

4th Quarter 2006

DELVE BRAND INDEX™
for Human Resources Outsourcing



The HRO Market: Bridging the Chasm?

Executive Summary



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TABLE OF CONTENTS*

| | |
|--|----|
| Sponsors..... | 2 |
| From the Desk of the CEO..... | 4 |
| Introduction..... | 9 |
| About the Delve Brand Index™ | |
| Scope & Methodology | |
| The Delve Research Process | |
| Respondent Profile | |
| Executive Summary..... | 13 |
| The Delve Brand Index for Human Resources™ | 15 |
| Key Outsourcing Objectives | |
| Provider Selection | |
| Top of Mind Provider Selection Criteria | |
| What Impacts Provider Selection? | |
| Buyers' Organizational Activities | |
| HRO and Transformation: It's in the Definition | |
| The Index..... | 23 |
| Provider Profiles | |
| ACS Global HR Solutions..... | 26 |
| Accenture HR Services..... | 29 |
| ADP..... | 32 |
| Aon..... | 35 |
| ARINSO..... | 38 |
| Convergys..... | 41 |
| ExcellerateHRO..... | 44 |
| Fidelity Employer Services Company..... | 47 |
| Hewitt..... | 50 |
| IBM..... | 53 |
| Special Topics..... | 56 |
| HR Outsourcing: from Transaction to Transformation, by Accenture | |
| Optimizing the Workforce to Deliver Financial Results by ExcellerateHRO | |
| A Higher Calling: Three Key Trends Driving the Need for Higher Value HR by Fidelity Employer Services Company | |
| The New Conventional Wisdom Around the Second Generation of HR BPO by Hewitt Associates | |

* The Table of Contents is presented in the Executive Summary only to provide an overview of the entire report. To learn how to access the full report, please see the last page of this Summary.





Richard J. Crespin

This year's *Delve Brand Index for HRO™* identified a number of key trends of interest to buyers and providers. Below we highlight some of these issues, and where possible, provide recommendations for addressing them. In the body of the report we go into more depth on the research and our findings. This introduction highlights overall observations stepping back from the specific data and looking across the whole sweep of the market in the context of our perception-based research.

In this year's study we observed a set of overall changes in the market, some changes impacting specific vendors, and a few leading indicators to watch over the next 12 to 18 months.

Overall Market Changes

We've hit the bottom of the "chasm"

In the economic lifecycle of every new innovation, from PDAs to HRO, the market enters a chasm between early innovators and the majority of buyers. (See Geoffrey Moore, *Crossing the Chasm*), often characterized by a disheartening "kerplunk" as the expectations of these new buyers go unmet and hit bottom. Across our sample we note unmet expectations and growing frustration. Many wondered aloud, "Why haven't they [providers] figured this out already?" and "We expected them [providers] to guide us through this process, but they haven't."

Like the early users of the Newton, Apple's early foray into PDAs, the early adopters of HRO would put up with a lot. They would change their behavior, adapt to the new solutions, and tolerate hiccups. The emerging buyers – in contrast to last year's respondents – have more practical minds. They want the Palm solution of HRO: one that brings the benefits and the "transformation" without the headaches. The new class of HRO buyer has a very high level of frustration with any problem they think falls into the vendor's area of responsibility. If they think the vendor could've or should've foreseen a given problem, they offer very little forgiveness. As the market continues to mature, frustrations will only grow more acute.

Delve recommendation for Buyers: Take responsibility for your education. All the advice in the world won't make up for a lack of knowledge on the client's part. New resources in the market can help HR leaders and staff stay on top of HRO practices. Take advantage of them. See more below under "Transformation misinformation" and "Blind-spot: training & change management."

Delve recommendation for Providers: Providers that crack this code will win a lot of new business. See more below under "Transformation misinformation" and "Blind-spot: training & change management."

Price has increased in importance

Last year price ranked a distant third in our overall survey of buying decision criteria. This year it ranks first. With the new class of buyer comes a growing demand for commoditization, easier-to-understand solutions, and faster results at a lower price.

Delve recommendation for Buyers: Three specific thoughts:

- * Set and demand better benchmarks. Sharing information with peers can only benefit you and the industry. Be prepared to invest, though, as worthwhile benchmarking isn't cheap.

