



HRO: A Market on the Move and Why You Should Care

Market Overview and Lessons Learned

October 11, 2006

A webinar sponsored by



About ADP

- Over 55 years of Payroll, Human Resources, and Benefit Administration service
- One of the leading providers of HR BPO services for the Mid-Market (ADP) Comprehensive Outsourcing Services
- Full service HR BPO suite including Payroll Administration, Human Resource Services, Benefit Administration, as well as additional complimentary services
- Sample clients include:



- Educate attendees team on what is happening in the HRO market:
 - Mid-market buyer adoption rates and key business drivers of interest in HRO
 - Common HRO process scope and the role of technology in service delivery
 - Governance practices and the role of retained HR
- Tie these trends and their implications back to the options available to session attendees and the lessons learned by buyers who already have adopted HRO
- Afford attendees the opportunity for Q&A on the market and their specific situation
 - You can submit your questions anonymously throughout the session today
 - We will have the option for questions via phone near the end of the session

Everest supports global 2000 organizations through three lines of business



Outsourcing information repository



Outsourcing industry research



Comprehensive consulting services

- Supports overall education of the industry through an informative web-site which posts white papers, articles, and surveys on current industry topics and trends
- Combination of quantitative and qualitative, proprietary outsourcing research data
 - Facts on market maturity
 - Size/type of opportunities
 - Understanding of economic and non-economic factors
- Unique portfolio of services across sourcing lifecycle
 - Deep sourcing functional expertise and the advisor of choice for complex, sourcing transformational programs

