
RESEARCH NOTE

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TO: Catalyst Investors
SUBJECT: Business Process Outsourcing: A Primer

THE BIG PICTURE

Business Process Outsourcing (“BPO”) is a large and growing market for solutions designed to streamline, improve or replace an existing non-core business function. In this report, we provide an overview of the BPO landscape and guidance on what BPO sectors we find interesting. This report is intended as a primer on BPO and our goal is to follow-up with additional reports on specific horizontal and vertical sections that warrant a “deeper dive”. For the purposes of this preliminary report, we have de-emphasized the IT Outsourcing arena within BPO as we feel it is a large enough market that it merits a separate discussion.

BPO YESTERDAY, TODAY AND TOMMOROW

Business Process Outsourcing (“BPO”) is an all-encompassing term which essentially describes **any delegation of certain business processes of an organization to external service providers**. BPO services benefit a wide range of companies – both large companies and SMBs – and span a wide range of offerings, including back office, middle office and customer facing services for both knowledge-based processes and transactional processes. Typically, a company’s contracted BPO services include **the administration of processes that are “core” to business operations, but processes which do not represent the business’s primary revenue or value-generating focus**. This means that BPO services can encompass the hardware, software, as well as staffing components that are required to run an entire business service or set of services – but cannot (or, rather, should not) relate to the businesses’ “special sauce.” Companies use BPO offerings to realize economies of scale, gain access to technology infrastructure without the need to develop solutions in-house, and achieve the ability to focus on core, revenue-generating business functions. BPO changes the operating models of companies by moving a predefined set of activities and outcomes to an external provider.

Over the last 20 years, the BPO market has been rapidly developing and evolving. Technological advances in telecommunications and the Internet have enabled the coordination of different organizational activities at a global level. Originally, the “outsourcing” component of the BPO definition was synonymous with the concept of “offshoring” certain services – to lower cost companies in countries such as India or the Philippines. The supply of skilled, low-cost labor in such countries was appealing to large C-corps who were managing extensive internal teams dedicated to relatively standardized, core business functions such as payroll or customer service. Instead, by outsourcing these functions, companies could realize cost savings of up to 35% - 50% in some instances.

The BPO industry has evolved to include integrated service offerings which span the entire value chain. The industry is no longer solely driven by the providers who outsource basic, service silos such as customer support or payroll. Service providers are now expected to function as more of a “partner” to clients, doing increasingly complex work and taking responsibility for the business outcomes of services. As the global marketplace is increasingly competitive, many companies now see outsourcing as a means by which to drive innovation, rather than solely relying upon outsourcing for narrower goals, such as cost reduction. Additionally, clients have moved downstream; new BPO service and delivery models are compelling for SMBs who do not have the resources in-house to manage back office responsibilities efficiently.

Catalyst’s viewpoint is that there is more-or-less a permanent role for traditionally human capital intensive services, such as call-center services, however it will increasingly be a role that is filled by a smaller, highly-skilled and versatile workforce as the human involvement component is only necessary for more ‘complex’ issues which cannot yet be resolved by automated systems and applications. There will continue to exist needs for technology-enabled managed services that will need to leverage both people and IP to deliver high quality outsourced services.

MARKET SEGMENTATION AND SIZE

In 2015, the global BPO market is expected to **grow 4% YoY and surpass \$950 billion**.¹ The value of worldwide outsourcing deals in 2014 was approximately \$120 billion. Through 2019, the BPO market is expected to increase by at least 15% through organic growth, expanded original scope and added services originating from existing BPO contracts.²

Borrowing from our friends at [Gartner](#), we have divided the BPO landscape into “traditional”, people-based BPO services (“TBPO”) and the more dynamic BPO SaaS offerings (“BPaaS”).

TBPO vs. BPaaS	
"Traditional" BPO or "TBPO"	BPO SaaS, or "BPaaS":
<ul style="list-style-type: none"> • Customized, single-tenant BPO service; less automation • Provider operates (and sometimes hosts) the buyer-specific platform • Analytics available infrequently • Nonstandard SLAs unique to client's development, higher costs than BPaaS offerings • Higher costs than BPaaS offerings 	<ul style="list-style-type: none"> • Highly standardized, multi-tenant service (e.g., single instance of software application services multiple customers) • Platform configuration offered; lacks customization • Reporting and analytics services available • SLAs tied to benchmarking metrics and lower costs • Inclusion of process enhancement technologies and services

Source: Gartner

It is expected that BPaaS market growth will exceed that of TBPO by over 2.5x through 2019, in large part due to the fact that the SaaS delivery model is much more accessible and appealing to SMBs. Gartner estimates that by 2019, more than 75% of new BPO contract sales will be for BPaaS offerings, as factors such as digital business operations, smart machines, the Internet of Things and other broad cloud-based functionalities will fuel investment and innovation in BPaaS.

