



The untapped market for offshore services

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Business processes and traditionally outsourced—but not offshored—IT services will be the main drivers of offshoring growth in the near future.

The global market for offshored IT services and business processes has nearly tripled since 2001. However, a study finds that service providers have so far captured only 10 percent of a \$300 billion opportunity. Over the next five years, the market will grow by an additional \$80 billion.

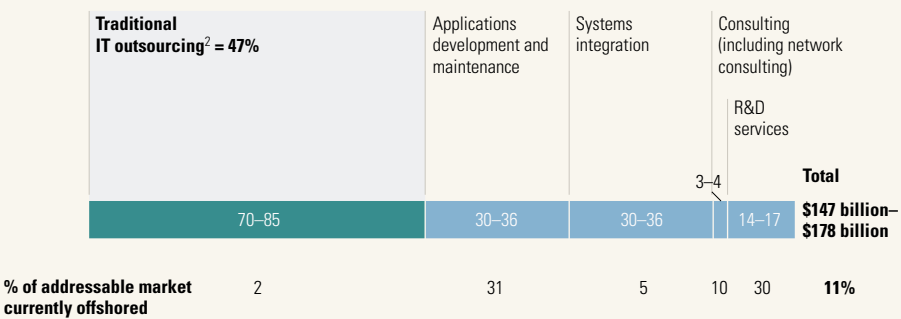
Our study, which includes a comprehensive analysis of the addressable market for offshoring, also highlights ways in which

this market may yet evolve.¹ It found that the drivers of future growth are likely to shift somewhat in IT-outsourcing services but will remain largely the same in business processes. Despite a significant slowdown in IT spending, the global offshoring market for IT services has grown by 21 percent a year since 2001. To date, this growth has come largely from applications development and maintenance and from R&D services—segments where we estimate that

EXHIBIT I

IT services offshoring is growing fast

Estimated addressable market in global offshore IT industry,¹ 2005, \$ billion



¹Addressable market determined according to spending in developed countries, factors affecting offshoring (eg, labor intensity, business risk, complexity of interactions), and estimated offshore cost savings for individual activities; includes United States, Europe (EU member countries, Switzerland, Norway), and Japan; analysis takes into account internal and external spending.

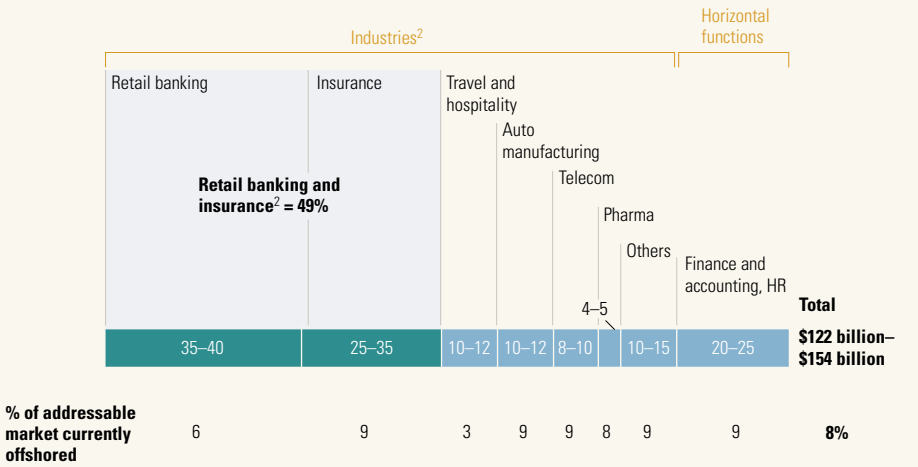
²Includes hardware/software maintenance, network administration, help desk services.

Source: Gartner; IDC; Nasscom Strategic Review 2005; McKinsey Global Institute; McKinsey analysis

EXHIBIT 2

Business process offshoring is growing even faster

Estimated addressable market in global offshoring of business processes,¹ 2005, \$ billion



¹ Addressable market determined according to spending in developed countries, factors affecting offshoring (eg, labor intensity, business risk, complexity of interactions), and estimated offshore cost savings for individual activities; includes United States, Europe (EU member countries, Switzerland, Norway), and Japan; analysis takes into account internal and external spending.
² Includes call centers, procurement opportunities.

