A Research Report by EquaTerra incorporating Morgan Chambers

Nordic Region Outsourcing Service Provider Performance Study 2008

EquaTerra
Incorporating Morgan Chambers

Introduction

For the second consecutive year, EquaTerra incorporating Morgan Chambers has conducted an in-depth investigation into the market for outsourcing services in the Nordic region, encompassing Denmark, Finland, Norway and Sweden. Each year, we ask executives responsible for managing outsourced service suppliers to provide us with their opinions on their providers' performance and wider outsourcing trends. Alongside the Nordic study, EquaTerra incorporating Morgan Chambers carries out similar studies in other mature outsourcing markets across Europe – the United Kingdom, Belgium/ Luxembourg (BeLux), and the Netherlands – enabling international comparisons to be made.

Experience shows that the results of these surveys prove insightful and useful for both parties in the outsourcing relationship. Specifically, they enable end-user organisations to compare their outsourcing plans with trends in the market as a whole, and to assess the strengths and weaknesses of their current and prospective suppliers. Meanwhile, service providers use the results of the study to reflect upon their portfolio choices and go-to-market strategies, including where to focus in developing and improving outsourcing service delivery.

It is important to remember that this study reflects the perceptions of key decision-makers in client organisations for outsourced services. This means the scores are not based on actual delivery of services measured objectively against explicit SLAs, but rather reflect the feelings and perceptions of the decision makers based on provider performance. The findings are purely based on end client responses. They are not the views of EquaTerra or its advisors but those organisations that have engaged with outsourcing providers in the region.

This year, more than 400 unique client-provider relationships are evaluated in this report, up from 300 in 2007, involving 240 of the top IT-spending organisations in the Nordic region, covering a wide spectrum of public and private sector industries. The participants in each case are the organisation's CFO, CIO or their direct reports. The responses enable an assessment of the perceived performance of 14 service providers.

Summary

Management summary

The results of this year's Service Provider Performance Study confirm that both outsourcing and global sourcing (near or offshoring) are continuing to increase among companies in the Nordic region, in line with other maturing European markets such as BeLux. However, what differentiates the Nordic outsourcing marketplace is supply-side fragmentation and a lack of differentiation among providers, that creates a clear opportunity for a supplier to win significant market share. Other key findings – again echoed in other markets – include growing use of outsourcing as a way to overcome skills shortages and improve quality, while objectives such as cost reduction remain important.

The main findings include:

- There is a major opportunity for a provider to truly win in this region. Our 2008 research shows there are currently no winners or losers, and that customers perceive very little differentiation between the suppliers. Together with a relatively fragmented supplier market and a lack of distinction between local and global firms, these conditions suggest the time is ripe for someone to make an impact in the Nordic region.
- The use of outsourcing is continuing to rise. Of the organisations interviewed, 82 per cent are intending to at least maintain their level of outsourcing, including 48 per cent who are looking to increase it. In contrast, only 8 per cent intend to outsource less.
- Outsourcing is increasingly being used as a way to overcome an IT 'skills crunch'. Over half of all organisations increasing their outsourcing activity are doing so as a way to get better access to skills. Cost savings and quality improvements are also important considerations, with quality emerging as a higher priority for companies based in the Nordic region in comparison to elsewhere in Europe.
- Global sourcing is strongly on the rise – the proportion of respondents using global sourcing is up from 23 per cent in 2007 to 41 per cent in 2008, with a further 9 per cent considering it. The strong focus among customers in the Nordic region on gaining access to skills and reducing costs may explain the speed and scale of this increase.
- There is a continuing need to improve governance of outsourcing contracts, with almost half of all participants (46 per cent) rating their skills to manage providers as weak to average. However, companies are not investing heavily in addressing this problem. The same proportion of customers (46 per cent) spend less than the recommended proportion* of 3 per cent of the contract value on governance.
- Service delivery for application management is truly suffering in the Nordics compared to the rest of Europe – with satisfaction being significantly lower across the board for the application management providers.
- In general, customers in the Nordic region think outsourcing providers are doing a reasonable job, but not a great one. In 59 per cent of cases, respondents say the initial driver for deciding to outsource has been realised or mostly realised, compared to 75 per cent who say it was realised in BeLux. And customers are satisfied with the results in 77 per cent of cases – again a relatively low score compared to other regions.

These findings and many more are explored throughout the report, accompanied by analysis and insight into why some of these findings have arisen, and what the impact will be for the industry.

*3 – 7 per cent of the contract value is generally recommended to be spent on governance, but this is dependent upon size, complexity and scope of the agreement.

