

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

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

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Executive summary

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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

WHY?

2

Offshore



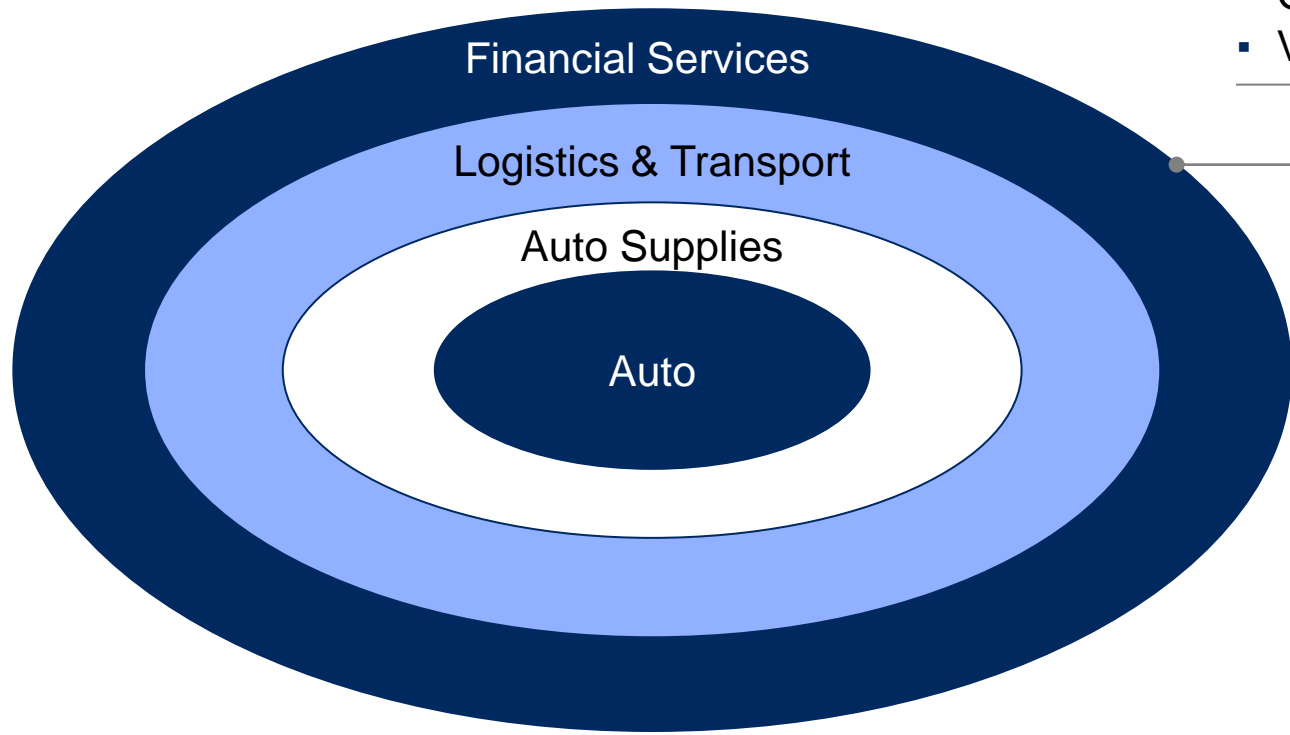
- Cope with skills shortage in onshore markets by tapping into offshore talent pools; e.g., India produces ~4 million graduates p.a. willing to participate in global workforces
- Improve quality of services through employing higher skilled labor; e.g. employment of commerce graduates for accounts payables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

