The changed agenda in the global sourcing industry: perspectives and developments

Global ICT services sourcing conference, Sharm-el-Sheikh
November 14, 2009
Executive summary

- Long-term trends towards increased outsourcing and offshoring are prevailing. Driven by a changing environment the industry size is expected to triple in the next 10 years
  - Fundamental advantages of outsourcing (focus on core) and offshoring (need to address onshore skills shortage and cost pressure) continue to hold, thus O+O industry will portray further growth
  - 20-25% of future growth likely to come from further penetration of already existing segments, while 75-80% likely to stem from new market segments: new verticals (healthcare, etc), SMBs and new domestic outsourcing segments in BRIC countries, overall tripling the addressable market to 1.5 trillion USD by 2020

- While the economic downturn has caused a moderate slow-down in industry growth, there are early signs of recovery
  - 2009 expecting slowest revenue growth in the history of the O&O industry
  - Early signs of recovery supported by increased industry activity in 2H 2009 and optimistic outlook of users
  - However, significant uncertainty remains about ultimate timing and shape of economic recovery (V vs. W)

- Moving forward, the imperatives for successful O&O management are coping with increased uncertainty and complexity combined with a strong belief in the fundamental growth perspectives of the industry
  - Companies need to focus on increasing their ability to manage uncertainty in a flexible and agile mode
  - The most predominant trends are taking the industry towards an unseen complex multi-dimensionality
    - Multi-servicing: Everything that can be can be outsourced a/o offshored will be
    - Multi-sourcing: Buyers of O+O services will play their market choices and exercise price pressure
    - Multi-shoring: Ever new locations will strive for a share in this growth market – Egypt seems well positioned
  - Key take-aways: 1) Consider that O&O fundamentals are prevailing and invest in bold moves, 2) Make your organization "fit" for managing uncertainty and consider O&O as key levers 3) Manage the emerging complex multi-dimensionality in O&O
Fundamental advantages of outsourcing and offshoring continue to hold

Fundamental advantages

1. **Outsource**
   - Focus on core business activities/capabilities
   - Outsource non-core, which are core for partner
   - Decrease cost through sharing partner’s scale
   - Variabilize fix cost, and thus
   - Increase sourcing flexibility to
   - Meet changing business conditions

2. **Offshore**
   - Cope with skills shortage in onshore markets by tapping into offshore talent pools; e.g., India produces ~4 million graduates p.a. willing to participate in global workforces
   - Improve quality of services through employing higher skilled labor; e.g. employment of commerce graduates for accounts payables processing
   - Lower cost base through labor arbitrage

SOURCE: McKinsey O&O Practice
Focus on the core business: Easier said than done!

Core- vs. Non-Core Business ?!
(Example: Automotive industry)

Main source of earnings at
- GM
- VW etc.

SOURCE: McKinsey
Core Capabilities mainly shaped by share of internal value generation

Is there a necessity for such a large difference in share of internal value generation?
Focus on core capabilities may look like A...

VALUE ADDED CHAIN OF INDUSTRIAL ENTERPRISE – EXAMPLE A

- Create
- Make
- Sell
- Service
- Administer
- Procure
- Customer Service

- Human Resource Management
- Accounting, Finance, Legal & Taxes, …
- IT Infrastructure incl. AD/AM

SOURCE: McKinsey
… or: Focus on core capabilities rather looking like B!

