BPO Providers Enjoy a Return to Financial Health

Survey gets a handle on the pulse of the industry. Growth, while slowing, continues unabated.

By Mark Hodges

EquaTerra recently completed its first-quarter Pulse Survey with those on the front lines of the BPO industry, offering from-the-field insights into sector trends and projections.

Each quarter, 70 to 100 EquaTerra advisors and approximately 20 service providers, answer our questions on the BPO market on a proprietary and confidential basis. Key findings from the latest quarterly survey are described below.

■ **1Q06 BPO Market Demand.** BPO market demand remains healthy, but its growth rate has declined for the fifth consecutive quarter. Still, it is rising at more than 20 percent, and corporations' desire to purchase BPO remains undiminished. Forty percent of EquaTerra's advisors cited demand as "increasing," compared with 59 percent of service providers.

■ **HRO Leads Market Demand.** In the first quarter, HRO was the strongest BPO area. In fact, HRO has claimed the No. 1 spot for the past five quarters, ranging from 26 to 29 percent of advisor citations; this was followed by finance and accounting outsourcing, which ranged from 18 to 23 percent of advisor citations. Between 66 and 82 percent of advisors over the past five quarters stated that benefits and payroll were the strongest HR process areas. This year's first quarter was no different.

HRO providers validated the same advisor observations, with 92 percent citing payroll and 69 percent citing benefits as those in the greatest demand.

■ **BPO Sales Cycles.** In EquaTerra's experience, the average length of the BPO sales cycle is nine to 12 months, starting with lead generation and qualification and ending with a signed contract. However, sales-cycle lengths vary significantly by deal, depending on process areas, clients, service providers, and whether sourcing advisors were involved. Sales cycle should not be confused with time-to-contract, which is defined as the period from the release of the RFP to actual contract signing. Therefore, time to contract (usually four to five months) is always a subset of the overall sales cycle.

In the first quarter, 30 percent of EquaTerra's advisors cited that the BPO sales cycle was lengthening. In addition, the number of advisors citing "shortening sales cycles" declined for the fourth consecutive quarter.

While EquaTerra advisors see the BPO sales cycle lengthening, 30 percent of providers cited last quarter's sales cycle as shortening, the highest level of citations over the past four quarters.

This discrepancy is most likely explained by a number of factors. First, BPO providers are being highly selective on the deals they are pursuing and electing to "no bid" at unprecedented rates. Second, they are targeting opportunities that are slightly smaller in scope and have more definitive close dates. Third, a small subset of EquaTerra's clients have lengthened negotiations due to a lack of transition capacity and resource shortage from their preferred BPO provider.

■ **Offshore "Hot Spots."** Advisors (85 percent) and providers (94 percent) cited India as the preferred multi-shore location, followed by Central/Eastern Europe (58 and 59 percent, respectively); Central/South America/Caribbean (41 and 31 percent, respectively); and China (33 and 29 percent, respectively).

■ **Pricing.** BPO pricing in the quarter was considered stable by 70 percent of advisors, while 20 percent cited pricing as more favorable to BPO providers. This pricing development has allowed service providers to be less reliant on dropping their prices to win business. This pricing equilibrium between buyer and provider is healthy for the industry as a whole.

■ **Contract Profitability and Return on Invested Capital (ROIC).** The financial health of BPO providers appears to be stabilizing. Consolidation has certainly helped, as has a more diligent pursuit selection. Virtually every BPO provider cited profitability as steady or improving, marking the first time that this has occurred since the Pulse Survey was instituted in 2004. In the quarter, 65 percent of providers said their contract portfolios would reach profitability in 12 to 24 months, and a significant percentage stated they would break even in less than 12 months. More than 70 percent reported a return on invested capital (ROIC) of 10 to 20 percent.

It finally appears that BPO providers are no longer simply on the path to profitability. They are actually achieving it. HRO

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