TRENDS

April 4, 2006

European IT Outsourcing Deals: 2005 Review

by Andrew Parker and Sonoko Takahashi

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European IT Outsourcing Deals: 2005 Review

Service Providers Run Faster To Stand Still; We Saw More Smaller Deals

This is the final document in Forrester's "2005 European Outsourcing Deals" series.

by Andrew Parker and Sonoko Takahashi
with Caroline Hoekendijk

EXECUTIVE SUMMARY

Forrester's quarterly outsourcing survey identified more outsourcing contracts than ever before in 2005 — we recorded 305 separate contracts. The UK stood firm at the head of the outsourcing league, but Germany faltered in its advance. Government and public sector activity growth was the single most notable feature of the year, with contract numbers up and aggregate deal value vastly increased; UK central and local government took the lion's share. As in 2004, about two-thirds of the contracts signed were new deals, but they had a higher average contract value in 2005. The number of deals for five years or less increased to about 70% of all deals. Because of this, and because many contracts clustered toward the bottom of our deal value range, most service providers had to work hard to build bookings success. But a few companies — notably EDS and BT — sustained the life of the megadeal.

TABLE OF CONTENTS

NOTES & RESOURCES

Forrester interviewed 24 vendors, including: Atos Origin, CSC, EDB, EDS, France Télécom, HP, Lufthansa Systems, Polaris Software, Siemens Business Services, Tata Consultancy Services, Unisys, and Xansa.

Related Research Documents

"European IT Outsourcing Deals: Q4 2005"
March 6, 2006, Trends

"European IT Outsourcing Deals: Q3 2005"
December 21, 2005, Trends

"European IT Outsourcing Deals: Q2 2005"
September 7, 2005, Trends

"Spring Comes To Europe's Outsourcing Market"
July 5, 2005, Trends

MARKING OUT THE YEAR-ON-YEAR OUTSOURCING SHIFTS: 2004 TO 2005

With 10 quarters of European outsourcing deal tracking behind us, Forrester is now in a position to provide a full year-on-year comparison of deal activity, highlighting deal trends with more precision than in the past. So what is the picture as we review 2005? In the last calendar year, Forrester saw a dramatic spurt in deal numbers relative to 2004.[1] Over the four quarters, we tracked a total of 305 deals with contract values above our €10 million threshold: That's up by almost 25% on 2004. 2005 saw 15 deals worth €500 million or more; that's one deal less than in 2004, but the contract value was more than 20% higher at €20 billion (see Figure 1 and see Figure 2).

Country Activity Trends Showed A Divergence Between Deal Numbers And Deal Value

Forrester observed at least one significant outsourcing deal in each of 17 countries across Europe in 2005. The UK remained the dominant focus for outsourcing activity in the region — both by deal numbers and by deal value (see Figure 3-1 and see Figure 3-2). Elsewhere in Europe, our survey revealed numerous shifts in the country-specific deal patterns.

- **UK deal value outstripped deal numbers.** UK firms signed 106 of the deals observed during 2005 — up from 90 deals in 2004. The near 18% rise in deal numbers lagged well behind the increase in aggregate deal value: UK-based organizations signed a whopping €21 billion in total contract value over the year — a 52% rise on the near €14 billion total for 2004. A small group of megadeals helped create this picture, including BT's €2.3 billion contract with Reuters and Ericsson's €2.2 billion contract with 3UK. Although the absolute number of megadeals was down in 2005, the size of the very largest deals was up. The top three UK contracts totaled €7.9 billion in contract value, against €4.4 billion in 2004 — with government business dominating this picture in both years.

- **Activity in Germany dropped off a cliff.** While the number of deals signed in Germany held up moderately well — 41 deals in 2005 versus 47 in 2004 — the total deal value signed in 2005 was €1.3 billion, compared with more than €5 billion the year before. This may partly reflect a higher number of deals with confidential contract information in 2005. But the fact remains that the average deal value of contracts we observed in Germany in 2005 was just above €30 million compared with well over €100 million in 2004 (see Figure 4). Clearly, we can't talk of an outsourcing explosion in Germany just yet.

- **A block of countries saw deal numbers rise — but not always deal value.** Countries with a large rise in deal activity included France, Italy, Spain, Norway, and Belgium. But not all of this activity growth tallied with increased spending: The average deal value actually fell in France and Norway by a substantial margin of at least 60%; the aggregate deal value in the two countries also declined slightly. In Italy, Spain, and Belgium, both average deal size and aggregate deal value grew, with particularly strong growth in average deal values in Italy and Spain — a near fivefold increase from 2004 to 2005.

- **A second group saw deal numbers — and mostly also deals values — stagnate or fall.** On the other side of the coin, several countries saw deal numbers remain constant, such as Austria and Denmark, or drop — like Finland, where deal numbers slumped by 60%. The aggregate deal value rose only in Denmark, and Austria and Finland saw average deal values collapse by 27% and 89%, respectively, in one year.