- * Be prepared for trade-offs. Commoditization requires standardization. If you want something completely customized to your environment, be prepared to pay for it. If you can accept standardization, you can decrease cost on both your part and the provider's.
- * Caveat emptor on taking the lowest priced bidder. HRO is *not* a commodity – at least not yet.

Delve recommendation for Providers: Simplify the offering and prepare to justify costs against benchmarks.

The Return of Procurement

Along with this general trend toward commoditization, we heard from several quarters that procurement functions, after something of an absence, would get more involved in strategic and tactical decision making in HR transformation projects. We heard of several cross-functional teams and even more integrated working relationships between procurement and HR counterparts. We also heard a general expectation that as the market matured, procurement would both need to get more educated about and play a larger role in these purchasing decisions.

Delve recommendation for Buyers: Step carefully. There are many benefits from this approach, but many pitfalls as well. Again, HRO is not a commodity – at least not yet.

Delve recommendation for Providers: Get ready to crack the code with procurement. Be prepared for either more involvement from procurement, stronger involvement from sourcing advisors, or both.

"From the Desk of the CEO" is truncated for the Executive Summary version of the report. To learn how to access the full report, please see the last page of this Summary.



About the Delve Brand Index™

The Delve Brand Index™ for Human Resources Outsourcing (HRO) is a set of tools and reports designed to help executives understand key drivers in the HRO industry, as well as how the leading outsourcing services providers are perceived and positioned in the marketplace. Specifically, this release of The Index™ explores buyers' HRO decision-making, looks at the intersection between HRO and transformation, and evaluates HRO suppliers and the factors driving their positioning and perception. Also included is a series of *Special Topics* related to the HRO industry. The Index™ is a dynamic, continuously growing data set that tracks changes in the HRO industry over time.

The Delve Brand Index™ for Human Resources Outsourcing provides a clear window on the competitive landscape and choices in today's HRO market. The Index™ is unique among market reports in that it provides information on HRO market perceptions, helping sell-side marketing professionals and buy-side executives make sense of the market.

In using this report, executives will:

- * Understand key HRO market drivers
- * Understand the issues that impact buyer decision-making
- * Understand and evaluate suppliers—their roles, positioning, fit, etc.

Scope & Methodology

To gain insights, Delve interviews senior executives and decision-makers about how they see the market from their specific vantage points. We look to HRO players for first-hand, interview-based market intelligence. The result is a complete report that combines market perceptions with Delve's opinion and analysis to provide the most complete overview of the market available.

Delve designed each self-contained section of this report so that executives can reference and excerpt data and analysis for specific situations.

The Index™ targets various types of market constituents, focusing on qualitative feedback from senior executives. Constituents interviewed include:

- * Buyers
- * Sourcing Advisors
- * Suppliers
- * Analysts
- * Media
- * Recruiters
- * Other Influencers (e.g., legal)

Respondent Profile

In the course of research, the Delve team contacted over 1,000 buyers, providers, advisors, analysts and experts, and conducted interviews with over 100 organizations specifically in support of this edition of the Delve Brand Index for HRO™. At the same time, during the course of our work outside of the Index™, we come in contact with literally thousands of industry contacts and tens of thousands of pages of information every year. The intelligence and insights we collect – during both dedicated Index™ research and our work that supports the outsourcing industry – inform our findings for each subsequent edition of the Delve Brand Index for HRO™.

Buyer Respondent Profile

For this edition of the Index™, we conducted in-depth interviews with HR leaders at 75 buyer organizations worldwide. (At several organizations, we interviewed more than one person.)

Outsource Status

Among buyer respondents, 70% are currently outsourcing HR processes, 19% are considering outsourcing HR processes, and the remaining 11% are not outsourcing, nor currently planning to do so.

Region

Among buyer organizations, 76% are global companies; the remaining organizations operate in one country.

Regional Breakdowns

| | | | |
|---------------|-----|-----------------------------|------------------------|
| North America | 53% | <i>Within North America</i> | <i>Within EMEA</i> |
| EMEA | 39% | United States 90% | Continental Europe 79% |
| Asia Pacific | 8% | Canada 10% | United Kingdom 21% |

Within the Asia Pacific region, the respondents were spread broadly across countries.

