

COMPETITIVE ANALYSIS

Expanding the Application Outsourcing Lens: 2008 Integrated and Discrete Views

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IDC OPINION

2008 was a strong growth year in traditional application outsourcing (AO) services, with discrete YoY growth estimated at 16% among the top 10 global AO service providers. Vendor-side research indicates some shift toward increased standalone AO contract activity. With the economic recession slowing decisions in the latter half of 2008, some customers became more focused on aggressively driving cost reductions and chose to increase transparency over application management (AM) engagements by separating out bundled deals as they came up for renewal. Yet a broader review of contracts indicates that others elected to leverage AO embedded within broader infrastructure deals. This 2009 update highlights the following findings:

- ☒ IDC estimates that as of year-end 2008, \$31.2 billion was earned in application management revenue among the top 10 global AO providers, with nearly 65% tied to discrete engagements and 35% integrated within larger IS outsourcing (ISO) contracts. Expanding this view further, \$40.8 billion is estimated to represent 2008 combined AMS revenue for the top 25 global vendors.
- ☒ Revenue estimates continue to support the view that key global players have grown sizable AM practices embedded within ISO infrastructure deals (e.g., IBM, HP-EDS, CSC, and Siemens AG), while Indian pure-plays continue to build their discrete AM practice, with some pushing harder to build up their ITO services revenue (i.e., Wipro Technologies and Tata Consultancy Services).
- ☒ According to IDC estimates, IBM continues to hold a significant combined AMS lead at approximately \$8.0 billion, reflecting its ongoing flexibility in evolving an AM practice that supports discrete and embedded AM solutions.
- ☒ As the economy remains contracted into 2010 with companies facing continued IT budget reductions, some customers will drive toward increased vendor consolidation at lower rate structures to further rationalize costs. As such, it remains critical for outsourcers to focus on optimizing their traditional outsourcing models using advanced technologies to support increased scalability, adaptability, and lower costs. The pursuit of a transformational agenda among outsourcers is critical as customers pursue greater AO cost efficiencies while pushing for higher value services that integrate reusable frameworks for application, business process, or quality assurance risk mitigation.

IN THIS STUDY

This IDC study continues to assess how the top 10 global AO service providers are performing as they expand their annuity-based revenue streams through a mix of discrete and embedded AM strategies. This document provides suppliers and customers with greater visibility into the world of AO by leveraging IDC's historical focus in discrete AM revenue and expanding it to include AO services bundled within IS outsourcing engagements. This study excludes AO that is embedded within larger business process outsourcing (BPO) contracts.

Methodology

The vendor revenue presented in this study represents IDC's best estimates based on the following methodology. Bottom-up/company-level data collection began in the winter of 2009, using multiple in-depth vendor interviews and analysis to refine detailed 2008 company models, which are updated on a quarterly basis. These interviews focused not only on AO but also on the larger financial company model to understand company strategies in how AO is packaged with other services, such as IS outsourcing, or linked into consulting or discrete project engagements, such as application development (AD) or system integration (SI) services.

For public vendors, we evaluated financial data and adjusted our 2008 estimates accordingly. Additional information was provided through an analysis of the companies' financial statements, annual reports, press releases, position statements, vendor interviews, customer case studies, and other public information. This activity forms the basis of the vendor revenue estimates reported in this document.

As part of the due diligence used in deriving a top 10 list, we shared our revenue estimates with all of these companies, asking them to review our estimates and provide feedback about accuracy. Not all companies are able to comment on AM-specific revenue as defined by IDC; therefore, the revenue data provided in IDC's top 10 list is not based on published figures but is an IDC estimate.

All revenue is stated in U.S. dollars. Currency conversions are therefore required for companies that report outside the United States. IDC has standardized its exchange rates and converts currency on a quarterly basis based on the latest calendar quarter rates and on an annual basis based on an average of the quarterly rates.

Note: All numbers in this document may not be exact due to rounding.

