GLOBAL OUTSOURCING: SEARCHING FOR THE PERFECT FIT

MODERATED BY STAN LEPEAK

MEET THE MODERATOR

Stan Lepeak is a Managing Director of Research at EquaTerra, the global outsourcing and insourcing advisory services firm. He has followed the business and IT services and IT marketplaces for more than 20 years. He is a noted commentator and frequent speaker on business and IT professional services, business process outsourcing, organizational change, risk mgmt, compliance, and underlying supporting technologies. From 2003-2004, Stan was VP and Research Lead at the META Group. He also spent six years with META Group as VP of its Electronic Business Strategies service. During 2000-2002, Stan was an executive at Elance, and SVP and Chief Research Officer at Ajunto.

Clarence Schmitz has served as Chairman and CEO of Outsource Partners International since 2002, when the firm acquired the BPO practice of KPMG. He has extensive finance and accounting experience and an established track record in building and operating professional service businesses. He was a co-founder of Golenberg Schmitz Capital Partners. From 1995 to 2000, he served as EVP and CFO of Jefferies Group, Inc.

John F. Lyons, SVP of Market Development for the N.A. subsidiary of Siemens Business Services, oversees Strategy and Portfolio Management, Alliances and Acquisitions, and Marketing and Sales Support. Most recently, John was CEO of Mimeo.com. Prior to that, Lyons was President of the Technology Acquisition Services division at Entex Information Services, and during this time he also served as CEO of The Global Alliance.

Shami Khorana is President of HCL Technologies America, Inc. Shami is responsible for managing U.S. operations and accelerating HCL's growth in the U.S. HCL is one of India's leading global IT Services companies, providing software-led IT solutions, BPO, and remote infrastructure management services. The company leverages an offshore infrastructure and its global network of 26 offices in 15 countries.

Tao Ye is the COO and President of China Operations of Objectiva Software Solutions. Prior to founding Objectiva, he served as General Manager of the Greater China Division of ONEWORLD Software Solutions. Prior to ONEWORLD, Tao was Program Manager for Intel Materials eBusiness effort. Tao has consulted and advised many high-tech start-ups and traditional companies in the U.S. and in China.

The business process and information technology outsourcing (BPO/ITO) markets are evolving in multiple dimensions. They are: 1) Becoming more global; 2) Encompassing a broader array of service areas; 3) Becoming more specialized by industry; and 4) Generating ongoing (and often misinformed and shrill) angst among Western countries not only due to job loss fears, but also because these regions are, in general, loath to change the historical status quo or share their pie with emerging markets.

In terms of "state-of-the-market" specifics, key findings from EquaTerra's 2Q06 Pulse Surveys – conducted among its advisors and a wide variety of leading service providers to reveal in-the-field insights into sector trends and projections – included: BPO and ITO market demand rebounded but is still down year over year and for full-year levels; contract profitability is positive but flattening; deals are becoming smaller and distributed across more service providers; BPO service provider capacity is still constrained; pricing competitiveness is stable and in some cases decreasing in BPO; and the HRO market, particularly for large global deals, remains challenged.

Delving more deeply into the results of the 2Q06 Pulse Survey results: the outsourcing market has undergone a period of rapid growth coupled with globalization over the past two to four years. As a result, service provider capacity, especially for BPO and multi-national or global deals, is constrained. At the same time, many leading service providers feel pressure to improve or at least maintain margins. As a result, buyers with more complex requirements or weak business cases cannot always find providers with the requisite skills and/or desire to compete for their business. Buying patterns are also trending toward more multi-sourcing and greater demands for process improvement over just cost reduction, creating more complex deals that can exacerbate buyer challenges with transition and ongoing governance. So while outsourcing continues to grow in size and acceptance, it is experiencing some growing pains that must be addressed by both buyers and providers.

Against this "market snapshot" back-drop, here are some questions around key issues facing the outsourcing industry today…

Outsourcing management and governance (OM/G) – what happens after the deal is done – is critical to outsourcing success. Yet many outsourcing buyers under-invest in OM/G, do not adequately prepare for it in advance, and often struggle to find staff with the requisite skills and experience to perform necessary activities. What can buyers do to get better OM/G? What can service providers do to help buyers in these efforts?

