned. And since there are multiple business processes being changed there are often more human touch points with the redesigned processes, that may require some behavioral change as well. The net result is that possessing capabilities in managing change is crucial in cross-functional BPO engagements or complete business function outsourcing.

Developing change management skills is not a trivial task and typically requires a long track record of major implementations of large enterprise-wide business support systems, project management expertise, as well as personnel coaching and development experience. The third aspect – personnel development – can be a key success factor in those BPO engagements, when employees are transferred from the customer to the provider. The provider's ability to adapt its corporate culture to the transferred employees and vice versa can signal disaster or success for the BPO engagement.

Firms like Accenture, Cap Gemini Ernst & Young, EDS (AT Kearney), IBM (through PwC Consulting acquisition), and others have developed change management skills through their management consulting practices. These practices provide consulting services for their customers' executive management in areas such as business strategy, corporate governance, organizational structure, mergers/acquisitions and new product development. Staff is hired for business acumen, not technical expertise. Change management skills are developed because many of those services management consultants provide are felt at many levels of customer organizations and the consultants are often called upon to help manage the change they're introducing to their clients.

#### ***PROCESS CONSULTING IS CRITICAL FOR FUNCTIONAL PROVIDERS***

Process consulting is critical for functional BPO providers because customers select them for their specific expertise, and their ability to introduce best practices to clients. That expertise and ability to bring it to clients, means that functional BPO providers need to have business consulting capabilities too. That requirement may have not always been so, particularly in the earliest days of BPO, when customers only "contracted out" (as illustrated in Figure 2), but as customers turned to "outside experts" more often, suppliers increasingly needed to consult with customers. Even today, few firms developed specific consulting groups, instead many customer-facing staff from the provider are expected to act as consultants to clients. Often the 'consulting' work goes uncharged and is considered a cost of sale, or embedded in the existing service fees. An example of such a provider is UPS Logistics. UPS Logistics provides some consulting services on how customers can improve their logistics processes, but the company typically includes that expertise in its BPO engagements. And unlike some functional BPO providers, UPS Logistics does have a small consulting group that supports customer engagements.

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#### **MARKET STRATEGIES**

IDC's opinion that functional BPO providers offer services that better match the current market demand but horizontal providers are positioned better to increase market share as the BPO market continues to evolve is supported in Figure 3. One of the underlying reasons for IDC's position is the management consulting practices that many horizontal BPO providers possess. The consulting practices grow over a long time period, usually with longstanding clients. Those long term customer relationships often elevate the management consulting firms into a "trusted advisor" position, which gives the providers an ability to exert a substantial degree of control over those accounts when considering outsourcing business processes and corporate functions.

