

Economic crisis: opportunities for developing countries on the EU market

Software and IT services outsourcing

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The European software and IT services sector has been seriously affected by the crisis. IT plays a crucial role in today's economy and because the downturn has hit nearly all vertical markets, IT service providers are facing difficult times. Former drivers for outsourcing and offshoring have been replaced by a trend towards protectionism/insourcing and careful screening of IT projects. Only the most essential investments and projects are being undertaken to keep processes up and running. Once the crisis is over, EU buyers will offshore with a greater intensity than before. Those service providers who dare to innovate, seek collaboration and work proactively will survive.

Opportunities and threats on the EU market

Impact of the economic crisis

In the early days of the crisis experts predicted that IT service providers would mainly benefit from the economic downturn. It was assumed that companies would invest in new solutions to reduce the costs of their processes. However, the opposite has occurred. Many EU buyers are focusing on short-term cost reductions by allocating projects to their own personnel and cancelling or shelving projects that involve a major share of external IT resources. The impact is most significant in the segments operating systems, software development and consultancy. Segments that experience continued demand include system management and application management. These are considered to be essential for companies to stay in business.



Mr Laszlo Klucs, CBI consultant: "In the long run there will be many opportunities for IT service providers from various DCs."

As a result of these developments, the market has turned into a 'buyer's market' with buyers dictating the prices and driving hard bargains. This development has resulted in lower margins for service providers and it has stirred up competition for the remaining IT projects. As a result, domestic service providers have become almost equally as interesting as offshore/nearshore providers. This has increased the pressure on service providers from developing countries (DCs) to secure their share of the market.

Currency fluctuations in several outsourcing destinations are an effect of the economic crisis. This will result in both opportunities for and threats to DC service providers, depending on the distribution of their clients among different currency zones. As a result of currency appreciation in relation to client countries, the attractiveness of major offshore/nearshore destinations, such as China has eroded. Russia on the other hand has become more attractive as a nearshore destination for EU buyers as a result of the depreciation of the Russian Rouble. Bear in mind that this situation might change in the months/years to come. The AT Kearney Global Services Location Index shows that countries whose currency is tied to the US Dollar have benefitted in recent years, as they have become more competitive against virtually all other countries.

Changing dynamics of IT outsourcing

The crisis has put many EU buyers and IT service providers in a difficult position. This has resulted in three important trends:

1. Longer sales cycle

Prior to the crisis the time between initial contact with potential customers and the actual closing of the deal was long. Convincing potential buyers required much time and effort. The crisis has made the sales cycle for IT services even longer. Customers are delaying final decisions to have more time to investigate the implications of the current crisis for their company and industry. In addition, projects are being postponed since EU buyers want to avoid engagement in long-term financial commitments in a rapidly changing market environment.

2. Switch to insourcing

In order to deal with the problems caused by falling demand, companies in various vertical markets are strongly focusing on reducing labour costs. The vertical markets that have been hit hardest by the crisis include automotive, banking and finance and retail. IT outsourcing projects planned with a large share of external IT professionals have been cancelled, put on hold or insourced in order to have enough workload available for their own employees. There is a clear trend of performing the most necessary IT related services in-house and cancelling all non-vital additional services. This trend of protectionism is very strong in the US and China, and has also been observed to some extent in Europe. In general however, the extent to which the crisis has had its effect on IT investments in Europe differs from country to country. Scandinavian countries have been impacted the least, while the UK, Germany, Portugal and Spain have seen demand for IT services decline considerably. Where there used to be a high level of openness towards offshoring/nearshoring among deciders, DC service providers will increasingly feel that negotiations are tougher and potential customers are harder to convince.

3. Increased price pressure

For companies planning to initiate large-scale IT projects as system integration, the use of external knowledge is virtually inevitable. The crisis has put IT service providers in a difficult position when competing for these projects. They face intense competition on price when bidding for contracts that are still being awarded. According to industry experts, price reductions range from 2 to 10% this year on the EU IT service market. Moreover, EU buyers want more value (meaning higher quality/performance) for their money than before the crisis. Large and multinational service providers should have the capacity to cope with these demands for a while, but small and medium-sized service providers could face serious problems.