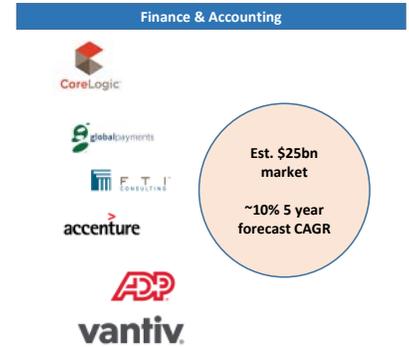
¹ The Complete Business Process Handbook, 2015

² Business Process Outsourcing, Worldwide: Gartner

BPO SERVICES BY HORIZONTAL SEGMENT³

Finance & Accounting (F&A)

- Financial reporting, payroll, accounting, tax services
- Providers seek to streamline processes; often offer multiple services within F&A segment
- “Blend” of traditional labor arbitrage and SaaS; will remain dependent on the talent of people employed in the sector
- Opportunities:
 - Industry is ready for advancement in robotic process automation, analytics and outcome models
 - Complex regulatory changes render outsourcing more advantageous (if properly regulated), especially to SMBs with limited resources



Governance, Risk and Compliance (GRC)

- Management of institutional systems and protocols in place to ensure accountability and sound ethics
- Outsourced risk assessments, process design and incident management, data protection and security
- Opportunities:
 - Industry need for holistic offerings, in order to reduce inefficiency, redundancy, gaps in coverage and a lack of visibility regarding org. risk levels
 - Applicable for highly regulated industries such as financial services and oil & gas
 - Analytics offerings to enhance incident monitoring and reporting real time



Human Resource Outsourcing (HRO)

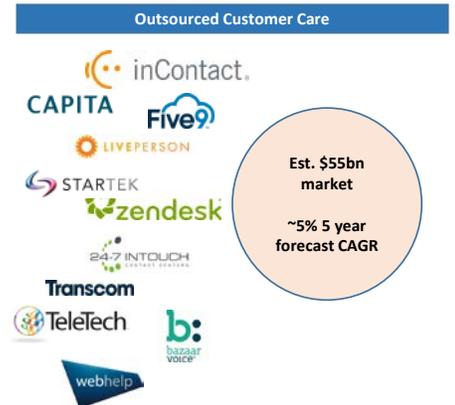
- Human capital management services, payroll and benefits administration, managed services providers, learning process outsourcing, recruitment process outsourcing
- Highly competitive as it is extremely commoditized, but needs further automation and analytics offerings
- Opportunities:
 - Cloud and BPaaS offerings for SMBs are in demand
 - Help companies address complex regulatory landscapes for certain industries
 - Health and wellness administration and services, employee rewards and recognition software and recruitment process outsourcing



³ Market size and growth data for horizontal segments sourced from Robert W. Baird

Outsourced Customer Care (OCC)

- Customer contact centers (technical support, sales, marketing), customer loyalty programs and database management, integrated CRM services
- Commoditized; providers compete by offering a compelling value proposition for how customers will be treated uniquely
- Opportunities:
 - Underserved SMB market
 - Multi-platform offerings (e.g., social media presence, live chat, etc.)
 - Big data analytics which can be used to optimize marketing strategy, predict customer behavior and improve retention / brand loyalty



Operations / Supply Chain Management (SCM)⁴

- Managing the operations along multiple steps of the business process such as logistics, procurement and warehousing, inventory management; master data management; planning and optimization
- Network effect is significant, suppliers and customers benefit from rapid access to streamlined information
- Opportunities:
 - Relatively nascent market, growing at a rapid rate; low competition
 - Expanded product lifecycle management analytics and tracking
 - Big data analytics



SELECTED INDUSTRY VERTICALS

The following are selected preliminary industry verticals that we find compelling.

