Market Vista™ : Select Findings Q4 2016

October – December 2016

Market Vista | Overview

Covers global services market research, analysis, and insights to demystify the market and direct clear, impactful decisions

Overall sourcing market

- Detailed analysis of trends by industry vertical and geography
- Report of transaction volume, size, and momentum
- Perspective on events with significant industry impact (e.g., M&A)
- Implications of regulatory changes

Service provider landscape

- Updates on service provider market share, capabilities, and performance
- Service provider profiles, including data on:
  - Transactions
  - Location footprint
  - M&A activity

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Location data and dynamics

- Data on market activity in key offshore geographies
  - Political
  - Macroeconomic
  - Promotion incentives
- Trends in wage inflation, attrition, and arbitrage

Processes and models

- Process-level trends
- Global In-house Center (GIC) set-ups, divestures, and overall trends
- Fact-based insights on adoption of emerging pricing models
- Data and perspectives on new opportunity areas

Quarterly report	Primer	Location database	Breaking viewpoint	Location insights e-newsletter	Industry trends

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Global services: Key market trends in 2016

1 Overall outsourcing demand growth remained steady; growth was led by North America as well as emerging markets; with significant decline in Europe

2 Growth in transaction volume was led by small enterprises; average deal size reduced for mid-sized and large enterprises

3 New GIC setups are at an all time high, with growth led by both existing firms and new adopters

4 Significant growth witnessed in location activity, but setups were more concentrated in select offshore/nearshore locations
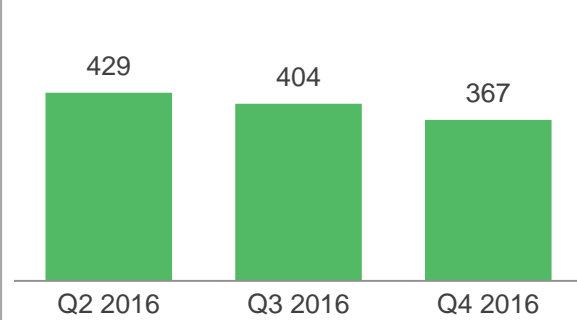
5 Leading service providers (esp. Indian-heritage providers) have significantly increased their onshore delivery capabilities, given the need for greater customer intimacy and stringent visa regulations (particularly in the United States)
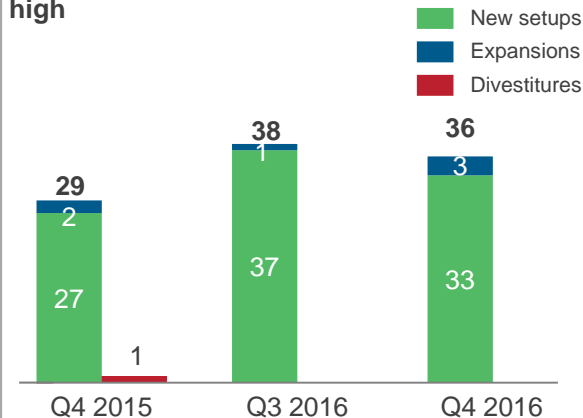
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Key market indices – Q4 2016

Outsourcing/offshoring market overview

Decline in outsourcing demand compared to the previous quarter
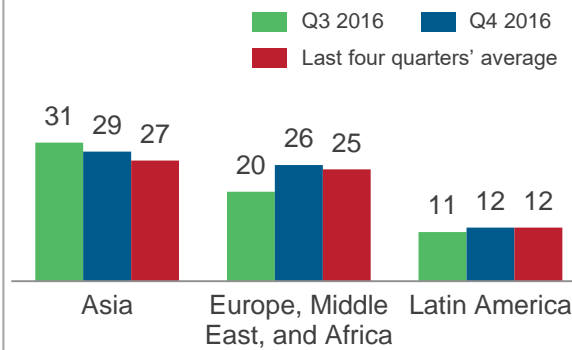Number of outsourcing transactions