TY: This issue exhibits itself differently depending on the size of the outsourcing client. Large, multinational organizations have a structured environment and designated communication paths that enable daily communication and issue escalation, based on documented systems. Small and mid size companies rely on more personal communication paths and the "hero" concept in managing alterative work environments. Both have challenges in terms of managing an external services relationship.

From the service provider side, the challenge is to continue to have visibility from all levels within the client organization to manage expectations and engage both sides in achieving the strategic objectives in the day-to-day delivery and work process.

For example, the less involved the executive team is in the ongoing relationship, the more risk the provider faces from line managers who are tasked with tactical deliverables and lack the tools/personnel to execute in a different work environment. When in a stressful situation, people will revert to what they know as opposed to assessing the current operating variables to accomplish the same goals. The actual success of an engagement can rely on the lowest level of employees (client and provider side), rapidly assimilating sophisticated communication skills, and global work practices.

From a service provider side, the more structured operating guides that can be instituted early in the process, the better the line managers at the client organization can successfully manage the external services integration.

CS: At the heart of every successful outsourcing agreement is strong communication and a spirit of partnership. All too often, companies fail to realize the full potential of outsourcing because the relationship with the provider tends to be more of a client-vendor relationship rather than a partnership. There are a number of actions that can be taken, both before and during the engagement, that will work to encourage healthy communication and partnership.

Probably the single most important element of successful outsourcing management and governance is ample involvement and ongoing support by the highest ranking members of management – at both the company and the outsourcing provider. It's critical to the long-term health of outsourcing that senior executives take an active role in governance meetings, even if only on a quarterly basis, and champion the solution throughout the organization.

Another best practice in communication and partnership is to contractually align the objectives of the company with those of the provider. At the outset of the engagement, the client should be upfront as to the goals they hope to achieve through outsourcing, and the contract and pricing should be structured so as to encourage behavior that works towards those ends.

Finally, ample attention should be directed toward assessing progress to date and lessons learned. Constant and constructive feedback should be shared between the company and the provider. While service level agreements (SLAs) are a good measurement as to whether the outsourcing solution is meeting the business objectives, there are aspects such as management style, that are better measured through regular satisfaction and feedback surveys. This information should be openly discussed in each governance meeting, and best practices should then be integrated into the project plan. Taken together, these and other such actions will work to establish and reinforce successful outsourcing management and governance practices.

JL: Outsourcers and their customers must jointly create and maintain OM/G to ensure the success of the relationship. At the beginning of the relationship, outsourcers should actively design their governance model as part of the value proposition and include it as part of their proposal. Outsourcers and customers need to arrive at a common agreement that governance is not a by-product of a loose collection of operational service level agreements, but is instead a binding set of actions designed to influence the behavior of the outsourcer in order to achieve a desired result (contract compliance and SLA attainment). It is the enterprise that consumes the services and is impacted the most by the success of the relationship. In order to be successful, buy-in to governance needs to happen at the enterprise level with IT tasked at setting the outsourcing scope. Outsourcers should come to the table with a well-defined relationship model to ensure success. This relationship model should adequately describe the linkages between customer and outsourcer, and detail how the customer will realize transparency and control over their service delivery. The OM/G must anticipate and incorporate some levels of flexibility to accommodate future changes in the business.

SK: As part of every engagement HCL commences with its clients, a steering committee is created which comprises senior management from both HCL as well as the client to ensure the highest level of governance. In addition, a program office is created to oversee the engagement – from start to finish – which ensures a holistic view of all activity. This program office is staffed by both HCL and its client to forecast activity in order to deliver transformational gains for clients. There are four pillars that comprise every HCL engagement to ensure the highest level of work is delivered: communication, trust, openness, and cultural understanding. Governance underscores these four pillars.

Many large BPO and ITO deals already have or will come up for renewal in next year or two. How well will incumbent service providers fare in these renewals? Will we see a major shift to new service providers? What are the key points buyers need to keep in mind when undertaking outsourcing renewal or negotiation?

TY: New service providers who can match service levels and provide more cost-effective solutions will vie for many of the engagements currently held by traditional suppliers. Some changes will be made on a strategic level, simply to diversify the capability – starting with smaller engagements to verify capability.