Methodology Changes

It is important to note that the analysis in this document reflects changes in IDC's view of the overall AM services market and the major vendors' 2008 revenue. Several changes include the following:

- ☒ **Updated company models.** IDC is continually updating its view of vendor revenue splits. These internally produced company models have changed for a number of the vendors included in this study. Moreover, as IDC has gained more

insight into the broader vendor model in regard to AO, this has required adjustments to the discrete component, while bringing greater clarity to the bundled component.

- ☒ **AO revenue view per vendor.** 2008 marks the second year that IDC has developed an estimated bundled and discrete AO revenue view per vendor.

Application Outsourcing Definition

AO is often used to indicate a broad set of outsourcing services, which include discrete application management (AM) functions that may be coupled with a range of project-based modernization activities.

Overall, AM services are designed to provide for the day-to-day operations, support, and maintenance of enterprise applications. AM services include but are not limited to end-user support, monitoring, proactive problem avoidance, issue resolution, service restoration, and root cause analysis. Patching, application enhancements, and operational responsibility for application performance and uptime are often core services. Various project-based activities can also occur within an AM contract, including package customization, implementation and integration, portfolio optimization, and legacy modernization. The main value proposition of AM services is that these services free IT budget and staff from the usually higher cost of in-house management of enterprise applications and allow access to the generally higher service levels and AM expertise offered by outsourcers.

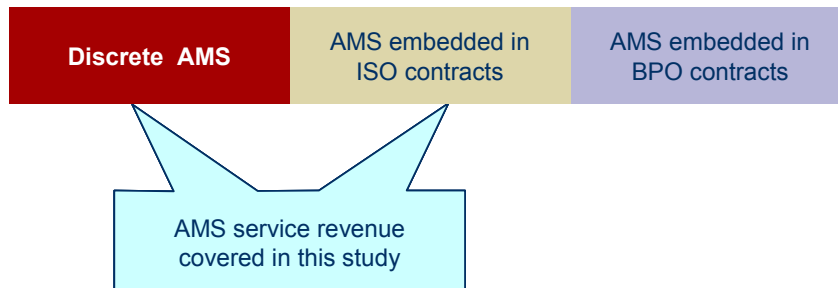
Distinguishing Discrete and Bundled Application Management Revenue

The IDC revenue estimates in this study reflect our best understanding of service providers' discrete AM services revenue for 2008 and estimated AM services revenue bundled as part of larger ISO engagements. By *discrete*, we mean that this revenue is captured from contracts *primarily* designed to provide AM services with 24 x 7 application monitoring functions and SLAs included. AM engagements that incorporate an application development component (e.g., modernization or enhancements) are included. AM revenue that these companies collect inside of broader IS outsourcing is identified in the bundled view per vendor. AM revenue collected as part of business process outsourcing contracts is, to the best of our ability, excluded from this study.

To provide further guidance, most, if not all contracts, are made up of multiple statements of work (SOWs). If an AM SOW is tied into/added on to a distinct engagement in which the provider is primarily focused on managing the application(s) and it is not linked into a larger ISO deal, then IDC would view it as a discrete application deal. If an AM SOW is added on to a bundled ISO engagement where the primary purpose is IS outsourcing, then IDC would view it as part of a bundled ISO contract. This is illustrated in Figure 1.

FIGURE 1

Company X's Total Application Management Services Revenue



Source: IDC, 2009

A Note on Application Outsourcing Versus Application Management

IDC often uses the terms *application outsourcing* and *application management* interchangeably. IDC's formal market name is *application management*, but the term *application outsourcing* is often used to indicate a broader set of services, including discrete application maintenance services. As this study reflects application maintenance services that may include a transformational component, in addition to AM bundling within larger ISO engagements, IDC has chosen to use both terms in discussing vendor application outsourcing revenue and the growing importance of this revenue stream.