Q2 2016	Q3 2016	Q4 2016
429	404	367

The overall GIC activity continued to remain high

Legend:
- New setups (green)
- Expansions (blue)
- Divestitures (red)

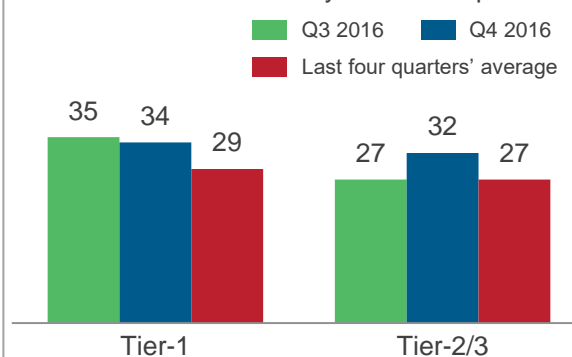|	Q4 2015	Q3 2016	Q4 2016
Total	**29**	**38**	**36**
Expansions	2	1	3
New setups	27	37	33
Divestitures	1		

Location dynamics

Increased activity in Europe, while rest of the regions witnessed similar level of activity
Number of offshore delivery center setups

Legend: Q3 2016 (green), Q4 2016 (blue), Last four quarters' average (red)

	Asia	Europe, Middle East, and Africa	Latin America
Q3 2016	31	20	11
Q4 2016	29	26	12
Last four quarters' average	27	25	12

Share of tier-1 locations was marginally higher than tier-2
Number of offshore delivery center setups

Legend: Q3 2016 (green), Q4 2016 (blue), Last four quarters' average (red)

	Tier-1	Tier-2/3
Q3 2016	35	27
Q4 2016	34	32
Last four quarters' average	29	27

## Service provider developments and trends

Traditional global service providers reported sequential decline in revenue
Sequential growth in revenue (percentage)

Traditional global service providers	Offshore-centric service providers	Overall
-1.40%	1.65%	-0.60%
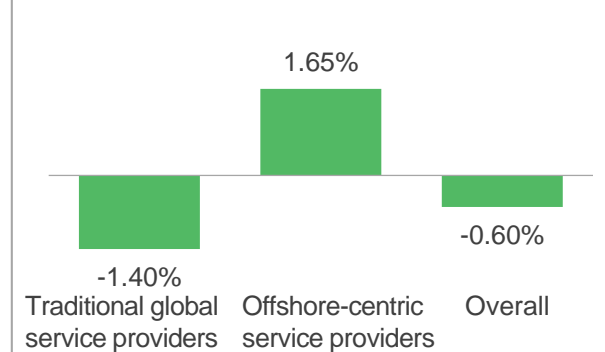
Operating margins for both traditional global providers as well as offshore-centric providers increased during the quarter
Sequential growth in operating margins (bps)

Traditional global service providers	Offshore-centric service providers	Overall
38	24	40
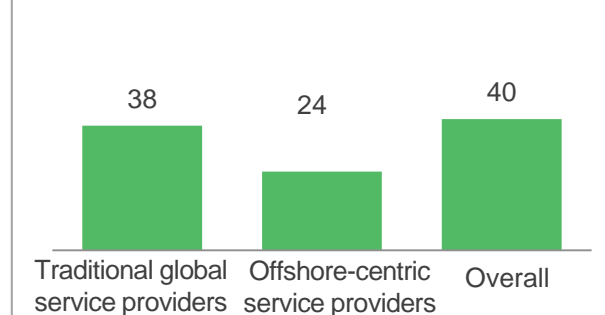
Transaction activity declined significantly in Q4 2016 with 367 deals, compared to 404 in Q3 2016
- Activity in the outsourcing market witnessed a notable decline owing to significant fall in ITO deals, while BPO transactions increased over the last quarter
- The energy & utilities vertical saw an increase in volume of transactions, while healthcare, retail & CPG, and technology & communication sectors saw a sharp decline in number of contracts vis-à-vis Q3 2016
- Outsourcing activity across North America as well as United Kingdom declined; however, there was an increase in the number of deals across Rest of Europe (RoE) and Rest of the World (RoW)
- The volume as well as the share of renewals / restructured deals remained similar to the previous quarter
- Volume of medium-term deals (five to seven years) increased considerably vis-à-vis Q3 2016, while contracts with very short-term duration (zero to three years) declined significantly
- In the current quarter, 29 major deals were signed including eight large deals (TCV between US$50-199 million), 20 very large deals (TCV between US$200-999 million), and one mega deal (TCV > US$1 billion)

