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EXCERPT

Zooming Out to Capture the Broader Application Outsourcing Opportunity: 2007 Integrated and Discrete Views (Excerpt from IDC #214063)

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IN THIS EXCERPT

The content for this excerpt was taken directly from the IDC Competitive Analysis Report, *Zooming Out to Capture the Broader Application Outsourcing Opportunity: 2007 Integrated and Discrete Views*, By Rona Shuchat (Doc # 214063). All or part of the following sections are included in this excerpt: IDC Opinion, In This Study, Situation Overview, Future Outlook, Essential Guidance, Learn More, and Synopsis. Also included is Table 1.

IDC OPINION

The traditional application outsourcing (AO) model continues to evolve, with client contracts often mirroring their experiences and expertise as first-, second-, or third-generation users. Supplier research indicates that as companies gain more awareness into how to increase outsourcing benefits, they may push for either a bundled or unbundled strategy that best meets their business objectives. This 2008 groundbreaking study highlights the following findings:

- IDC estimates that as of year-end 2007 nearly $27 billion was earned in application management (AM) revenue among the top 10 global AO providers, with 64.2% tied to discrete engagements and 35.8% integrated within larger IS outsourcing (ISO) contracts. Broadening this view further, over $35 billion is estimated to represent 2007 combined AMS revenue for the top 25 global vendors.

- Revenue estimates indicate that most traditional players have grown sizeable AM practices embedded within ISO infrastructure deals (e.g., IBM, EDS, CSC, Siemens), while Indian pure-plays have clearly started from a discrete AM focus. This is shifting as most outsourcers strengthen their services to address the full IT stack.

- According to IDC estimates, IBM held a significant combined AMS lead at nearly $7.3 billion, reflecting its historical growth and flexibility in evolving an AM practice that supports discrete and embedded AM solutions.

- To remain competitive, service providers will need 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

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reusable frameworks for application, business process, and quality assurance modernization.

IN THIS STUDY

This IDC study establishes the first baseline for assessing 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. 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 2008, using multiple in-depth vendor interviews and analysis to develop detailed 2007 company models. 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 2007 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 are IDC estimates.

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′ 2007 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.** 2007 marks the first year that IDC has developed an estimated bundled and discrete AO revenue view per vendor.

SITUATION OVERVIEW

IDC's 2007 Top 10 Providers in Global Application Management Services

The top 10 worldwide AM providers, in the aggregate, attained estimated revenue of over $27 billion in 2007, reflecting combined (IDC estimated) discrete and bundled AM revenue. The discrete AM revenue for this vendor group is estimated at over $17 billion for CY07, or nearly two-thirds of the total, while the AMS revenue bundled within ISO engagements is estimated at $9.6 billion. Taking an even broader view, the top 25 worldwide AM vendors are estimated to have reached total AMS revenue of over $35 billion in 2007.

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, 2007

2007 Rank	Vendor	Revenue ($M)	AM Bundled with ISO (%)	Discrete AM (%)
1	IBM	7,292.4	41.0	59.0
2	Accenture	4,578.6	2.2	97.8
3	EDS	4,100.0	56.7	43.3
4	CSC	2,550.2	67.5	32.5
5	Tata Consultancy Services (TCS)	1,655.6	15.9	84.1
6	Siemens AG	1,509.8	72.1	27.9

TABLE 1

Worldwide Consolidated Application Management Services Revenue by Top 10 Vendor, 2007

2007 Rank	Vendor	Revenue ($M)	AM Bundled with ISO (%)	Discrete AM (%)
7	Fujitsu Limited	1,423.0	46.9	53.1
8	Atos Origin	1,236.2	22.6	77.4
9	Infosys	1,193.1	7.0	93.0
10	Logica	1,176.7	4.1	95.9
Subtotal		26,715.6	35.8	64.2
	Top 11–15	3,998.4	33.7	66.3
	Top 16–25	4,389.1	19.4	80.6
Total		35,103.1	33.5	66.5

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, 2008

Trends

Most of the service providers offer a broad range of application management services (see Worldwide Application Outsourcing 2007 Service Provider Analysis: IDC Leadership Grid, IDC #211640, May 2008, and 2007 Offshore Application Outsourcing Providers: A Growing Competitive Force, IDC #210794, March 2008, for more analysis of AMS). However, there are variations in how service providers are building up revenue in application management. This study highlights the difficulty in discerning whether the AO trend is truly shifting toward discrete, more granular or modular contract services or whether 2007 findings are reflective of economic trends that have characterized that particular time frame.