VALUE ADDED CHAIN OF INDUSTRIAL ENTERPRISE – EXAMPLE B

Create  Make  Sell  Service  Administer

Procure

Customer Service

Human Resource Management

Accounting, Finance, Legal & Taxes, …

IT Infrastructure incl. AD/AM
Offshore talent pools can yield quality and productivity gains

## Business Process Offshoring

<table>
<thead>
<tr>
<th></th>
<th>Number of correct transactions/number of total transactions</th>
<th>Total satisfaction factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent</td>
<td></td>
</tr>
<tr>
<td>U.K. Benchmark</td>
<td>95</td>
<td>85</td>
</tr>
<tr>
<td>Remote facility</td>
<td>98</td>
<td>92</td>
</tr>
</tbody>
</table>

## IT Offshoring

<table>
<thead>
<tr>
<th>Project performance</th>
<th>Percent on time and budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>30</td>
</tr>
<tr>
<td>2</td>
<td>45</td>
</tr>
<tr>
<td>3</td>
<td>75</td>
</tr>
<tr>
<td>5</td>
<td>95</td>
</tr>
</tbody>
</table>

41 of 58 CMM level 5 companies in India

SOURCE: McKinsey P360
While cost savings remain a driving factor for O&O activities …

### Why outsource or offshore?

<table>
<thead>
<tr>
<th>Number of mentions as important</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost savings</strong></td>
<td>72</td>
</tr>
<tr>
<td><strong>Flexibility increase</strong></td>
<td>65</td>
</tr>
<tr>
<td><strong>Quality improvements</strong></td>
<td>55-60</td>
</tr>
<tr>
<td><strong>Shortening of throughput/development time</strong></td>
<td>45-50</td>
</tr>
</tbody>
</table>

### Cost savings in support functions

<table>
<thead>
<tr>
<th>Indexed numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business</strong>¹ support and expert functions²</td>
</tr>
<tr>
<td><strong>Transaction processing</strong>³</td>
</tr>
<tr>
<td><strong>Demand management</strong></td>
</tr>
<tr>
<td><strong>Organization/governance</strong></td>
</tr>
<tr>
<td><strong>Process and execution</strong></td>
</tr>
<tr>
<td><strong>IT system design/process automation</strong></td>
</tr>
</tbody>
</table>

**Original cost base**

**Sourcing (offshoring/dation outsourcing)**

**Consolidation**

**Future cost base**

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¹ Includes management reporting, budgeting and forecasting, decision support
² Includes tax, treasury, risk management, audit, M&A
³ Includes accounts payable, accounts receivable, T&E, all accounting processes

SOURCE: McKinsey Finance 360 Database; McKinsey O&O Practice, MIT Sloan CISR Survey on 80 Outsourcing contracts
... many companies have recognized the potential of O&O beyond labor arbitrage

**Transaction factory**
- Master transaction center for WE
- Driver
  - Low-cost labor
  - Broad talent pool
- Examples
  - Lufthansa (Cracow)
  - Zurich/Capgemini (Cracow)
  - P&G/HP (Bucharest)

**Knowledge hub**
- EU/global center for core competencies
  - Deep talent pool
  - Engaged workforce
  - Building career models
- Examples
  - Delphi (Cracow)
  - Siemens (Wroclaw)
  - SAP Labs (Sofia)

**Corporate/regional headquarters**
- (Co-)Center of EU business management
  - Customers/suppliers moving East
  - Interesting markets
  - Established EE footprint
- Examples
  - Dell (Bratislava)
  - JCI (Bratislava)

**Faster move to knowledge-intensive services driven by combination of factors**
- Talented workforce with good functional knowledge
- Cultural proximity/accessibility/time-zone overlap
- Language capabilities

SOURCE: McKinsey EESTCom2, April 2007
Users are convinced of the (growing) importance of O&O

### Companies offshore more ...

<table>
<thead>
<tr>
<th>Shift of work</th>
<th>Headcount changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>More functions offshored</td>
<td>Onshore</td>
</tr>
<tr>
<td>Tightening of business cases</td>
<td>Offshore</td>
</tr>
<tr>
<td>Quicker transition</td>
<td>31-60</td>
</tr>
<tr>
<td>Fewer functions offshored</td>
<td>3-50</td>
</tr>
<tr>
<td>Others</td>
<td>4</td>
</tr>
</tbody>
</table>

... and O&O workforce takes up additional/higher value-add work

- **European Investment Bank**
  - Onshore staff more heavily affected by lay-offs
  - Continued buildup of O&O resources
  - Relative part of headcount in low-cost locations increased