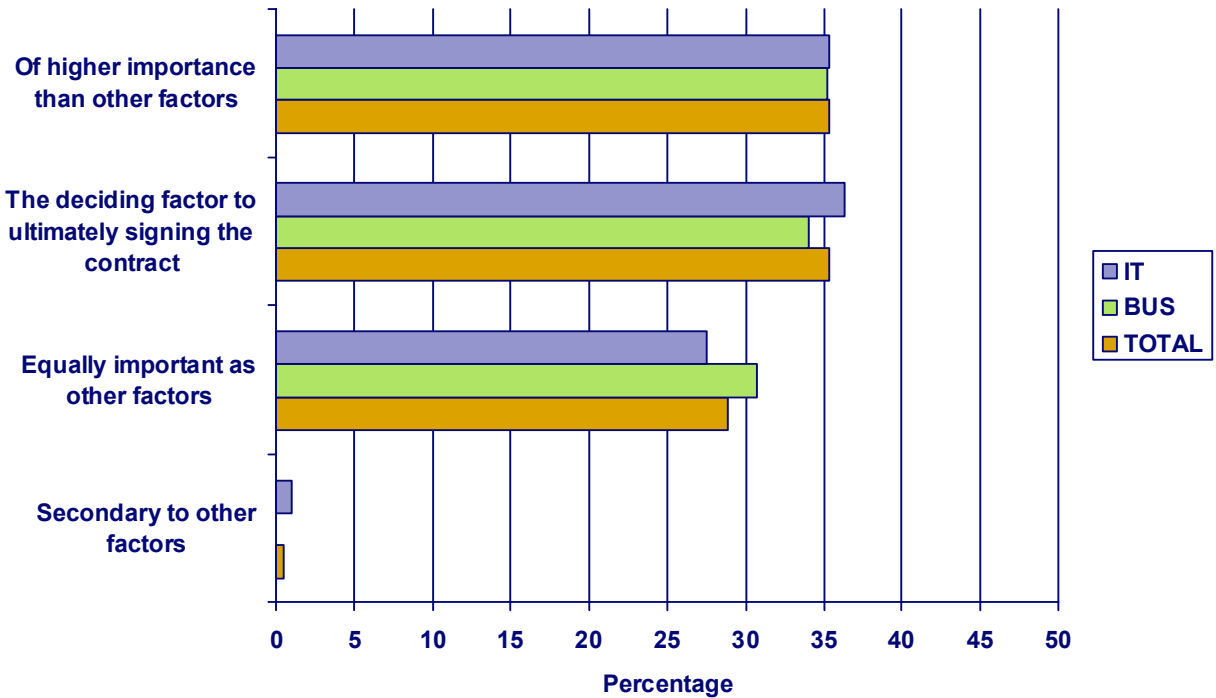
**THE IMPORTANCE OF TRUST**

IDC Canada recently explored the issue of trust in our Q1iPanel survey. IDC asked 190 respondents (from medium and large sized organizations) how important trust was when considering an outsourcing engagement. As Figure 4 illustrates, trust between a vendor and a client is an extremely important consideration, if not the most important consideration, when considering an outsourcing engagement.

**FIGURE 4**

IMPORTANCE OF TRUST

*How important a consideration is trust between customer and outsourcer?*



N=190.

Source: IDC Canada, Q1iPanel Survey, 2003.

Approximately 35% of the total sample said that trust was the deciding factor to ultimately signing the outsourcing deal, while the same percentage said it was of higher importance than the other factors (but not the deciding factor). Another 30% said trust was of equal importance to the other consideration factors, while only a miniscule proportion of respondents felt that trust was secondary to other factors. Also of note is the fact that no one felt that trust was a relatively unimportant consideration.

**STRATEGIC TRUST: INTEGRATED BPO ENGAGEMENTS**

IDC believes that some firms are using their position as trusted advisors to their advantage by steering customers towards more comprehensive, integrated BPO engagements. Advising customers to think strategically about BPO, firms are able to stickhandle BPO decisions beyond the reach of functional BPO providers, who often

have broader service offerings and superior process execution skills and, therefore, better aligned with the present market opportunity that many horizontal BPO providers. The story can be compelling because it emphasizes the greater benefits that can be achieved through the combined effect of leveraging economies of scale and economies of scope. And IDC sees some horizontal BPO providers as successful storytellers because it must be told to a company's executive management – especially the chief executive officer – where most BPO decisions are made and where those providers' management consulting practices have established relationships. In fact, IDC Canada research from early 2003 indicates that the chief executive officers (CEOs) take more prominent roles in BPO decisions when compared to IT outsourcing decisions. More than 45 per cent of survey respondents suggest that CEOs are the most influential decision maker in BPO decisions but only 29 per cent of respondents say CEOs are most influential in IT outsourcing decisions. Furthermore, 51 per cent of respondents suggest that CEOs are the final decision maker in BPO decisions but only 26 per cent say that CEOs are the final decision maker in IT outsourcing decisions. Clearly those vendors with the ear of the chief executive officer, as well as other c-level executives, will have a leg-up when trying to convince companies to think strategically about BPO and to increase the scope of a potential BPO engagement.