Figure 1 European Megadeals 2004: Europe-Wide Activity

European outsourcing deals of €500 million or more signed in 2004

Vendor*	**User**	**Country**	**Deal length** (years)	**Deal value** (millions)	**Deal value** (€ millions)
Accenture	Barclays	UK	6	£400	€600
Atos Origin	KarstadtQuelle	Germany	8	€1,600	€1,600
Capgemini	Schneider Electric	France	10	€1,600	€1,600
CSC	Swiss RE	Switzerland	10	$700	€560
CSC	Zurich Financial Services	Switzerland	7	$1,300	€1,100
Fujitsu Services	Walsall Council	UK	12	£650	€936
Fujitsu Services /TCS/BT/PwC	National Health Service	UK	10	£896	€1,290
Fujitsu Services	Capgemini (Aspire)	UK	10	£1,000	€1,470
HP	Nokia	Finland	5	€500	€500
IBM Global Services	Department for Environment, Food, and Rural Affairs	UK	7	£400	€596
IBM Global Services	Lloyds TSB	UK	7	£500	€720
SBS	National Savings and Investments	UK	5	€656	€656
SBS	BBC Technologies	UK	10	€2,640	€2,640
SBS	RAG Aktiengesellschaft	Germany	7	€500	€500
T-Systems	Deutsche Post Worldnet	Germany	5	$1,600	€1,302
Vertex-United Utilities	Thurrock Council	UK	15	£427	€615

*Some vendors may have signed deals during the period that are not reflected in these findings.

Source: Forrester Research, Inc.

Figure 2 European Megadeals 2005: UK-Centric Business

European outsourcing deals of €500 million or more signed in 2005

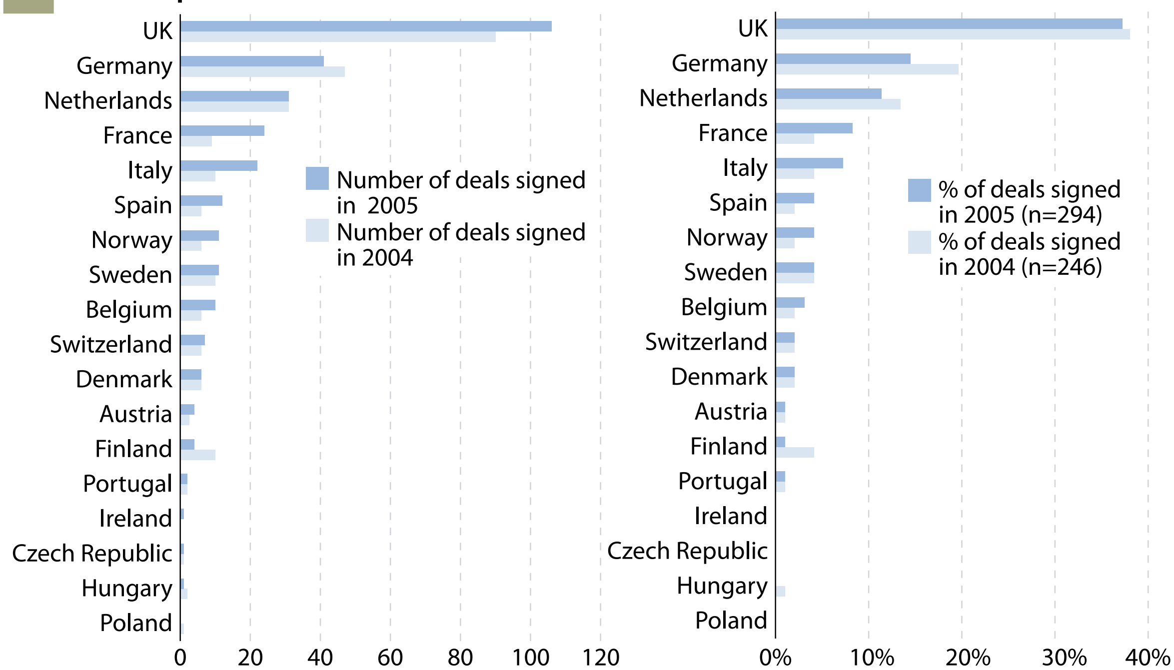
Vendor*	User	Country	Deal length (years)	Deal value (millions)	Deal value (€ millions)
Atlas (EDS, EADS, Fujitsu Services, General Dynamics, LogicaCMG)	Ministry of Defence	UK	10	£2,300	€3,404
Atos Origin	Department for Work and Pensions	UK	12	$1,000	€756
BT Global Services	Reuters	UK	9	$3,000	€2,280
BT Global Services	Ministry of Defence	UK	5	£1,500	€2,220
BT Global Services	Department for Work and Pensions	UK	5	€870	€1,273
BT Global Services	Barclays	UK	7	£500	€720
CUBIT (BT GS, Unisys, Capgemini)	Metropolitan Police	UK	7	£350	€512
EDS	Department for Work and Pensions	UK	5	$1,710	€1,408
Ericsson	3UK	UK	7	£1,500	€2,194
IBM Global Services	ABN AMRO	Netherlands	5	€1,500	€1,500
IBM Global Services	Fiat	Italy	9	€1,800	€1,800
LogicaCMG	Energias de Portugal	Portugal	10	€510	€510
MCI	ABN AMRO	Netherlands	5	€500	€500
TCS	Pearl Group	UK	12	£486	€711
Xchanging	Boots Group	UK	7	£400	€592

*Some vendors may have signed deals during the period that are not reflected in these findings.

