



The financial maelstrom does not spare IT suppliers

February 2009



Outsourcing is a major component of IT services and software. A division of labour and specialisation through outsourcing promise cost savings. Many companies pay heed to that message. Europeans, for instance, spend more than EUR 66 bn per year on outsourcing – nearly a third of total spending on IT services and software. [chart 1](#)

On average, 41% of European firms purchase IT services from external suppliers. Companies in richer and more northern countries tend to use external suppliers more often than those from poorer or more southern regions. Also, the size of the firm plays a role: More than 90% of large European firms rely on external IT suppliers, but only about 25% of really small firms. [chart 2](#)

European clients award more than half of the global outsourcing volume. The US used to be the pioneer in outsourcing. However, over the last few years European clients awarded an ever larger share of global outsourcing contracts: in 2008, the reading was almost 60%. [chart 3](#)

Economic crisis does not spare IT services and outsourcing. With outsourcing being such an integral part of the economy, it is little wonder that the current economic crisis spills over to IT suppliers. In the second half of 2008, the European contract volume plummeted by nearly 25% compared to the same period in 2007. [chart 4](#)

Demand from the financial services sector is contracting sharply. In the wake of the financial crisis, banks in particular have reduced their outsourcing plans. Other sectors have held up better, but in the second half of 2008 outsourcing plans were cut across the board. [chart 5](#)

Cost pressure may boost outsourcing – up to a point. During the first year of the crisis, many believed it would actually help outsourcing vendors because they would deliver the cost savings every firm so badly needs. As a consequence, stock market valuations for IT services providers held up remarkably well. That changed in autumn 2008, when the economy turned from bad to worse. [chart 6](#)

Financial crisis adds little demand. A survey among German financial institutions confirms the view that outsourcing is all about cost savings. The banking crisis will necessitate cost savings, and thus favour outsourcing in the future. But the high level of uncertainty at the moment trumps this effect. [chart 7](#)

US hit the worst, Asia still holding up. With the financial crisis originating in the US it is unsurprising that demand from American banks is affected the most. But there is no room for complacency in Europe, where the downturn is only slightly smaller. Asia still shows small positive growth – but that, too, may adjust downward going forward. [chart 8](#)

Over the long run, outsourcing thrives on economic progress. Firms in richer countries outsource non-core IT and business services more often than those in poorer regions: Cross-country evidence shows a clear relationship between GDP per capita and outsourcing volumes – the UK being an outlier. This encourages the notion that once the current turmoil is past and growth has resumed, the business model of outsourcing still looks promising. [chart 9](#)