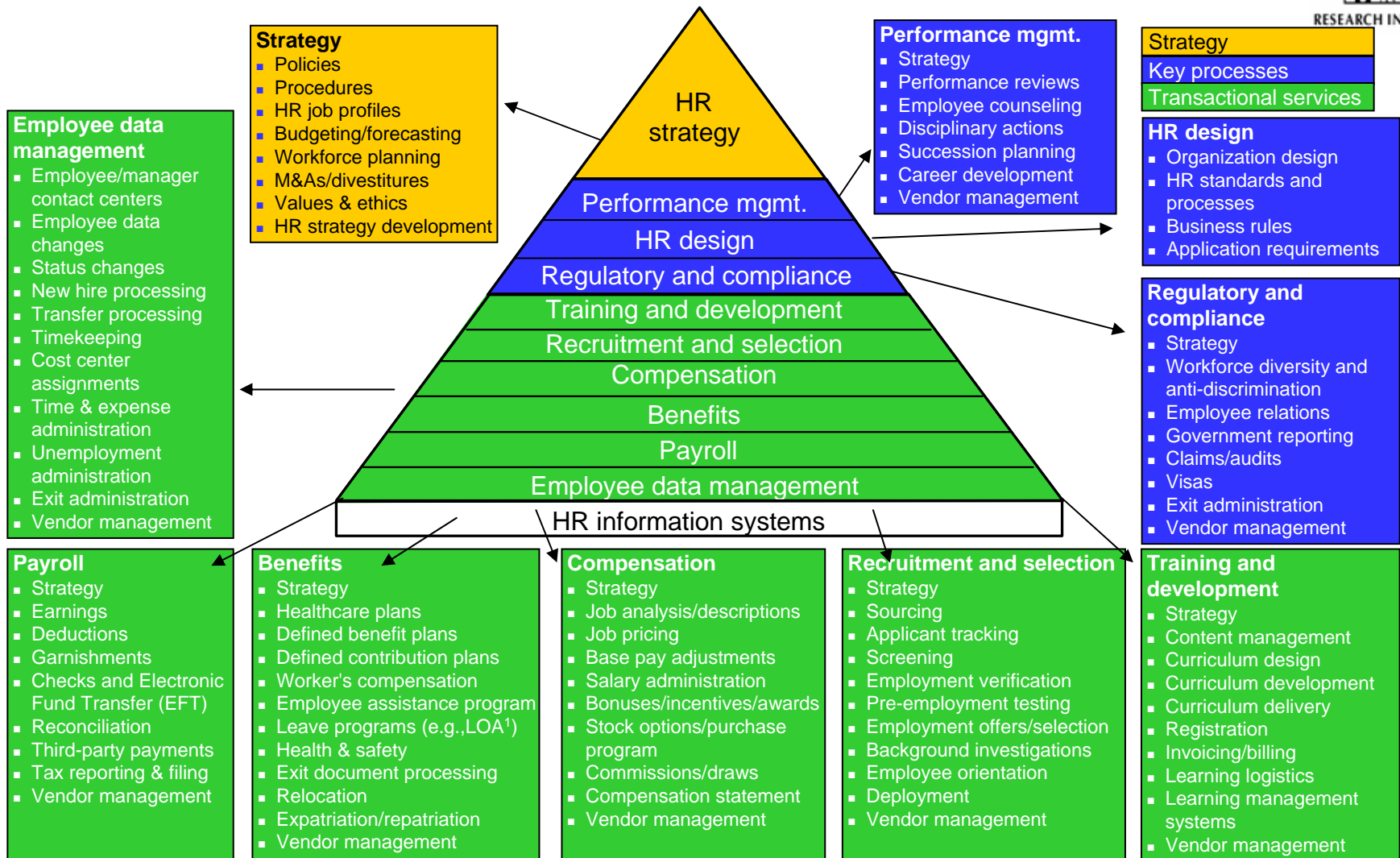
Representative clients



Everest's Coverage of the HRO Services Industry



RESEARCH INSTITUTE

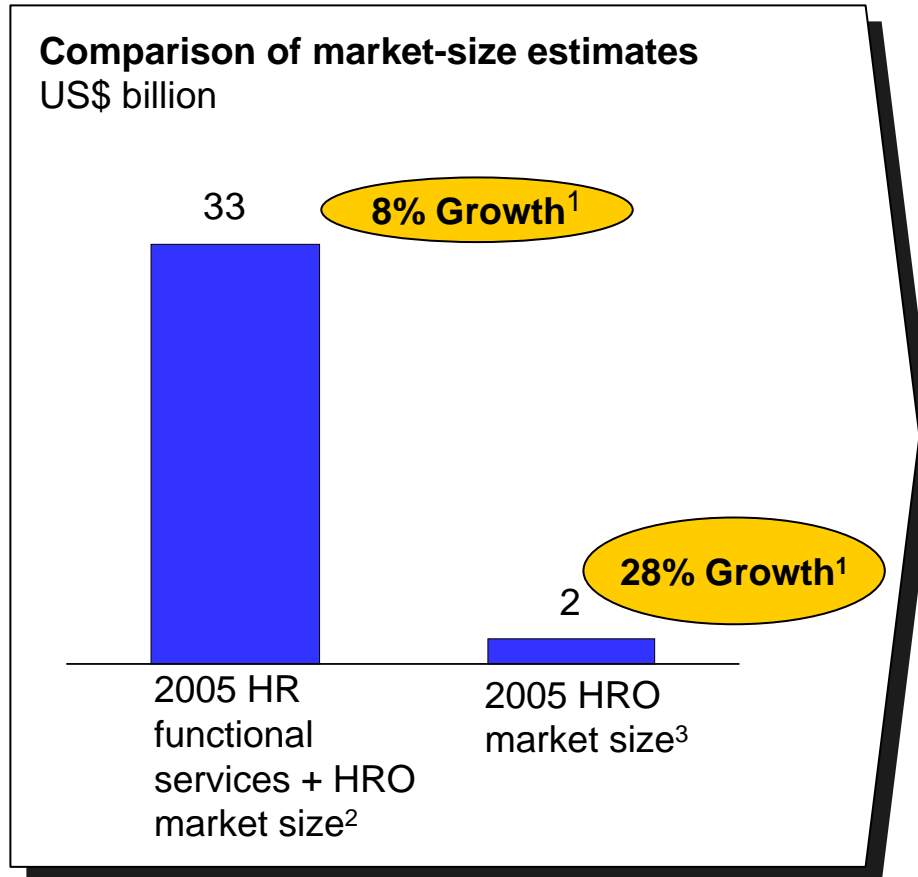


Everest analysis includes all HRO transactions as of March 31, 200
 HRO transactions include a minimum of three HR processes and service more than 3,000 employees



- Session overview
- **HRO market trends and lessons learned**
 - **Overview of HRO and drivers of buyer interest**
 - **Trends in HRO process and technology delivery**
 - **Governance and the role of retained HR**
- Key elements for buyers to consider

The HRO market is growing 3-4 times faster than the HR functional services market



There is substantial expected growth in the HRO market

- The HRO market comprises only 6% of the overall HR outsourcing market, which includes a lot of single-process outsourcing
- The HRO market is growing at 3-4 times the rate of the single-process HR functional services market

1 Compound Annual Growth Rate

2 Based on Gartner's estimate (CAGR based on 2003 through 2007 market estimates). Some elements of this market may be in flat negative growth stage, as the HRO segment is clearly growing at a very high rate