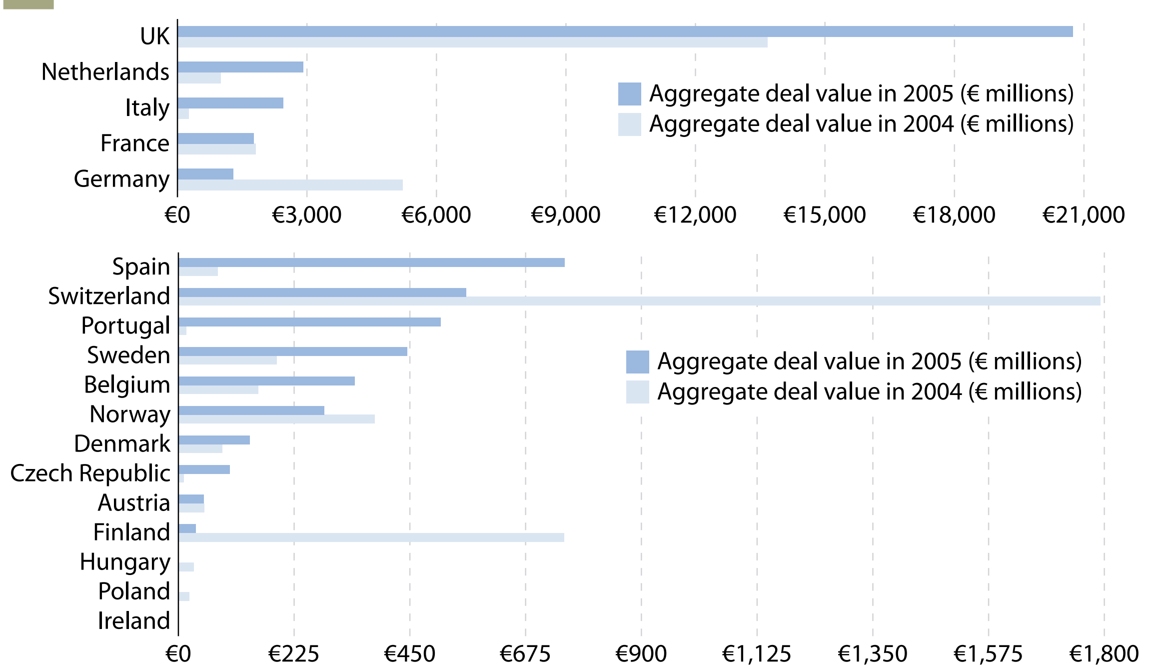
Source: Forrester Research, Inc.

Figure 3 Other Countries Struggled To Match The UK's Outsourcing Activity

3-1 2004's top three countries still lead in 2005



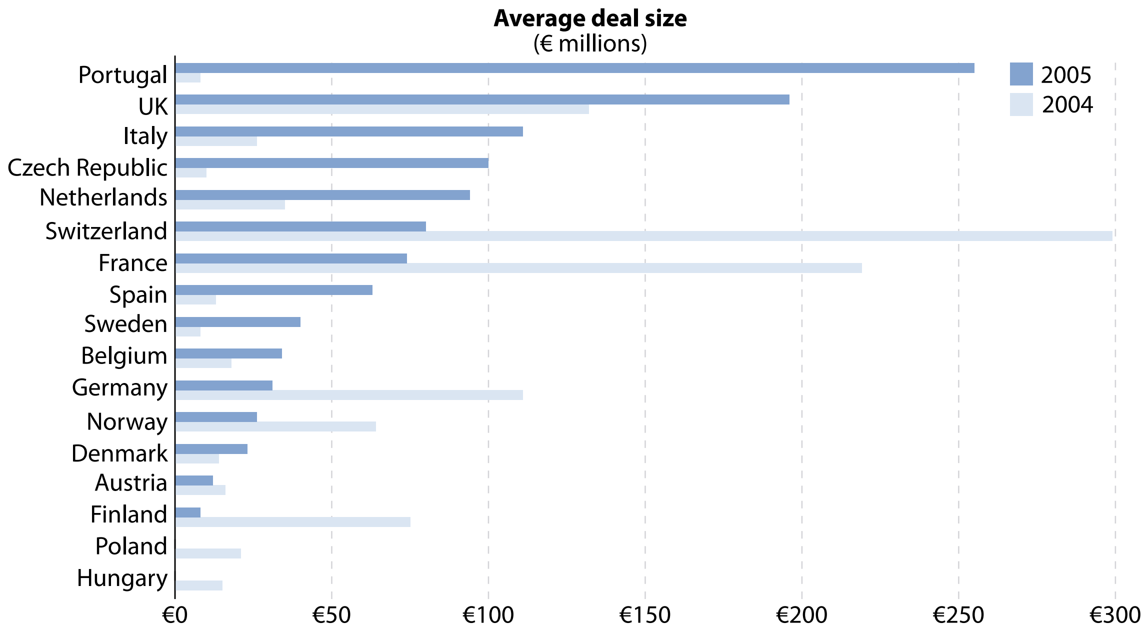
3-2 Germany dropped down the aggregate deal value ladder



Base: European outsourcing deals with a contract value of €10 million or more and with a known client country

Source: Forrester Research, Inc.