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SOURCE: EESTCom survey 2009; press; interviews
Growth of O&O continues keeping fundamental momentum

Significant industry growth

Offshoring revenues
USD billions

- ESO
- CAGR
- ITO
- BPO

Global transformative forces are the main driver of future growth

SOURCE: NASSCOM report 2009; McKinsey O&O Practice
Five global transformative forces impact the outlook of the O&O industry

**Opportunities**

- Rise of untapped market segments
  - New Geographies
  - New Service lines; e.g. climate change Verticals like public sector, healthcare
  - SMB customer segments
  - Increased adoption of global sourcing

- The great rebalancing
  - Asian 21st century
  - Emerging markets scaling up, also in innovation
  - Further urbanization

- Productivity revolution
  - Shrinking working age population in key developed countries
  - Huge pressure on productivity to achieve economic growth

- Pricing the planet
  - Rapidly increasing consumption/supply gap in key natural resources creating need for resource efficient climate change solutions

- Market State
  - Global economic crisis led to major shifts in industry structures and regulatory control
  - Countries compete for business activities

**Risks**

- Erosion in existing segments from
  - Automation
  - Cannibalization of existing services (e.g., SaaS replacing production support)
  - Spend consolidation
  - Slowdown in adoption due to greater regulatory control

**Global Grid**

- Increased Internet + mobile links transforming the way people interact/live
- New trade flows among developing countries

Currently untapped segments will drive 75-80% of incremental growth by 2020

Total addressable market for global sourcing and domestic outsourcing, 2020

- USD billions
- 20-25% of growth from core markets
- 75-80% of growth from market segments, that are not core today
- Core markets 2008
  - 6 verticals (BFSI, telecom, retail, pharma, manufacturing, travel)
  - North America, Western Europe, Japan
  - Large enterprises
- Growth in core markets
- New verticals in developed countries
  - Public sector
  - Healthcare
  - Media
  - Utilities
- New customer segments
  - SMBs
- Domestic outsourcing market in new geographies
  - Brazil
  - Russia
  - India
  - China
- Total addressable market in 2020
  - 1,500-1,640
  - 895-980
  - 405-440

Innovation can further expand the addressable market

SOURCE: Global Insight; Gartner January 2009
Sources of new market growth by 2020 are: ① Four additional verticals, SMBs across numerous verticals and ③ Domestic BRIC outsourcing

USD billions

1. Global sourcing addressable market for new verticals, 2020

<table>
<thead>
<tr>
<th>Vertical</th>
<th>Addressable Market (USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector and defence</td>
<td>90-105</td>
</tr>
<tr>
<td>Healthcare providers</td>
<td>58-65</td>
</tr>
<tr>
<td>Utilities</td>
<td>25-30</td>
</tr>
<tr>
<td>Media (printing and publishing)</td>
<td>17-20</td>
</tr>
<tr>
<td>Total</td>
<td>190-220</td>
</tr>
</tbody>
</table>

2. Global sourcing addressable market for SMBs by vertical in core geographies, 2020

<table>
<thead>
<tr>
<th>Vertical</th>
<th>Addressable Market (USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>80-90</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>~40</td>
</tr>
<tr>
<td>Travel</td>
<td>~35</td>
</tr>
<tr>
<td>Wholesale banking</td>
<td>30-35</td>
</tr>
<tr>
<td>Insurance</td>
<td>~20</td>
</tr>
<tr>
<td>Retail</td>
<td>[15-20]</td>
</tr>
<tr>
<td>Others</td>
<td>230-250</td>
</tr>
<tr>
<td>Total</td>
<td>230-250</td>
</tr>
</tbody>
</table>