SITUATION OVERVIEW

IDC's 2008 Top 10 Providers in Global Application Management Services

The top 10 worldwide AM providers, in the aggregate, attained estimated revenue of \$31.2 billion in 2008, reflecting combined (IDC estimated) discrete and bundled AM revenue. The discrete AM revenue for this vendor group is estimated at \$20.2 billion for CY08, or nearly two-thirds of the total, while the AMS revenue bundled within ISO engagements is estimated at \$11.0 billion. In an even broader view, the top 25 worldwide AM vendors are estimated to have reached total AMS revenue of \$40.1 billion in 2008.

Table 1 presents a view of estimated global AMS revenue, with percentage allocations identifying the distribution in discrete versus bundled AMS revenue (with ISO) for the top 10 category. Revenue estimates in Table 1 exclude AMS integrated into business process engagements.

TABLE 1

Worldwide Consolidated Application Management Services Revenue by Top 10 Vendor, 2008

2008 Rank	Vendor	Revenue (\$M)	AM Bundled with ISO (%)	Discrete AM (%)
1	IBM	8,048.2	36.7	63.3
2	Accenture	5,530.5	5.1	94.9
3	HP-EDS	5,255.7	56.4	43.6
4	CSC	2,942.3	65.2	34.8
5	Tata Consultancy Services (TCS)	1,865.2	14.9	85.1
6	Siemens AG	1,733.3	68.4	31.6
7	Fujitsu Ltd.	1,547.8	46.6	53.4
8	Capgemini	1,477.4	20.6	79.4
9	Infosys	1,453.1	6.3	93.7
10	Atos Origin	1,322.4	22.4	77.6
	Subtotal	31,175.8	35.3	64.7
	Top 11–15	4,985.0	12.5	87.5
	Top 16–25	4,626.1	21.4	78.6
	Total	40,786.9	30.9	69.1

Notes:

Total AMS revenue includes both discrete AM and bundled AM within ISO.

Bundled percentage specifically represents estimated AMS revenue bundled with ISO services. Estimated AM revenue embedded within BPO is excluded.

Source: IDC, 2009

IBM maintained a significant lead in combined global AMS revenue in CY08, reaching an estimated \$8 billion. A shift toward increased discrete contract activity is noted, with the percentage of discrete AM increasing from an estimated 59% in the 2007 study to 63% in 2008. In the latter half of 2008, the discrete value proposition for customers was weighted toward realizing greater cost reductions and streamlining operations. IBM was able to respond to customer demand to accelerate the pace of reductions, leveraging its optimized global delivery model of offshore, nearshore, and onshore capabilities, in combination with flexible contractual arrangements.

Accenture experienced strong global discrete AO activity in 2008, with 17% YoY growth. Its application-centric and asset-light strategy continues to frame its go-to-market approach, with an industrialized AO program driving its dedicated sales organization. Accenture's focus has been to help customers increase the overall operational efficiencies of their application portfolios, often beginning with a few applications and expanding upon the inventory of assets that are taken under its management. Collaboration between its consulting, SI, and outsourcing groups help identify new opportunities and drive additional contract activity.

HP-EDS is also pushing toward increased discrete AO activity. Postmerger activities between HP and EDS (from 4Q08 onward) continue to influence the integration of their combined application service portfolios under EDS, now an HP company. The combined entity also brings significant infrastructure expertise to the broader IT stack that supports embedded AO deals.

While CSC historically built out nearly two-thirds of its AO revenue through embedded IS outsourcing deals, it is increasingly shifting its strategy to support discrete AO contract activity. Its renewed focus on strengthening its broader application portfolio as well as industrializing a number of vertical practices is opening up increased opportunities to sell standalone AO contracts. The distribution of its discrete versus embedded AO revenue estimates in CY08 is under review.

Tata Consultancy Services showed healthy 17% YoY growth in discrete AO revenue in CY08. Analysis indicates a small shift toward greater discrete AO contract activity in 2008, adjusting from 84% in 2007 to 85% in 2008.