Figure 4 Changes In Average Deal Size Showed A Patchy Picture



Base: European outsourcing deals with a contract value of € 10 million or more and with a known client country

Source: Forrester Research, Inc.

The Public Sector Had An Outsourcing Spending Bonanza In 2005

Looking at the numbers of contracts signed by industry, 2005 saw remarkable consistency with 2004 (see Figure 5-1). Levels of activity in both years were highest in the financial and public sectors, with the next group of industries including telecom, manufacturing, CPG and retail, and services. Travel and transport was the main industry with a dramatic shift in deal numbers: It fell from driving 7% of all the deals in 2004 to 3% of all deals in 2005. Here's how the other year-on-year shifts played out:

- **Government organizations leaped ahead of finance firms.** In overall aggregate spending, government and public sector organizations swept ahead to kick the financial sector off the top of the outsourcing table in 2005. Forrester tracked more than 70 public sector outsourcing contracts through the year, with the aggregate contract value of known deals totting up to a massive €12 billion (see Figure 5-2). Despite higher deal numbers, the financial sector scored only an aggregate of €7.1 billion in outsourcing spending for deals of known value.

- **Just two sectors saw substantial outsourcing spending growth.** Several sectors saw an uptick in outsourcing spending, including finance, manufacturing, and high-tech. But just two had spending explosions: automotive and the government and public sector. Fiat accounted for the automotive spending bulge with just one deal: July 2005 saw the Italian giant sign a €1.8 billion infrastructure outsourcing deal with IBM. Megadeals made the difference in the public arena, too, as the sector almost doubled its outsourcing spending year on year. BT scored two

UK government deals adding up to more than €3 billion, and EDS signed a range of new and renewal government business, with several contracts ranging from €1 billion to nearly €3 billion in value.

- **More industries saw average contract values falling.** Leaving aside verticals where deals were recorded only in one year or the other, more than half of the sectors saw average deal values fall in 2005 compared with 2004 (see Figure 6). The margin was narrow: Sectors with average deal value shrinkage outnumbered those with growth by seven to six — and the decline was small in most cases. But dramatic change occurred in several industries: Oil and gas, services, and utilities all saw the average deal value fall by almost 60% or more.

Infrastructure Outsourcing Demand Reached A Plateau

To give more insight into buyer demand, Forrester categorized the deals by service type — bearing in mind that many deals contain services of more than one type. Buyers' most often required areas of service delivery in 2005 saw a tapering off of the buying mix of 2004. No compensatory rise occurred in demand for other areas of outsourcing delivery.

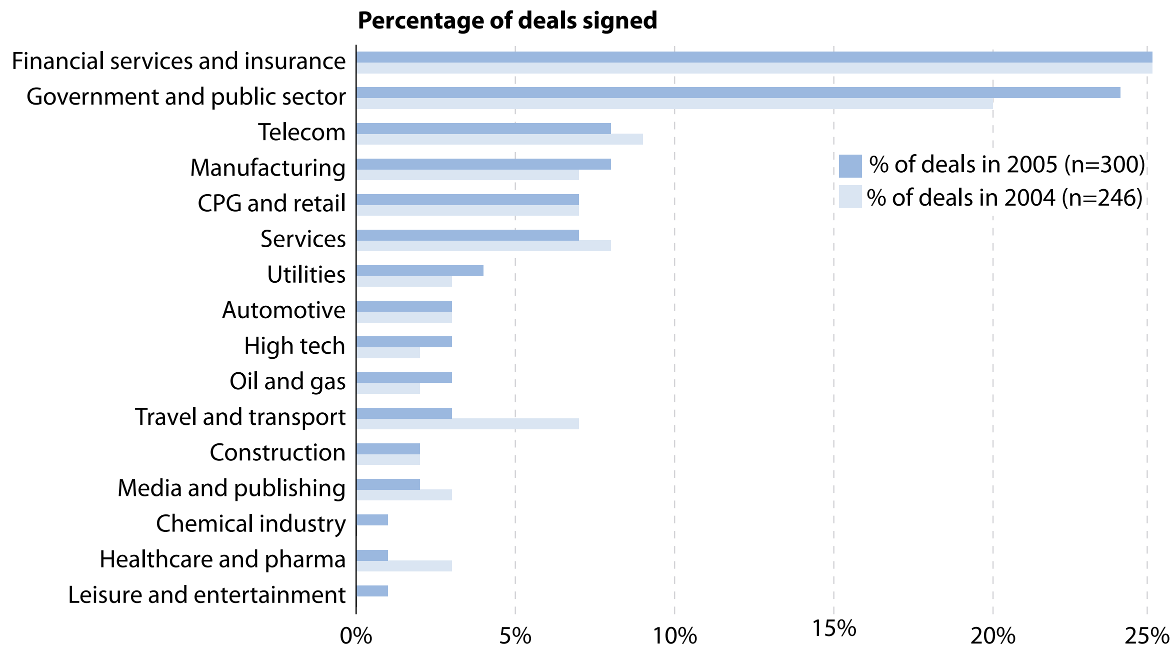
- **Buyers cut back on contracts with bundles of services.** Across all the deals we analyzed in 2004, we identified an average of 2.2 discrete elements of service delivery; in 2005, this dropped to just over 1.8. A higher proportion of the deals focused on just one area of service delivery. What does this mean? Buyer firms appear to increasingly want more specialized or more focused service from outsourcing providers and are turning away from the one-stop-shop approach.