1. Trends in the marketplace

a) An opportunity to win in the Nordic region

The Nordic region's combination of healthy growth in the outsourcing market, relatively low satisfaction with current providers, fragmented supplier market and lack of perceived differentiation between the various providers indicates that a supplier who really gets its act together could make dramatic gains in customer satisfaction and potentially market share. Many of the satisfaction ratings of suppliers by customers against the various KPIs are within a narrow range from top to bottom, suggesting that no single provider has really broken from the pack. However, 82 per cent of customers say they would be likely to recommend their provider to someone else, suggesting that while they may be relatively dissatisfied, they do still like their suppliers. Nordic customers' relatively strong focus on access to skills and quality improvements as reasons for extending their outsourcing programmes suggests that these could be key areas of differentiation for suppliers.

b) The increasing importance of outsourcing

Outsourcing – with several years of healthy growth behind it – is continuing to enjoy strong momentum and traction among organisations within the Nordic region. With 48 per cent of those participating in our study saying they will 'certainly' or 'probably' outsource more, growth in this market is set to continue in the years to come with new users and existing users alike. With increasing use of outsourcing comes rising market maturity, as organisations improve their ability to use outsourcing as a way of delivering services. However, Nordic customers' comparatively low levels of satisfaction with their outsourcing providers, and respondents' mixed views on the achievement of the original rationale in their contracts, suggest that suppliers need to raise their game to help drive the market forward.

c) Access to skills as a reason for outsourcing

Of those organisations intending to increase their existing levels of outsourcing, more than half (52 per cent) point to access to skills as a reason for doing so – the same proportion as cost savings. This shift towards a focus on skills echoes the findings in other European markets, and suggests that as the Nordic market matures clients are ready to place greater importance on the value side of the deal. Quality improvements are a further strong influence, cited by 41 per cent of companies looking to outsource more. The skills crunch in the Nordic market also has implications for global sourcing strategies, since companies that are struggling to find the skills they need onshore may well look to find them more easily – and cheaply – offshore, often through an outsourcing relationship.

d) A sharp rise in global sourcing delivery

Global sourcing is expanding quickly among companies in the Nordic region, with 50 per cent of our respondent companies either using global sourcing (41 per cent) or considering it (9 per cent). (However, that still leaves a further 50 per cent who are neither doing it nor considering it – compared to 48 per cent in BeLux and 30 per cent in the UK.) Equally significantly, most companies that are already sourcing globally are intending to increase the scope of their nearshore/offshore activities. Among companies already using near/offshoring, application management customers are the most committed to increasing their use of nearshore/offshore centres, with 60 per cent intending to do so, compared to 55 per cent for infrastructure management and 33 per cent for end user management. In terms of centres currently being used, India leads the way, ahead of Eastern Europe and then the Baltics.

e) Continuing issues over governance capabilities

The quality of customers' governance of their outsourcing contracts remains an area of concern in the Nordic region. The past year has seen only a very marginal improvement in respondents' assessment of their own competence to manage their service providers, with 54 per cent now rating it 'good' or 'excellent' (up from 52 per cent in 2007), and 46 per cent regarding it as 'average' or 'weak' (down from 48 per cent). However, this is actually better than the findings in BeLux, where 51 per cent assessed their own competence as 'average' or 'weak'. Perhaps more worrying for the development of the Nordic regional marketplace is customers' continuing under-investment in their governance capabilities and processes. Levels of spend on governance remain low, with 46 per cent spending less than the recommended minimum of 3 per cent of the contract value on governance, with 9 per cent spending more than 7 per cent on it. In general, the industry benchmark is that effective governance should cost between three per cent and seven per cent of the total outsourcing budget, depending on the size and complexity of the contracts involved. For larger contracts or those where the processes are relatively simple, the percentage can be much smaller than this; likewise, for complex deals the required investment to bring about return is often greater. However, this figure acts as a good balance check against the appropriate level of investment a company should make to ensure success of the contract.

f) Dissatisfaction with application management

Satisfaction with service delivery for application management is declining fast in the Nordics, and is very low compared to the rest of Europe. The average satisfaction level for this service has slumped from 61 per cent in 2007 to 55 per cent in 2008, well below the average satisfaction scores of 59 per cent for end user management and the 61 per cent for infrastructure management. The implication is that application management is a real problem area – and therefore may present particular good opportunities for both onshore and near/offshore suppliers that can get it right.

2. The performance of service providers

In general, this study paints a mixed picture of customers' perceptions of outsourcing providers' performance during the past year. Customers generally claim to be more satisfied than in 2007, but their satisfaction ratings are still some way below the levels seen in other markets in Europe. Nordic respondents' average general satisfaction rating of 61 per cent represents an improvement from the 57 per cent we reported in 2007, but still contrasts poorly – for example – with the 68 per cent recorded in BeLux in 2008. So while there is a sense that customer satisfaction is moving in the right direction, the progress is relatively slow and is from a low base.

Alongside this overall modest improvement, several interesting themes emerge. One is the diverse mix of global and local suppliers in the marketplace, now joined by the Indian providers as global sourcing becomes more prominent. Each of these groups have their own areas of market strength in terms of customer perceptions, with none dominating the satisfaction ratings across the KPIs. The fact that many of the rankings are within a narrow range underlines the competitive nature of the market and the opportunities for greater differentiation.