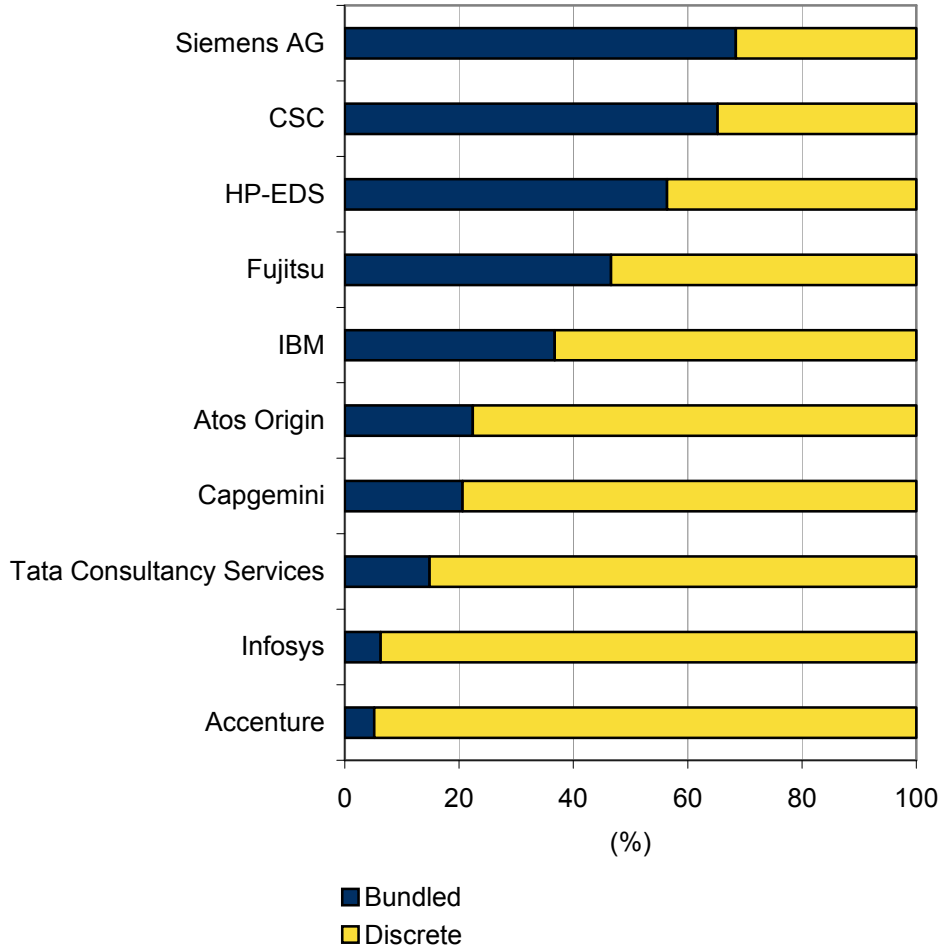
Interviews with Siemens AG indicate that discrete AO activity was stronger in 2008, with a corresponding shift from 28% estimated in 2007 to 31.6% in 2008. Total global AMS revenue, including the embedded AO with ISO portion, is estimated to have reached \$1.7 billion in 2008.

Deeper analysis of Capgemini AO revenue growth, particularly in Western Europe, has resulted in an upward adjustment to its estimated global AMS revenue to \$1.5 billion in 2008. This places it in eighth position among the global top 10 players in this combined AMS assessment.

Other companies, such as Fujitsu Ltd., Infosys, and Atos Origin, showed minimal shift in estimated discrete AO versus embedded AO revenue in 2008, compared with the 2007 analysis (see Figure 2).

FIGURE 2

Worldwide AMS Revenue Distribution for the Top 10 Vendors:
Bundled Versus Discrete, 2008



Note: Bundled percentage specifically represents estimated AMS revenue bundled with ISO services. Estimated AM revenue embedded within BPO is excluded.