1 Focus on the core business: Easier said than done!

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

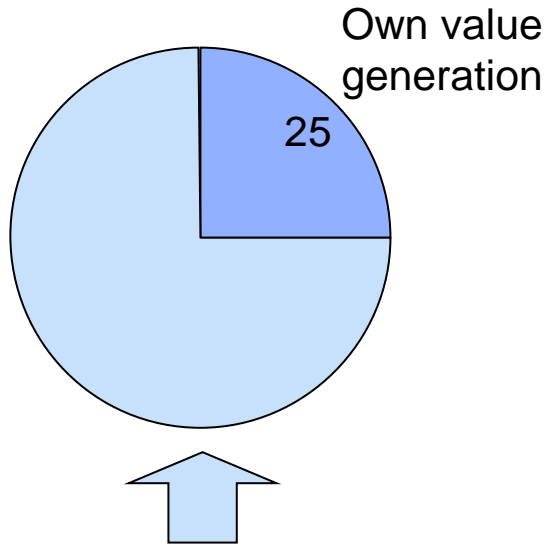
Main source of earnings at

- GM
- VW etc.

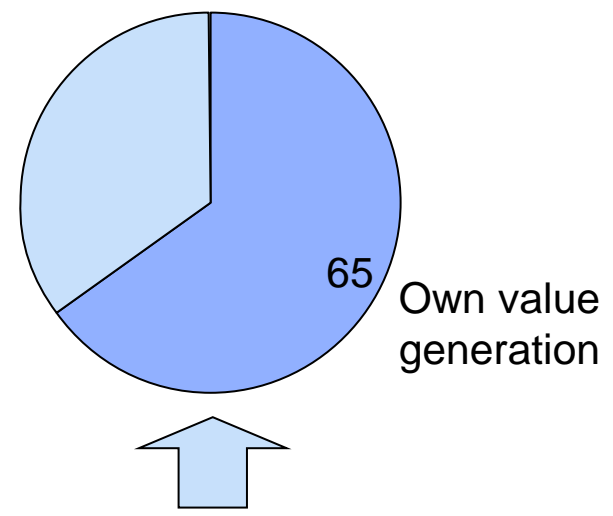


1 Core Capabilities mainly shaped by share of internal value generation

A
Global OEM



B
Regional Supplier

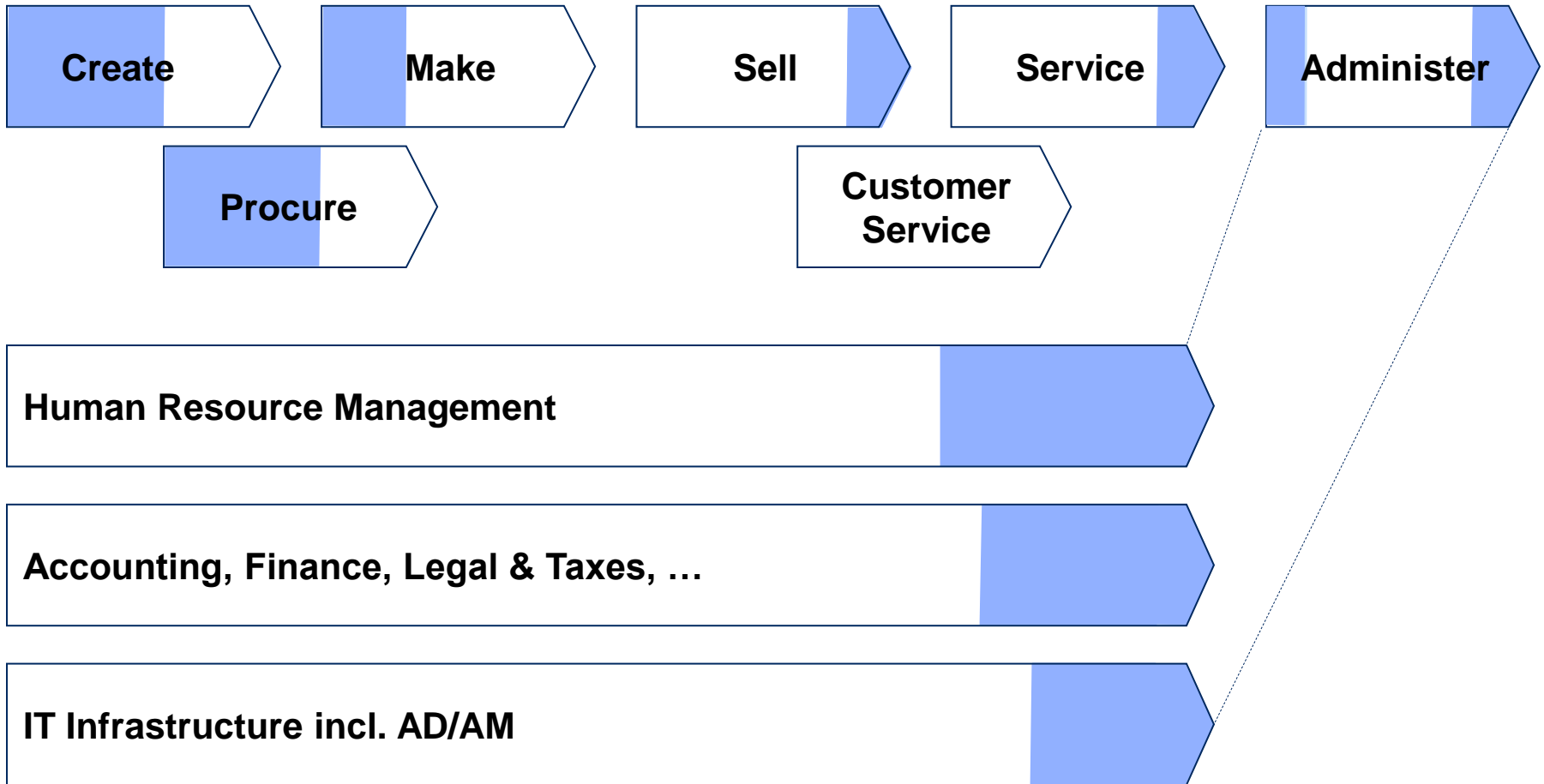


Is there a necessity for such a large difference in share of internal value generation?