- **The top three service categories lost ground, year on year.** Of all the service types we track in our survey, companies bought most from infrastructure management, apps management, and helpdesk and support services in 2004 (see Figure 7). These three outsourcing categories formed a far smaller percentage of all the deals signed in 2005, however, with infrastructure outsourcing falling by a full 20 percentage points. Each of these three service types was present in far fewer contracts in 2005 than 2004, despite the overall increase in the numbers of contracts signed. Nonetheless, infrastructure services still topped the outsourcing league, while telecom and network outsourcing climbed to second place in the table.

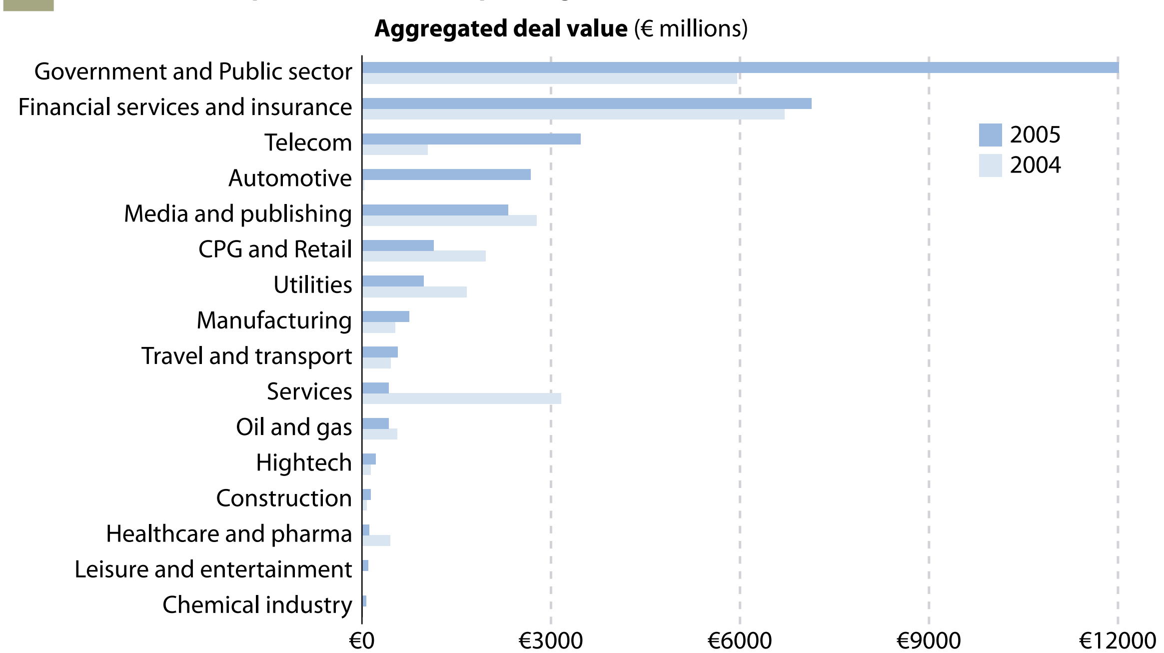
- **BPO gained more interest.** The percentage of contracts in 2005 that contained elements of BPO was six percentage points higher than in 2004. Along with the overall jump in deal numbers, 2005 saw a jump in the number of BPO contracts from 33 to 59. Most new BPO signings took place in the UK, Germany, and the Netherlands. Firms outsourced their financial services back office, HR, and F&A. But firms in countries like Italy, Norway, and Switzerland also took a step forward with BPO, with activity centered on industries like telecom and services.