Trends are as follows:

- **Client experience — key factor.** Supplier research indicates that client experience is one of the key indicators that help determine how subsequent contract renegotiation may proceed. On a second or third outsourcing renegotiation, clients have increased awareness of how to derive greater benefits from such activities. Renewing clients tend to increase their demand for greater visibility into overall performance, with more granular use of metrics and SLAs to meet business requirements.

- **Fixed and modular pricing structures.** In driving toward lower cost structures, some companies are adopting more modular approaches toward the pricing of AM engagements. For example, some providers 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 marks a very gradual shift away from fixed-price AMS contracts toward variability in IT cost structures. This may be selected when a customer has had sufficient experience in outsourcing particular applications and can further leverage those improvements via alternative pricing approaches.

- **Cyclical patterns in renegotiation.** Supplier research further indicates 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. While cost containment, risk mitigation, and operational performance improvements remain common drivers to adoption, internal budgetary pressures can also steer companies along different outsourcing paths.

- **Influential role of vendors.** Historically, service providers and third-party advisory firms have played pivotal roles in influencing the ways in which customers have purchased these services.

Optimizing the Traditional Outsourcing Model

As providers move forward in growing their global AMS revenue, the investment and service offerings they incorporate into their broader portfolios will be critical to their success. Traditional outsourcing models need to be optimized to keep pace with technology advancements. As companies adopt increasing use of SOA and composite application development, outsourcers will experience an increasing demand for such services. This is expected to impact both project- and annuity-based offerings.

Cost containment or reduction will remain highly important to corporate performance, with global requirements for cross-functional data access and real-time or near-real-time intelligence on company operations and profitability metrics. IDC further expects that the outsourcing model will not only be required to increase use of virtualization at the hardware level, but that virtualization at the client, desktop, and application layers will gain momentum as these services are adopted with increasing speed.

Virtualization of the application layer is expected to consume more outsourcing resource and expertise as companies seek to reduce the TCO tied to custom legacy applications. Advanced modeling tools and techniques are also targeted to take on a more critical role in better synchronizing across the full application life cycle, from design through development into the production and application maintenance phases.

Outsourcers will need to continue to invest in refining their globally integrated delivery models, with increased focus on localized customization, language, and regulatory compliance support. Validation services will also play a key role in supporting quality-of-service (QoS) requirements. Companies will be vigilant in looking for solutions that support reliability, high performance, scalability, and robust security capabilities across the application and infrastructure layers.

Providers will need to consider the optimum approaches to selling such services, be they in modular SOWs or bundled within broader packages. The need to adapt to customers' transformational business and risk-mitigating requirements as part of an outsourcing solution will remain critical to growth and partnership with customers.

While traditional outsourcers need to consider their internal strategies and capital investments in datacenter and application services, they also need to determine how they plan to play in the nascent cloud-based utility computing market. What partnerships or investments will enable them to leverage their existing expertise while growing new revenue streams? How will they support the scalability demands required of the online marketplace? The massive datacenter investments and expansion strategies of the largest online providers (e.g., Google, Amazon) indicates pressures will only mount to transform the traditional labor-based outsourcing paradigm.

FUTURE OUTLOOK

Global service providers are expected to continue to increase synergies between AMS and other parts of their service portfolio. This will be visible in tighter linkages between consulting, discrete project, and outsourcing teams. Whether it is transformational work embedded in an AO engagement or full-scale application redesign via a CAD engagement, both variations need to be viewed as part of the long-term continuum in servicing the broader client portfolio.

The relative importance of business intelligence tools and independent or integrated validation services are expected to take on greater importance. IDC expects these components will become more integral to AM services as companies continue to persevere in the quest to improve business decision making through improved data access and accuracy.

Global integrated delivery models that scale with fluctuating demand will require well–honed, automated, virtualized operational frameworks. 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 greater pressure to improve operational performance, with clients requesting application management services that integrate infrastructure management more tightly with AM for consolidated performance metrics and improved end-user experiences.