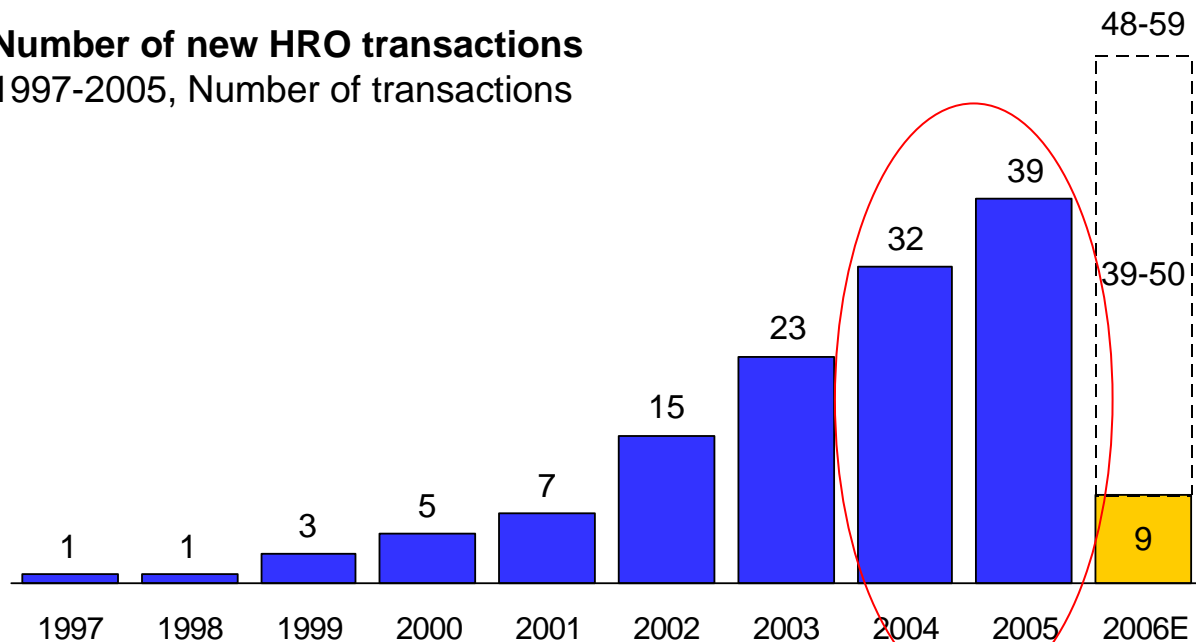
3 Everest estimate (CAGR based on 2003 to 2005 actual growth rate) based on a "bottom-up" estimate from transactional data

Source: Everest Research Institute; Gartner Dataquest March 2005

The past two years account for 59% of the total HRO transactions to date – which highlights strong and growing interest in comprehensive outsourcing of HR

- Total deals grew from 86 deals in 2004 to 135 deals in Q1 2006 – a 57% increase
- 80 of the total 135 HRO transactions to date (59%) were signed between 2004 – Q1 2006
- 70 of the total 135 HRO transactions (52%) are by mid-size companies
- A total of 6.0 million employees lives are served through HRO deals

Number of new HRO transactions
1997-2005, Number of transactions



2006E: Projected based on 2002-05 CAGR

Sample size: Total of 135 transactions signed as of Q1 2006 with a minimum of three HR functions and servicing +3,000 employees

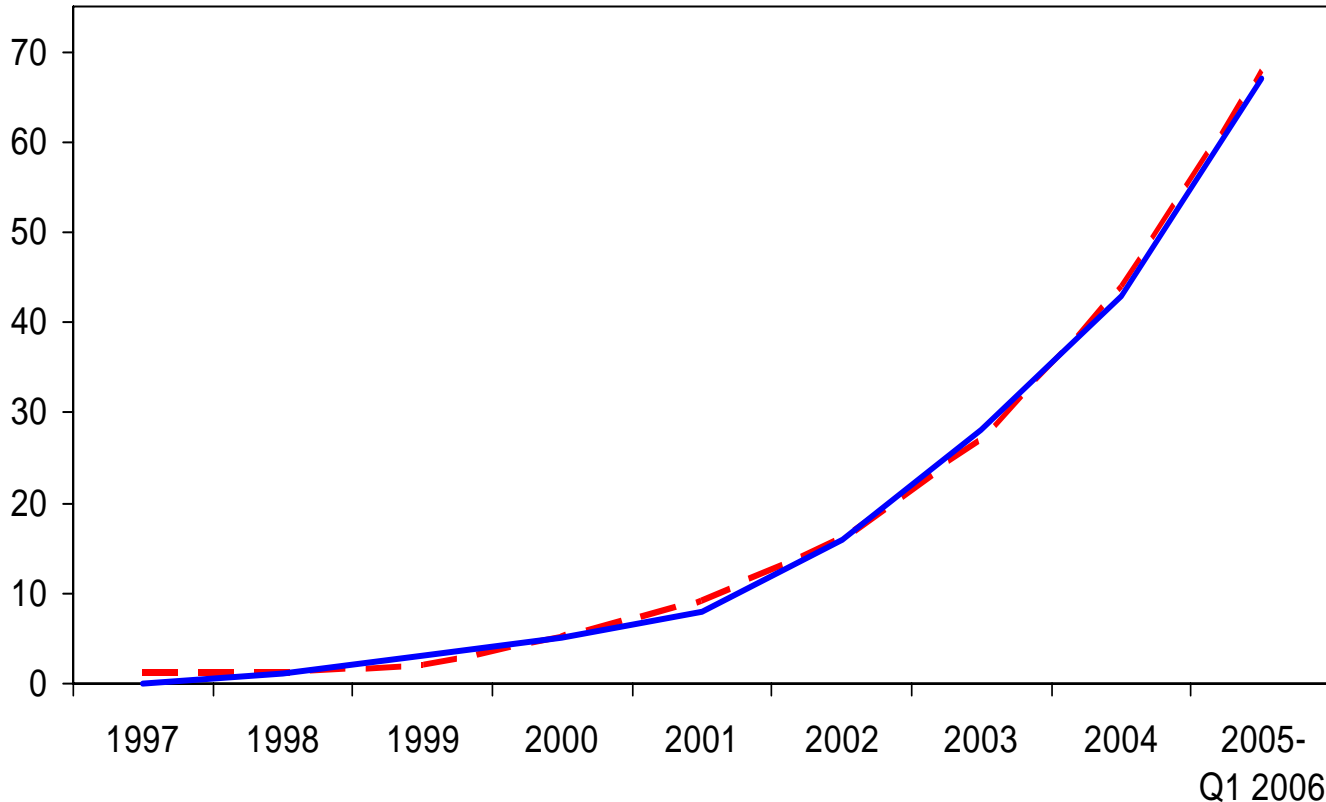
Source: Everest Research Institute, June 2006