## **FUTURE OUTLOOK**

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### **INDUSTRY IMPACT**

Business consulting is inextricably linked with the BPO industry but its impact on the industry's direction is only beginning to emerge. Business consulting will impact functional and horizontal spending on BPO services. It will also foster the growth of a new type of service provider, one that will reshape the competitive landscape in Canada and abroad. And due to the need to provision business consulting, IDC predicts that the industry servicing the BPO market will increasingly consolidate as vendors try to remain competitive. At the same time, IDC believes that, as more companies adopt BPO, aspects of the traditional management consulting market will also see fundamental change.

#### ***SPENDING WILL CHANGE – GROWTH IN "TRUE" BPO***

Current market demand for BPO services is for traditional BPO services, which involves some specialized business consulting services, but future demand will increasingly shift to emerging forms of BPO. In most areas, BPO spending involves single tasks or processes as highlighted in Figure 2. IDC believes that this will continue to be so throughout this decade. However, IDC predicts that spending on emerging forms of BPO, such as outsourcing of complete corporate functions, will grow more rapidly. The impact of this trend will be that horizontal BPO providers may be better suited to compete by offering services that meet customer needs when outsourcing integrated business processes or even across corporate functions.

For example, when Hydro One wanted to outsource various back-office and front-office activities, it chose Cap Gemini Ernst & Young as its service provider because the company had the knowledge and expertise to handle several areas, including: customer care, logistics, finance and accounting, and others. Similarly, when BC Hydro was considering outsourcing its information technology, customer care and fleet management operations, it requested tenders from vendors willing to supply services to one, two or all of those areas. Accenture eventually won the business with its cross-functional bid. (Please refer to the *Key Industry Announcements* in the *Learn More* section of this document for more information).

The shift in spending from functional to horizontal will be considerable. For example in human resources, IDC estimates that the Canadian market size for emerging BPO services amounted to roughly C\$310 million in 2002, whereas spending on processing services amounted to C\$1.4 billion last year. However, IDC forecasts that BPO will grow at a compound annual growth rate (CAGR) of 17% until 2007, resulting in approximately C\$690 million in spending. IDC predicts growth in human resources BPO spending will more than double that of human resource processing services, which IDC estimates will grow at slightly more than 7% CAGR until 2007.

IDC believes the shift in BPO spending will result from more companies subscribing to the "core competencies" school of thought presented earlier in this study. Although IDC believes the "transaction cost" justification will continue to be relevant in future years, it will likely not be paramount among factors causing companies to outsource BPO. A recent study by IDC found that, even during uncertainty facing many businesses today, cost is not the most important driver for outsourcing among Canadian executives. Furthermore, executives from Canada's largest companies identified the ability to focus on their core business as the biggest benefit from outsourcing – including more than 47 per cent of executives from companies with revenues exceed C\$1 billion annually.

Yet the shift in BPO spending that IDC predicts will not occur without the impact of business consulting, specifically change management consulting. Emerging forms of BPO involve more change and more complexity than traditional forms of BPO; as such, successful BPO providers will need to help guide customers through that change process. If they do not, or cannot, then IDC foresees that early adopters of newer forms of BPO may have unworkable arrangements with suppliers and unsuccessful engagements. If this occurs, companies waiting to see how their peers' fare may choose to purchase traditional forms of BPO or perform the service internally because the cost and aggravation may turn out to be less than following the path of their peers.

#### ***LEAD BPO PROVIDERS EMERGE TO ALTER COMPETITIVE LANDSCAPE***

In other regions, including the United States, IDC has watched a new type of BPO service providers emerge – one that should reshape the industry. The lead BPO provider (LBP) role is emerging; the LBP's role, whose purpose is to serve as the primary relationship holder in a BPO engagement, meaning that, ultimately, it is solely responsible for delivering on the terms of the contract with the customer. IDC believes the LBP must have the ability to integrate the work of multiple partners to service the needs of the customer.