Organization Size

The majority (75%) of buyer respondents we interviewed employ 10,000+ employees.

Fully 86% of buyer respondents have annual revenues of \$1 billion, and 14% have annual revenues of more than \$50 billion.

Industry

Buyer respondents are weighted toward manufacturing; that industry accounts for 40% of the buyer respondent pool. The next most common buyer respondent industries are finance/insurance/real estate, which comprises 16% of buyer respondents, followed by services and transportation/communication/electric & gas, each of which accounts for 12% of respondents. The remaining 20% of buyer respondents are scattered among various industries.

In the Delve Brand Index™ 2005 Overview, we noted that the human resources outsourcing (HRO) market, while maturing past the early adopter phase, was nonetheless a market defined by change. The market continues to mature and change fairly rapidly, with both new and renewal deals in existing and new market segments quickly changing the buyer and provider landscapes.

At the same time, in 2006, we noted a distinct stabilizing of perception in many quarters, and several of the factors motivating buying decisions have stabilized and become consistent across the industry and year-over-year.

Across our research over the past year, the following points stand out.

Why buyers outsource HR isn't changing. Cost savings continues to be the number one reason cited by buyers for entering into HR outsourcing. While adding or improving service, accessing expertise or technology and even transforming HR make the “top 5” list, cost savings remains firmly at the top of the list – a finding consistent since 2004.

But how they select their provider is. While provider selection criteria are much the same as in 2005, their relative importance is changing with the market. In our 2006 research, “price” overtook “values and culture” as the most commonly cited provider selection criterion. This is not to say that other issues – compatible values and culture, provider capability, global reach, experience and reputation – are not important, they are (in fact, they round out the list of key selection criteria), but price is moving up the list. The HRO industry is experiencing increasing pricing pressure as it moves farther from the early adopter phase, and increasingly buyers are commoditizing HRO and component processes, demanding better and more service at lower prices.

At the same time, buyers aren't looking for the “cheapest” provider; while price is clearly a main factor, it isn't the only factor.

“Global” still draws. Buyers continue to place high value on a provider's global presence, as we first noted in 2005. However, what has changed is buyers' focus. Whereas last year buyers valued a provider's ability to provide services in multiple currencies and languages, those capabilities are now considered table stakes. Increasingly, buyers are placing much higher value on whether or not a provider offers: (1) services across all of buyer's locations, and (2) a local presence in each of their locations.

The HRO market in Europe continues to grow incrementally. The highly segmented nature of the European market – lack of common laws, languages and social values – continues to limit the growth of HRO in Europe. The HRO market in Europe is commonly considered to be a slow-build, incremental market, unlikely to move quickly to wholesale MPHRO.

Buyers prefer best in class. Our research indicates a preference among buyers for best-in-class, point solution providers over full-service providers: 60 percent of buyers say they prefer providers of best-in-class point solutions over providers of full-service solutions. Those who



are inclined to go with best in class generally are seeking HR expertise; those who prefer one provider seek ease of management and seamless delivery.

But even buyers who want full service are stymied. There's an ongoing belief among buyers that no company is successfully providing full service, end-to-end, global HRO services. Time and again buyers noted – and lamented – this hole in the market. In fact, some even expressed downright frustration that providers hadn't yet “figured it out.”

Size matters. Larger global organizations generally express an interest in working with large, more recognized providers, notably Accenture, Hewitt, and IBM. Smaller firms, on the other hand, generally pointedly prefer not to work with larger HRO providers, sensing that, as a smaller firm, they would receive second-tier service.

Limited change management on the buyers' part offers opportunity for providers. Buyers report generally limited internal changes as a result of HR outsourcing. And, while many report establishing success measures, few effectively identify, implement or measure metrics beyond SLAs. The result is that although the provider can indicate how well it is performing against specific goals, nobody can effectively say whether or not HR outsourcing is a success for the buyer. This situation presents an opportunity for providers which, because of their experience, are well positioned to help buyers plan, launch and measure progress against their overall HR change goals.

