

The Five Most Likely Outsourcing Trends of 2006

ValueNotes Database, January 2006

Small cities, knowledge process outsourcing and global competencies – these are the buzzwords for the India-based outsourcing industry in 2006. ValueNotes Database looks at what's in store for BPO in India this year.

1) KPO jobs: In demand

Predictions of a boom in the knowledge process outsourcing industry are rife, with estimates for the industry size ranging from anywhere between \$12 billion and \$15.5 billion for 2010. This envisages a growth rate of 40 to 50 percent for the industry for the next five years.

The explosive growth will necessarily mean a large increase in the workforce engaged in providing KPO services. Although there have been predictions of looming labour shortages for the Indian outsourcing industry, 2006 is unlikely to witness this, at least in KPO. Higher billing rates than BPO for employers and the high-end work perception among employees will help KPO jobs to be 'hot' through 2006.

Hiring of professionals such as doctors, lawyers and engineers will be stepped up. In fact, a recent ValueNotes report on legal offshoring predicts that employment in legal outsourcing in India will grow more than ten-fold by 2010. Another ValueNotes research shows that the number of employees in publishing outsourcing will grow 5.6 times by 2010.

2) Consolidation and Fragmentation: Hand-in-hand for KPO

Even though consolidation activity picks up pace, the emergence of "KPO" will see a proliferation of new service providers dotting the competitive landscape. "The opportunities in knowledge services are attracting a new breed of entrepreneurs, typically professionals like lawyers, doctors, engineers, scientists, etc. into the offshoring business", says Arun Jethmalani, CEO of ValueNotes Database.

Minimal entry barriers and low infrastructure and set-up costs will encourage the smallest of KPO set-ups. Unlike commodity services such as call centers, CRM or large-scale back-end processing, the minimum critical mass or size for KPOs need not be very large. High degrees of specialization will allow even small firms to exist profitably. Further, since the knowledge business is not necessarily scale driven, concepts such as home-shoring and freelance work are also gaining popularity. This will drive the increasing fragmentation of service providers.

3) Small Towns will Join the Party

India's status as the No. 1 destination is not in doubt. However, much of the growth has been concentrated in a few cities such as NCR Delhi, Mumbai, Bangalore, Pune, Hyderabad and Chennai. Rising attrition and wage costs in the larger cities coupled with attractive benefits being offered by state governments will drive the BPO move to the hinterland.

Various state governments in association with STPI India are developing IT/software parks with comprehensive infrastructure to encourage companies to move to smaller cities.

Hotspots in 2006:

Jaipur, Jodhpur (Rajasthan)
 Gandhinagar (Gujarat)
 Amritsar, Patiala (Punjab)
 Nasik, Nagpur, Navi Mumbai (Maharashtra)
 Lucknow, Kanpur (Uttar Pradesh)
 Hubli, Mangalore (Karnataka)
 Bhubhaneshwar (Orissa), Mohali (Haryana)
 Vishakhapatnam (Andhra Pradesh)
 Kochi, Thiruvananthapuram (Kerala)
 Coimbatore, Madurai (Tamil Nadu)

States such as Punjab, Rajasthan, Uttar Pradesh taking the cue from Maharashtra, Andhra Pradesh and Karnataka, have started investing heavily in IT Parks.

4) Captives in India.... for good

As offshoring goes mainstream at large multinational corporations, 2006 will see a spurt in expansions of offshore presence by large corporations.

However, the bulk of this will be towards fully owned captives, driven by two factors. The first is the increasing sensitivity towards IPR, data security and confidentiality; all of which make captives the simpler choice. Coupled with this, many large corporations that have been testing the offshore waters will look to plunge into the water in a bigger way. Adds Neeraja Kandala, Analyst, ValueNotes, *"several Fortune 500 and FTE 100 already have their captive centers in India. This trend will further accelerate keeping in mind the changing dynamics of the industry."*

Beyond a certain size, the economics of captive centers are favorable as compared to contracting to third-party vendors; and many corporations will seek this route as they expand their Indian presence.

5) Acquire to gain hold

Acquisition activity reached new highs in 2005, and we expect 2006 to be much busier. However, in addition to the mega-deals, we are likely to see the emergence of a large number of small deals. This will be driven by acquisitions in the knowledge services space, where acquirers will find it worthwhile to do small deals to acquire domain knowledge, new customers and position themselves in this small, but fast growing segment.

In 2005, systems integrators and IT companies formed the maximum percentage of acquirers. Indian IT companies have been entering the business process outsourcing industry in a big way, and acquisitions are an easy way to acquire domain specific capabilities. Cognizant, KPIT and Patni were among the larger IT companies setting up BPOs in 2005.

This year, we expect KPO to become a major target area for acquisitions. KPO acquisitions will form the growth strategy of two types of companies:

- Already established KPO companies who want to gain specific domain expertise, or clients in a particular area or geographic region
- Multi-service BPO companies wanting to climb the value chain by adding high-end capabilities to their portfolios.

Deal sizes will be smaller primarily because KPO outfits are normally smaller than CRM or back-end processing service providers, since their business is not necessarily dependent on scale.

About ValueNotes Outsourcing Practice

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