Source: IDC, 2009

Top 11–15 AO Vendors

The next tier of high-performing AO providers with sizable consolidated AM revenue includes Cognizant, Logica, Wipro, NTT DATA, and CGI. IDC estimates that Cognizant AMS revenue is heavily weighted toward discrete deals, with 2008 combined revenue revised upward to \$1.32 billion. Logica has an estimated \$1.05 billion in combined AMS revenue, with approximately 95% tied to discrete AM deals. Wipro has similar leanings toward discrete, with 90% of its AMS revenue being unbundled, representing slightly over \$1 billion in 2008. Approximately 87% of CGI's AMS revenue is estimated to come from discrete AM engagements, with a total AMS revenue estimate of \$757 million.

Trends

- ☒ **Economic downturn influences discrete AO deals.** The analysis of 2008 AO service revenue provides some support to the premise that the AO trend is shifting toward discrete, more modular service contracts. Indications from this research are that service providers that were offering highly flexible embedded or discrete options continued to win opportunities on both fronts. In some cases, having this broad portfolio capability is key to inviting customers in to reassess how to best manage their own outsourcing strategies. According to IDC application services survey research conducted in 1Q09, 32% of a 400 U.S. respondent sample expressed interest in the bundling of AO and IO (infrastructure outsourcing) services. Figure 3 presents an overview of enterprise bundled outsourcing preferences as surveyed in 1Q09. While a customer may choose to bundle or unbundle, knowing that the provider is experienced in the management of large-scale systems management across the infrastructure and application stack brings added confidence that different renegotiation options are possible. Furthermore, during the latter part of 2008, in response to the global economic crisis, companies did slow their rate of decision making on how they would plan to renew or add on AO contracts, whether they would be unbundled, reduced, or augmented in nature, depending on available capital and operating expenditures. Yet, based on many vendor interviews, it was apparent that some customers chose to focus more on discrete deals to drive cost reductions, with the ability to monitor efficiency gains on a more granular level (e.g., use of KPIs and ROI tracking).

