

## Can Buyers Live Happily Ever After with a BPO Niche Provider?

By Kathleen Goolsby, Senior Writer and Gary N. Bowen, Business Writer

"There's always room in a growing outsourcing market for niche providers," according to Donavon Favre, president of Procurement Solutions at New York City-based Accenture, a management, consulting, and technology services outsourcing firm.

That's true...for a while -- at least while a market is in a high-growth mode. But we predict 2004 will bring dynamic changes on the business process outsourcing (BPO) playing field, and buyer enterprises need to be aware of how this can impact their outsourcing strategies.

### Trend: Growth

The growth in utilization of BPO strategies - shifting back-office, labor-intensive functions and transactions to technology-enabled processes - is now particularly dominant in small and midsize businesses. Research and advisory firm Gartner, headquartered in Stamford, Connecticut, predicts the European BPO market alone will hit the \$39 billion mark by 2007. In the US, buyers are heavily adopting BPO, especially in the financial services and healthcare arenas, as well as federal, state, and local governments.

Market growth is naturally accompanied by the proliferation of service providers, and the BPO playing field is now dotted with a wide variety of niche players bringing their specialty expertise to bear upon business functions.

History reminds us that growth always leads to change. We believe many of the players in 2004 will begin to look very different.

### Prediction 1: Consolidation

Just as some former IT niche players providing such services as help desk, mainframe, or network connections have now been folded into larger IT provider firms, some BPO niche players will change team uniforms as their services are added to other players' portfolios.

Either through provider alliances to meet a particular client's needs or through larger companies' acquisitions of niche players, market consolidation will impact buyers in three ways:

1. Just as too many chefs can spoil the soufflé, trying to manage multiple niche providers can become too challenging for most buyers. Most companies, says Accenture's Favre, "don't want to outsource to 15-20 different BPO providers. Providers with a strong niche will end up aligning with others that can manage them and use them as part of a greater offering."
2. Consolidation of niche specialties into a larger provider's overall offering can bring even greater value through an outsourcing solution. Buyers who choose to take advantage of a full-service human resources solution, for example, will be able to achieve greater enterprise-wide strategic outcomes than buyers who choose to outsource only benefits or payroll.
3. Some buyers are currently considering (or already are) outsourcing to niche players that will eventually be acquired by other firms. Without adequate contractual provisions, this can cause challenges for a buyer. In any outsourcing arrangement, a buyer's due diligence on the potential provider should include the provider's financial stability and the future direction and strategy of the provider. Risk mitigation should include a short-term contract if there is any doubt as to the niche provider's intent to merge with or be swallowed by other providers.

Provider consolidation is not a matter of the strong absorbing the weak. Specialized expertise in a particular function is an inherent key to success in BPO. Providers lacking particular expertise but wanting to gain clients will be forced to acquire niche players with specialty expertise. "We expect some strong alliances of traditional process outsourcers with content experts to provide customers with the assurance of deep technical expertise in the areas that pertain to their specific business," observes Marc Schwartz, a principal in the outsourcing practice at Deloitte, a BPO service provider based in New York City.

Absolute Backgrounds, for example, performs employee background checks. Once a niche function appealing only to a certain market, background checks are now a crucial component of recruiting/hiring functions in the US because of terrorism threats. Companies providing this niche expertise are now sought as alliance partners for broader human resources (HR) offerings.

### **Prediction 2: Niches Will Become Narrower But with Deeper Expertise**

Nevertheless, we predict that many niche players will choose not to be acquired by or merge with other outsourcers looking to provide broader offerings. Some niche players have a theater of operations and client pipelines that are very strong for the foreseeable future.

SourceNet Solutions, a College Station, Texas service provider, for example, has decided to continue focusing on its core expertise – accounts payable (AP) - instead of major expansion to other finance and accounting functions. It's a good niche for SourceNet, Dan Reiff, senior vice president for business development, says, because "AP is where most buyers derive significant value from outsourcing. Most companies that decide to outsource their finance and accounting function start with AP. If you look under the covers of most finance and accounting requests for proposal (RFPs), the initial thrust is related to payables."

SourceNet will, of course, expand a business relationship into related finance and accounting processes upon client request; and it currently performs payroll and other back-office processes for some of its clients. "Today, there is significant opportunity for AP outsourcing, so we need to focus where we can bring clients the most value," Reiff says. "That's our core business. However, as the client's perception of value shifts to a fuller finance and accounting requirement, SourceNet will be positioned to engage," he adds.

To remain successful as a niche player, an outsourcer must have a niche marketplace of customers as well as core expertise. That narrow marketplace must be one where the number of potential customers in the pipeline will continue to grow, but where those customers' needs will not expand to a broader offering. Look for these pure-play providers in 2004 to focus heavily on honing their deep domain expertise by improving the workflow with best practices and intelligent use of technology, new intellectual capital, and cost savings.

Michael Alper is president of Woodland Hills, California's Meridian Health Care Management, a provider of administrative infrastructure, systems, managed care expertise, and claims processing services to healthcare providers and payers. His company has evolved from niche services of billing and payment services to becoming a claims processor in the managed care arena. Meridian's expertise is also growing deeper. John Cochran, Meridian's executive vice president, says technology is enabling claims processing to be performed closer to real time.

Dallas, Texas' Aurum Technology has a niche market among community banks and credit unions. "We started out as a niche BPO provider and have morphed into one that now offers a full line of services," says Aurum's vice president of marketing, Patrick Owens. Today, the provider's offering includes check imaging, data management, ATM services, e-banking and the technology that makes it work. Many of these services, which are taken for granted now, were embryonic or didn't even exist when Aurum was established.

### **Prediction 3: Some Niche Players Will Have a New Face**

Some niche players, however, will have to evolve. Despite their strong brands, competition will force some of the pure-play niche providers to restructure their service offerings.

For example, ADP, a BPO pioneer with a payroll niche, evolved beyond its narrow niche in order to compete with HR providers who have encroached its market by rolling payroll services into their offerings. ADP TotalSource now offers a bundled services approach, which includes benefits and other HR functions. It's an attractive solution to small and mid-size firms that do not have in-house expertise and resources and cannot afford the broader scope of services of larger HR providers.

### **Prediction 4: Competition Will Impact Pricing**

The current marketplace hot spot for niche players is the small to midsize enterprises. According to Katharine Jones, PhD; analyst for Boston, Massachusetts-based research firm, Aberdeen Group, "Middle market companies have been doing many of these tasks themselves as best they can for as long as they can as a short-term solution. Eventually though, they realize it doesn't make economic sense to do it themselves."

Customers in this market are often attracted to niche players because of their affordable pricing for an important but non-core function. We believe larger providers are turning their attention to making their offerings more affordable to this mid-market. As they begin creeping into this space over the next three years, look for the competition to prompt new pricing models among both the large and the niche players.

### ***Forecasts for 2004:***