The LBP role was identified several years ago in the logistics market, where several providers started aggregating services from "third party logistics providers" in areas such as warehousing, fulfillment, transportation management and others. Instead of investing in costly infrastructure, the new LBPs partnered with other vendors to offer a full BPO offering. Accenture termed this new role in the logistics industry as a "4PL" or fourth party logistics provider. IDC thinks the success LBPs have seen in the logistics market will carry over to the other BPO markets too, since it has been a means of more closely aligning the customer's and the provider's business goals. It can also make the financial and other business metrics more visible since the customer only has to measure the performance of a single provider.

The leadership that Accenture displayed in helping shape the LBP role in logistics suggests the relevance of business consulting, specifically technology and operations strategy consulting, in creating this role in other BPO segments. LBPs will need to become "market makers" to make the role viable. They will need to convince customers that there is value in paying for a 'middleman' when purchasing BPO services. Successful LBPs will likely need the means of providing technology and

operations strategy consulting to structure BPO engagements that appear seamless to the customer. To create a seamless customer arrangement, the LBP may need to redesign some of its operations, or that of its client, to meet the needs of the customer. And if the LBP does not have proprietary management consulting capabilities, it will likely need to partner for them. (For more information on the LBP role, see IDC#VPW000168 In the *Related Research* section of this study.)

#### **INDUSTRY CONSOLIDATION WILL ACCELERATE**

IDC predicts that, due to the impact of spending growth in broader scope BPO and the emergence of the LBP to help satisfy the needs of the market, industry consolidation in the BPO market will accelerate, in part to bolster business-consulting skills. Already, the market has watched firms like CGI acquire insurance industry expertise to augment some of its BPO offerings. In addition to offering cross-functional BPO services, such as human resources and finance and accounting, CGI is offering vertical specific BPO services, such as in property and casualty insurance. CGI acquired Underwriters Adjustment Bureau (UAB) Ltd., in January 2003, to increase the amount of business domain expertise it possessed in its BPO business unit. Acquiring UAB improves its ability to offer a complete BPO service to property and casualty insurance companies.

It is unlikely that functional BPO providers like ADP and FedEx Logistics will develop or acquire change management expertise to provide through (formal or informal) internal consulting groups. If any of these firms decide to be a LBP, then they may acquire some of those capabilities. However, it is more likely that they will venture into partnering relationships to obtain additional business consulting skills they might need. For example, Fidelity Employer Services and IBM formed a partnership to jointly market HR payroll and benefits outsourcing services in the United States. From Fidelity's perspective, this relationship leverages IBM's change management strength and entrenched customer relationships. From IBM's perspective, the relationship allows it to offer best-of-breed HR outsourcing services to customers without developing those capabilities internally. The result is that Fidelity can behave like a LBP without possessing all necessary components. (For more details on the IBM and Fidelity relationship, see the *Key Industry Announcements* section.)

## **ESSENTIAL GUIDANCE**

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### **ACTIONS TO CONSIDER**

The boundaries of the corporation are changing, in part, due to outsourcing. The success seen by companies who have outsourced their information systems departments is leading to more companies to adopt BPO. Although not new, BPO is evolving to meet customer demand for a broader service offering than traditionally supplied to the market. Due to the emerging market opportunity and the slowing growth in IT outsourcing, new vendors are entering the BPO market. IDC observes that vendors in the BPO market are gravitating around two provider categories: horizontal and functional. Looking forward, IDC offers the following thoughts and recommendations on how horizontal and functional providers can adapt to the evolution of the BPO market to remain successful in the future.

#### **RECOMMENDATIONS FOR HORIZONTAL PROVIDERS**

IDC offers the following advice for horizontal providers, such as IBM Global Services, CGI, EDS, Accenture and others (highlighted in Figure 3).

