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KPO Industry Growth Impacted by the Great Recession



EVALUESERVE
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Executive Summary

As the Knowledge Process Outsourcing pioneer Evalueserve approaches its ten-year anniversary, it has revised its industry forecast and believes the recent Great Recession has taken a three-year bite out of the KPO industry's growth.

In its widely accepted report in 2005, Evalueserve predicted that KPO industry revenues would reach USD 16.7 billion by 2010-11. However, primarily due to the Great Recession, the global research and analytics firm now estimates these revenues will not be achieved until 2013-14. 'While it may seem counterintuitive, recessionary times actually meant slower overall growth for offshoring knowledge services, since many firms were forced to shift their focus to survival mode,' comments Evalueserve Chairman Dr. Alok Aggarwal, 'Most major offshoring initiatives were shelved or significantly stalled during the depths of the crisis as leadership was cutting to the bone and, understandably, worrying about their own personal situations.'

Unlike the more mature Business Process Outsourcing (BPO) and Information Technology outsourcing (ITO) practices that have become strictly cost-saving commodities, Knowledge Process Outsourcing (KPO) services are more complex and still evolving. 'These services are customized, require deeper experience, skills and domain knowledge in particular sectors such as legal, technology or telecom,' explains Aggarwal, 'While cost savings are certainly a factor, many savvy firms are now viewing KPO 2.0 as a truly transformational opportunity which, when managed properly, can also provide new sources of revenue.' Aggarwal believes this bodes well for the future growth of KPO.

'Firms are more strategically evaluating the most efficient implementation of a disciplined, global research and analytics platform to also support the launch of new products and services, in fact often targeting emerging markets,' adds Aggarwal. 'Therefore, while India continues to be the largest provider of KPO, the industry has gained traction in other developing countries as offshoring combines with onshore and near-shore outsourcing in a hub-and-spoke model. Firms are now seeking the best value rather than simply focusing on the cheapest cost.' Evalueserve predicts that the market share of the Indian KPO industry will fall to 59% of the global market by 2013-14 from over 70% four years ago. However, with India and China producing the greatest number of talented and fresh candidates armed with KPO potential, both countries are still poised to remain the most important spokes in the knowledge services wheel.

Background and History

Founded in December 2000, Evalueserve coined the term Knowledge Process Outsourcing (KPO) in 2003 in an effort to differentiate its services from the booming BPO/ITO markets. KPO refers to outsourcing activities that require significant domain expertise, high analytical skills, and frequent client interactions. The firm published the first two articles [1,2] on KPO in 2004, where it predicted that the KPO industry was likely to achieve revenue of USD 16.7 billion by 2010-11 (i.e., April 2010 – March 2011). In 2005, the term KPO and Evalueserve's revenue estimate were used by India's National Association of Service and Software Companies (NASSCOM) in its annual report [3] and since then, Knowledge Process Outsourcing and the term KPO have both become standard terms in the outsourcing industry. Since 2005, more than one hundred articles have been published referencing Evalueserve's revenue forecast of USD 16.7 billion in 2010-11.

Unfortunately, the most developed countries experienced a severe recession during 2008 and 2009, and therefore, the main purpose of this article is to analyze the impact of the Great Recession on the growth of the KPO industry and to recalibrate the forecast given with other industry factors.

Section 2 reviews the current market size and expected growth of this industry worldwide over the next four years. *Section 3* discusses the market size and expected growth of the KPO industry specifically in India. Finally, *Section 4* discusses several sub-sectors that Evalueserve believes are likely to experience significant growth in the KPO space.

Global KPO Industry – Current Market Size and Expected Growth

In Evalueserve's 2004 and 2005 articles [1, 2, 4], it projected that the global KPO industry would reach USD 16.7 billion in revenue, employing 350,000 professionals in developing countries worldwide by 2010-11. Of this, Evalueserve predicted KPO firms in India would employ approximately 255,000 professionals generating revenue of USD 11.2 billion. In early 2007, Evalueserve [9] estimated the market size of the global KPO industry at that time to be USD 4.4 billion and the number of professionals working in the industry to be 106,000 worldwide. It also estimated that firms in India contributed USD 3.05 billion in KPO revenues and employed 75,000 professionals.