Source: Gartner; IDC; *Nasscom Strategic Review 2005*; McKinsey Global Institute; McKinsey analysis

offshoring has reached about 30 percent of its potential. In R&D, new growth opportunities are opening up in increasingly advanced services. The John F. Welch Technology Centre, in Bangalore, for example, is conducting R&D in technologies such as propulsion systems for aircraft engines and in this way contributing significantly to the design of GE's latest jet engine. Nevertheless, our analysis suggests that, during the next five years, more traditionally outsourced—though not offshored—IT services, such as hardware and software maintenance, network administration, and help desk services, will account for 47 percent of the addressable market for offshored IT services (Exhibit 1).²

The global market for business process offshoring has grown by 49 percent a year since 2001 and appears likely to continue

outpacing the market for offshored IT services. Banking and insurance account for nearly half of the addressable business process market, but companies have captured less than 10 percent of it thus far (Exhibit 2). In the next five years, the lion's share of growth is likely to come from these two industries: there are opportunities worth \$23 billion to \$25 billion, for example, in the offshoring of retail-banking activities associated with deposits and lending, \$9 billion to \$11 billion in credit card processing, and \$3 billion to \$4 billion in mortgage processing. Among cross-industry functions, human resources (HR) and finance and accounting appear set to fuel growth.

While the global addressable market for offshoring is a stunning \$300 billion, the pace of adoption will be shaped by the interplay of three forces: supply (the

EXHIBIT 3

Expanding the market through innovation

Potential benefits through global offshoring of business processes for major pharmaceutical company,¹ \$ billion



Innovative services

Avoid slippage

- Improve compliance, quality of trial data by using doctors/nurses to manage protocols/case reports

Increase capacity

- Offshore development of products below \$1 billion net present value

Enhance analytics

- Expand analyst support to include smaller geographies and brands

Improve decision making

- Add offshore management information systems (MIS), analytical support to identify emerging trends faster

Increase monitoring, control

- Reduce unnecessary payments to contract research organizations (CROs) through offshore monitoring of CRO charges
- Follow up with patients to ensure compliance (eg, that patients actually take their medications), which is particularly important in expensive, long-term therapies

¹Estimates based on typical US pharmaceutical company with \$10 billion in revenues.

capacity and quality of offshore locations), demand (the rate at which companies adopt offshoring), and the actions of industry players. We built a model to study this interplay and to evaluate various scenarios for different industries. Our analysis indicates that approximately 35 percent of the work that could potentially be offshored, worth \$110 billion and divided equally between IT services and business processes, actually will be offshored by 2010. We believe that India’s offshoring industry, which has captured two-thirds of the current global market for offshored IT services and almost half of the global market for offshored business processes, can maintain its leadership position. But to do so the industry, together with India’s central and state governments, must address a few key issues, such as bridging a potential shortfall of nearly half a million qualified workers and improving the country’s infrastructure.

The potential expansion of the markets that offshoring can address—say, through new models that go beyond the simple replication of onshore activities—is hard to forecast, since precedents are few and the potential varies greatly among industries. Still, companies can start by looking for ways in which offshoring would allow them to increase their revenues, to avoid or reduce costs, and to improve their utilization of capital.

One leading US bank, for instance, saved \$100 million by using offshore staff to detect fraud in low-value transactions that could not be scrutinized profitably onshore. Lower processing costs have even allowed banks to create new products, such as subprime lending to previously unviable customer segments. As for the pharmaceutical industry, it could double the value it creates from offshoring (Exhibit 3), through new or redesigned processes and services that

would improve compliance and the quality of its trial data, enhance its analytical capabilities, and help it develop products for consumer microsegments.

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¹The study—*Extending India's Leadership in the Global IT and BPO Industries*, published in December 2005—was conducted jointly by India's National Association of Software and Service Companies (Nasscom) and McKinsey, and is available for purchase at www.nasscom.org/publications.asp. The markets discussed in this article are those we consider "addressable," meaning that they can be served using a delivery model based primarily on offshore work. (Indian IT companies typically perform 25 to 30 percent of their work in the client's country and the rest offshore.) Our market estimates are limited to industries that are currently offshoring on a significant scale.

²The size of the addressable offshore IT market was determined using a three-step methodology. First, we examined spending on IT services in developed countries. Then, in a detailed analysis involving primary as well as secondary research, we applied to each service the six key factors (including labor intensity, business risk, and the complexity of interactions) that affect the decision to offshore tasks. Finally, we estimated the offshore cost savings for individual activities.