CS: Realistically, you can't forecast the likelihood of renewal across the entire market. This truly is a case-by-case decision. The health of the outsourcing engagement likely mirrors the relationship between the company and provider. If during the recent contract timeframe, both parties have shown that they can work together to successfully resolve issues and make a positive impact on the business, and that they both share similar values regarding worth ethic, involvement, and decision-making, then it's likely that the contract will be renewed – and vice versa.

For those relationships that are successful, one important consideration during the renewal process is putting in place mechanisms that encourage ongoing cost-saving process improvements. Initial cost savings are generally easy to recognize for first contracts, largely due to the impact of offshore labor arbitrage. It is ongoing costs savings that are more difficult to realize. However, there are actions that can be taken to encourage continuous improvement, and these should be considered during the renewal process.

For example, at OPI, we consider a successful outsourcing engagement as one in which our annual revenues go down – not up – each year for a select process due to continuous improvement initiatives. While this is part of our methodology, this behavior is also typically reinforced by a pricing structure which encourages such action. Considered a best practice, it is recommended to put in place contractual mechanisms and pricing terms such as gain-sharing, that encourage cost-saving process improvements.

JL: Incumbents will fare well first and foremost if they've performed successfully in the pre-existing relationship. However, that in and of itself may not be enough if the service provider can't also articulate a strong vision of the future that capitalizes on innovation and transformation in process architecture, technology, and global access to competitive, skilled labor in a flexible contract arrangement.

In order for renewals to move forward, agreements will need to reflect a greater degree of flexibility, identify initiatives that create business value, improve price competitiveness, and optimize operations and governance through a gain/share approach.

SK: Renewals may result in multisourcing strategies. All the trends seem to indicate that the large global outsourcing deals will be divided among multiple vendors. So, multisourcing is on the way. The reason: customers may get better pricing and reduce their own risk.

As multi-national service providers continue to expand their global service delivery capabilities and India-based firms expand their geographic footprint in Western markets, China, and other emerging services markets, does one group have an inherent advantage over the other? Will multi-nationals emerge stronger given broader services footprints (e.g., consulting, systems implementation, ITO and BPO), more specific business process and vertical industry experience, and more executive-level relationship? Or will the Indian firms emerge more strongly given their lower cost base, efficient delivery models, and greater experience in remote delivery of complex services?

TY: It seems natural that over time, the emphasis will shift from purely cost-based drivers to much more of an expertise- or value-based model. The companies that will thrive are those that evolve to providing the outsourced services with higher quality and efficiency than their competitors. As global costs and experience levels equilibrate, pure labor costs will become much less important in the equation. Therefore, the long-term winners will be diverse in makeup. In the short term, labor arbitrage will certainly play a factor likely of causing a shift toward emerging markets like China. The companies that will succeed in China are those that can most effectively accelerate the natural development of experience via technology or leveraging experience gained elsewhere (India or the U.S.).

CS: Speaking only for finance and accounting outsourcing, multinationals still and will continue to enjoy an advantage over India-based firms, primarily because of cultural differences that India-based firms face when working directly with Western businesses. This advantage manifests itself in process-specific knowledge, vertical industry experience, and more executive-level relationships.

That said, India-based firms do enjoy lower base costs and more efficient delivery models. And for finance and accounting, this advantage will not disappear anytime soon. Indian universities offer advanced accounting training, and the supply of accountants in India is not diminishing.

However, what is happening is that India-based firms are developing and fostering skills desired by Western businesses. Hands-on experience is allowing India-based firms to acquire culture-specific business knowledge and to hone these skills. At the same time, outsourcing and offshoring is becoming more culturally accepted among Western businesses. Taken together, in the long-term, these factors will work to break down the advantage that multinationals currently hold, creating a more level playing field.

JL: A customer should carefully evaluate an outsourcer's global capabilities and experience along with their ability to leverage the most efficient labor and operations model, rather than one that focuses solely on a specific market like India. We believe greater value will be driven from outsourcers that provide services on a global basis, who understand the needs of each market and offer services specific to that market – beyond simply leveraging only cost arbitrage.