## DEVELOP MARKET FOR LEAD BPO PROVIDERS – MIGRATE THE NOTION OF VALUE FOR BPO

IDC believes horizontal (or cross-functional) providers are currently better positioned to gain market share in the BPO market because their established management consulting practices place them in positions of trust for many companies. Yet IDC's opinion is predicated on the assumption that the BPO market opportunity will shift from its current form – i.e. processing services and select business processes – to one that involves broader, integrated business processes, and even complete corporate functions, being outsourced. To be sure, the current leading providers in various BPO segments will want to prevent this scenario as it may make them less significant in the market.

Horizontal providers must change the rules of the game in the industry by developing the market for lead BPO providers (LBPs). Although not synonymous, horizontal providers and LBPs are similar and many horizontal providers, (e.g. Accenture and Cap Gemini Ernst & Young), are pushing into the LBP role because they do not possess all the process execution capabilities some competitors do – nor do they want to obtain those capabilities. Through creating a market for LBPs, those horizontal providers will be able to grow their businesses in a manner that requires lower capital investment and plays to their strengths in terms of structuring and managing alliances.

The emergence of the LBP role, as one that is valued by customers, represents a migration from the current notion of value in the BPO market. Today, customers value process execution expertise, technical skills and breadth of service, but the LBPs may have none of these strengths. Instead, LBPs primary value is relationship management. The LBP's strength in managing relationships is important in managing the client's expectations and needs, and in managing service delivery from potentially, multiple suppliers. For a customer to value the LBP role the vendor must have superior skills to manage complexity and change than the customer does – and those skills must be a core competency of the vendor, (i.e. a strength that is part of its DNA and not one that might disappear). Although there are signs that customers' notion of value in BPO services is migrating now, IDC recommends that firms aspiring to be LBPs accelerate the value migration by educating customers of the importance of having a primary vendor who gives them the total solution and manages the solution on behalf of the customer. IDC also recommends that aspiring LBPs should emphasize the following aspects of customer service to accelerate the predicted value migration:

- Personalization of service
- Responsive to customer needs
- Expert advice in managing multiple suppliers and aligning their individual goals with the goals of the customer
- Flawless performance of SLAs that meet the unique needs of the customer

## GET INTIMATE WITH CUSTOMERS: KNOW CUSTOMERS BETTER THAN THEY DO

Inherent to the role that sees a single vendor managing multiple supplier relationships for the customer, is a thorough understanding of the customer's requirements and future direction. The LBP has to be able to tailor a solution, involving various services from different suppliers, for the specific needs of each customer. This can be challenging because different suppliers will be trying to standardize their services to

maximize their profit through leveraging economies of scale. To be a successful LBP, IDC recommends that BPO providers:

- ☒ Invest in customer research and information systems that can seamlessly integrate information and applications from various suppliers
- ☒ Download decision-making authority and responsibility to employees who are closest to the customer
- ☒ Build an organizational culture that focuses on customer service and satisfaction that results in greater customer loyalty and retention

#### ACQUIRE SKILLS THAT CAN BECOME CORE COMPETENCIES AND PARTNER FOR OTHERS

Companies cannot be the best in everything they do, nor can they afford to do everything themselves. As such, IDC recommends horizontal providers should consider what core strengths they have and obtain skills that complement them, through acquisition or growing them organically. Vendors should look to partner with best-of-breed providers for other services. In the case of CGI, they acquired property and casualty (P&C) insurance claims management and underwriting expertise through UAB because it was fundamental to providing a vertical P&C insurance BPO offering. Although CGI's offering is targeted at a particular industry, IDC stills views it as a horizontal offering because it does not involve a specific corporate function.

