

The Top Outsourcing Events of 2006 and What They Mean for 2007

By Beth Ellyn Rosenthal, Editor



Yisrael Dancziger, CEO of [Digital Fuel](#), sees 2006 as the end of the honeymoon period for outsourcing. "Now that buyers and suppliers are married, they have to figure out how to make this relationship work," he says. He sees the major events of 2006 through that prism: Suppliers tried to figure out how to become profitable and buyers strove to gain the true business value they needed.

1. The GM Outsourcing Deal

EDS's 10-year systems-integration services contract expired in June. [EDS](#) won the lion's share of the business in the next contract. But the auto maker gave five other firms a piece of the business: [IBM](#), Compuware, Covisint, and [Wipro](#) also won pieces of the \$3.8 billion, five-year contract. Bob Pryor, [Capgemini](#)'s CEO for Outsourcing, North America, says [HP](#) and Capgemini "were actually the big winners. Both companies won a substantial portion of the re-compete and significantly increased their share of GM business," he says.

"The biggest surprise was that [EDS](#) didn't give up as much as they thought they would," says Joe Hogan, VP of Strategic Outsourcing Programs for [Unisys](#). Hogan says the new contract showed that the Indian suppliers now are able players in the big deals. "The market is morphing from the Big Three to the Terrific 10," he says.

And the deal "validated the multi-sourcing model. You have to take notice," he says.

Pryor points out GM's multisourcing approach is "the third-generation outsourcing model." He says these changes are noteworthy because "this was the largest outsourcing deal in 1984. Now things are more complex and dynamic, so companies have to do things differently." GM really wanted an integrated delivery model with seamless and consistent services provided across 30 countries. Today they recognize that was too difficult a challenge for any one company, so the auto maker chose to split up the work with best-of-breed global providers, he explains.

Dancziger sees the break-up as a natural occurrence as the market matures. "Different services lines require different expertise. That expertise has grown tremendously. Today it's difficult to claim you are an expert in every service line or vertical," he explains.

And the Digital Fuel CEO says buyers want to spread the risk and not rely on a single supplier for all their needs. "They want to treat outsourcing suppliers like their stock portfolios," he explains.

Zach Lonstein, CEO of [Infocrossing](#), says the GM deal signals a big reduction in the number of mega-deals in the future. Buyers will break up deals into best-of-breed, he posits. "There's no reason to hire a general contractor when you can go directly to the subcontractors," he says.

Lynn Blodgett, Chief Operating Officer of [Affiliated Computer Services \(ACS\)](#) says the demise of the mega-deal will ensure "buyer satisfaction remains the key to winning and retaining the shorter-term contracts buyers now want." He adds advisors, who this year played a bigger role in facilitating deals--BPO in particular--will tell their clients about providers' retention rates.

2. Hewitt's Earnings Calls

In August the pure-play human resources (HR) provider opened the proverbial kimono and showed Wall Street its poor profitability in its third-quarter earnings call. "They told the analysts it's hard to make money in HR even if you're the leader," explains Gianni Giacomelli, Head of Global Strategy BPO for [SAP](#). "That news sent shock waves through the industry. It sent everybody back to the drawing board."

Michael Murphy, Vice President, Strategy and Growth for ExcellerateHRO, says, "When the leader says it isn't going well, it puts a spotlight on industry profitability." He says HRO will enjoy "great growth opportunities" in 2007. "But you have to have financial outcomes that create stability for suppliers," he says.

Jim Konieczny, [Hewitt's](#) Global Leader for Multi-Process HR Outsourcing, says while Hewitt's HR BPO performance (primarily the 2005 class of contracts) will fall significantly short of prior expectations, the company reported an increase in the margins of the benefits outsourcing business in the third quarter. "Hewitt is aggressively addressing the issues with its HR BPO portfolio and has already implemented key process improvements to drive future performance," according to the company's Q3 call.

Of course, Hewitt was not the only HR supplier to announce losses. Convergys broke out its HRO-only revenues for fiscal 2005 and announced it incurred a loss of \$50 million on revenue of \$163 million, reports Marc Pramuk, VP, HRO Research, [Everest Research Institute](#).

Giacomelli says the true learning that came out of this news is that buyers need to treat BPO differently from ITO. "Many buyers used to see the BPO contracting phase as a negotiation to beat up the supplier to get the price down, just like in ITO. But BPO needs to have a different mind-set. A good BPO engagement has to be more like a joint venture," he posits.