Figure 5 Activity By Industry Showed Little Variation

5-1 The top two industries accounted for almost half of all deals



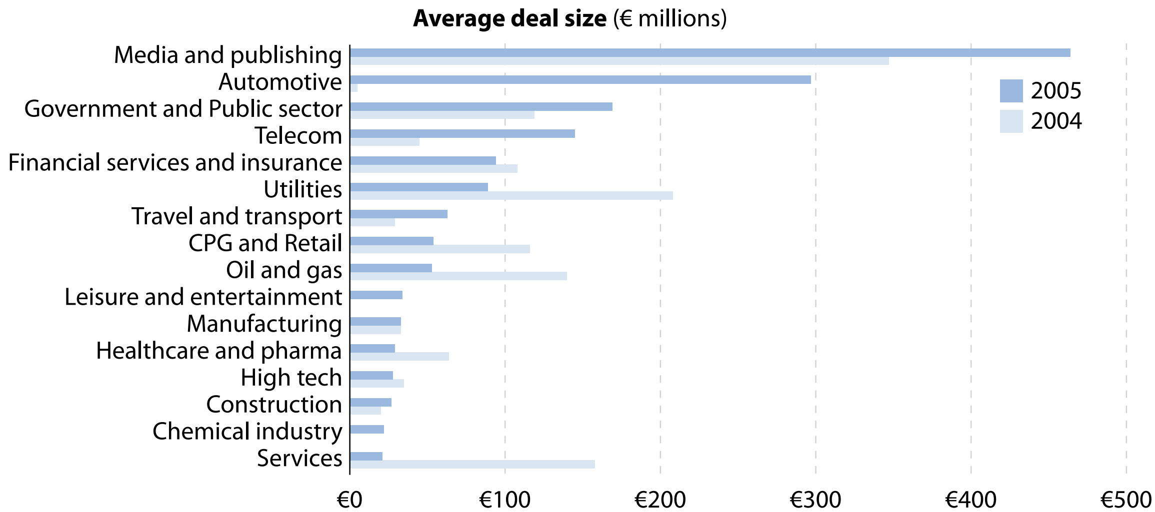
5-2 Government leaped ahead on total spending



Base: European outsourcing deals with a contract value of €10 million or more and with a known client industry

Source: Forrester Research, Inc.

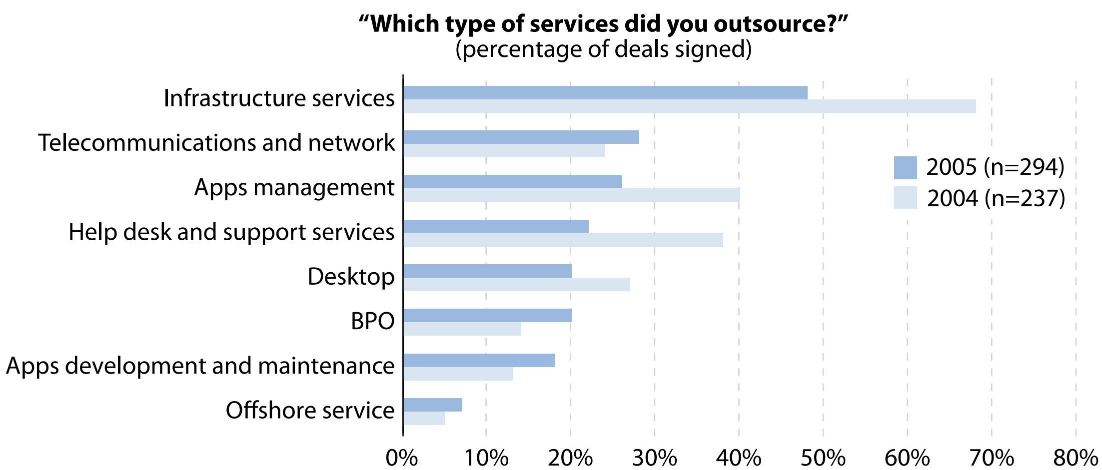
Figure 6 Most Industries Showed An Average Deal Size Of Less Than €100 Million



Base: European outsourcing deals with a contract value of €10 million or more and with a known client industry

Source: Forrester Research, Inc.

Figure 7 Service Demand Was More Balanced



Base: European outsourcing deals with a contract value of €10 million or more and with a known service type (multiple responses accepted)

Source: Forrester Research, Inc.

SMALL SHIFTS RESULTED IN MORE SPENDING

The total value of outsourcing contracts rose by 28% over the year to €32.6 billion. More than half of the 2005 value came from eight contracts with a value of more than €1 billion. The average deal length went down from 5.4 to five years.

Buyers Wanted To Keep It Short And Simple

The phenomenon that we saw last year stayed the course, with 2005 again seeing more short and small deals than big contracts. Some 70% of the deals we tracked were for five years or less, and 65% were for less than €50 million in total contract value (TCV) (see Figure 8-1 and see Figure 8-2).

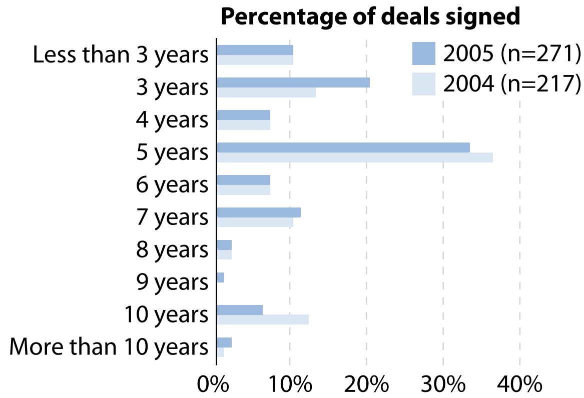
- **The public sector preferred shorter deals; the financial sector longer.** With each having 65 deals of a known deal length at year end, these two industries bought the most outsourcing services. We saw that the public sector had a tendency toward deals for up to five years in duration, while firms in the financial sector signed more deals for five years or longer (see Figure 8-3). This may in part reflect the fact that the public sector activity in 2005 included a high number of renewals and extensions — business that tends to show shorter, lower-value contracts than new contracts.