Two HRO market segments (3K-15K employees and >15k employees) have tracked each other in terms of number of transactions

Cumulative distribution by number of transactions

Cumulative number of transactions

- >15K employees segment
- - 3K-15K employees segment



The mid-market has paralleled large employers in terms of growth rate: Both segments have similar adoption levels in terms of number of transactions

Sample size: 135 transactions signed as of Q1 2006
Source: Everest Research Institute, June 2006



Why are mid-size companies seeking the comprehensive outsourcing of HR?

“Typical” mid-size HRO buyer¹

- 8,200 employee domestic-US firm
 - Half of mid-size HRO deals are firms with <5,000 employees
- 5-6 year contract term
 - 5 years by far is most common, though deals have been as short as 3 years and as long as 10 years
- Scope is the “core” HR infrastructure
 - Payroll, time & attendance, HRIT, employee data management, reporting
- Majority of deals expanded over time
 - Relationship with supplier began as the discrete outsourcing of a single HR process and grew over time

Business drivers of the HRO decision

- Organic growth
 - Strategic growth plans require new HR infrastructure
 - Recent growth outstripped existing infrastructure / legacy environment
- M&A / divestitures
 - Mergers / acquisitions have resulted in redundant systems and/or processes
 - Divestitures has created the need for new infrastructure and/or processes
- Technology refresh
 - The company is due for an upgrade or enhancement to its IT systems and is seeking to optimize the investment