3. Total addressable market from new geographies, 2020

<table>
<thead>
<tr>
<th>Geography</th>
<th>Addressable Market (USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>90-100</td>
</tr>
<tr>
<td>China</td>
<td>205-225</td>
</tr>
<tr>
<td>Total</td>
<td>380-420</td>
</tr>
<tr>
<td>Brazil</td>
<td>40-45</td>
</tr>
<tr>
<td>Russia</td>
<td>45-50</td>
</tr>
<tr>
<td>India</td>
<td>90-100</td>
</tr>
<tr>
<td>China</td>
<td>205-225</td>
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<td>Total</td>
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SOURCE: Global Insight; Gartner January 2009; McKinsey analysis
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Overall revenue and profit performance of leading Indian O&O players worsened in 2008

Percent

<table>
<thead>
<tr>
<th>Sequential quarter change</th>
<th>Revenue growth for leading Indian O&amp;O players(^1)</th>
<th>Net Profit growth for leading Indian O&amp;O players</th>
</tr>
</thead>
<tbody>
<tr>
<td>1Q08</td>
<td>4.0</td>
<td>-7.9</td>
</tr>
<tr>
<td>2Q08</td>
<td>3.7</td>
<td>6.2</td>
</tr>
<tr>
<td>3Q08</td>
<td>28.0</td>
<td>-4.6</td>
</tr>
<tr>
<td>4Q08</td>
<td>9.1</td>
<td>-4.2</td>
</tr>
<tr>
<td>4Q08</td>
<td>1.4</td>
<td></td>
</tr>
</tbody>
</table>

1 Results declared in the last 4 sequential quarters of FY 2009 for Top 13 players, Rs to US$ conversion based on income statement publication date rate

SOURCE: Kotak Tech quarterly data book; company websites
2009 expecting slowest growth in the history of the O&O industry

**O&O industry revenue**

<table>
<thead>
<tr>
<th>Year</th>
<th>US$ billion</th>
<th>BPO</th>
<th>ITO</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>62</td>
<td>19</td>
<td>43</td>
</tr>
<tr>
<td>2007</td>
<td>80</td>
<td>25</td>
<td>55</td>
</tr>
<tr>
<td>2008</td>
<td>90</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>2009</td>
<td>94-96</td>
<td>32-33</td>
<td>62-63</td>
</tr>
</tbody>
</table>

1 Including ESO and High Tech R&D services
2 Estimates

SOURCE: NASSCOM, EESTCom 2009, Customer surveys, McKinsey analysis
Decision makers have an optimistic view of their future O&O activities and expansion, with early signs of recovery evident even within 2009.

What are your growth plans for captive offshore locations in the next 12-18 months?

Percentage of respondents (n = 45), EESTCom survey 2009

<table>
<thead>
<tr>
<th>Will not change much</th>
<th>Expand employment in offshore locations</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-30%</td>
<td>10-20%</td>
</tr>
<tr>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>31</td>
<td>13</td>
</tr>
</tbody>
</table>

In percentage terms, how would your outsourced FTE volume change in the next 1-2 years?

Percentage of respondents (n = 30), GLG survey

<table>
<thead>
<tr>
<th>Volume decrease</th>
<th>Volume increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-10%</td>
<td>11-20%</td>
</tr>
<tr>
<td>5</td>
<td>45</td>
</tr>
<tr>
<td>20</td>
<td>30</td>
</tr>
</tbody>
</table>

Examples of early signs of recovery for 2010¹ (USD Mio)

<table>
<thead>
<tr>
<th>4Q08</th>
<th>1Q09</th>
<th>2Q09</th>
<th>3Q09</th>
</tr>
</thead>
<tbody>
<tr>
<td>208</td>
<td>202</td>
<td>217</td>
<td>245</td>
</tr>
</tbody>
</table>

German market growth (estimates in %)

<table>
<thead>
<tr>
<th>IT market</th>
<th>Outsourcing market</th>
<th>Total size</th>
</tr>
</thead>
<tbody>
<tr>
<td>-2</td>
<td>2009</td>
<td>5</td>
</tr>
<tr>
<td>0</td>
<td>2010</td>
<td>7</td>
</tr>
</tbody>
</table>