HRO isn't transformational ... by itself. Buyers see HRO as one of the tools they can (and sometimes must) use to transform their HR functions. HRO is viewed as a driver of process-specific transformation, sometimes as one stop in the transformation journey. But, very few view HRO as driving the transformation of their HR function.

Provider perceptions are slow to change. We noted last year that a few players dominated the landscape, and that still holds true this year. Accenture, Hewitt, and IBM are most often noted as the dominant full-service providers (insofar as buyers believe there are any “full-service” providers); ADP and Fidelity, while highly recognized, are viewed as leaders in their niches and less as full-service providers.

And views of other providers outside of the top few remain much the same, as well. In spite of changes in offerings and won/lost contracts, perceptions of providers do not keep pace with the market. We're seeing a delay of as much as 12 to 18 months (and in some cases to infinity) from the time a provider introduces a new message to the time it takes for that message to be absorbed by the market.

The Index

In building The Index™, Delve identified five key characteristics as indicators of HRO leadership. These attributes are defined below. Using these attributes as rating criteria, Delve ranked each provider (10 being the highest ranking and 1 the lowest, because there are 10 providers profiled) by characteristic based on our conversations with market constituents and developed a total composite score for each of the main providers.

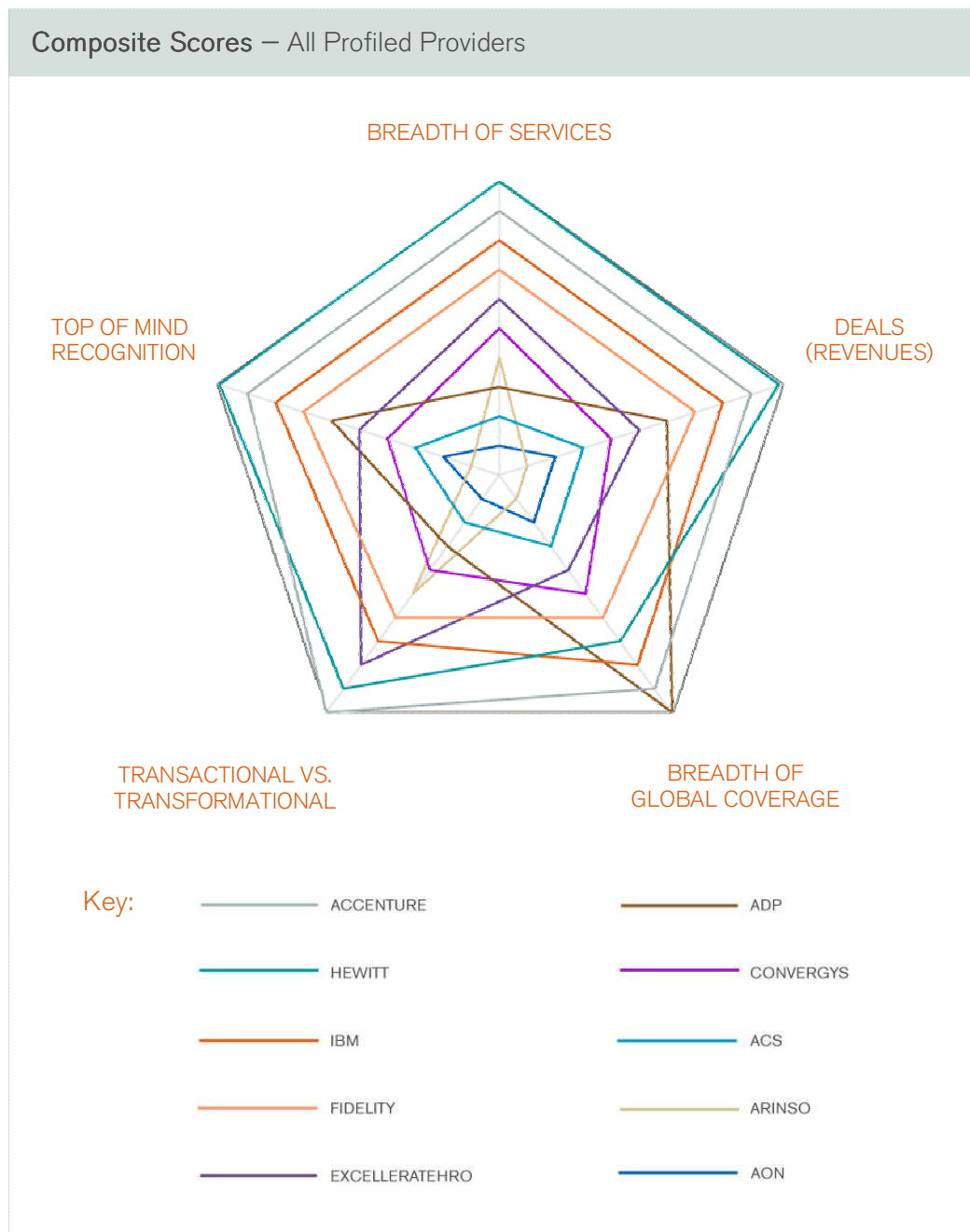
It is important to stress that the scores applied to each supplier represent a combination of perceptions gleaned from interviews with market executives and experts and Delve's analysis of available information. The Index is an effort to quantify information that is essentially qualitative in order to provide a visual and perceptual map of the main providers. Scores on individual characteristics are relative – they show where our research indicates each provider is positioned relative to one another, by characteristic.