- **Long agreements pushed the spending up.** Looking at the spectrum of deal lengths, three-year agreements grew the most as a percentage of all deals — by seven percentage points. The average contract size for deals of this duration was €17 million (see Figure 8-4). The increase in overall outsourcing spending between 2004 and 2005 clearly did not come from these shorter deals. Deals for up to and including three years accounted for 30% of the total number of deals, but they only drove 5% of the total European outsourcing deal value.

- **Wholly new contracts soldiered on.** Despite claims that outsourcing has become much more of a renewals business, Forrester tracked a near-identical division of new deals and renewals and extensions in 2005 as in 2004: The difference was just a three percentage point increase in renewals, and thus a three percentage point decrease in new deals (see Figure 8-5). The average deal size for new deals went up, while the average TCV for renewals or extensions dropped from €85 million to €78 million. EDS and Fujitsu Services did well on extending and expanding their client engagements: At least half of the deals that we tracked in Europe for them were renewals or extensions, some of which exceeded €100 million in TCV.

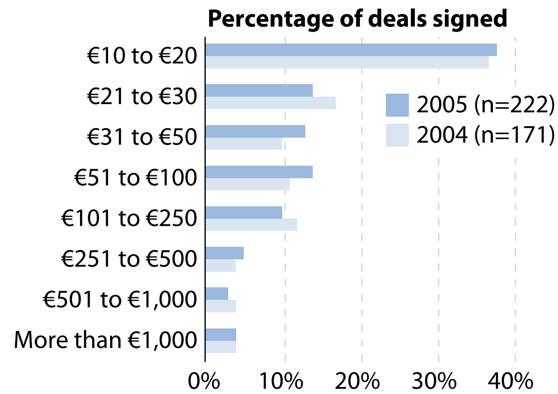
Figure 8 The Focus Continued To Be On Short And Small Engagements

8-1 Buyers were not keen on long-term commitments



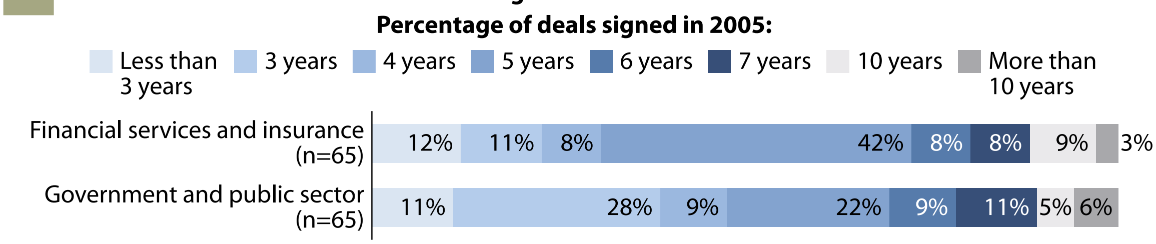
Base: European outsourcing deals with a contract value of €10 million or more and with a known deal length

8-2 Many small deals make up for a megadeal shortage



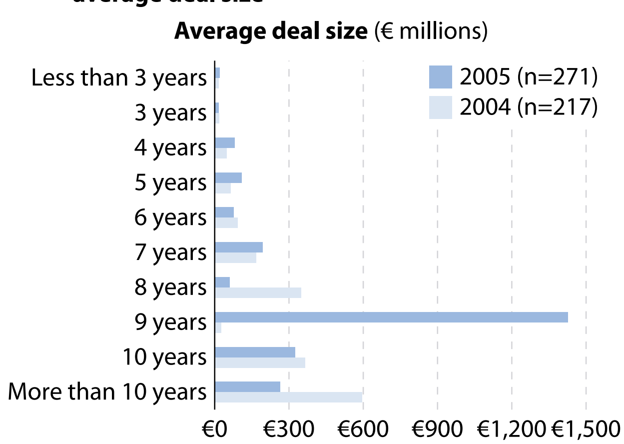
Base: European outsourcing deals with a contract value of €10 million ormore and with a known deal size

8-3 Industries focused on different deal lengths



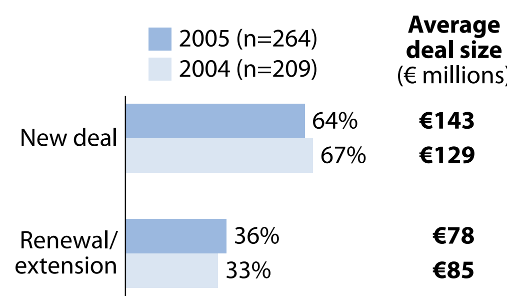
Base: European outsourcing deals with a contract value of €10 million or more and with a known deal length

8-4 Two megadeals distorted the nine-year average deal size



Base: European outsourcing deals with a contract value of €10 million or more and with a known deal length

8-5 Renewals kept the same share, but declined in value



Base: European outsourcing deals with a contract value of €10 million or more and with a known contract type

Source: Forrester Research, Inc.