1 Profits declared in the last 4 sequential quarters, Rs to US$ conversion based on income statement publication date rate, Indian Fiscal year

High uncertainty of so far unseen recent crisis situation best addressed via scenarios

Ifo-Index in points, year 2000 = 100

Dealing with high uncertainty ... ... via scenarios

SOURCE: FTD, Oct.28, 2008, p16; updated with Ifo stats and complemented with scenarios
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To navigate the uncertainty, companies need to become more adept at “shaping the future”

- **Build awareness**
  - Model company performance and impact under each scenario

- **Enhance resilience**
  - Significantly increase scope and intensity of resiliency actions to safeguard current business

- **Increase flexibility**
  - Build and acquire options for your business and implement "no-regret" moves

- **Determine posture**
  - Take conscious decision whether company wants to play defense, attack or adapt

SOURCE: McKinsey Center for Managing Uncertainty
Overarching trends in O&O towards complex multi-dimensionality

1. Multi-servicing

- Proliferation of services offshored or outsourced
- New customers, verticals and geographies being serviced
- Tendency towards industrialization of transactional services and adoption of higher value activities

2. Multi-sourcing (exampl.)

- Buyers increasing pressure on service providers through increased experience and sophistication in outsourcing
- Buyers outsourcing 1 activity to several service providers
- Determination of right amount of vendors (typically 2 or 3)

3. Multi-shoring

- Tendency to diversify risk
- Emerging location continue to sustain due to economic attractiveness and risk diversification
- Advanced location and governance architectures are developing

SOURCE: McKinsey
Opportunities for global sourcing exist across various functions of the healthcare provider value chain

<table>
<thead>
<tr>
<th>Healthcare provider</th>
<th>Sub-function</th>
<th>Share of employment</th>
<th>Theoretic maximum share of function that can be outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patient care provision</td>
<td>Physician, practitioner services</td>
<td>▪</td>
<td>19</td>
</tr>
<tr>
<td>Nursing services</td>
<td>Nursing care provision</td>
<td>▪</td>
<td>25</td>
</tr>
<tr>
<td>Other professional healthcare services</td>
<td>Operating room</td>
<td>▪</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Diagnostic laboratory etc.</td>
<td>▪</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Radiography/nuclear medicine</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Case management</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Pharmacy</td>
<td>▪</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Respiratory therapy</td>
<td>▪</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Physical therapy</td>
<td>▪</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Transport</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Other health professional clerical</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td>Hospitality functions</td>
<td>Housekeeping</td>
<td>▪</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Plant operations and maintenance</td>
<td>▪</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Security</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Laundry/linen</td>
<td>▪</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Food services</td>
<td>▪</td>
<td>15</td>
</tr>
<tr>
<td>IT services</td>
<td>ADM</td>
<td>▪</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>Hardware operations¹</td>
<td>▪</td>
<td>40</td>
</tr>
<tr>
<td>G&amp;A</td>
<td>General management and legal</td>
<td>▪</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Purchasing</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Patient billing</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Finance and accounting</td>
<td>▪</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Personnel/HR</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Planning</td>
<td>▪</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Medical records</td>
<td>▪</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Admissions</td>
<td>▪</td>
<td>20</td>
</tr>
</tbody>
</table>

1 Hardware operations not included

Total addressable market for healthcare providers is expected to be USD 58 billion-65 billion by 2020

SOURCE: Interviews; McKinsey Global Institute analysis
Potential technology and business services offerings for healthcare providers

Most important technology services applications

<table>
<thead>
<tr>
<th>Application</th>
<th>Per cent</th>
<th>Top-3 priorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computerised practitioner order entry (CPOE)</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Electronic medical records</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Clinical information systems</td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>Bar-coded medication management</td>
<td>43</td>
<td></td>
</tr>
<tr>
<td>Clinical data repository</td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>Enterprise-wide clinical information sharing</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Evidence-based medicine at point of care</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>Point-of-care data collection</td>
<td>29</td>
<td></td>
</tr>
</tbody>
</table>

Important business services offerings

- **Patient-facing services**: Medical call centres to reduce cost of hospital admissions, telemedicine for remote monitoring and disease management
- **Payer/provider-facing services**: Billing, administration, scheduling, purchasing etc.