Difficult times for ITO, but the future looks bright

The current market situation does not look prosperous for DC service providers. However, even in these difficult times there are opportunities that can be seized. Since EU buyers are hesitant to engage in long-term commitments, DC service providers should focus on the market for smaller sized projects and easy to implement IT solutions. There is still significant demand for IT solutions resulting in a fast return on investment for the customer.

Looking beyond the crisis, an additional number of opportunities can be observed in the mid- and long-term. The original drivers for outsourcing will become important again: customers will seek cost reductions through IT solutions, improved business processes and focus on their core activities. As these investments require a large number of IT professionals, the lack of qualified personnel will cause European companies to offshore with greater intensity than before. In addition, small and medium-sized buyers will finally take the plunge of nearshoring/offshoring in search of cost reductions.

How to seize opportunities on the European market

There are several possibilities open to DC exporters to take advantage of the opportunities on the European market.

Short-term recommendations:

IT service providers are highly dependent on the economic situation of customers in their vertical target markets. However, there are some clear actions service providers should undertake now to benefit from the current opportunities on the market:

- 👉 **Focus on fast return on investment (ROI).** Search for (new) services that can offer fast ROI to customers, especially focus on tasks that can be transferred easily from the customer's side (outtasking). Look for solutions around services that are still in high demand despite the crisis, such as IT security (e.g. remote configuration and maintenance of firewalls) or virtualisation services. Other areas of interest suitable for high ROI could be application services and Software as a Service (SaaS). To stimulate the interest of your potential customer you should include a calculation of potential cost savings in your offer. Finding out which services can provide fast ROI requires proper research, both in-house and among your customers. Determine the areas of excellence within your company and evaluate which solutions can be developed in that field. Make sure your company has the capacity for the necessary operations. After that you should investigate the needs of your target group. Contact your network and stress the fact that there are mutual benefits involved, so called gainsharing.
- 👉 **Be proactive.** Instead of waiting for the crisis to blow over, now is the time to prepare your company for better days. Expand your EU network and keep it alive by visiting conferences and (potential) customers. The aim of this contact is not only to sell, but to know what is on your customers' minds. Having a good network can benefit your chances for future sales because you will be better equipped to match your offer to the needs of your (potential) customers. It is advisable to assign these visits to an employee with experience in Europe since a practical knowledge of common EU business practices is very important. To get to know all the ins and outs of your target market and the changes caused by the crisis you should perform market research and do a competitor analysis. Gain access to the knowledge of relevant industry associations directly or with the help of your customer. Use all your contacts and research to understand the nature of changes in markets and future developments. It is possible to benefit from these opportunities by differentiating your offer.

Changed attitude towards outsourcing

An example of a change in the market is that more companies have become interested in outsourcing. Some industry branches and smaller companies that had not been very open to outsourcing and offshoring/nearshoring prior to the crisis have now come under high cost pressure and are therefore ready to consider these practices. The companies and branches showing this change of attitude vary from country to country. One example is the German retail sector. Before the crisis this sector was characterised by small margins and a reluctance to outsourcing. Now the sector is under even higher cost pressure and is suffering from low liquidity. As a result, achieving cost reductions has the highest priority within this sector. More and more companies are realising that IT projects in particular will help to reduce cost on non-core business processes.

Also read reports of research institutes to stay on top of developments in the market, some examples are:

- 🌐 EITO - <http://www.eito.com> - 'The financial crisis and ICT markets in Europe'
- 🌐 Nasscom - <http://www.nasscom.org> - 'Impact of the economic crisis on outsourcing'
- 🌐 PAC - <http://www.pac.com> - webinar 'How to survive in the Western European IT market'

When analysing research reports, be aware of:

- **Coloured results.** Results may be coloured, either positively or negatively, by the specific interests of the agencies.
- **Service description.** Definitions of services and segments within IT differ per source.
- **Outdated reports.** Check the publication date and if the reports cover recent findings instead of surveys dated 4 months ago.

Golden rule: Perform additional qualitative research!