1 Focus on core capabilities may look like A...

Core capabilities

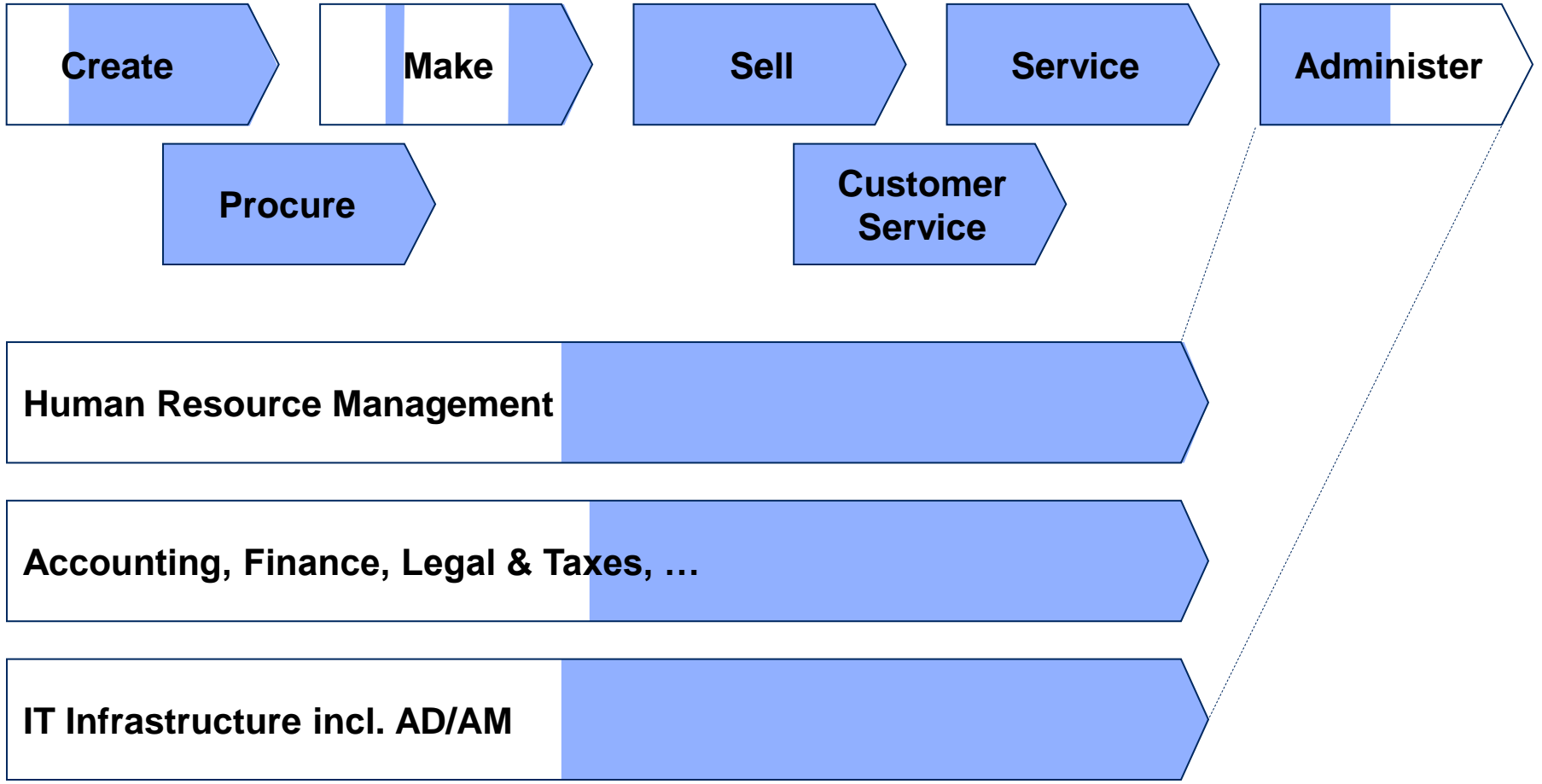
VALUE ADDED CHAIN OF INDUSTRIAL ENTERPRISE – EXAMPLE A