Evalueserve's updated analysis now predicts the KPO industry's global market size will reach approximately USD 17 billion only in 2013-14, which implies the industry will essentially lose three years of strong growth that was forecast in 2004. This slowdown can be attributed to the following factors:

In 2007-08, the industry grew by approximately 40% worldwide, which while good for top-line revenue, caused "overheating" in the market, thereby leading to significant employee attrition and extremely high wage inflation. This was exacerbated by a 10-15% appreciation of currencies in emerging markets compared to the U.S. Dollar and the British Pound. Therefore, even before the recession started, the global KPO industry had begun to exhibit signs of a potential slowdown in 2008, and Evalueserve's articles [7,8,9] actually discussed the possibility of this industry achieving approximately 10% lower revenues than its own 2004 estimates.

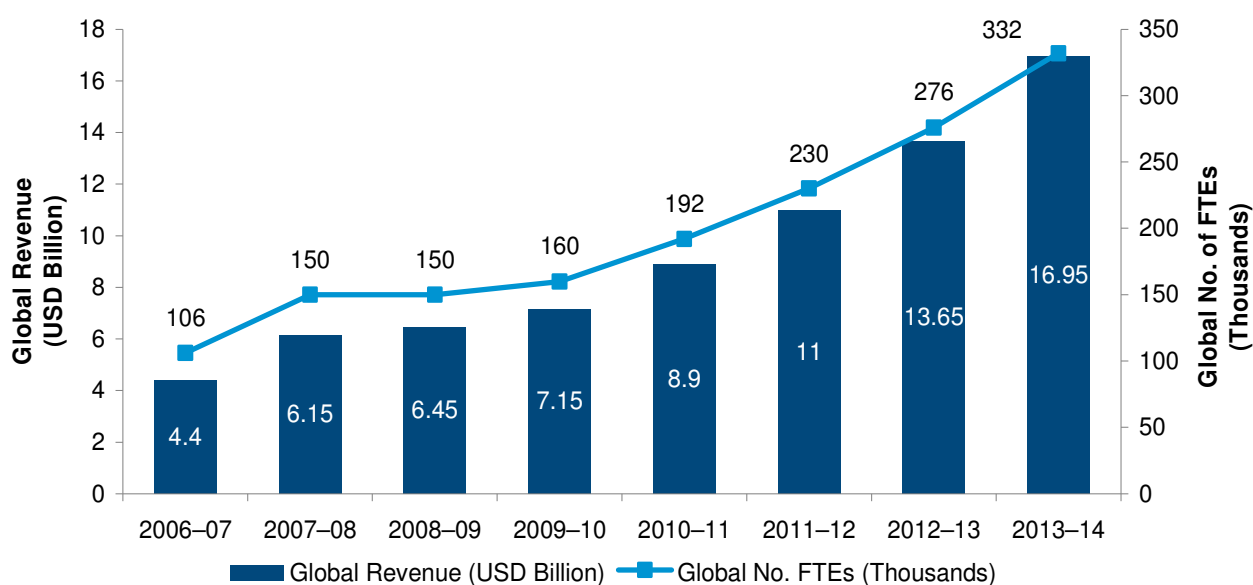
Then came the financial crisis and recession in the United States and Europe when the industry grew only by 5% in 2008-09. Most firms in these regions essentially stopped any additional expenditure, which also resulted in a freeze or cut in most discretionary spending (including hiring of consultants, part-time workers, onshore and/or offshore outsourcing). A significant spike in unemployment in developed countries created uncertainty for procurement managers and line managers who feared for their own survival and delayed any significant new initiatives.

Since September 2009, the paralysis has eased and discretionary spending has also increased; subsequently, the KPO industry grew 11% during 2009-10.

Going forward, the future of the KPO industry looks reasonably bright; especially if the United States and other developed economies can avoid a double-dip recession. In Evalueserve's view, the likelihood of such a double-dip recession is low, and based on this assumption, Evalueserve expects the KPO industry to grow at an annual rate of approximately 24% for the next four years (2010-14), thereby achieving a market size of USD 16.95 billion in 2013-14.