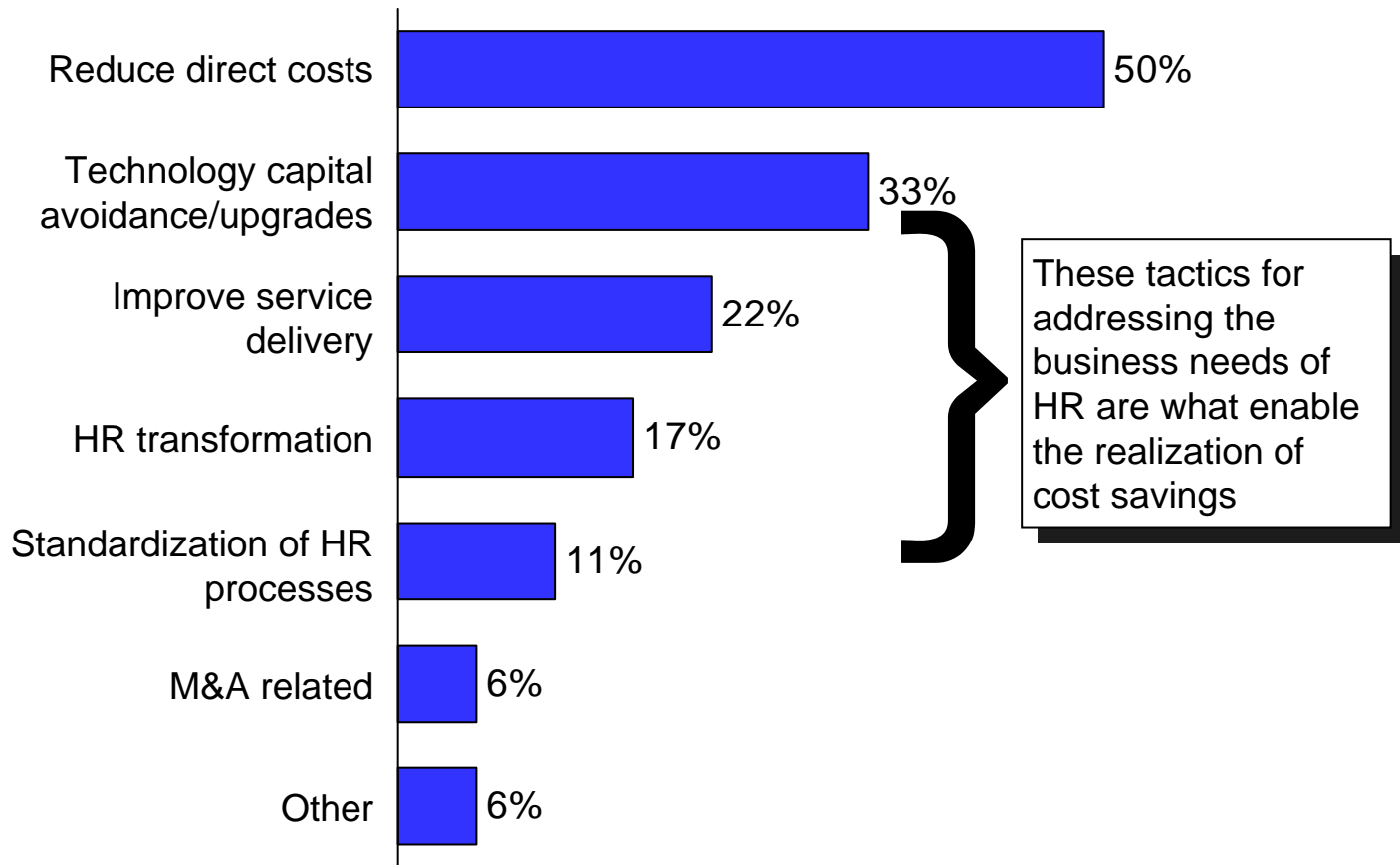
1: 70 transactions signed as of Q1 2006

Source: Everest Research Institute, June 2006

While cost reduction is the key driver for HRO today, technology capital avoidance is the compelling event that motivates many buyers to outsource HR

Driver for HRO

Percentage of buyers¹



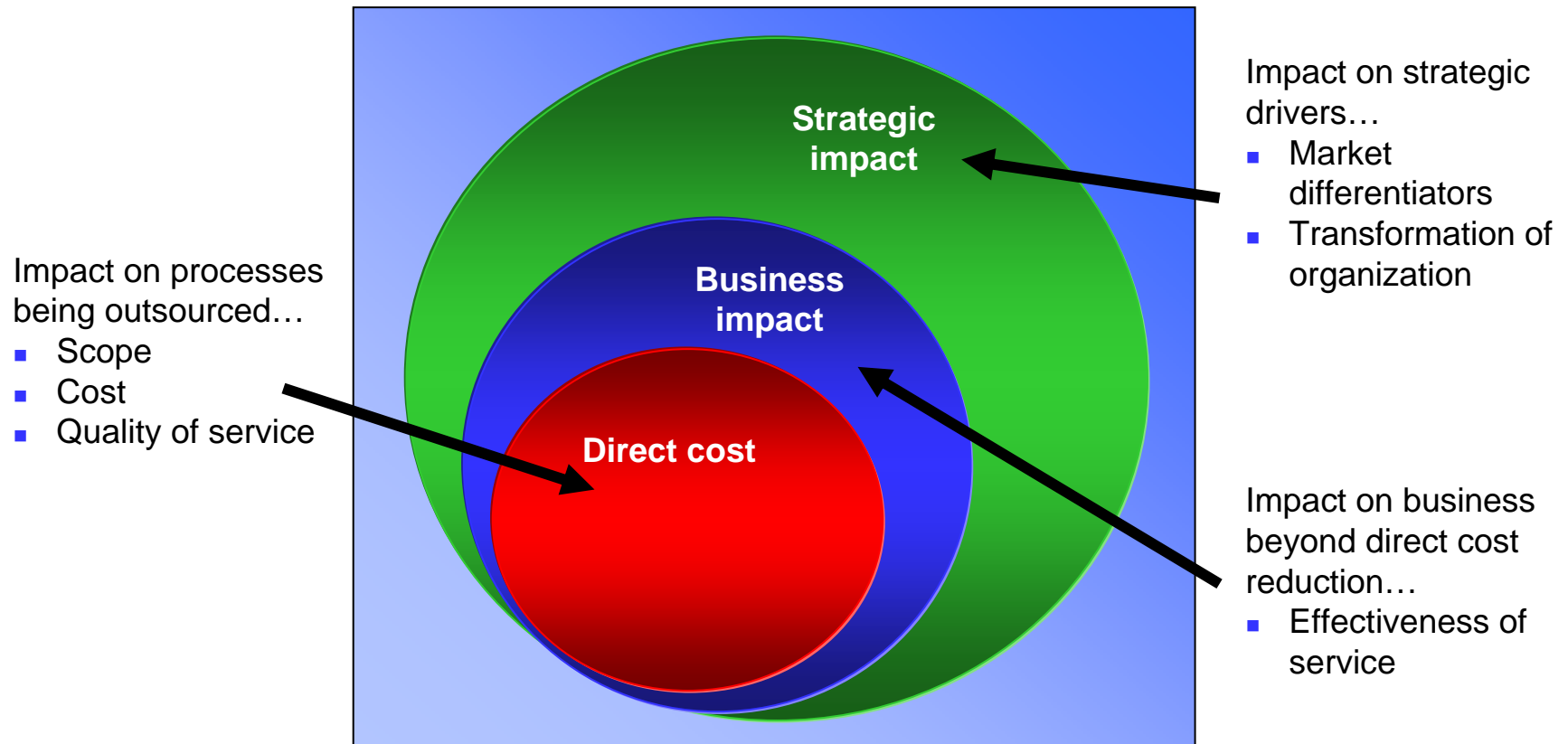
¹ Multiple responses to the driver for HRO have been counted as well and hence the total exceeds 100%