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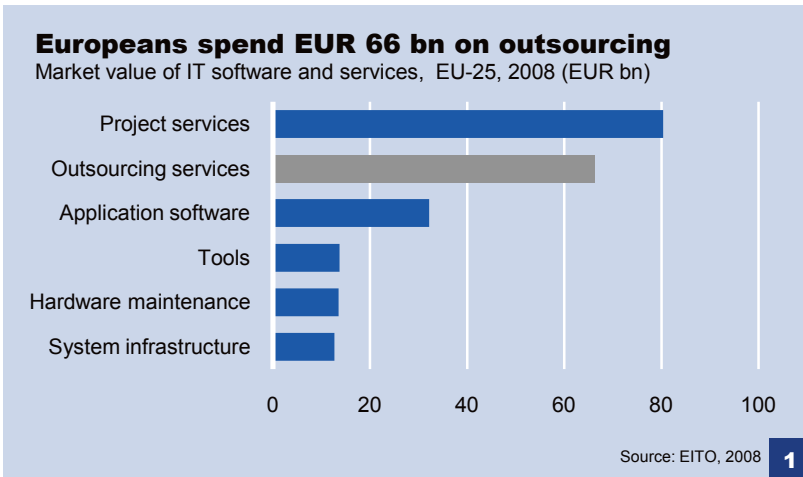
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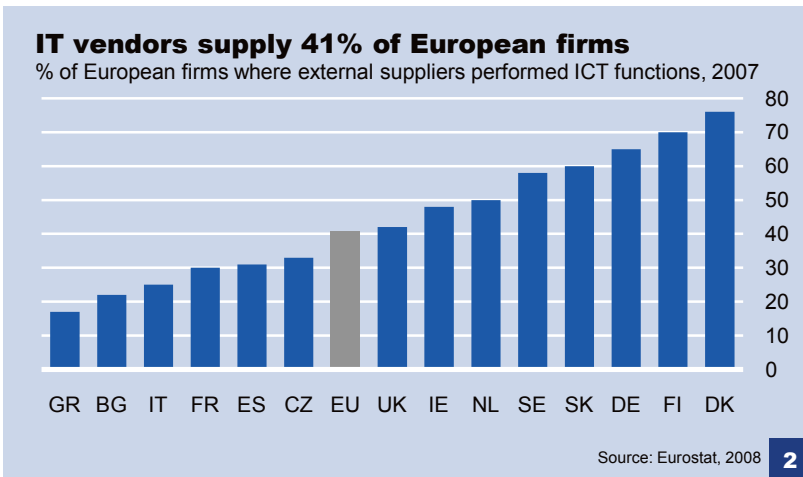
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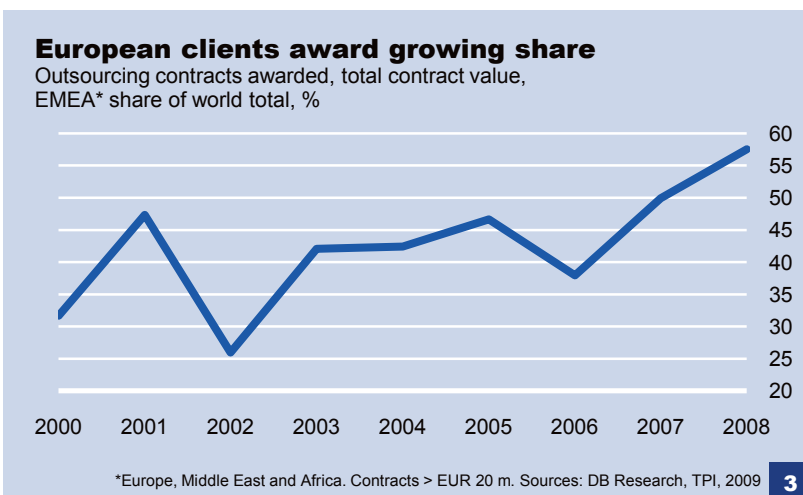
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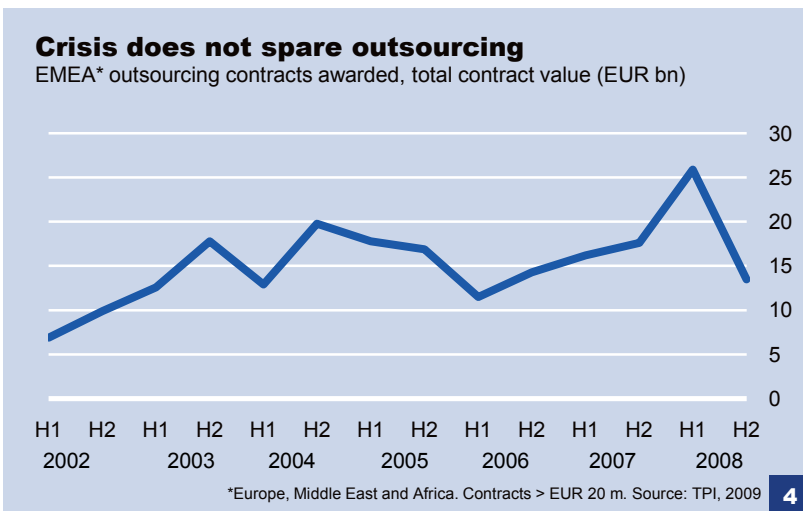
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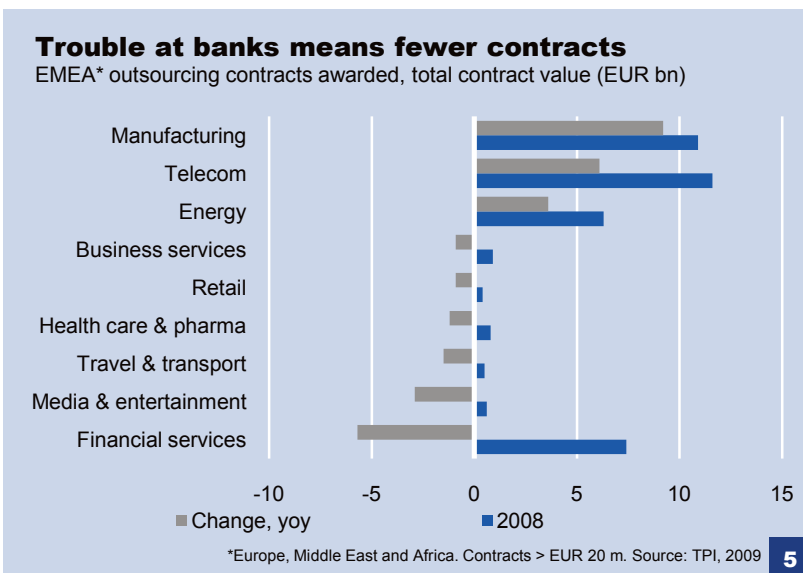
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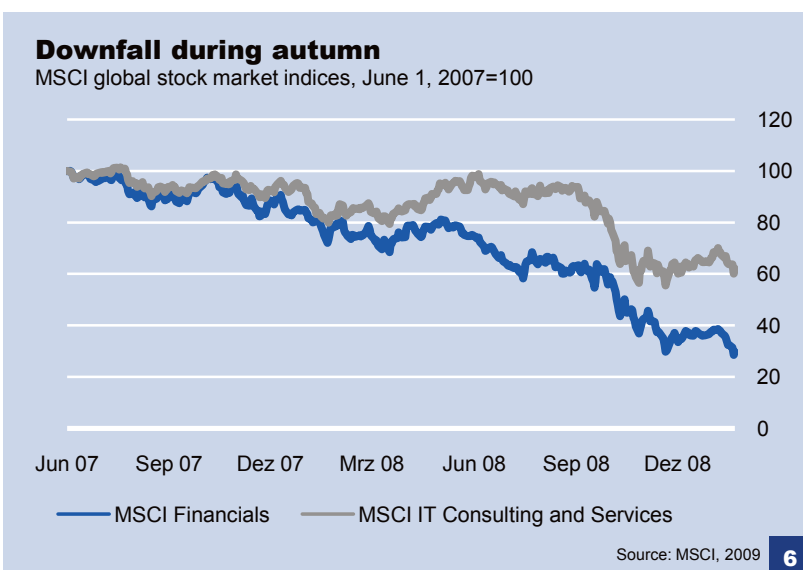
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Demand from the financial services sector is contracting sharply. In the wake of the financial crisis, banks in particular have reduced their outsourcing plans. European financial institutions have slashed their outsourcing contract awards by almost EUR 6 bn compared to the previous year. Other sectors have held up better, but in the second half of 2008 outsourcing plans were cut across the board. [back to front page](#)