- 👉 **Transparent communication.** Stress your reliability in all your communication to (potential) customers and provide openness on issues such as creditworthiness. Demonstrate transparency and respectability by inviting potential customers to visit your nearshore/offshore facilities at any time, grant audit visits to your locations. Prove your reliability by referring to high rankings in important country risk indexes. Good examples are the rankings of AT Kearney (<http://www.atkearney.com>). Go to 'Our expertise' and click on 'Global Business Policy Council'. Use the rankings to formulate a positive article about your country.
- 👉 **Safeguard jobs of qualified staff.** Maintain your competitiveness by retaining skilled IT professionals. Keep in mind that despite the pressure on your company's profits, laying off employees will lower your ability to react when the market opens up again. In the case of declining demand you should allocate abundant staff to (new) in-house projects. These can either be related to developing solutions for the short-term (e.g. fast ROI solutions) or in the area of seizing long-term opportunities.

SPECIALISE – INNOVATE – COLLABORATE

Long-term recommendations:

A sign of recovery in the market means you have to be there to win the order. The following actions will prepare your company for that moment:

- ➡ **Specialise.** Focus on (a few) vertical/horizontal markets and approach customers in these markets by showing industry and technology specific expertise. There is a clear trend among EU buyers to select the 'best-of-breed' for each service they need. In the near future, specialised service providers have the best chances of winning contracts. To achieve this level of expertise you should set stringent performance levels for employees and hire more domain specialists. Consider (temporarily) employing foreign domain experts who stem from your target market(s). They can help you to build up domain knowledge, improve communication with and understanding of customers and gain higher credibility when making proposals. Within the crisis such experts are more affordable, easier to find and more willing to relocate.
- ➡ **Innovate.** Develop solutions that cater to the specific IT needs of your customers, instead of providing highly standardised services. According to EU experts, the solutions DC service providers are able to offer to the local market usually lack the proper level of innovation for the EU market. Foreign experts can help you to understand the national particularities which many domains are characterised by. Invest in research and development to make the switch to more advanced technologies. Thereby, focus on current and expected trends in the market. The issue of "Green" IT for example will grow in importance in the years to come. Green IT initiatives will no longer be considered optional, but will become a must for every service provider, provided that the solution reduces costs as well. To upgrade the level of innovation in your company you should:
 - Assign a small group of employees in your company to monitor market developments. Work out the best strategy to implement these technologies or processes and benefit from these trends.
 - Cooperate with university research departments. For many of your EU competitors this has proven to be a successful strategy in the past, because it has provided them with the competitive advantage needed to survive in a highly competitive market.
 - Set up local research training centres, possibly in cooperation with industry associations. By creating a local technology hub more related companies can be interested in working together. This will increase capabilities and accessibility of markets for all participating parties.
- ➡ **Collaborate.** Improve your chances of success by engaging in strategic alliances with other local service providers. This can only be realised if DC service providers do not see other companies as competitors, but as colleagues. In practice, several smaller companies can tender for larger contracts. Cooperation is possible in many business processes, such as research and development, sales and marketing activities. Make sure you have a wide scope and do not limit your search to other software and IT service providers. Work together with the local end-users of your solutions, for example a call centre service provider who uses an advanced database system. This company can provide you with valuable input on positive and negative experiences. In cooperation with this company you can offer new services such as a user help desk, which you could not offer alone without high investments and risks.
- ➡ **Follow up on developments.** Solutions and delivery models in the IT services sector are changing rapidly and it is your job to keep abreast of them. For example, to play a role on the emerging market for software-as-a-service (SaaS) you need specific knowledge of developing this type of software, designing adjusted processes and the proper infrastructure to sell these services.

**Conclusion**

The economic crisis has resulted in a longer sales cycle, protectionism and price pressure. In the short term, there are chances for DC service providers who will act proactively. The investments necessary to benefit from short-term opportunities will also be useful for the long-term. In the years ahead, the EU market will adopt offshoring to a much larger extent than before the crisis, offering many opportunities to well-prepared companies.

This article was compiled for CBI by Facts Figures Future

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