Globalization is in fact accelerating the introduction of new markets for economic labor and diverse vertical skills. Today, India is a strong player, but many other counties are emerging as challengers. Outsourcers should provide solutions that allow them to lead their clients to the right markets at the right time for the right services versus a one-size-fits-all model.

The Philippines are especially good given their strong cultural ties to the U.S.

SK: Multinationals like EDS and Accenture have expanded their presence from the U.S. to India, and now to China and other markets with a cost advantage. But this expanded footprint does not necessarily mean an advantage. India has the benefit of experience and a mature set of skilled labor that Western markets and China do not have. India-based vendors are several years ahead of its competitors in the areas of business process and strategy.

Will increasing geopolitical risks (e.g., nuclear proliferation, terrorism) have a significant negative impact on global outsourcing? Will non-Western service locations (e.g., India, China, and Asia-Pacific) suffer more as a result of these increased risks? Are outsourcing buyers today sophisticated enough to factor in risks when making their outsourcing location decisions? What should buyers do to adequately address these risks and prepare for worst-case scenarios?

TY: The opportunity that China and other emerging sourcing locations offer is global risk diversification. In general, globalization has offered some surprising discoveries. For those companies who have been long-term investors in global capabilities, it is clear that skill sets and competencies can be different, based on cultural, educational, and economic realities in different global locations.

For those companies who are just investigating the global capability model, it will be important not only to evaluate the country, but also the specific companies. In the end, it is the company that you choose, not the country. Business risks should be clearly identified – and it should be in the vernacular of the actual exposure that the company will have. There are a variety of ways to process through risk mitigation.

For the outsourcer services buyer, it is a clear understanding of what exposure the initial program will have, and limiting exposure until the relationship with the services provider is tested and confirmed. This takes a concerted effort from the internal line mangers within the organization to adapt internal process (communication, documentation, networks, etc.) to function in an external mode.

For the services provider, it requires each client functional area that is invested in the process to be managed by a similar functional expert on the services side. Eliminating misunderstanding and inconsistencies early in the process is aided by discussions with professionals in the same function.

For both sides, a backup plan for obvious scenarios should be addressed as the partnership is structured – a roadmap for both issue escalation and resolution, as well as disaster recovery plan are essential to both sides mitigating risk and establishing a basis for operations.

Larger, more sophisticated consumers of outsourcing services certainly consider risks of all types when developing their outsourcing strategy. Geopolitical risk is certainly on the list but falls behind other types of risks such as vendor concentration/power, price inflation, turnover, and epidemic. The vendors themselves must also consider these risks, and it is certainly an important driver behind the pace of movement into China.

CS: Frankly, this hasn't been much of an issue for many of our clients. Most providers today are committed to providing a level of safety and security that ensures ongoing day-to-day operations. Providers, especially those operating in non-Western service locations, have put in place extensive precautionary efforts including ample data and network security, as well as location and communication redundancies. Additionally, efforts are taken at each location to address country-specific risks.

The truth is that when providers can no longer ensure the industry standard in security and safety, or when the costs of providing such services escalate over and about the savings offered by the location's preferential wage rates, the provider will voluntarily exit the market. Until that happens, I don't foresee a significant negative impact on the majority of non-Western service locations. Competitive markets will always drive demand for labor and services that offer preferential wage rates. So long as providers are able to balance the benefits with the risks, the popularity of outsourcing will continue.

Buyers today are sophisticated enough to factor risks into their outsourcing location decision, and buyers should conduct due diligence on the provider's service locations. We typically recommend that prospects plan a site visit to the service location they are interested in, and thoroughly review all security and safety features offered by the provider. Achieving a level of trust and comfort with your provider will lay a strong foundation going forward.

JL: Both outsourcers and customers are more sensitive to geopolitical risks than ever before and understand that they must be ready to recover rapidly from a disaster. Consequently, outsourcing solutions should include a comprehensive, fault tolerant global support model that provides business continuity and recovery to ensure optimum availability and support of critical business functions needed by the customer.

A customer should require that an outsourcer be able to address their disaster recovery needs by having an appropriate business continuity solution that balances a multi-country strategy and overall economic impact.