A. Healthcare BPO

- Can be defined as payor, provider, and pharmaceutical outsourcing
 - Payor market: claims processing, member services, HR services and finance & accounting
 - Provider market: Medical billing, medical coding, medical transcription and finance & accounting
 - Pharmaceutical market: Contract research organizations, contract manufacturing organizations, non-clinical services
- U.S. accounts for largest share of healthcare BPO market driven by recent regulatory changes
- According to Research and Markets, the Global Healthcare BPO market is expected to grow at a CAGR of 5.32% from 2014 – 2019E, driven primarily by increased cloud adoption

B. Commerce / Consumer Service BPO

- Industry experiencing significant pressures to reduce costs and increase revenue while improving customer experience and loyalty
- Integrated BPO models can merge front and back office functions to provide a superior customer experience

⁴ Market size and growth data from Everest Group

- Supply chain management + front office / customer management
- Key imperatives for retailers:
 - Cost reduction
 - Digital retail / strategy and execution of digital strategy
 - Seamless supply chain management
 - Elevated consumer experience
- Integration is key in this industry; crucial to provide customers with flawless end-to-end experience

C. Banking, Financial Services and Insurance BPO

- Tend to be highly specialized BPO services designed to help with credit card lending, consumer lending or commercial lending segments of the financial services market
- Outsourced functions include new customer acquisition services, account servicing processes, consumer and commercial lending services and back office transaction process management
 - Established BPO markets: Payment processing, mortgage processing, core bank administration
 - Emerging BPO markets: Procurement, risk management, compliance, other analytics roles
- Property and Casualty (P&C) and Life and Annuities (L&A) carriers are looking for advanced BPO capabilities
 - Seeking business platforms, robotic process automation, operational analytics, expanded scope of services such as actuarial and underwriting support

D. Legal Services BPO

- Est. at \$3bn global Legal Process Outsourcing (“LPO”) market, growing at 20% annually
- Originally a cost-savings initiative to use paralegals and document reviewers for non-core, tedious or routine tasks such as patent drafting and legal research
- Now, LPO has the following characteristics:
 - Remains very standardized processes which are outsourced
 - Hybrid onshore / offshore models (“best shoring”, dependent on the complexity of projects)
 - Use of technology as a key differentiator (ex.: technology assisted review, such as eDiscovery)
- For SMBs, online legal services can provide easily accessible, affordable legal services
- Larger corporations benefit from using outsourcing companies’ large teams of lower cost, English speaking, highly qualified staff in offshore countries such as India

CATALYST KEY QUESTIONS AND OBSERVATIONS

When Catalyst is considering an investment in a technology-enabled BPO company, it is critical that we understand the following topics for the company we are analyzing:

- The maturity of the sector / subsectors in which the company we are analyzing operates
 - How fast is the addressable market growing? Is the company gaining market share from competitors or converting customers from in-house solutions? Are there outside complexities influencing the “status quo”?
- The “going concern” of key execution tactics for the services in the sector
 - **Do we believe fundamentally the technology-enabled service will continue to require a significant human component and not be automated for the foreseeable future?**
- The deployment of technology and its end goal
 - Is the company leveraging technology to **provide its solution at a lower cost** than competitors or to **provide a better customer experience?**

- High-performing BPO companies **use technology as a source of innovation and advantage, rather than just as the method of delivery**
- Customers expect companies to undertake analytics on transactions / service offerings to improve and add value to the business with features including data mining, decision support tool and consulting services
- The best companies will have **industry expertise, analytics and innovation** that can help a customer utilize the large amounts of data to improve business operations

We have identified several qualities that we find appealing in BPO providers:

- In an attractive BPO business model, **incentives are aligned between the BPO provider and the client:**
 - Outsourcing contracts can be designed so that both the customer and the BPO provider have a risk and reward sharing incentive structure
 - A stronger relationship between the BPO provider and customer should increase switching costs for the customer
- BPO providers should be prepared to properly **mitigate the risks / concerns** that companies have about outsourcing
 - Data privacy and security concerns can be barriers to adoption
 - Providers should manage concerns by implementing innovative, “best in class”, project management strategies
- BPO provider must be able to provide **actionable insights into business strategy**
 - Strategic partnerships between a company and its BPO provider are developed by using technology to provide analytics, automation and digitization
 - Clients will be willing to sign higher outsourcing contracts if partner is executing on business strategy vs. providing cost savings alone
- A streamlined, specialized, highly intelligent outsourced service can be a **barrier to entry**
 - Cost and knowledge barriers are too high for companies to try to develop automated processes internally – forces companies to turn to an outsourcing provider
 - Drain on a company’s internal resources to focus on activities that don’t generate revenue but still require specialization

Catalyst Investors employs a proactive, research-based approach to investing. We target sectors that are experiencing above-average growth. If you are a growth-stage BPO company seeking investment, our team would love to start a dialogue. Please send inquiries and business plans to courtney@catalyst.com.