Examples

- **Dutch company**: providing outsourcing for billing and collections
- **German medical call centre company**: offering on-line and off-line medical consulting for hospitals
- **British company**: administering and supporting corporate healthcare programme
- **German company**: providing disease management counselling for chronically ill patients

SOURCE: Interviews; McKinsey Global Institute analysis

1 2007 HIMSS leadership survey of hospital CIOs
**Product design market will expand as companies globally source increasingly complex activities**

**Ability to manage risk**
- Criticality/risk associated with process
- Source of competitive advantage
- Requirement to retain in-house skills

**Modularity**
- Ease in defining work packages with well defined interfaces
- Number of feedback loops
- More external interfaces and instabilities

**SOURCE:** McKinsey analysis
Consumerisation of technology will stimulate adoption of global sourcing by SMBs and even individuals.

NEW CUSTOMER SEGMENTS

SOURCE: McKinsey analysis
Pricing pressures likely to continue, but potentially with increase in volumes

<table>
<thead>
<tr>
<th>What is the likely change in technology and business services billing rates in 2009?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2009 outlook</strong></td>
</tr>
<tr>
<td>Reduce billing rates by more than 10%</td>
</tr>
<tr>
<td>100</td>
</tr>
<tr>
<td>20</td>
</tr>
<tr>
<td>100</td>
</tr>
<tr>
<td>10</td>
</tr>
<tr>
<td>Reduce billing rates by 5-10%</td>
</tr>
<tr>
<td>34</td>
</tr>
<tr>
<td>40</td>
</tr>
<tr>
<td>Maintain current billing rates</td>
</tr>
<tr>
<td>36</td>
</tr>
<tr>
<td>46</td>
</tr>
<tr>
<td>Increase billing rates</td>
</tr>
<tr>
<td>10</td>
</tr>
<tr>
<td>4</td>
</tr>
</tbody>
</table>

Percent respondents, n = 29

**Existing contracts** | **New contracts**
---|---
Reduce billing rates by more than 10% | 20 | 10
Reduce billing rates by 5-10% | 34 | 40
Maintain current billing rates | 36 | 46
Increase billing rates | 10 | 4

O&O prices are likely to decline …

“[There are] predictions that contract prices charged by Indian firms are likely to drop. CLSA¹ […] predicts they will fall by 3-5% in the next fiscal year, starting in April 2009”

– Economist, Oct 2008

We are experiencing pricing pressures of anywhere from 4% to 15%.

– Subramaniam Ramadorai, CEO of TCS, March 2009

…but providers willing to help companies increase O&O efficiency

**UK Pharma company**

- Intuition to grow large outsourced baseline further led to renegotiation of existing deals
- Providers recognize the growth potential and offer
  - Rate adjustments, especially if overall volume increases
  - Cooperation on efficiency improvement
  - More specialized services

SOURCE: Economist; Forbes Asia; interviews 4/2009
Dual sourcing ADM Outsourcing deal as challenging model of a next generation multi-sourcing arrangement

- Retained in-house
  - ADM strategy & architecture guidance
  - Select Competence Centers
  - Vendor Management & Controlling

- Bulk of USD 1 billion ADM budget outsourced to A or B for 7 years

- Out of 6,000 ADM FTEs in next 3-5 years (of which 3,500 are contractors), 2,500 move to A or B

- Contracted blended rate of USD xxx p.d. requiring massive offshoring

- Recent B acquisition in India gets substantial load out of this deal

SOURCE: Various press clippings
Companies diversifying location footprints with established locations loosing share