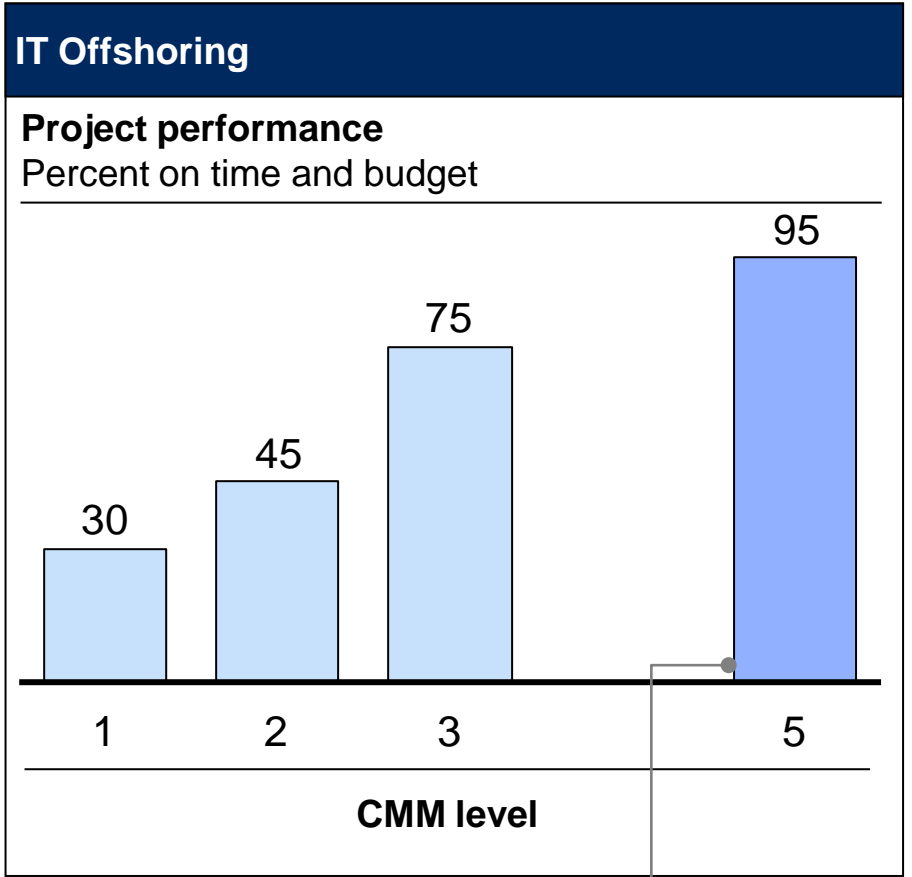
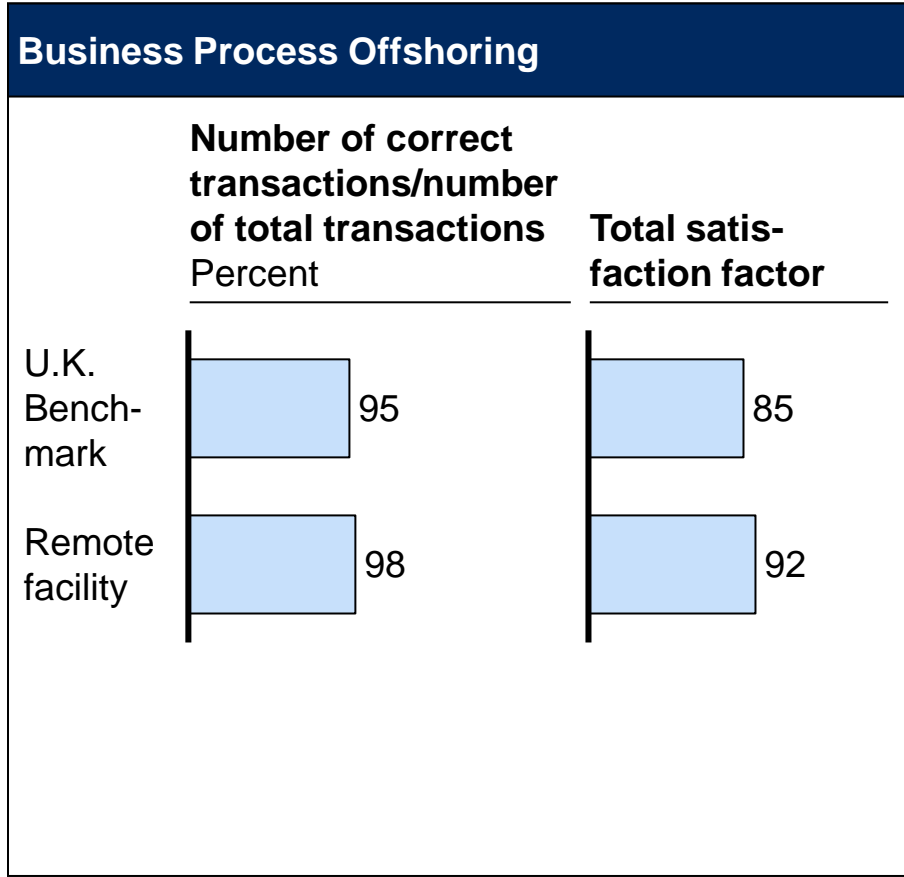
1 ... or: Focus on core capabilities rather looking like B!

