12 IT Outsourcing Predictions for 2012

– Stephanie Overby, CIO

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The IT outsourcing industry in 2011 was largely marked by smaller deals, hesitant customers, profit-squeezed providers and a whole lot of talk—but not as much action—on the cloud computing front.

Much of that could continue through the New Year—the economic uncertainty behind last year's sourcing trends is unlikely to lift until the latter part of the year. Nonetheless, the next 12 months will bring with them some new IT outsourcing trends and maybe even a few firsts. Following are 12 predictions from forward-looking outsourcing observers.

1. 2012 Will Be a Mixed Bag of M&A Activity

Don't look for a HP-EDS, Dell-Perot, Xerox-ACS type of merger next year. "Outsourcing providers will shy away from mega-mergers," says Phil Fersht, founder of outsourcing analyst firm HfS Research, due to a shortage of attractive second-tier providers capable of delivering more than added scale. (Unless you're in China. Michael Rehkopf, outsourcing consultancy TPI's director for North Asia is predicting a 2012 marriage between two of the top 20 Chinese service providers).

Stateside, the large providers are more likely to snap up software or cloud-based tool markers a la IBM-Emptoris, says Fersht. Or we could see a three-way merger of niche mid-size players to create a new large IT service provider, says Mark Ruckman, outsourcing consultant with Sanda Partners. And while last year's prediction of an offshore provider gobbling up a major U.S.-based multinational didn't come to pass, it's not dead yet. "Look for at least one—and maybe more—major acquisition of a western service provider by an Indian heritage firm," predicts Sid Pai, TPI India's managing director.

2. Outsourcing Buyers Take it Slowly

That recovery we were all looking forward to in 2012? It's delayed. Many outsourcing decisions will likewise be postponed. "Threat of recession will hold back one-in-four buyers from signing contracts until current economic uncertainty lifts," says Fersht of HfS Research. "And a rocky economy isn't helping drive definitive behavior, with three-quarters buyers expecting either little change in focus when it comes to outsourcing, or they simply do not know what they are going to do."

Buyers that remain in the market will focus their outsourcing dollars on a smaller number of deals with simpler pricing models—at least in the first half of the year, says outsourcing consultancy Everest Group, adding that by fall increased business confidence could boost outsourcing activity in general, and offshoring deals in particular.

3. The Cloud Comes Down to Earth
Do you get the feeling that even cloud computing providers are ready to retire the term cloud computing? The good news, says Shaw Helms, a partner at the outsourcing practice of K&L Gates, is that "by the end of 2012, the buzz around 'cloud' will have significantly died down." IT leaders and managers will be looking more critically at cloud computing risks and being more critical of its value. "IT departments will no longer be getting pressure from the C-Suite to implement cloud computing without a thoughtful evaluation of the alternatives," Helms says.

2012 will also be the year that IT gets serious about cloud computing governance. "Companies will begin to publish firm policies on what can be cloud, who has to review cloud services, what data can go into a cloud service, and who has to be involved in [cloud] decisions," predicts Adam Strichman, founder of outsourcing consultancy Sanda Partners. "Things like, 'What are the privacy laws in the country that houses the data' and 'What are security restrictions for people who have access to the data.'"

4. IT Service Buyers Look Beyond Labor Arbitrage (But Vendors Don't)

Outsourcing customers still want to keep costs low when they farm out IT services. But next year, they'll want more—increased global flexibility or better technology, for example, says Fersht. The only problem is that their IT service providers will still be reading from the labor arbitrage handbook. "Providers will still be overly focused on cost reduction for their clients, as opposed to process improvement and innovation," Fersht says.

5. IT Outsourcing Deals Gets Small

It used to be "go big or go home" for the sales teams of big outsourcing providers. But now that they've wrung everything they could out of the Fortune 1000, they're setting their sights on smaller enterprises. "Even IBM is making a concentrated effort to win more business from small firms," notes Helms of K&L Gates.

In 2012, profit margin will trump deal size for the first time, "Service providers looking for market share are becoming increasingly willing to cannibalize their revenue by introducing pricing models based on consumption and business outcomes," says John Lytle, consulting director for outsourcing consultancy Compass. "The result: lower costs for clients and smaller deal sizes. Providers, meanwhile, are able to leverage economies of scale and are incentivized to deliver services more efficiently." The only ones left out in the cold will be outsourcing consultants and lawyers who will have to figure out how to get deals done faster and cheaper, says Helms.

6. IT Offshore Providers Take Over Infrastructure Outsourcing

Offshore service providers have been slowly but surely building the infrastructure capabilities in hopes of moving beyond application development and maintenance work. This year, that effort pays off. "2012 will see a number of companies that have relied almost exclusively on U.S.-based IT infrastructure providers continue to shift business to offshore companies," says Steve Martin, partner with outsourcing consultancy Pace Harmon.

7. IT Service Providers Account Managers Get the Boot

Outsourcing customers growing annoyance with provider account management services will reach a rolling boil next year. They're tired of too much focus on sales and not enough attention to their unique needs, says Fersht of HfS Research. Providers will struggle with the account management role, a title with a seeming revolving door of talent whom they've long rewarded largely for business development. Account managers will have to start putting relationship ahead of revenue. Bye-bye, sales guy.

8. More Backsourcing Talk Than Action

Outsourcing clients will continue to complain about their IT services relationships in the coming year—and then decide it's just too much work to bring it all back in-house. "Companies will evaluate, strongly consider, and even begin to architect the movement of currently outsourced services to an insourced service delivery model—only to fail to pull the trigger in the end," predicts Pace Harmon's Martin. "While the economics and potential for service improvement through assuming control of one's own destiny will appear enticing at the business case level, the tasks of building data centers, standing up help desks, and hiring hundreds of resources will prove too daunting."
9. IT Outsourcers Embrace Riskier Models

Pricing pressures will continue to squeeze provider margins, especially offshore. To support growth and profitability, vendors will have to consider innovative—and risky—engagement models such as joint ventures including customer-specific innovation labs and dedicated centers of excellence, according to Everest Group.

10. Application Development Migrates Stateside

Financial services firms, for example, have provisioned the maintenance of scores of lines of code from offshore providers in the last decade. But in 2012, they may begin to question the offshore model. "There will be a retraction in application maintenance outsourcing going offshore as big financial services firms finally recognize how to merge quality and cost metrics," says Michael Engel, managing partner, HfS Consulting at HfS Research. Next year, they will discover that it's actually cheaper to do the work in secondary U.S. cities either via a third-party or their own captive centers, Engel says.

11. IT Security Takes Center Stage

Sometime in the next year, a large IT service provider is going to be humiliated by a public hack of a client's systems, predicts Ruckman of Sanda Partners. "2012 will be the year of security," he says. "[Outsourcing] companies are going to look for new and better ways to protect their data and [that of] their customers.

12. Global Companies Seek Global Support Beyond India

More large companies will seek to diversify their back-office footprint, not to save money but to access local knowledge and language skills to support their offshore operations benefitting providers with delivery centers in such countries as Brazil, Malaysia, Mexico, South Africa, Romania, Bulgaria, says Fersht of HfS Research. "India will not lose business but rate of growth will slow."

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