Figure 1 provides the global KPO compound annual growth rate (CAGR) of approximately 20% for 2006-10 and Evalueserve's updated projections for 2010-14.

Figure 1: Global KPO Industry – Market Size and Number of FTEs (2006-14)



Source: Evalueserve

India's KPO Industry – Current Market Size and Expected Growth

In 2006-07, the KPO industry in India accounted for more than two-thirds of the global revenue and Evalueserve's earlier estimates [1, 2, 4, 7] in 2004 and 2007 assumed India would continue to account for two-thirds even when the industry's global revenue reached USD 16.7 billion. That assumption was based on India's advantage over other emerging markets with respect to the availability of talent, English language skills, and lower wages (e.g., 15-20% lower than China and 40-50% lower than Eastern European and South American countries). However, several factors have since pushed global firms to reconsider their offshore outsourcing strategies.

The annual attrition rates in Indian KPO firms soared to 30-35% during 2006-08 [7,8,9]. Unfortunately, there was an irrational exuberance and large MNCs were offering exaggerated salaries to support their burgeoning offshore captive centers in a war for talent. The unintended consequence was even more costly attrition for all firms during this time. This 'Lemming Effect' and the fact that venture capitalists were readily funding any firm that was in the KPO sector, provided the impetus for annual local wage inflation rates to hit a remarkable 19% during 2006-09.

At a macro level, the euphoria surrounding the growth of the Indian economy and the significant influx of Foreign Institutional Investments led to a 25% appreciation of the Indian Rupee to the U.S. Dollar within a span of 14 months during 2007-08. These factors not only affected the KPO industry in India, but also the overall Indian export industry.

Now that the extreme pain of the Great Recession has eased, at least for the moment, attrition and currency valuations are again beginning to become a cause for concern. Although the Indian Rupee depreciated substantially (52 INR to 1 USD) during the throes of the recession, it has appreciated again by more than 15% during the last eight months. Any appreciation beyond 46 INR to 1 USD will further restrict not only the growth rate of the Indian KPO industry, but the overall Indian export industry. Although attrition had eased during 2008 and 2009, it has again risen above 20% during the first two quarters of 2010.

As mentioned in the opening summary, another reason for lower growth rates in India is that KPO implementations are starting to develop in a hub-and-spoke model, where the hub may be an onshore or nearshore location, while India and other countries serve as important spokes in the wheel. In fact, several countries in Latin America (e.g., Chile, Costa Rica) are quickly becoming potential hubs for U.S. nearshoring,

while many Eastern European countries (e.g., Romania, Poland) are becoming nearshoring hubs supporting Germany, Switzerland, and other mature European markets.

For these reasons, Evalueserve forecasts the KPO industry in India to grow by approximately 20%, which is lower than the 24% forecasted growth rate for the global KPO industry in Section 2. Correspondingly, Evalueserve had to throttle back its forecast given the changes in previous assumptions and now expects the Indian KPO industry to account for only 59% of the global KPO industry in 2013-14, rather than the 70% and above it had estimated four years ago.

Figure 2 shows the CAGR during 2000-07 and Figure 3 displays it for 2006-10 with Evalueserve's projections for 2010-14. In particular, the Indian KPO industry is expected to reach nearly USD 5.95 billion in revenues in 2010-11 and USD 10 billion in 2013-14.

Figure 2: Indian KPO Industry – Market Size and Number of FTEs (2000-07)