■ Core capabilities

VALUE ADDED CHAIN OF INDUSTRIAL ENTERPRISE – EXAMPLE B



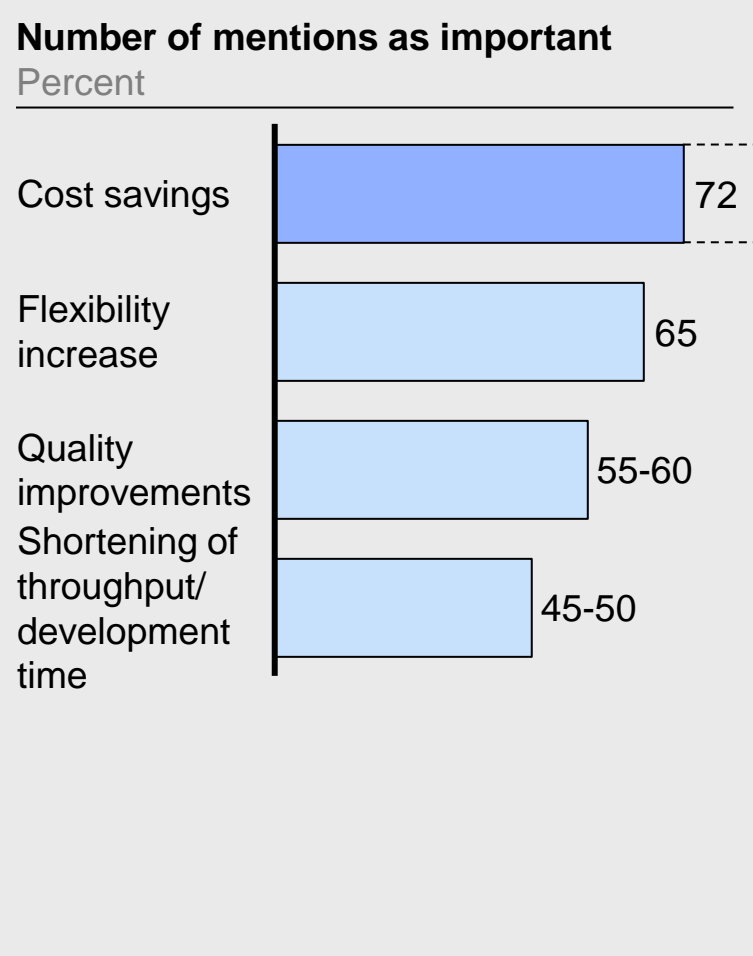
2 Offshore talent pools can yield quality and productivity gains INDIA EXAMPLE