#### SELL HORIZONTAL MESSAGE AT C-LEVEL

IDC believes that horizontal providers, and LBPs in particular, have to sell their messages to c-level executives since they influence and make BPO decisions. Just like when convincing executives to outsource their information systems departments, selling the notion of focusing on core competencies and higher value BPO services requires vendors sell to c-level executives. Try using a continual business process improvement message to c-levels rather than the BPO nomenclature.

#### **RECOMMENDATIONS FOR FUNCTIONAL PROVIDERS**

IDC offers the following advice for functional providers, such as Convergys, ADP and UPS Logistics and others (highlighted in Figure 3).

#### GO-TO-MARKET CROSSROAD: DIRECT OR INDIRECT

IDC recommends that functional providers prepare for the emerging BPO market through developing partnering skills to compete with LBPs. Many functional providers have grown their businesses largely through direct sales models but that approach may not be suitable in the emerging BPO market. If the LBP role develops as predicted by IDC, then functional BPO providers could easily be squeezed out of dealing with consumers of their services. In this scenario, the LBP is the client for the functional BPO provider since the LBP will manage the customer relationship. In the event of the LBP role emerging, IDC believes the functional provider needs to have partner management skills on par to those possessed by systems integrators and other IT providers. Specifically, IDC recommends functional BPO providers consider the following go-to-market actions:

- ☒ **Recruit top sales staff from systems integrators.** The skills required to sell large system integration projects are the same skills needed to sell BPO. With many system integrators experiencing a challenging market, top sales resources may be falling short of their income expectations. As a result of this situation, some of them may be looking for a new challenge in a growing market like BPO.

- ☒ **Hire partnership managers with experience in information technology.** One casualty in the IT industry is the role of alliance manager, due to slowing market growth in the industry during the past several years. Many technology providers had created large alliance management organizations to foster rapid growth. But these organizations added to the company selling and marketing costs so as market growth slowed, the organizations have been downsized or eliminated. This provides an opportunity for functional BPO providers to hire experienced partner managers from an industry that they will increasingly leverage in the emerging BPO market.

#### FOCUS ON OPERATIONAL EXCELLENCE OR PRODUCT LEADERSHIP

As the emerging BPO market dawns, IDC recommends that functional BPO providers choose a strategic focus on operational excellence or product leadership, since it will be overly challenging to do both. In the event that the LBP role becomes a reality in the BPO market, many functional BPO providers will find their traditional end-user clients engaging with LBPs to manage their outsourcing arrangements, circumventing their client/supplier relationship. The implication of that scenario is that functional BPO providers will sell to LBPs not consumers of their services. The LBP may value functional BPO providers' services differently than they saw in the past. In some instances, the LBP will value a best-of-breed functional BPO provider – one that offers the best service offering albeit potentially at higher cost. In other instances, the LBP will value a low-cost provider. Since few companies can offer low cost yet high value services continuously, IDC recommends that the functional BPO provider consider choosing strategically between being a low cost provider or a best-of-breed provider. In choosing those strategic options, IDC recommends that the company consider which operating model best suits its capabilities and objectives:

- ☒ **Operational Excellence.** The operating model needed here is one that optimizes and streamlines production and delivery processes to eliminate costs. Operations must be standardized, volume-based and simplified. Specialize in a particular business process – the market wants experts and that means a narrow focus. Firms considering this model should consider the utility-based service delivery model and consider becoming the business service provider (BSP) type of BPO provider.
- ☒ **Product Leadership.** The operating model needed here is one that fosters new services through research and development. Operations may be required to be decentralized and processes (i.e. management and delivery) must be flexible to allow rapid introduction of new services. Firms considering this model should consider investing in process consulting, business consulting and change management skills – to ensure clients get maximum value from BPO engagement. Partnering with consulting firms for business consulting skills is likely the best option for broader business expertise.