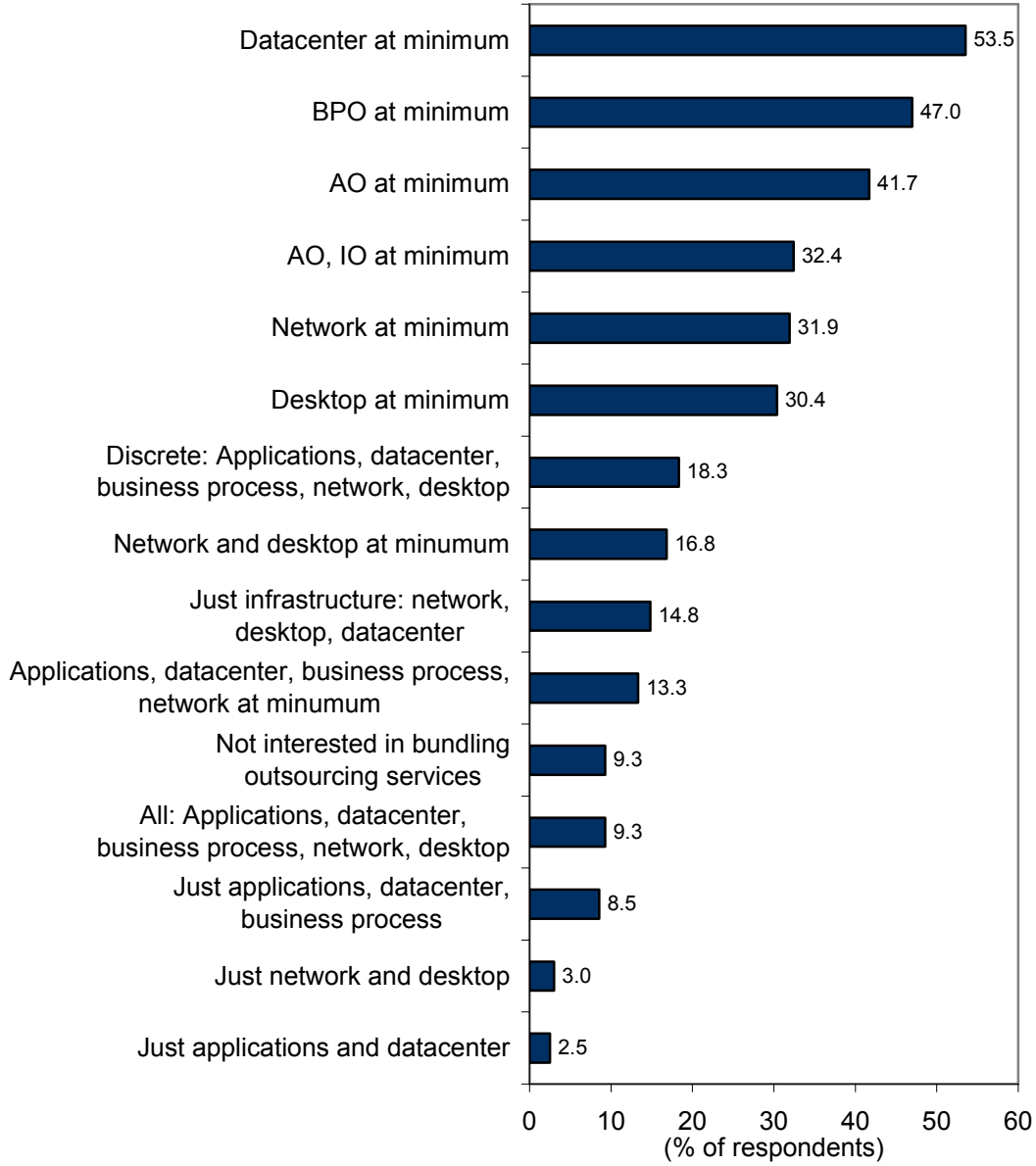
- ☒ **Fixed and outcome-based pricing structures.** Interviews with customers and providers further indicates that adoption of risk- or outcome-based pricing is still in its nascent stage of adoption. Customers that have a number of years of experience in AMS may opt for outcome-based pricing models where they have gathered detailed insight into the current productivity levels that shape an AO engagement. This has a greater likelihood of occurring when the vendor and the customer both have sufficient knowledge of the current application performance and the vendor is willing to step up to some level of risk sharing as effort is directed toward introducing additional efficiencies (e.g., increased infrastructure or application virtualization and leveraging variable on demand infrastructure as part of a private infrastructure environment). Some providers do offer a cost-per-incident or dollar-per-concurrent-user approach in AMS, with the goal of reducing IT costs as productivity improvements increase. This continues to mark a very gradual shift away from fixed-price AMS contracts toward variability in IT cost structures.

- ☒ **Patterns in renegotiation.** Supplier research continues to support the guidance that initial experiences in bundled approaches can lead into unbundled engagements during contract renewals, or vice versa, emphasizing how companies apply their expertise to increase the business value of follow-on outsourcing contracts. Yet cost containment, risk mitigation, and operational performance improvements remain the strongest drivers to AM adoption at this time and are expected to hold this trend through 2010.

FIGURE 3

Enterprise Outsourcing Portfolio Requirements over the Next 24 Months

Q. Please select which outsourcing services you would look to bundle together within a single outsourcing contract over the next 24 months, even if you are not actually planning to do so.



n = 398

Note: Multiple responses were accepted.

Source: IDC's 2009 Application Services Survey, February 2009

FUTURE OUTLOOK

IDC expects that global service providers will continue to look for ways to adapt their application service portfolios to drive toward greater operational efficiencies in AMS, especially as the economic downturn continues. Tighter linkages and collaboration between consulting, discrete project, and outsourcing teams are expected to continue to allow for more effective mining of opportunities across existing clients. Some providers such as Accenture have already operationalized a direct sales organization to focus on AO. Others will continue to incentivize their sales organization to sell across the organization.

The relative importance of business intelligence tools and independent or integrated validation services continues to show traction within the broader portfolio of enterprise service requirements. IDC expects these components will become more critical to the broader application service portfolio as companies continue to look for improvements in quality of service or product delivery, leveraging these services as part of a larger risk mitigation strategy or accelerated time-to-market approach.