New service delivery models are also gaining ground, with online providers pushing their as-a-service solutions (e.g., PaaS, BPM as a service, 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 development options from multiple perspectives, incorporating legacy assets with newer service delivery solutions (e.g., hosted AM, SaaS, 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.

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 become "trusted" partners in supporting the tighter alignment of corporate IT systems with near- and long-term business objectives.

As the scope and value of AO continues to increase for the enterprise customer, the maturity, flexibility, and depth of service portfolios need to 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.

- **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 techniques.

- **Leveraging the self-financing model for transformation.** While legacy system modernization remains a high priority for customers, the parallel requirement exists to lower costs and reinvest these customer savings to drive transformation. Vendors need to continue to leverage offshore resources as well as new delivery models (e.g., utility computing, SaaS) as part of providing a self-financing investment model, as shown in *SOA's Role in Legacy Modernization: Keys to Success in Application Outsourcing* (IDC #209945, December 2007).

- **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 or treat such services as a pipeline for AO to cultivate customer relationships with more growth potential over the long term.

- **Developing ISV and online partnerships.** Partnerships with ISVs will be critical to maximizing the value of new application methodologies that incorporate SOA. A key component of success for outsourcers is the need to have a well-integrated application platform strategy across all business processes. This will enable outsourcers to evolve their own expertise in designing, provisioning, and managing highly dynamic virtualized infrastructure and application environments. Customer applications (modernized legacy, advanced Web, etc.) will demand increasing speed and flexibility as new business opportunities present themselves on a global scale. Partnerships with online providers will also be key in evolving the spectrum of application services, as newer models leverage scalable online developer and test communities across different platforms.

- **High-performance outsourced application portfolios.** Promote the value of outsourcing expertise through validation initiatives that start with clear, agreed upon application business requirements. Incorporate the benefits of rule verification for business process alignment. Assist end users with adaptable BI solutions for faster data intelligence gathering. Enterprises need to continue to improve their business processes and procedures to ensure that data repositories are accurate and complete in support of improved business decision making.

LEARN MORE

Related Research

- *Worldwide Application Outsourcing 2007 Service Provider Analysis: IDC Leadership Grid* (IDC #211640, May 2008)

- *Platform-as-a-Service: As Clouds Form, Outsourcing's Role Not So Nebulous* (IDC #lcUS21255608, May 2008)

- *Transformational Outsourcing: Where Are Enterprises on the Adoption Curve?* (IDC #211854, April 2008)

- *2007 Offshore Application Outsourcing Providers: A Growing Competitive Force* (IDC #210794, March 2008)

- *Worldwide and U.S. Hosted Application Management Services 2008–2012 Forecast* (IDC #211217, March 2008)

- *Worldwide and U.S. Application Management Services 2008–2012 Forecast* (IDC #211215, March 2008)

- *Application Modernization: Do Service Providers Play Variations on the Same Tune?* (IDC #210518, February 2008)

- *Worldwide Outsourcing Services 2008 Top 10 Predictions: Converging Forces Are Reshaping What It Will Take to Win!* (IDC #210351, January 2008)

- *SOA's Role in Legacy Modernization: Keys to Success in Application Outsourcing* (IDC #209945, December 2007)

- *New IBM Tools for Legacy Modernization Add Competitive Edge to Application Outsourcing Toolkit* (IDC #lcUS20953407, November 2007)
- *Analysis of Worldwide Application Management Contracts: A Five-Year View, 2002–2006* (IDC #209239, November 2007)
- *Worldwide and U.S. Application Management Services 2006 Vendor Shares: IDC's Top 10 Vendors* (IDC #209024, October 2007)

Synopsis

This IDC study establishes the first baseline for assessing 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 is reaching critical mass as the intrinsic values of these services are recognized around the world.

"Discrete and bundled AM service revenue reached an estimated $35 billion in 2007 for the top 25 global service providers," said Rona Shuchat, director of Application Outsourcing Services at IDC. "This reflects growing adoption of enterprise use of third-party providers, not only for standalone AM service but also for transformational value-added services linked into AM or broader bundled outsourcing solutions."