Cost pressure may boost outsourcing – up to a point. During the first year of the crisis, many believed it would actually help outsourcing vendors because they would deliver the cost savings every firm so badly needs. As a consequence, stock market valuations for IT services providers held up remarkably well. That changed in autumn 2008, when the economy turned from bad to worse. [back to front page](#)

Demand is cost-driven, not crisis-driven

% of German financial institutions considering this factor as highly important for IT outsourcing

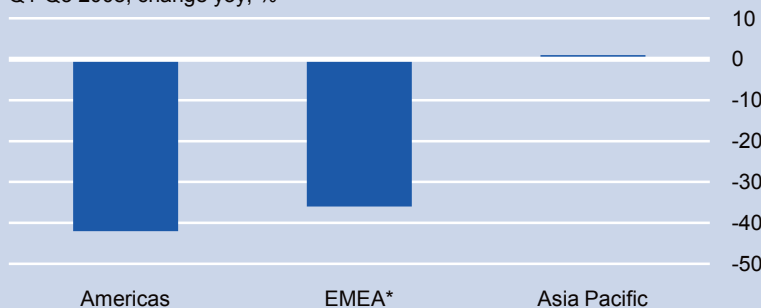
Need to reduce IT service costs	98
Need for increased flexibility / scalability	96
Increased focus on core business	92
Need for efficiency improvements	82
Need for improved access to expert services	76
Need for IT modernisation	58
Need for compliance	50
Need to minimise or share risks	42
Need for additional IT staff	16
Current banking crisis	2

N=50. Source: Nelson Hall, 2008 **7**

Financial crisis adds little demand. A survey among German financial institutions confirms the view that outsourcing is all about cost savings. Only one respondent out of fifty says it's not. While cutting costs will become ever more important in the future, again only one out of fifty says that the banking crisis will be a highly important factor for outsourcing in its own right. The banking crisis will necessitate cost savings, and thus favour outsourcing in the future. But the high level of uncertainty at the moment trumps this effect. [back to front page](#)

Epicentre in the US

Financial services outsourcing contracts awarded, total contract value, Q1-Q3 2008, change yoy, %

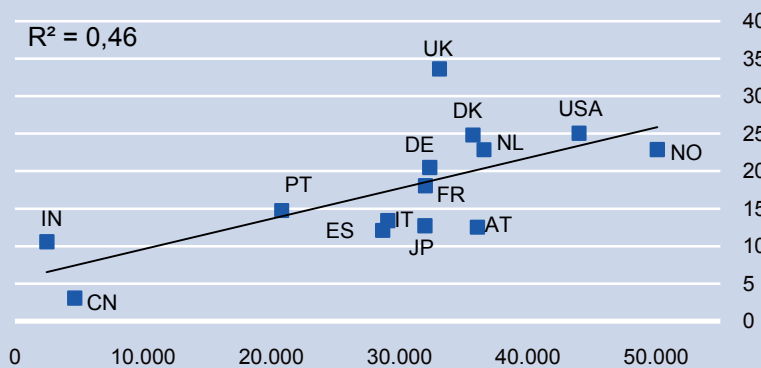


*Europe, Middle East and Africa. Contracts > USD 25 m. Source: TPI, 2008 **8**

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Rich countries outsource more

GDP per capita (USD, x-axis) v outsourcing volume (% of domestic IT market, y-axis)



Sources: DB Research, EITO, NASSCOM, World Bank, 2009 **9**

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