SK: HCL's recommendation is to engage in multi-geo delivery models. Additionally, companies should stay educated and aware and evaluate several locations upon choosing an outsourcing partner.

Will increasing geopolitical risks (e.g., nuclear proliferation, terrorism) have a significant negative impact on global outsourcing? Will non-Western service locations (e.g., India, China, and Asia-Pacific) suffer more as a result of these increased risks? Are outsourcing buyers today sophisticated enough to factor in risks when making their outsourcing location decisions? What should buyers do to adequately address these risks and prepare for worst-case scenarios?

TY: China's pre-eminent future in the outsourcing or globalization of services is assured. The communications infrastructure, educational policies, government support, private enterprise investment, population, and flood of returnees all point to the rapid establishment of a solid business base. China has the advantage of a long history of adaptability – they are not burdened with the "not invented here" mindset – but are observant and open to learn from the "best in class."

Both the private investors as well as the government are committed to providing world class, competitive services. So the rapid assimilation of quality and technical credentials clearly identifies the interest and capability of the Chinese business community to understand and achieve global business quality standards.

This is not to say that China does not have some mind-bending challenges. Clearly the change from an agrarian society to a technical society creates more than a few dislocations. We see the issues that China faces on a daily basis – the whole debate in terms of money valuation, exports, and health systems is in the worldwide press.

But China has some significant allies in its quest to solve its challenges. There is significant investment of multinationals in China's future, both relying on the availability of low-cost consumer exports to fuel current home markets, as well as the promise of an internal consumer market. The question is, of course, time. If we were to look at one segment – technical services – we have several observations.

The management availability to structure and successfully develop large scale organizations based on a western business model is evolving, but will take another five to ten years to become a basic business posture. Business scale and the availability of strong cadre of global players based in China will grow, but will not be an overnight process.

As for China usurping India or other significant players in the global market, it seems to us that each geographic area has an intrinsic set of capabilities that allow them to become a leader in specific areas – but it is also clear that no one area has a lock on all capabilities. There is also the potential for the internal Chinese market to absorb much of the business energy and capability that is currently being established in China. As we move forward, China will be a target for many of the services that are delivered by other geographic areas.

The near-term future for outsourcing in China is extremely bright. The number of purely China-based providers is growing very rapidly, as is the number of outside companies establishing operations in China. China's infrastructure, including hard infrastructure like roads and power systems as well as its educational infrastructure, can support rapid and extensive growth. In areas like ITO, the limit to growth is experienced especially with project management of larger projects and on issues requiring more experience, such as architecture and design. The ITO industry in China is relatively young and has grown rapidly. The result is that the number of resources with ten years of experience is small compared with India or the West. However, with each passing year this number grows significantly, and companies that leverage experience from other parts of the world can accelerate the learning curve significantly. Although not without issues, the Chinese government's methodical approach to building infrastructure and industries is the major driver of their ascension. Outsourcing, and particularly ITO, has been identified as a strategic industry for China and they are making the necessary investments to be a leader in the market.

CS: For the types of finance, accounting, and tax outsourcing that we at OPI provide, Chinese firms or China-based service locations are not strong contenders in the provider market. One of the reasons that India, for example, is flourishing in F&A outsourcing is because they have a very established accounting profession and offer advanced accounting education at most universities. This truly is a prerequisite when selecting successful F&A service locations, as the skills required to perform such functions as account consolidation and regulatory reporting require quite a sophisticated level of accounting-specific knowledge. Given the language barriers and the lack of a developed accountancy profession in China, in conjunction with the strong supply of F&A professionals in India and Eastern Europe, I don't see the Chinese F&A outsourcing market ramping up in the near future.

JL: China has an immense and fast-growing economy. They will continue to evolve as both a consumer and provider of outsourcing services. The pace of their provisioning capabilities will be impacted in part by cultural, language, and intellectual property concerns. Beyond India, other emerging nations have targeted the outsourcing market as attractive economic development opportunities. Initally, newer entrants will offer commodity type services, and over time, attempt to develop more sophisticated offerings.

SK: HCL acknowledges that China is a force to be reckoned with. China has a managed economy and can keep costs low, although there is a lot of pressure which may eventually push the country to open up its markets – which will undoubtedly force costs to go up.