Source Everest Research Institute, June 2006

Buyers should consider the financial, operational, organizational, legal, and strategic options for value creation in HRO

Most HRO transactions only focus on direct cost, rather than operational and strategic impact

Everest Total Value EquationSM (TVE)

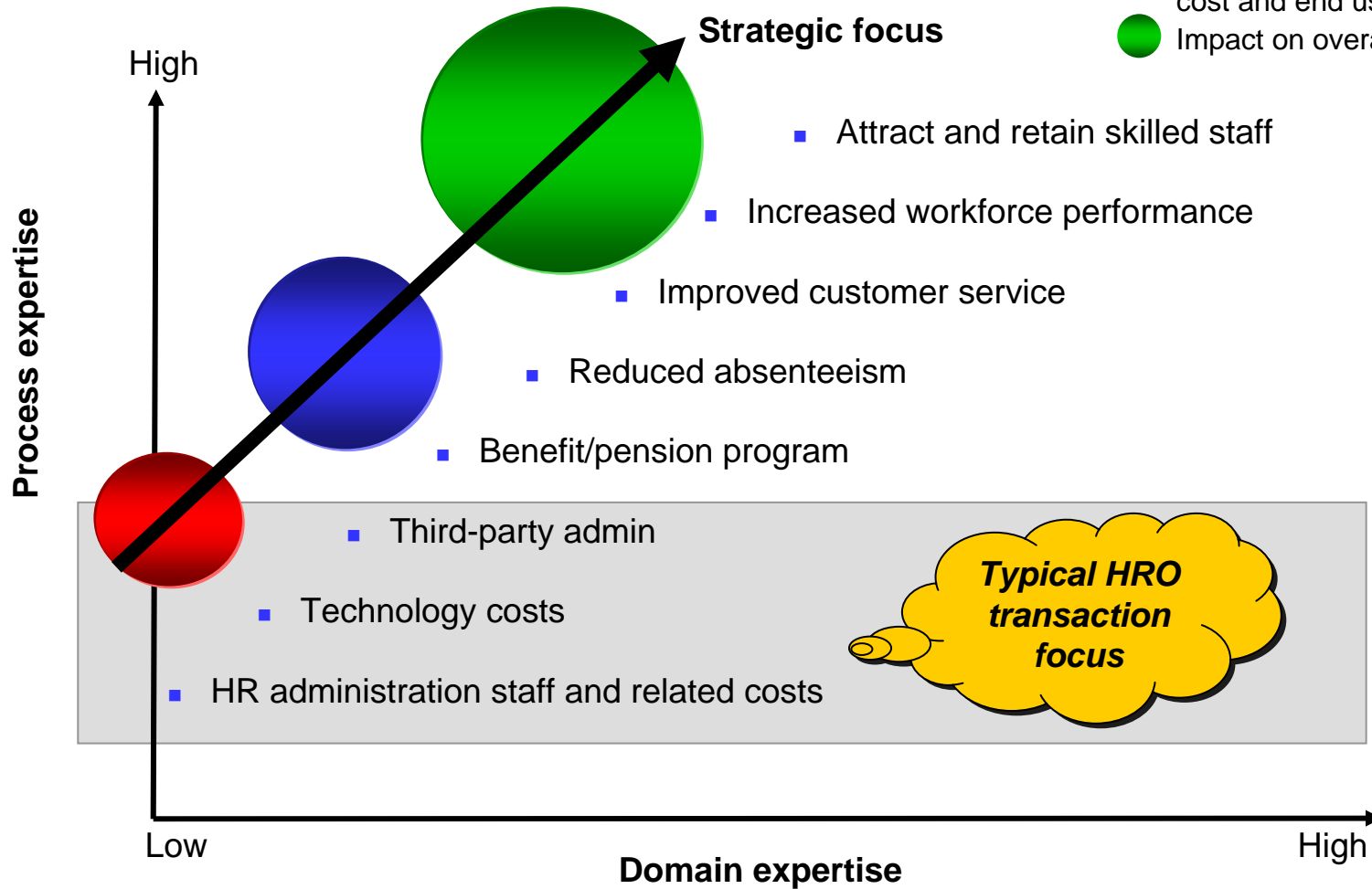


Source: Everest Research Institute

Overall business and indirect costs have a far greater buyer impact than direct costs alone



- Impact on direct cost
- Impact on direct and indirect cost and end users
- Impact on overall business