Mapping Characteristics

1. Top of mind mentions: unaided mentions when asked to name HRO providers.
2. Transactional vs. transformational reputation: respondent perception of the provider's reputation as a transactional provider versus a transformational provider – from lift-and-shift on one end of the spectrum to fully transforming the HR function on the other end.
3. Global coverage: respondent perception of the breadth of the provider's global offering.
4. Deals: total estimated revenues (2005). Source: Everest Group.
5. Breadth of service coverage: respondent perception of the breadth of the provider's service offering.



The figure below shows the relative positioning of the leading HRO suppliers in today's market according to our research. The Provider Profiles section provides by-provider detail and individual ratings.







The Delve Group, Inc.

About The Delve Group, Inc.

The Delve Group specializes in positioning and perception for business-to-business companies.

Using its industry expertise and strategic creativity, Delve creates positioning and perception for its branding, marketing, & communications clients. With comprehensive competitive and market intelligence services, Delve measures and analyzes how effectively companies achieve their desired positioning and perception among target audiences. The combined value ensures Delve's clients accelerate growth, strengthen brand awareness, and create lasting advantage.

Headquartered in New York City, Delve operates throughout the United States and in the European Union. Learn more at www.delvegroup.com or by calling 212-255-3870.

The Delve Brand Index for HRO—Q4 2006

The market for Human Resources Outsourcing (HRO) services is evolving rapidly. Information about HRO suppliers is highly perishable as the market constantly shifts with new deals, mergers, and services. Understanding the strategy, positioning, and services of various suppliers can be a challenge for market constituents. Moving beyond traditional media and market analysis, Delve offers buyers and sellers of HRO services a current snapshot of the HRO competitive landscape.

Benefits of the Delve Brand Index for HRO

By knowing the drivers in a decision to outsource (to whom, for what, and why) executives can use the timely information provided in the reports resulting from the study to further develop their brand or go-to-market strategy and compete to win. Specifically,

HRO providers subscribe to the Index to ...

- ✓ Understand market trends
- ✓ Learn how market constituents perceive them and their services
- ✓ Develop strategies and tactics to position themselves and develop tools for success
- ✓ Improve sales/service delivery through enhanced market insight

HRO buyers purchase the Report to ...

- ✓ Learn what peer companies think about HRO
- ✓ Understand the nuances of HRO providers services
- ✓ Establish the buying criteria that lead to better provider selection
- ✓ Improve the chance of selecting the right provider

The Delve Index for Human Resources Outsourcing is available as a stand-alone report for and can be supplemented with an on-site workshop to help buyer and seller executives apply the results to their own business needs. To learn more, please contact [Elizabeth Boudrie](mailto:eboudrie@delvegroup.com) at 212-255-3870, ext. 20 or by email at eboudrie@delvegroup.com.