3. Standardization makes big strides in HRO: The IKEA/ADP contract and ADP's acquisition of Employeease.

[ADP](#) is a payroll provider known for its philosophy of standardization. Giacomelli says the IKEA contract is important because "nobody this big has opted for a standardized approach." He believes this transaction is a "watershed deal telling HR executives global corporations don't need uniqueness all the time."

Murphy says the acquisition "makes a lot of sense" by combining payroll with HR and benefits in a standardized offering.

Dancziger says the search for standardization and repeatability is spilling into other areas of BPO. The CEO says "every service provider I met this year is pursuing a significant initiative to create a centralized backbone to provide services."

He says both buyers and suppliers are playing with delivery models that are "more like a utility." He says buyers like "the agility and fast response and suppliers need to make a living."

4. ADP enters the finance and accounting outsourcing (FAO) space.

Leon Busch, President and CEO of [SourceNet Solutions](#), a subsidiary of Mellon Financial, finds it interesting that a payroll provider entered the FAO space. "Its decision validates FAO if an organization like ADP wants to be part of the FAO space," he says.

5. [Accenture](#) wins one of the largest HRO deals to date.

The Unilever contract is a \$1 billion, seven-year global deal. It included a broad range of HR services including recruiting, payroll, and performance management and covers 200,000 employees across 100 countries.

6. We've talked about it for years but it really happened this year: ITO and BPO integration.

T.K. Kurien, CEO of [Wipro](#)'s BPO business, says in 2005 just two percent of its BPO deals integrated IT with business processes. This year that number jumped to 36 percent. And judging by the Wipro pipeline, that number will be in the 60-70 percent range in 2007.

"Buyers want us to process their transactions without any human intervention," he explains. He says suppliers have to do things manually because of either poor IT or bad data or both. Integrating the two eliminates both. "You need this integration to improve processes and increase productivity," he says.

7. It was a dramatic year of leadership musical chairs. The changes included:

Accenture: Kevin Campbell became Group Chief Executive-Outsourcing

ACS: Mark King became CEO after serving as Chief Financial Officers and Chief Operating Officer

[Ceridian](#): CEO Ron Turner announced his retirement; Kathryn Marinello will take his place.

ExcellerateHRO: Kathryn Kelly replaced Steve Bohannon as President.

Fidelity: Guy Pattan stepped down as the head of HRO

Hewitt: Russ Fradin replaced Dale Gifford as CEO.

HP: Patricia Dunn out as Chairman of the Board.

8. The middle market became the new battlefield for BPO outsourcing suppliers.

Pryor says "everyone is after the middle market today." That's a sea change from the Holy Grail quest for the multi-billion dollar mega-deal.

9. Venture capitalists up the ante.

Pryor notes private equity firms "are going after bigger and bigger deals." Initially venture capitalists funded smaller BPO firms or green field start-ups. "This year they went after multi-billion dollar companies. Currently there's a lot of money in the market; they are attempting to put together bigger plays," he says.

10. IBM makes a \$6 billion investment in India.

Lonstein predicts this investment will exacerbate the already high attrition rates at Indian BPO firms. He says Indians like working for high status companies; "smaller companies suffer at the hands of bigger ones." He says when IBM--the ultimate blue chip--opens its doors, "it will roil the labor market." He predicts "turnover will become even greater, which will increase the cost of doing business."

11. Business outcomes have replaced cost savings as the No. 1 reason to outsource.

Pryor says companies are asking about "the ultimate business impact" when determining whether to outsource. "Creating value has more influence on the board today," he reports.

Business outcomes are also introducing innovative pricing policies, according to Dancziger. This year the two partners in an outsourcing deal attached pricing mechanisms to business parameters. "Things have gone past time and materials. We saw usage-based pricing, performance-based pricing, and results-based pricing. The underlying theme is for both partners to share in the success of the enterprise," says the Digital Fuel CEO.

Ditto for service level agreements, Dancziger adds. "Buyers are more oriented toward business results. They are adding business parameters to core facts to measure provider performance," he says.

12. Recruitment Process Outsourcing (RPO) crossed the chasm.

In the early days of HRO, according to Kim Davis, President and Co-Founder of TalentTrack, it was rare to include recruiting in the scope of an HR deal. "Recruitment was at best an afterthought," he says. This year "almost every HRO deal had a recruitment piece," he reports.

He says deal interest and volume has gone up significantly in the last six months. "Buyers are better informed today. HR suppliers also "recognize the need to have an RPO component," which may include partnering with a firm like TalentTrack. That's why our sales funnel has increased," Davis reports.

He notes this year was the first year third-party consulting firms became engaged in RPO work.