Outsourcing Providers Battled It Out In The "Small" Deal Arena

Again in 2005, it was the megadeals that caught the media's attention — with heart-stopping numbers like the €2.2 billion contract between 3UK and Ericsson standing out. But such deals made up less than 5% of all the outsourcing activity in Europe over the year (by contract numbers). At the other end of the scale, deals with contract values between €10 and €101 million represented 79% of all deal activity with a known deal value, up from 76% in 2004. So how did Europe's leading outsourcing providers divide up the pot?

- **Megadeal success drove the biggest backlog growth.** The so-called backlog of contracts represents the signed business that a service provider will recognize as revenue over the life of each contract. Just a few firms stood out at the head of the backlog growth list: BT Global Services with more than €7 billion in 2005 bookings, EDS with more than €5 billion, and Ericsson with its one megadeal in the year. Only Atos Origin crept into this frame with no single deal above the €1 billion mark, but even that strong performance turned on the firm's €756 million contract with the UK's Department for Work and Pensions (DWP). With that deal in its pocket, Atos Origin pulled in known bookings of €1.3 billion.

- **Providers varied between sector focus and broad industry coverage.** A few firms showed a marked tendency to concentrate their outsourcing business in a few industries: T-Systems signed 21 of 29 contracts in just four industries — finance, manufacturing, telecom, and services; five of Unisys's seven deals were in finance; and even EDS concentrated 24 of its 36 contracts in the finance and public sectors. At the other extreme, Atos Origin signed business in 11 industries, and no more than four of its 25 contracts fell in any single sector.

- **Smaller deals' prevalence led to low average contract values.** Providers mostly had to work harder than ever in 2005 to pump up the backlog. Despite its success, Atos Origin clearly demonstrated this: Leaving aside the DWP contract, its 10 other signings with known deal value averaged just €44 million apiece. Among 15 solo deals, Capgemini signed just one deal for more than €100 million — and no less than nine valued at less than €50 million. Getronics failed to sign a single deal above €50 million, and the majority of contracts that Fujitsu Services, LogicaCMG, and SBS signed all fell below that figure.[2]

2005'S HIGHLIGHTS: DIFFERENTIATED OFFERINGS AND WILLING BUYERS

Many deals reported during 2005 were alike in service focus, in size, or in industry. To gain further insight into the year's outsourcing trends, we picked out the following eye-catching deals:

- **Accenture took over the logistics for BP Lingen.** Accenture and BP Lingen closed an agreement for logistic services in maintenance, repair, and operations. It is unusual to see an established IT services player sign a substantial logistics deal. Clearly, the long-established IT services specialists like Accenture and IBM see an imperative to spread their focus and open up new areas of growth.

- **Atos Origin started managing a healthcare center.** Atos Origin's involvement in healthcare services took a new twist in October 2005. From implementing and managing healthcare solutions, it went one step further and announced a plan with the Department of Health to manage a UK National Health Service (NHS) walk-in center. The contract includes refurbishing the site, recruiting healthcare professionals, and running the service on a daily basis.

- **The UK's Ministry of Defence (MoD) was the unstoppable buyer.** There were several buyers, such as the UK's Department of Work and Pensions, ABN AMRO, and the Norwegian police, that closed more than one deal during 2005. The UK's Ministry of Defence was the absolute big-spending champion, with four deals reported. Deals in the public domain alone included two megadeals worth more than €5 billion in total. These deals both contribute to the Defence Information Infrastructure Future project, which is due for completion in 2007.

SUPPLEMENTAL MATERIAL

Methodology

We tracked IT outsourcing deals worth €10 million or more by surveying 24 IT service providers and doing additional desk research for 13 IT service providers.

Companies Interviewed For This Document

Accenture

Atos Origin

BT Global Services (BT)

Capgemini

Cognizant Technology Solutions

Computer Sciences Corporation (CSC)

EDB

Electronic Data Systems (EDS)

Finsiel

France Télécom-Equant

Fujitsu Services

Getronics

Hewlett-Packard

Infosys

LogicaCMG

Lufthansa Systems

Polaris Software

Siemens Business Services (SBS)

Tata Consultancy Services (TCS)

TietoEnator

T-Systems

Unisys

Wipro

Xansa

ENDNOTES

1 Forrester started to track IT outsourcing activities from firms that are headquartered in Europe on a quarterly basis in Q1 2004. Deals reported with a total contract value of €10 million or more totaled 247 in 2004. See the June 16, 2005, Trends "Europe's Diverse Outsourcing Market In 2004."

2 In all cases, these numbers reflect an analysis of deals with contract value available to Forrester. We are unable to allow for deals where the provider or client insists on keeping deal value information confidential.

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