In this report last year, we highlighted the opportunities in the Nordic marketplace and commented that the Logica/WM Data acquisition appeared to be a good attempt to capitalise on them. This year's findings suggest that this remains the case, with Logica putting in a strong overall performance backed by its established local base via WM Data and global scale. Local providers such as EDB also hold up well. At the same time, the research reveals something of a resurgence in satisfaction ratings for global providers such as HP and IBM, albeit from a relatively low base in 2007. Meanwhile, the Indian providers lead the satisfaction ratings on the price KPI, but lag behind the market on several others.

In summary, the Nordic region is a dynamic outsourcing market where there is a lot to play for and all types of participant – local, global, offshore – have the potential to succeed. Ultimately, this means the customers should be the winners when the market reaches full maturity. However, findings such as the low satisfaction ratings for application management show there is some way to go before that comes about.

Conclusion

Next steps in outsourcing performance in the Nordic region

What do the results of our Nordic study tell us about the outlook for service providers in the Nordic marketplace? Among the many points and perspectives that arise, we believe the key for providers is the scale of the market opportunity that presents itself. This raises the question of how they can best exploit it. In our view, the answer to this question has four aspects.

1. Positioning for differentiation

As we have noted, the Nordic outsourcing marketplace remains highly fragmented on the supply side, demonstrates little differentiation between suppliers, and has a relatively low level of customer satisfaction. Providers need to position themselves to turn these dynamics to their advantage. This may involve consolidation (such as Logica/WM Data), higher investment in customer relationships and service, and/or greater focus on particular service areas and client objectives. In an environment with no clear winners, suppliers can sieze the opportunity to win market share.

2. Expanding the offer from costs to skills

Across the Nordic region, access to skills is increasingly important to Nordic customers' decision-making around outsourcing. The skills crunch has now caught up with cost savings as a rationale for expanding the use of outsourcing, and is likely to overtake it this year. Quality improvements are also gaining ground. Suppliers need to respond to customers' increasing focus on value-based objectives, while also continuing to offer cost benefits. Offshore providers may sometimes have an edge on costs and even on IT skills, but onshore providers benefit from the relatively scarce availability of Nordic languages elsewhere in the world, as well as more effective relationship management.

3. Assess the opportunity in application management

In comparison both with the Nordic marketplace for other services and Europe as a whole, the satisfaction ratings for application management are low, and declining. Application management is also an area where access to skills is especially important, and where the growth in near/offshoring is at its greatest. All these factors present an opportunity for the existing players and new entrants in this segment to differentiate themselves and become the clear provider of choice. We believe all players in the market should assess this opportunity, and evaluate strategies to capitalise on it.

4. Help customers to address shortcomings in governance

As in other maturing markets, customers in the Nordic region are concerned about their competence to manage outsourcing relationships and contracts, but are failing to invest sufficiently to bring their governance up to the required standard. Often IT functions may find themselves battling internally for investment in the retained organisation. Suppliers have a clear role to play in using their customer contacts at senior management level to underline the value that a well-funded, strong and competent retained organisation brings to both parties. This in turn will help to strengthen customer relationships and satisfaction, and to increase supplier differentiation.

The qualifications of EquaTerra incorporating Morgan Chambers for conducting this research

In September 2007, Morgan Chambers was acquired by EquaTerra, creating the leading independent sourcing advisory firm – EquaTerra incorporating Morgan Chambers. With offices throughout Europe, Asia and North America, we support clients in making the right choices around their sourcing initiatives.

What we do

EquaTerra incorporating Morgan Chambers offers advice to all organisations looking to improve efficiency and cost effectiveness through the transformation of process, shared services or outsourcing of their information technology (IT), human resources, finance and administration or procurement teams.

Why clients choose us

Our experienced advisors help clients achieve sustainable value in their sourcing decisions through a unique access to market knowledge and a refreshing ability to 'get to what matters' for you and your business. This is all underpinned by a robust, tested methodology that can be applied locally as effectively as it can globally.

Key facts about EquaTerra incorporating Morgan Chambers include:

- 2,000 client engagements supported
- Delivered across 60 countries worldwide
- 19 languages supported
- Eleven offices world-wide: Amsterdam, Atlanta, Brussels, Frankfurt, Helsinki, Houston, London, New Delhi, Shanghai, Stockholm, Washington D.C.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. Our advisors average more than 20 years of industry experience and have supported over 2000 transformation and outsourcing projects across more than 60 countries. Supporting clients throughout the Americas, Europe, Middle East, Africa and Asia Pacific, we have deep functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes. EquaTerra helps clients achieve significant cost savings and process improvement with internal transformation, shared services and outsourcing solutions.

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