**Country footprint**

<table>
<thead>
<tr>
<th># of companies in the sample</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% =</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td>&gt;=3 countries</td>
<td>28%</td>
<td>39%</td>
</tr>
<tr>
<td>1-2 countries</td>
<td>72%</td>
<td>61%</td>
</tr>
</tbody>
</table>

**Share of growth in seats for BPO & ITO**

<table>
<thead>
<tr>
<th>100% = thousand FTEs</th>
<th>2008</th>
<th>2009 E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other locations</td>
<td>51</td>
<td>58</td>
</tr>
<tr>
<td>India</td>
<td>49</td>
<td>42</td>
</tr>
</tbody>
</table>

SOURCE: EESTCom 2009, McKinsey analysis
Strong momentum seen in the growth of emerging offshoring destinations, based on strong performance in niche areas

- Limited movement of scale services to near-shore North American destinations though some movement of near-/close-shore services
- Eastern Europe continues to maintain share of offshore FTEs
- ~86% of growth in existing centers
- China doubling ITO jobs with 100,000+ FTEs likely to be added in domestic and export in 2009
- Argentina and Brazil with different risk and talent profiles; European languages
- Emergence of Argentina with notable landmark transactions
- Emergence of Egypt as potential scale location of choice
- Morocco continues to be destination of choice for French companies (~5 deals in 2009)
- Philippines are preferred destination for voice
- Continued growth in Malaysia
- Vietnam still nascent

SOURCE: McKinsey
Global sourcing is happening at various shores

Labor cost index for various shores/semi-experienced software engineer 2006 est.

**British**
- London: 130
- Nottingham: 65
- Talinn, Riga: 35
- Hyderabad, Bangalore, …: 15

**German**
- Hamburg: 100
- Rostock: 60
- Gdansk, Bratislava, Cluj: 30 - 40
- Novosibirsk, Dalian: 10 - 20

**Spanish**
- Madrid: 80
- Valladolid: 50
- Constanta, Varna: 30
- Buenos Aires, Mexico City: 15 - 25

- **Labor regulation**
- **Proximity**
- **Compliance**
- **Cultural affinity**
- **Cost**
- **Scale**

**SOURCE:** McKinsey O&O Practice June 2007
Egypt seems well positioned in attracting O&O industry investments

- Government progressing in reforms targeted to attract investors and to simplify doing business
- Dedicated agency (ITIDA) supporting growth of BPO/ITO sector and inflow of new investors
- Integrated demand strategy with talent pool enhancements established to attract investors with specific service offerings

- Tax reforms (e.g., reduction of personal and corporate tax rate)
- Customs reforms
- Intellectual property protection reforms
- Financial sector reforms

- Support and foster development of BPO/ITO industry
- Guide and promote investments in ICT/BPO sector
- Increase exports of ICT products and services
- Support R&D in the ICT sector and implement results

- Focused outreach to targeted investors based on Egypt's value proposition
- University curriculum interventions to scale up suitable graduates pool for BPO activities to 10,000+ on annual basis
- Finishing schools and structural university interventions to enhance skill set in European languages by 1000+ annually
- IT specific talent programs under design to support growth of ITO industry

Sources: ITIDA;
Focus on CORE appropriate for majority of enterprises; a small league will be capable to capture COPE advantages

% of WE enterprises regarding proper complexity management strategy

- Managing for simplicity across the whole value chain
- Capturing value from lean programs and taking out variance wherever feasible
- **Focus, focus, focus**

- Capturing value from network management strategies; e.g. hub & spokes
- Exploring the long tail
- **Partner ecosystems**

**CORE:**
- Complexity Reduction

**COPE:**
- Complexity Performance Enhancement

Key take-aways for successful O&O management in the current and likely future environment

1. Consider that O&O fundamentals are prevailing and invest in bold moves to increase your long-term benefits

2. Make your organization "fit" for managing the uncertainty and consider O&O as key levers to increase flexibility and agility

3. Manage the emerging complex multi-dimensionality in O&O and apply the best mix for your organization