GIC market activity remained strong in Q4 2016, with 33 new setups, three expansions, and no divestiture
- Overall, the GIC set-up activity remained in line with the previous quarter, with a slight decline in activity in India and Latin America
- Leading companies, such as 3M, ABB Group, Amazon, JLL, Samsung, General Electric, and Microsoft, announced new centers

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Location activity in Q4 2016 was higher compared to the previous quarter, driven by significant growth in Nearshore Europe; activity in tier-1 locations was marginally higher than tier-2 cities

- New center set-up activity recorded an all-time high with 67 new delivery centers set up in Q4 2016. Activity was led by both GICs and service providers. Tier-2 cities experienced an increase in activity with 32 new center setups recorded in Q4 2016, compared to 27 in the previous quarter
- Key location risk/opportunity trends for Q4 2016 include – robustness of India's Internet connectivity was exposed due to a recent cyclone in Chennai; growing attractiveness of Argentina's global services industry due to economic and political changes; change in relative ranking of offshore and nearshore locations with currency fluctuations in 2016; and impact on global services industry given the recent election of Donald Trump as the President of the United States
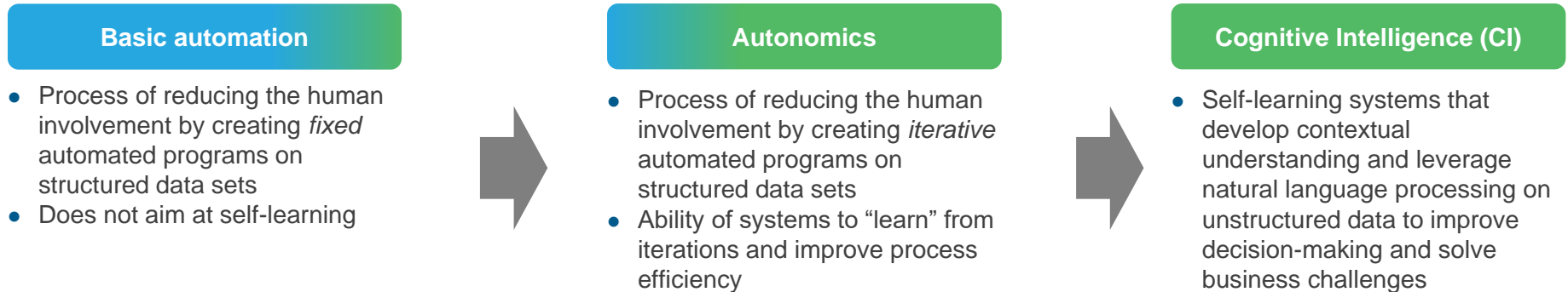
Most service providers reported sequential growth in revenue

- There was a marginal increase in the operating margin of both traditional as well as offshore-centric providers. On the other hand, the revenue increased marginally for offshore-centric service providers, while it declined for traditional service providers
- Both, the overall transaction activity as well as the share of Market Vista Index service providers, decreased significantly in Q4 2016 as compared to the previous quarter
- Overall M&A activity increased due to growth in acquisitions from offshore-centric service providers. On the other hand, alliance activity declined, compared to the previous quarter
- Overall location activity for leading service providers declined as compared to the previous quarter, driven by decrease in activity for traditional service providers