Global integrated delivery models that scale with fluctuating demand will require well-honed, automated, and virtualized operational frameworks. As the economy gradually recovers, clients are expected to increase their expansion requirements regionally and globally and will be looking to outsourcers to adapt existing footprints to future demand and coverage needs. There will be continued pressure to improve operational performance, with clients requesting application management services that integrate infrastructure management tightly with AM for consolidated performance metrics and improved end-user experiences.

New service delivery models are gaining ground, with online providers pushing their as-a-service solutions (e.g., PaaS, BPM as a service, and integration as a service). These new commercial ventures will run in parallel with outsourcers continuing to market their traditional custom, packaged, and integrated application services. Enterprises will view IT portfolio management from multiple perspectives, integrating legacy assets with newer service delivery solutions (e.g., hosted AM, SaaS, and infrastructure as a service). IDC expects that enterprises will continue to keep an eye on evolving a consolidated data and IT system architecture where costs are contained as system needs grow.

It is expected that companies will look for additional cost efficiencies they can gain through private, hybrid, or public cloud-based models. Enterprises that have already begun the journey of experimenting with private cloud configurations may turn to outsourcers to evolve this type of framework in ISO deals. Some will turn to hosted infrastructure providers that are offering hybrid models, allowing customers to hold a set of dedicated assets with the ability to scale with a shared virtualized pool of assets based on fluctuating demand curves. IDC expects that once companies become comfortable at leveraging utility-based models for storage- and infrastructure-level needs, they will increasingly turn greater interest to applying virtualization at the application level. They will be expanding on their use of new Web 2.0 application platforms as well as adapting portions of their legacy portfolio to fit into this more modular, componentized approach.

ESSENTIAL GUIDANCE

The application outsourcing landscape is expected to remain highly competitive as customers continue to look for ways to reduce costs while introducing greater value into the outsourcing equation. In line with this, IDC believes it is important for providers to highlight their successes as well as show their willingness to be "trusted" partners in supporting the tighter alignment of corporate IT systems with near- and long-term business objectives.

Even with the proliferation of cloud models, enterprises are still expected to continue to adopt AO as a means to drive increased cost efficiencies into their operations. With strong growth still expected in this market segment, it is critical that the maturity, flexibility, and depth of service provider portfolios keep pace. IT service providers that plan to increase their share of the application management services market, either through discrete or bundled engagements, need to focus their efforts on the following areas:

- ☒ **Outsourcing value proposition.** Outsourcers in the AO market need to continue to refine their value propositions, which should resonate with low-cost, high-quality, proactive application management solutions that extend up the infrastructure and application stack. Elements of transformation and integration, speed and reliability of automation, and global scalability will remain important factors influencing this space. Moreover, localization, personalization, and greater mass customization will evolve into more critical components as virtualized hosted delivery platforms become more accepted paths forward.
- ☒ **Thoughtful RFP responses.** Interest and commitment to an engagement begins at the RFP stage. Potential customers initiate their provider selection process early on in the RFP stage, and it is important for providers to respond to RFPs with care and limited "boiler plate" output. Customers may eliminate a well-qualified vendor if the RFP feedback is poorly crafted in support of any engagement, no matter how small. Customers are highly sensitive to the attention they receive throughout the RFP process.
- ☒ **Expansion of application service capabilities.** Outsourcers will need to continue to optimize their traditional AM service portfolio. This will require the increased use of virtualization at the application layer, supporting advanced modular design for legacy and newer code development. Composite application life-cycle support is expected to take on a greater role as application integration and proactive AM services are needed in support of these newer development models.
- ☒ **Offering flexible discrete or bundled AM contracts.** Maintain flexibility in contract options. Promote both discrete or bundled AM within larger IS- or BPO-type contracts with output-based pricing strategies. Embed transformational services (e.g., consulting, application optimization, consolidation, or integration) as part of AO engagements. Even during these difficult economic times, companies are looking for ways to improve the operational efficiencies of their application portfolio. It is important to think outside the box for opportunities to enable this, even within tight budgetary constraints. Lengthy portfolio assessment must be collapsed into shorter review cycles with concrete recommendations for how to provide short-term ROI options.