## LEARN MORE

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### RELATED RESEARCH

- ☒ *Customer Demand for Solution Services and Business Process Outsourcing* (IDC #29464, May 2003)
- ☒ *Lead BPO Providers: Altering the Dynamics of the BPO Competitive Landscape* (IDC #VWP000168, May 2003)
- ☒ *The Evolution of HR Outsourcing Services: The Impact of New Entrants and Changing Alliances on Building a Successful Competitive Strategy* (IDC #28414, December 2002)
- ☒ *'IT-enabled' BPO: Is There Any Other Kind?* (IDC #VPW000151, January 2003)
- ☒ *Exult Acquires PwC's International BPO Operations* (IDC #29590, June 2003)
- ☒ *Convergys Acquires Avaya Global Employee Service Operations* (IDC #29589, June 2003)
- ☒ *BPO Adoption Patterns and Buying Intentions: IDC's 2003 BPO Survey* (IDC #BP01K, January 2003)
- ☒ *The Emergence of BPO in Canada: New Sourcing Strategies* (IDC #CA041ASJ, December 2002)
- ☒ *Canadian Business Outsourcing Services Forecast, 2003-2007* (IDC #CA052ASK, April 2003)
- ☒ *Hewitt Associates Acquires Cyborg Worldwide to Enter Payroll Market and Expand Its HR Outsourcing and BPO Services* (IDC #29705, June 2003)
- ☒ *IT Solution Priorities – Canadian CEO Viewpoints* (IDC #600CIK, January 2003)
- ☒ *Canadian Consulting & Integration Services Forecast, 2003 – 2007* (IDC #CA605CIK, March 2003)
- ☒ *Reengineering the Corporation*, Michael Hammer & James Champy, 1993.

### KEY INDUSTRY ANNOUNCEMENTS

- ☒ ADP Brokerage Services signed an agreement to acquire Dataphile Software, a provider of straight-through-processing solutions for the financial services industry, in May 2003. The acquisition will introduce additional solutions to ADP's BPO offerings.
- ☒ BC Hydro and Accenture signed an agreement in February 2003 that sees Accenture manage BC Hydro's customer service, IT, network computing services, human resources, financial systems, purchasing and facilities management. The 10-year contract is valued at approximately C\$1.45 billion and transferred more than 1,500 employees to Accenture.
- ☒ CGI acquired Underwriters Adjustment Bureau Ltd., a provider of claims management, underwriting and actuarial services to the property & casualty insurance industry, in January 2003 for C\$53 million. Approximately 1,300

employees join CGI and the deal is expected to contribute approximately C\$100 million in annual revenues to CGI's Business Process Services unit.

- ☒ IBM acquired PwC Consulting for U.S.\$3.5 billion in October 2002. PwC Consulting was merged into the renamed Business Consulting Services group, comprising 30,000 IBM consultants and 30,000 transferring PwC Consulting employees, within IBM Global Services. The acquisition enhances IBM Global Services' ability to bring business process expertise to its outsourcing customers.
- ☒ Hydro One Inc. and Cap Gemini Ernst & Young (CGEY) Canada Inc., signed an agreement in February 2002 that results in CGEY managing and operating existing business processes and technology enabled services for Hydro One. The 10-year agreement is valued at approximately C\$1 billion and transferred more than 900 employees from Hydro One to Inergi, a subsidiary of CGEY.
- ☒ EDS announced a seven-year contract in October 2002 with Aon Corp.'s HR outsourcing group. Under the terms of the agreement, EDS will engineer and implement the systems architecture to provide the HR computing environment and other IT support for Aon.
- ☒ In July 2002, Fidelity Investments and IBM announced an agreement where IBM will outsource to Fidelity Employer Services Company (FESCO) the administration and of its pension, health and welfare plans along with other HR services. As part of the agreement, approximately 450 IBM employees who provide HR transaction and administration support to IBM U.S. employees and retirees will transfer to FESCO. Fidelity plans leverage this transaction to expand its HR payroll and benefits outsourcing business. In a related agreement, IBM Global Services and Fidelity formed a relationship to market HR payroll and benefits outsourcing services.

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