Source: Everest Research Institute



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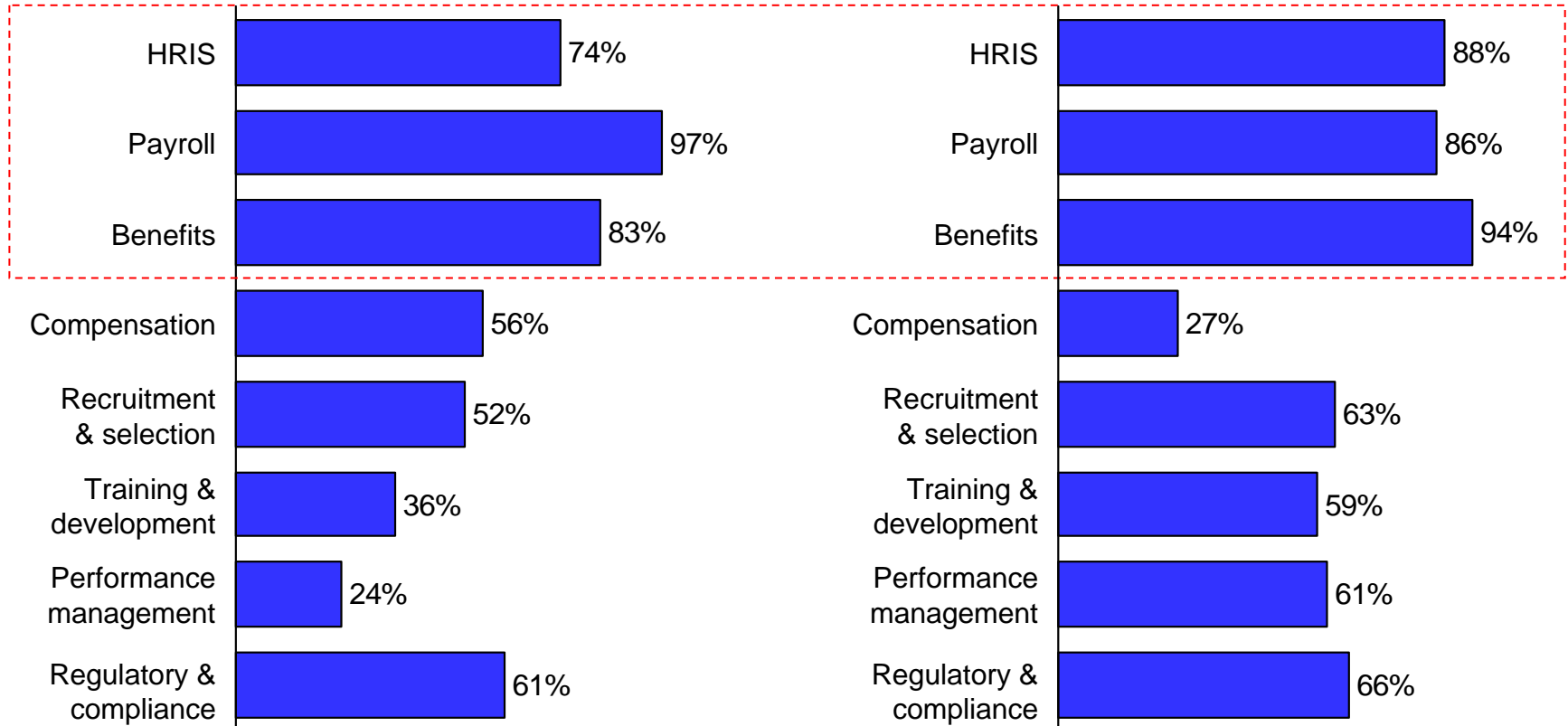
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“Core” HR processes (payroll, benefits, HRIT, reporting) are in scope for most mid-market HRO deals, though interest is growing in recruiting and compensation



Frequency of inclusion
(3K-15K segment transactions)

Frequency of inclusion
(>15K segment transactions)



Sample size: 130 transactions signed as of Q1 2006
Source: Everest Research Institute, June 2006



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While evaluating suppliers, buyers should carefully consider cultural fit, solution design, financial impact of the solution, and overall HR capability

Supplier evaluation categories and subcategories	Description
Cultural fit <ul style="list-style-type: none"> ■ Partnering ability ■ Flexibility ■ Values 	As evidenced in the supplier's ability to convey sensitivity to client's concerns around disruptive change, quality and flexibility
Solution design and quality <ul style="list-style-type: none"> ■ Quality of execution ■ Service levels ■ Proposal completeness ■ Transition and operations risk 	Based on the supplier's ability to demonstrate a compelling solution and strategic vision for its product offerings
Financial impact <ul style="list-style-type: none"> ■ <Number of years> cost NPV ■ Financial risk 	Any defensible benchmark savings offered through case studies or supplier's best practices or convincingly cost-effective solutions
Supplier HR capability <ul style="list-style-type: none"> ■ Scale ■ Scope ■ Technology ■ Geographic delivery capability 	Assessment of supplier's HRO capability in terms of scale of current operations, scope in terms of HR function capability and quality, technology capability, and geographic spread

Source: Everest Research Institute, June 2006



- Cost reduction is the primary objective for outsourcing HR. However, as the deal matures over time, the expectations evolve beyond simply the cost element and towards realizing:
 - improved service delivery (continuous improvement)
 - the strategic alignment of the HR organization with the overall business goals of the firm
- Change management remains an important concern, with buyers expecting better change management / project management guidance and support from the suppliers
- Clearly defined roles and responsibilities is another stumbling block in governance
 - There is a strong need for team consistency – both on the supplier and the buyer teams
- A key element of governance, and an emerging focus for retained HR staff, is the creation and leveraging of an HR reporting and analytics environment
- HRO is a means, not an end unto itself
 - Remain clear on the strategic goals of the firm and the role of sourcing as a tactic within this strategic environment
 - The best HRO engagements are those where client and supplier work together in a partnership