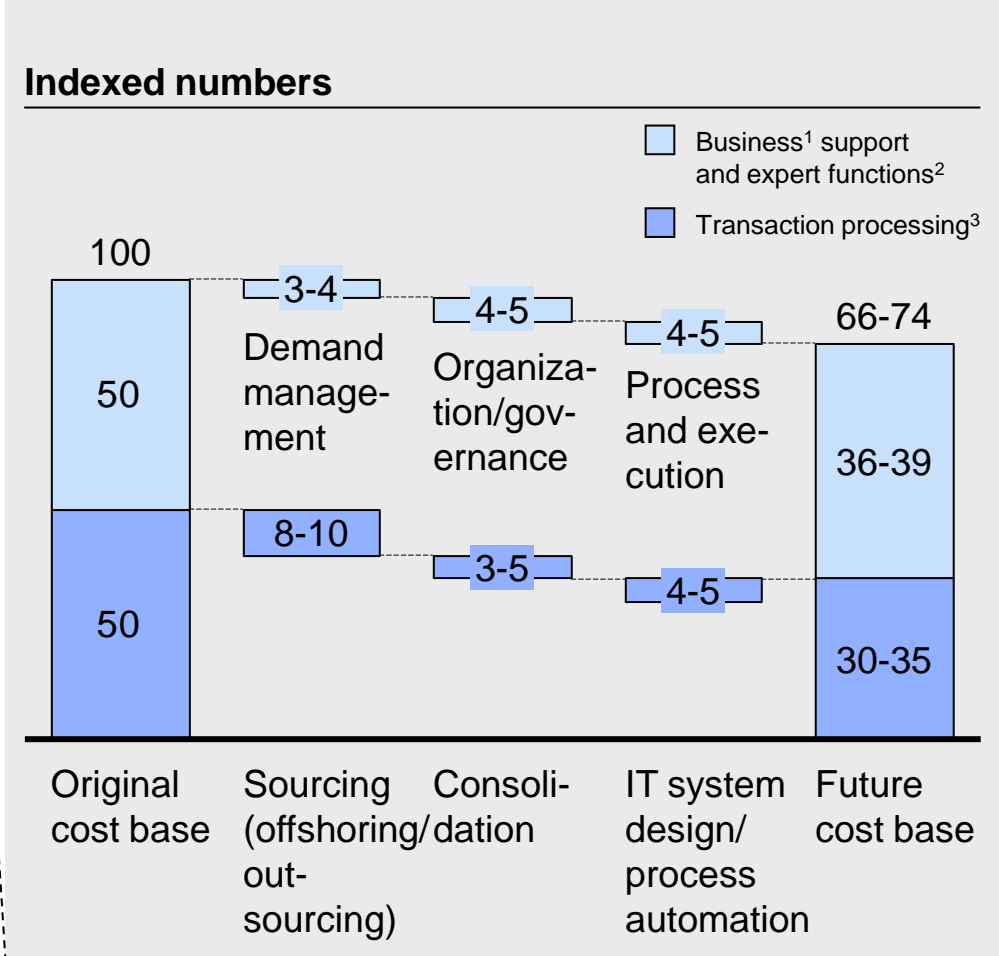
41 of 58 CMM level 5 companies in India

While cost savings remain a driving factor for O&O activities ...

Why outsource or offshore?