As the business and IT services markets continue to globalize, buyers are faced with an increasing array of locations – both country and region – from which to choose. How can buyers assess whether a particular emerging services location is right for them? Should they rely on the service provider to pick the best location? How much does the location matter as it relates to the process being outsourced, or the buyer's vertical industry?

TY: Location for services provisioning is a complex decision, simply because of all the conflicting information sources. As well, location can be a significant factor if certain skill sets, industry, and experience are critical to the program. The basic decision will be based on project/work parameters and skill requirements, resource availability, capability, cost, time constraints, and communication ease.

If the buyer is working with a long-term partner, location can be managed through a discussion matching capabilities with delivery requirements. For a new geographic area, it is important to review specifically with each potential provider, capabilities and the delivery requirements. Verifying with current service provider clients is important to discover any issues that require adaptation.

CS: Buyers can and should be inquisitive about the locations where the work will be performed, but their real true concern should be quality. As the saying goes, "You should care more about the taste of the sausage rather than where the sausage was made." That said, quality can be affected by location for certain types of outsourcing. Location should be closely considered when cultural or language differences might impact quality.

Culture differences tend to be more pronounced in services that require interaction with customers or employees – for example, when outsourcing call center services or certain types of HRO. Language differences will impact quality on a much broader scale and can impact virtually all types of outsourcing. While the risk of language differences is somewhat mitigated for quantitative-based transactions, language differences will impact quality even for many F&A functions.

In the end, if the outsourcer provides services that meet the required culture and/or language requirements, and provided that the final product adheres to all service level agreements (SLAs) concerning timeliness and quality, then the location itself is often best decided by the service provider.

JL: Customers should always start with their goals and the business rationale for considering outsourcing. Once those are established, an organization considering outsourcing some of its business processes should work with with an expert in the service areas being evaluated or targeted. A customer also needs to assist the outsourcer in developing their operational delivery approach by openly sharing their global business strategy. A customer should emphasize to the outsourcer that global flexibility and delivery architecture is critical because certain areas can provide better access to vertical industry expertise.

An outsourcer should provide thought leadership on emerging markets, entry timing, risk, and exit impact based upon their global capabilities. The outsourcer's operational framework needs to be agile enough to support the business decision to enter or exit a market by being able to the balance opportunity and risk. Additionally, the outsourcer's ability to react and respond to change as the environment evolves needs to be considered.

SK: Location truly depends on the needs of the customers, especially if there are language considerations or specific skill sets that are required.

Many pundits, particularly equity analysts, question whether HRO service providers will ever consistently be able to turn a decent profit (e.g., 10+ percent deal margins). Are there inherent challenges to HRO that may limit service provider profitability? Are some of the challenges we've seen in early, large HRO deals really systemic problems, or simply representative of a less than mature yet rapidly growing market? Should buyers care about HRO service provider profitability?

CS: I believe the challenges facing the HRO market to be more systemic in nature. With HRO, you have a combination of more standardized functions – like employment contract generation – and very advanced functions such as benefits administration. For those more standardized HR functions that can and are being outsourced, the potential value-add by outsourcing has been severely limited through the use of technology alternatives. Today, so many of the HR functions that can and are being outsourced are already highly automated. There is little room left for labor arbitrage and processes improvements to really make a difference.

On the flip side, the advanced functions, such as benefits administration, require a degree of decision-making, judgment, and cultural awareness that is difficult for offshore providers to deliver. When an employee has a question about medical benefits or 401K, cultural difference can make it very difficult for an offshore professional to fully address employee concerns.

What we are seeing today with HRO, specifically around those standardized functions that can viably be outsourced, is fair markets at work. The market will pay according to the value-add created by the outsourcing arrangement. With so many of these functions having a large technology-driven component, the potential value-add by outsourcing isn't very compelling.

JL: The financial success of an ITO arrangement is based upon mutual success. The ingredients for a successful ITO arrangement can be found where both the customer and outsourcer derive mutual benefit.

For this to happen, the outsourcer must continually challenge traditional models with innovation in process and technology, and with people creating opportunities to optimize cost of delivery while maintaining service quality.