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Cognitive intelligence – replacing labor by using machine learning, analytics, mobile technologies, and cloud computing

Sophistication of automation in the solution: Low   ■■■■   High

Basic automation

- Process of reducing the human involvement by creating *fixed* automated programs on structured data sets
- Does not aim at self-learning

Autonomics

- Process of reducing the human involvement by creating *iterative* automated programs on structured data sets
- Ability of systems to "learn" from iterations and improve process efficiency

Cognitive Intelligence (CI)

- Self-learning systems that develop contextual understanding and leverage natural language processing on unstructured data to improve decision-making and solve business challenges

Drivers for cognitive intelligence

Productivity improvements: Faster processing with less scope of errors due to lower human involvement

Cost savings: Allows replacement of costly FTEs with technology, saving recruitment and training costs

Higher compliance: Requirements can be embedded into rules with the ability to accommodate exceptions

Improved relationships: Gainsharing with clients due to cognitive technologies can lead to stronger client relationships

Better flexibility: Can be scaled and altered quickly to suit changing requirements

Barriers to cognitive intelligence

Low availability of requisite talent: Need for both domain and technical knowhow poses constraints in talent availability

High implementation costs: Significant investment to set up, test, and, implement complex cognitive projects

Ongoing upkeep: Continuous optimization and support required to ensure control on automated processes

Change in business model: Cannibalizing existing FTE-based revenue streams

Longer time-to-market: Being in the nascent stage, complex cognitive projects may take longer pilot periods before going live

Source: Everest Group (2017)
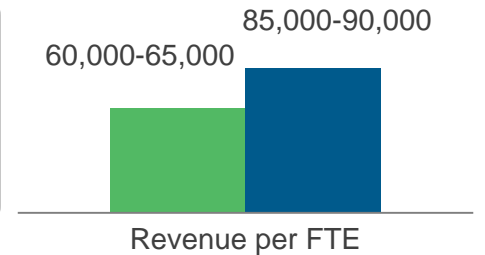
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Service provider(s) that have successfully developed capabilities in cognitive intelligence have been able to achieve significant benefits compared to peers

Best-in-class provider ■ **Leading providers** ■

Revenue per FTE

- The revenue per FTE is under tremendous pressure for most providers in the industry, given cross-currency volatility and increasing competition
- The revenue per FTE for the best-in-class service provider is higher by 40% compared to the peer group. Furthermore, it increased by 12% (CAGR 2012-2016), compared to a growth of 3% for the peer group

60,000-65,000   85,000-90,000

Revenue per FTE

Utilization rate

- Service providers that have successfully adopted CI capabilities have been able to reduce the need for incremental hiring, thereby increasing utilization rate
- In 2016, the average utilization rate for the best-in-class provider was ~92% as compared to 79% for the peer group

79%   92%

Utillization rate[1]
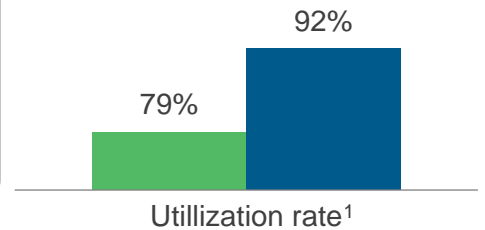
Cost savings

- Automation (with emphasis on CI) has been able to provide annual cost savings of ~US$200-300 million to service providers
- Service providers, successful in adopting CI capabilities, have been able to achieve even higher cost savings

1   Representative of overall utilization rate for the firm (i.e., inclusive of both IT and BP services)
Note: All analysis conducted at company level. Hence, it is indicative but not directly reflective of "impact of cognitive intelligence'"
Source: Everest Group (2017)

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Service providers need to rethink their traditional talent and cost models to "*make it a success*" in cognitive intelligence

Impact on service providers

Talent imperatives for service providers

Talent model

Providers need to rethink their talent strategies and delivery models, and address the dichotomy between nurturing specialized skill sets and "deskilling" commoditized skills.