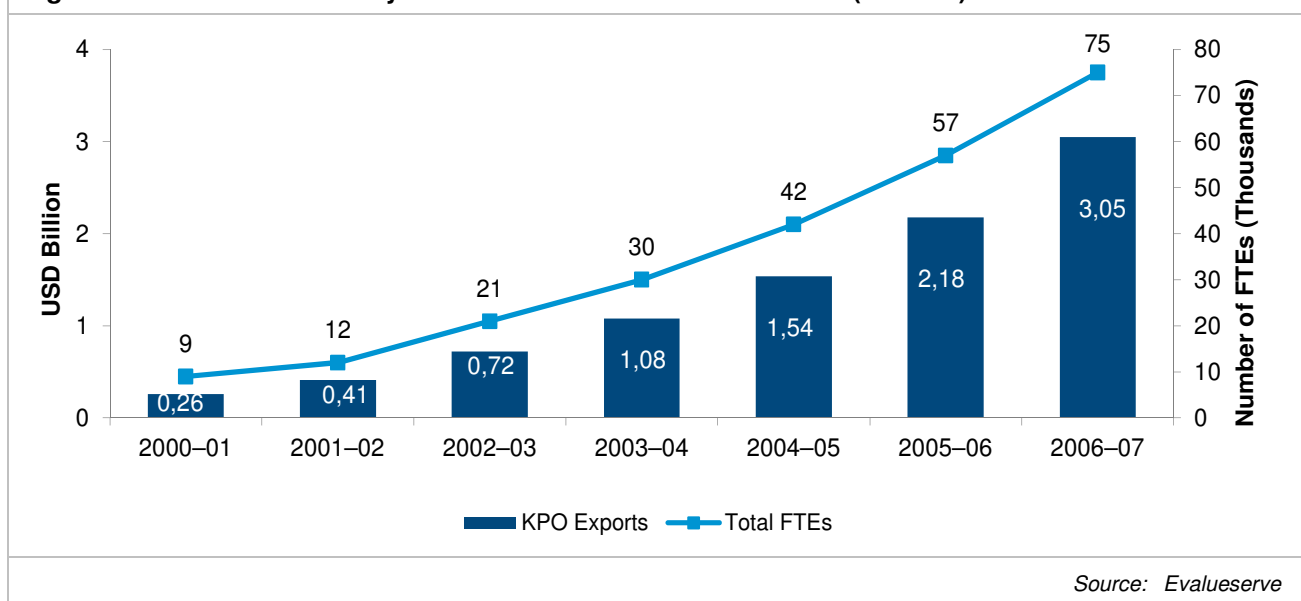
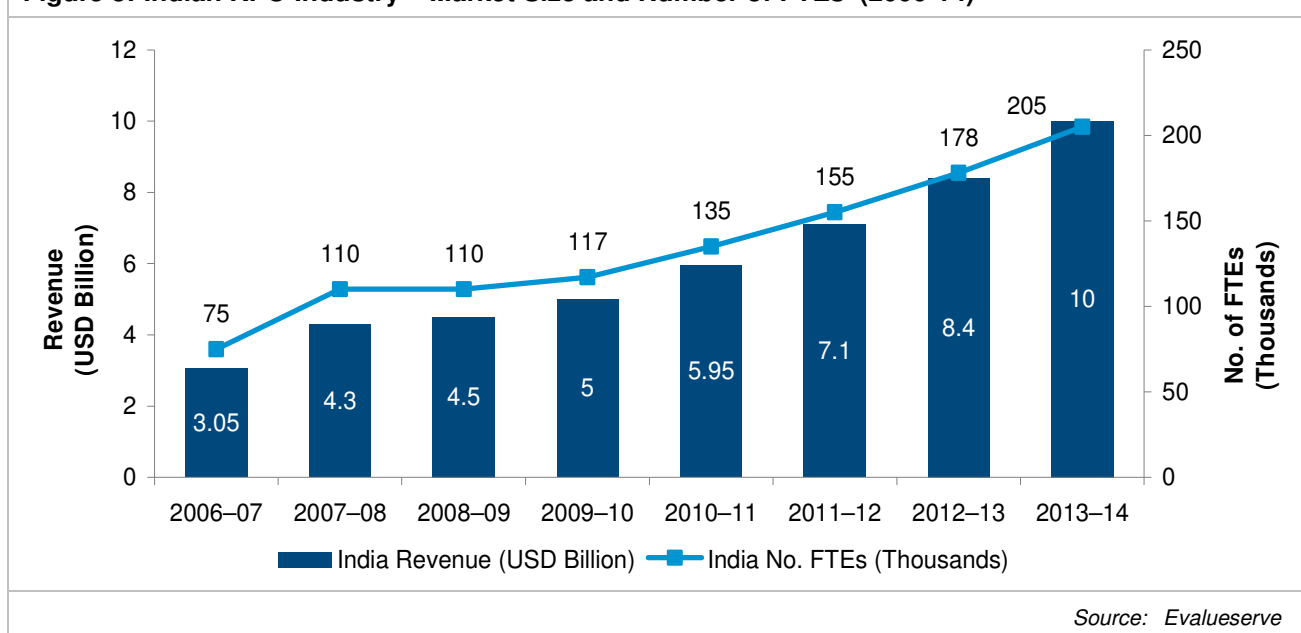