A percentage of these improvements are operationally transparent to the customer, implemented over time to maintain outsourcer profitability. The remaining opportunity for improvement can be significant for the customer, but must be aligned with their business needs for transformation and/or change. This is as much the customer's responsibility as the outsourcer. An ITO arrangement that remains operationally stagnant will not gain the highest cost savings for the customer or highest profit for the outsourcer. And without profit, the outsourcer will be severely challenged in maintaining or increasing service levels and bottom-line value to the customer. Customers should care very much about the service provider's profitability.

Customer will continue to seek and require improved price performance. Successful providers will harness innovative solutions, new technologies, and improved cost models to meet these client requirements. Clients should ask for examples of this across the provider's portfolio.

SK: HRO has a very large market opportunity; however, many service providers haven't been able to make a lot of money in this area because of the relatively new practice area. As businesses fine tune business models, service provides will better be able to map to HRO processes.

While ITO has matured and back-office BPO is maturing, what are the next "hot" BPO areas? Is it "Knowledge Process Outsourcing?" Logistics or document services? Or will the market evolve more along industry, rather than process?

TY: We see some specific areas in the overall category of BPO that China seems particularly well-suited to execute in the early stages of the industry development. Two major plays for BPO, call center and operations utilizing English language skills for processing, are not the best match for Chinese skill sets at the present time. But, if one looks at specific operational process components, China can offer a distinct set of capabilities.

As evidenced from the success in the manufacturing sphere, we believe that China can incorporate task-driven operations in a cost-effective model. Our own experience in document conversion for financial services companies has shown us that our China-based teams can provide high-quality services, if the language equation is adequately addressed.

Expanding this experience, we expect specific industries with large scale consistent information requirements will have a real opportunity to work with China's service providers. Financial service industries, healthcare, and medical verticals all have information processing that can be process driven with excellent results. The key will be matching subsets of information processing to minimize language requirements. This will require a larger scale of operations and process controls that adhere to privacy requirements.

The growth of this market will be based on the migration of the work through the largest service providers and the emergence of China-based niche providers, specializing in industry-based services.

CS: Before we start talking about new BPO areas, we should acknowledge that there really is a lot of room to expand and strengthen the breadth and depth of services provided in the existing BPO arenas. Be it finance and accounting or logistics outsourcing, these areas are growing and have yet to mature. The next hot areas may not be entirely new outsourcing offerings, but instead we'll see the outsourcing of processes that lie further up the intellectual food chain. Specifically, services with greater experiential content will begin to be outsourced.

We are already seeing the finance and accounting outsourcing market moving in this direction. For example, in the last year we have added to our service offerings such functions as FAS123(R) stock option accounting and market intelligence/research services. At the same time, companies have become more comfortable outsourcing many of their complex functions. During 2006, it was not unusual to see a client who had outsourced one or two discrete functions decide to make the move to full-service finance and accounting outsourcing. With full-service F&A outsourcing, many of the services provided require an advanced level of decision-making.

This trend will continue and will largely be driven by both the market's comfort level with outsourcing and by the new availability of an offshore population with ample "on the job training." Experience plays an important role, such that today we are able to outsource functions to India that we couldn't outsource several years ago. With each year that passes by, the capability coming out of India is increasing exponentially.

As these trends continue, it will become much more commonplace to see very advanced decision-based processes outsourced and managed offshore.

JL: While we agree with the maturation of ITO and back office BPO, we still see considerable opportunity for consolidation aligned with industry know-how. The future of horizontal process outsourcing lies with vertical-specific process and technology being integrated with traditional technology and process. For example: X-ray or Catscan modality with clinical management systems, insurance billing systems, and the overall patience care process. These vertical processes will all be optimized in much the same way the payroll process has been transformed – but with much higher stakes.

Additionally, customer care BPOs are gaining much greater traction than previously expected, given the complexity of these models.

We think the ITO market will continue to offer attractive growth rates and expansion opportunities for higher value services. This will be especially true for services aligned by industry verticals.

SK: KPO is definitely the next hot button. A lot of recent Indian college graduates have specialized in analytics and logistics. Additionally, HCL sees verticals like healthcare and insurance claims processing as "hot" areas.