New opportunities

Cognitive allows providers to generate alternative revenue models and opens up opportunities to convince clients to reinvest into discretionary "change the business" spend.

Operating cost

Automation helps providers to save FTE costs and overheads, while improving client outcomes. However, it requires upfront investments in both talent and IP.

Hiring	As cognitive requires specialized skill sets, service providers will be challenged to hire skilled resources to deploy and maintain automation suites. Providers can cross-leverage talent post-deployment without additional investments.
Training	Service providers need to reskill and upskill their workforce to drive convergence between applications and infrastructure layers, while addressing the challenge of a "deskilled" workforce, giving rise to an extensive skill set transition.
Retaining	Challenges associated with hiring and training resources will make employee retention a key imperative for service providers. Innovative compensation strategies and agile ways of working can help to retain talent.
Disengaging	As cognitive displaces few resources, service providers will need to revaluate their delivery models to optimize resource utilization. Local regulatory frameworks and labor laws may restrain providers from shedding redundant talent.

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List of Market Vista Index service providers

Traditional global service providers

accenture
High performance. Delivered.

Atos

AON Hewitt [3]

Capgemini
CONSULTING.TECHNOLOGY.OUTSOURCING

CONVERGYS
Outthinking Outdoing

CSC

NTT DaTa [1]

Hewlett Packard Enterprise [2]

IBM [4]

UNISYS

xerox

Offshore-centric service providers

Cognizant

EXL

GENPACT

HCL

Infosys

Tech Mahindra

TATA CONSULTANCY SERVICES

WIPRO
Applying Thought

WNS
Extending Your Enterprise

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1 NTT Data acquired Dell Services acquisition of Dell Services and the acquired entity is now called NTT Data Services
2 HP Enterprise Services (HP ES) is the global business and technology services subsidiary of Hewlett Packard Enterprise (HPE)
3 Aon acquired Hewitt in October 2010. The combined entity is now called Aon Hewitt
4 The services division of IBM is referred to as IBM Global Services (IBM GS)

Additional research recommendations

The following documents are recommended for additional insight into the topic covered in this report. The recommended documents either provide additional details on the topic or complementary content that may be of interest:

1. **Market Vista™ Q3 2016** (EGR-2016-8-R-1973); 2016. This report summarizes the key trends and developments for Q3 2016 in the global offshoring and outsourcing market

2. **Argentina Global Services Industry – Breaking Political Shackles?** (EGR-2017-2-V-2058); 2017. In the past four to six years, Argentina has been viewed with caution by investors in Information Technology (IT) and Business Process (BP) services owing to significant geopolitical and macroeconomic concerns. However, a change in government in December 2015 led to several changes in economic policies and resulted in increased interest from global stakeholders. This viewpoint describes the development of the global services industry in Argentina from 2011 to date, including the latest developments. In addition, it also provides Everest Group's outlook on the global services sector in the country in the next three to five years

3. **Buyer Geography and Industry Trends reports:** Trends for Q3 2016. These reports provide data, developments, and insights on outsourcing and offshoring trends for a particular buyer geography / industry. These reports provide the research and analysis that enable users to navigate through complexity and make clear, effective decisions suited to their focus region or specific industry. These reports provide detailed information on transaction activities, Global In-house Center (GIC) developments, service providers' market shares, and key outsourcing transactions. Regions covered include: the United States and Canada; Europe; and Rest of the World. Industries covered include: Banking, Financial Services, and Insurance (BFSI); Manufacturing, Distribution, and Retail (MDR); Energy & Utilities (E&U); Healthcare; Technology; Telecom; Public Sector; and Travel & Hospitality

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