- ☒ **Developing cloud-based strategies.** A key component of success for outsourcers is the need to have a well-integrated application platform strategy. This will enable outsourcers to evolve their own expertise in designing, provisioning, and managing highly dynamic virtualized infrastructure and application environments. The use of private cloud or hybrid cloud services in conjunction with custom or packaged application management is another opportunity. Partnerships with or enablement services for support of online/cloud-based providers will also be key in evolving the spectrum of application services as newer models leverage online developer and test communities across different platforms.

LEARN MORE

Related Research

- ☒ *Worldwide and U.S. Discrete Application Management Services 2008 Vendor Shares: IDC's Top 10 Vendors* (IDC #218356, July 2009)
- ☒ *Cloud-Based Application Development and Testing Services: Customers' Leading Requirements and Provider Preferences* (IDC #217995, May 2009)
- ☒ *2009 Application Testing Demand Side Survey Results* (IDC #218108, April 2009)
- ☒ *2009 Application Services Demand Side Survey Results* (IDC #218106, April 2009)
- ☒ *Brand Impact: U.S. Companies Rank IBM, Microsoft, Oracle, HP-EDS, and Accenture as Top 5 Vendors for Application Modernization* (IDC #217877, April 2009)
- ☒ *Brand Recognition: U.S. Companies Rank IBM, Microsoft, Oracle, HP-EDS, and Accenture as Top 5 Vendors for Application Outsourcing* (IDC #217876, April 2009)
- ☒ *Brand Awareness: U.S. Companies Rank IBM, Microsoft, Oracle, HP-EDS, and SAP as Top 5 Vendors for Application Testing Services* (IDC #217880, April 2009)
- ☒ *Despite the Need for Belt Tightening, Customers Are Looking for Long-Term Sustainability* (IDC #1cUS21742809, March 2009)
- ☒ *Worldwide and U.S. Hosted Application Management Services 2009–2013 Forecast* (IDC #217157, March 2009)
- ☒ *Worldwide and U.S. Application Management Services 2009–2013 Forecast* (IDC #217144, March 2009)
- ☒ *Offshore Application Development: Strategies to Consider* (Financial Insights #FIN216451, February 2009)

- ☒ *Cloudy Camaraderie Coming: Who's Your Partner?* (IDC #IcUS21623009, January 2009)
- ☒ *Worldwide Outsourcing Services 2009 Top 10 Predictions: The Impact of a Turbulent Economy and Continued Disruptions* (IDC #216190, January 2009)
- ☒ *Capgemini Begins Wrapping Cloud "Best Practices" Around Amazon Web Services* (IDC #215609, December 2008)
- ☒ *Global Testing Services: Coming of Age* (IDC #214504, October 2008)
- ☒ *Zooming Out to Capture the Broader Application Outsourcing Opportunity: 2007 Integrated and Discrete Views* (IDC #214063, September 2008)
- ☒ *Platform-as-a-Service: As Clouds Form, Outsourcing's Role Not So Nebulous* (IDC #IcUS21255608, May 2008)

Synopsis

This IDC study presents the second assessment for how the top 10 global AO service providers are performing as they expand their annuity-based revenue streams through a mix of embedded and discrete AM strategies. Enterprise adoption of application outsourcing services remained strong in 2008 as companies recognized the value of these services in driving greater operational and cost efficiencies.

"Discrete and bundled AM service revenue reached an estimated \$40.8 billion in 2008 for the top 25 global service providers," said Rona Shuchat, director of Application Outsourcing Services at IDC. "This reflects continued adoption of AO third-party services by the enterprise customer, with a particular emphasis on leveraging AO to drive cost reductions and increase operational efficiencies."

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