Source: Everest Research Institute, June 2006



Contents



- Session overview
- HRO market trends and lessons learned
- **Key elements for buyers to consider**



Summary Findings

- The HRO market continues to grow rapidly
 - Everest is experiencing strong buyer interest in HRO
 - We are projecting 2007 will see an increase in deal announcements and continued growth in buyer interest in HRO

- Two distinct segments have emerged in the HRO market: mid-market and large employers
 - Despite the media attention on the large employer segment, the mid-market represents just over half (52%) of the contracts announced thus far

- While cost reduction is the key driver for HRO today, technology capital avoidance is the compelling event that motivates many buyers to outsource HR
 - While large organizations are seeking how to best minimize the necessary investments in their large ERP systems, mid-market companies are seeking greater automation and functionality in their HR systems and reporting

- “Core” HR processes (payroll, benefits, HRIT, reporting) are in scope for most mid-market HRO deals
 - Majority of deals expand over time, with relationships beginning first as the discrete outsourcing of a single HR process and grew over time

- While evaluating suppliers, buyers should carefully consider cultural fit, solution design, financial impact of the solution, and overall HR capability

Source: Everest Research Institute, June 2006



Implications of HRO trends for buyers

Value Creation



Value creation

- **As the market matures, value creation will continue to increase along multiple dimensions**
Maturing supplier capabilities, declining HRO prices, increasing offshore adoption, and the emergence of industry standards are expected to create further value for new and existing buyers:
 - As supplier offerings mature, buyers will benefit from increased processes as well as global capabilities
 - Significant price reductions in the market implies better value proposition for new buyers as well as for existing buyers with contracts coming up for renewal
 - Increased offshore adoption is expected to further drive cost savings
 - Emergence of industry standards are expected to reduce cost of delivery, create industry benchmarks, and achieve faster implementation

- **HRO is an increasingly attractive option for mid-market organizations**
There will be an increase in activity in the mid-market segment, as buyers look at HRO for cost reductions, access to new technology, and better alignment of resources with business needs

- **The HRO mid-market is beginning to support multi-national and even global buyers**
Suppliers are making significant investments in developing global HRO delivery capabilities, and most of the current suppliers already have completed at least one global HRO transaction

Source: Everest Research Institute, June 2006



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Implications of HRO trends for buyers

Risk Management



Risk management

- **Buyers need to carefully select technology, balancing the trade-offs between functional capability and costs (implementation, operating, and exit)**
- **Buyers need to have contractual provisions that protect against supplier changes**
It is always prudent to define an exit strategy, as realistically there will come a time to part ways. In addition, the supplier landscape continues to change with M&A activity. Suppliers will seek out partners to add complementary capabilities or build scale; players that fail to scale up are likely to fade
- **Buyers must design contracts with enough flexibility to take advantage of positive market or supplier trends**
As the market evolves, buyers will need to be flexible to adapt to changes in scope, scale, and value propositions. Looking forward, buyers should be flexible in their contract requirements as they expand to other geographies and/or seek broader services. Solution requirements (e.g., technology) and outputs (e.g., pricing) can change significantly with a change in scale and scope (global vs. local)

Source: Everest Research Institute, June 2006



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- Attendee Q&A
- Questions you should consider in self-reflection following this session:
 - *How well is your HR team operating as an internal business partner? Why do think this?*
 - *What percent of HR time is spent on administrative transactions vs. strategy execution?*
 - *How centralized / integrated / consistent are your HR processes and platforms?*
 - *What impact do previous IT decisions have on HR execution?*
 - *What effort is needed to bring the business units into consensus about HR service delivery scope and quality?*
- Next steps – We will be sending these session slides out to today’s attendees as a .pdf
- Thank you for your time today!

Get the answers today that lead to tomorrow's success



Everest Research Institute has the resources, experience, and capabilities to provide companies with the strategic intelligence, analysis, and insight that are crucial to making the right decisions in today's outsourcing marketplace.

With the vision of our leadership team, the personal commitment, and indeed, the passion of our professionals to deliver real value to our clients, our organization is unsurpassed in its ability to guide your company's future success.

Everest Group

Everest Research Institute

Two Galleria Tower
13455 Noel Road, Suite 2100
Dallas, TX 75240
+1-214-451-3000
www.everestresearchinstitute.com
info@everestresearchinstitute.com

Everest Group

150 E., 52nd Street, 16th Floor
New York, NY 10022
+1-646-805-4000

Everest Canada

5915 Airport Rd #400
Mississauga, ON L4V1T1
Canada
+1-905-405-5640

Everest UK

Gainsborough House
100 Pall Mall
St. James's
London, SW1Y 5HP
+44 (0)20-7664-8920

Everest Australasia

Level 6, 90 Mount Street
North Sydney, NSW 2060
Australia
+61-3-9833-1018

Everest India

Ground Floor, Tower A
Unitech Business Park
South City - I, Gurgaon
New Delhi National Capital Region
India 122001
+91-124-304-1000