Figure 3: Indian KPO Industry – Market Size and Number of FTEs (2006-14)



Rapidly Growing KPO Sub-Segments

Several sub-sectors have grown fairly well in spite of the recession – and some perhaps because of it. We will highlight three below including (4.1) banking, finance, securities, and insurance (BFSI) research and analytics services; (4.2) legal, paralegal and Intellectual Property (LPO) services; and (4.3) publishing. Conversely, data management, search and analytics services; architectural services; and translation and localization services have proven to be laggards with respect to growth.

BFSI Research and Analytics Services

By March 2007, there were approximately 4,900 professionals in low-cost countries providing BFSI research and analytics-related services. Of this, 3,500 professionals were providing services from India and earning USD 175 million in annual revenue. These services included library information services for investment banks, data modeling, equities research, fixed-income research, insurance analytics, risk analytics and structured products related work. Our estimates show that by March 2010, 11,500 professionals were providing an expanded set of such services from low-cost countries and earning annual revenues of approximately USD 690 million (of which approximately 9,200 were from India earning USD 510 million in annual revenue). The reasons for this growth can be attributed to (a) BFSI traditionally leading the way in cutting costs and adopting new technologies and services (e.g., aggressively sending IT work to low-cost countries in the 1990s) and (b) the Great Recession hitting this industry the hardest because even now, most BFSI firms are cautiously replenishing staff by only using consultants, part-time workers, local and offshore outsourcing.

Legal Research and Legal Process Services

By March 2007, there were approximately 2,700 professionals in low-cost countries providing services related to legal research, intellectual property research, and other legal-related services. Of this, 2,500 professionals were providing services from India and earning USD 95 million in annual revenue. Services included electronic document management services (e.g., word processing, legal transcription, and legal coding, tagging and summarization), electronic document discovery services (i.e., reviewing electronic records for potential discovery in litigation), intellectual property services (e.g., prior art search, landscaping with respect to patents and trademarks, overlap and evidence of use analysis), and legal research services (e.g., preliminary drafting of pleadings, employee contracts, and non-disclosure agreements).

Evalueserve estimates [11] that in March 2010, 5,500 professionals were providing an expanded set of such services from low-cost countries (earning an annual revenue of approximately USD 265 million, of which approximately 5,100 were providing these services from India earning USD 250 million in annual revenue). The reason for this growth can be largely attributed to the Great Recession where the legal departments of large, mid-sized, and small corporations were forced to reduce their costs, which they partly achieved by offshoring and partly by reducing the fees of their external law-firms. In fact, this cost pressure is likely to continue for the next 3-4 years and hence both the legal departments within organizations and corporations as well as law firms themselves are likely to more aggressively offshore low-end work in the legal and intellectual property sectors.

Offshore Outsourcing of Publishing Services

In 2006-07, there were approximately 12,000 professionals in low-cost countries providing services related to publishing; of this, 9,000 professionals were providing services from India, earning approximately USD 300 million in annual revenue. Approximately 55% of this revenue was earned through the creation of content (primarily in science, technology, medical and other academic domains) and by creating and organizing content for textbooks, magazines and business-to-business marketing materials. Evalueserve's estimates show that by March 2010, 29,000 professionals were providing an expanded set of such services from low-cost countries earning annual revenues of approximately USD 930 million (of which approximately 24,500 were from India earning USD 790 million in annual revenue). The reason for this growth can be largely attributed to the Great Recession and the fact that the traditional publishing industry is gradually

losing market share to electronic publishing and is under significant pressure to reduce costs. Indeed, the pressure on traditional publishers will only increase as more people move to reading content online.

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Dr. Alok Aggarwal, the author of the article, is the Co-founder and Chairman of Evalueserve. Prior to starting Evalueserve, Dr. Aggarwal was the Director of Emerging Business Opportunities for IBM Research Division worldwide.