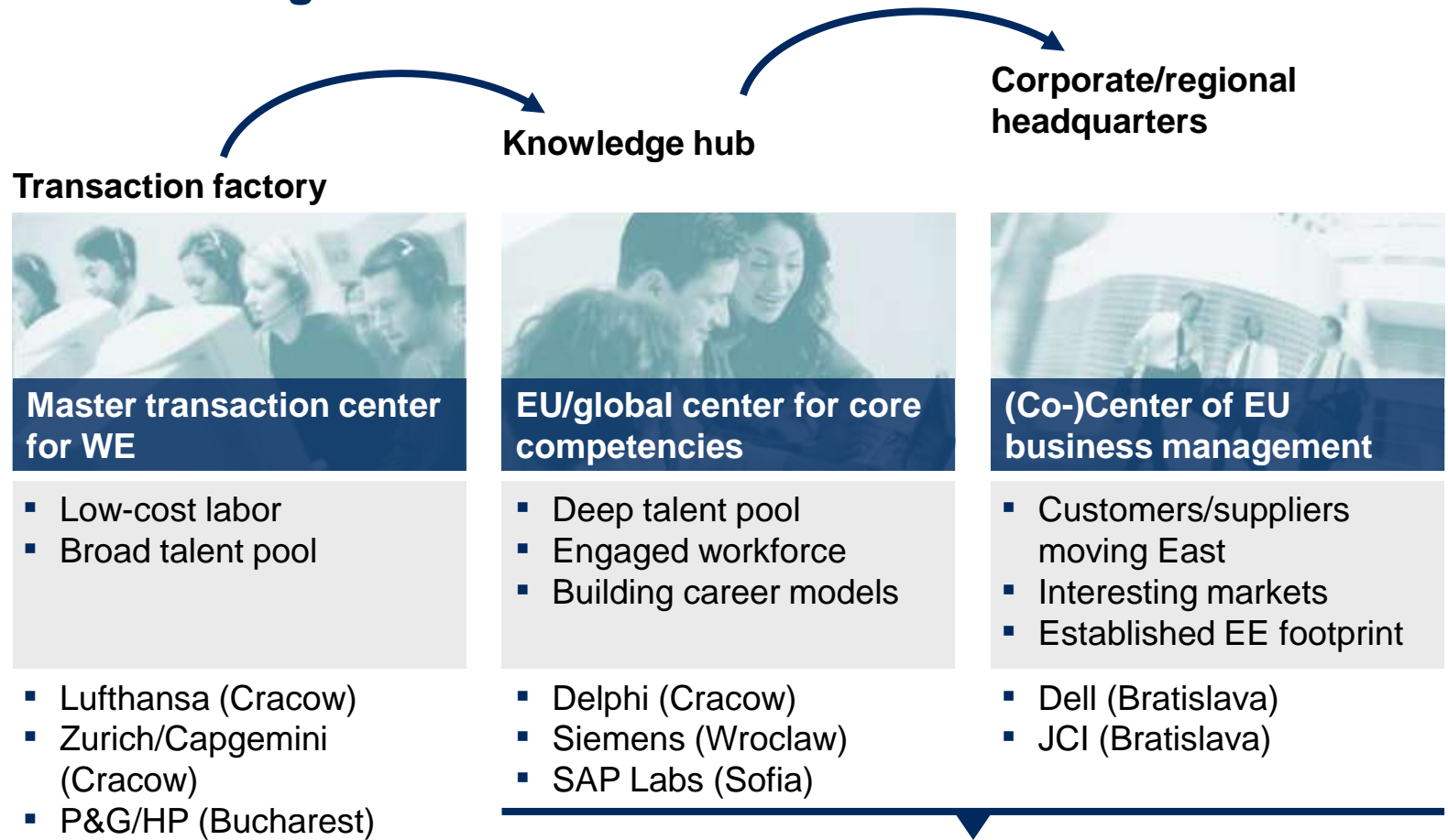


Cost savings in support functions



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

... many companies have recognized the potential of O&O beyond labor arbitrage



Faster move to knowledge-intensive services driven by combination of factors

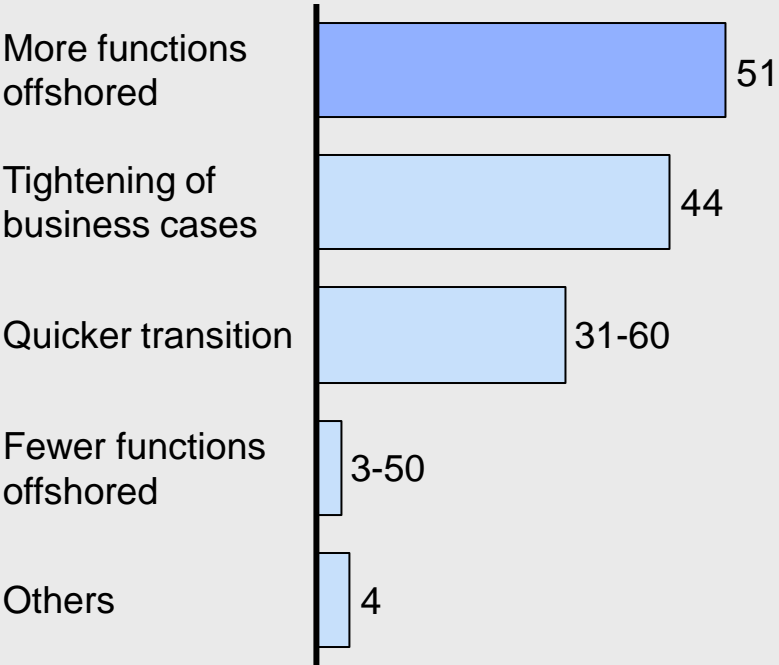
- Talented workforce with good functional knowledge
- Cultural proximity/accessibility/time-zone overlap
- Language capabilities

Users are convinced of the (growing) importance of O&O

Companies offshore more ...

How do you foresee the impact of the recent financial crisis on offshoring activities and decisions?

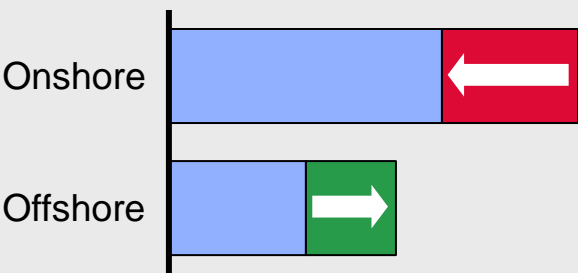
Percentage of responses (n = 76), EESTCom survey 2009



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

Shift of work

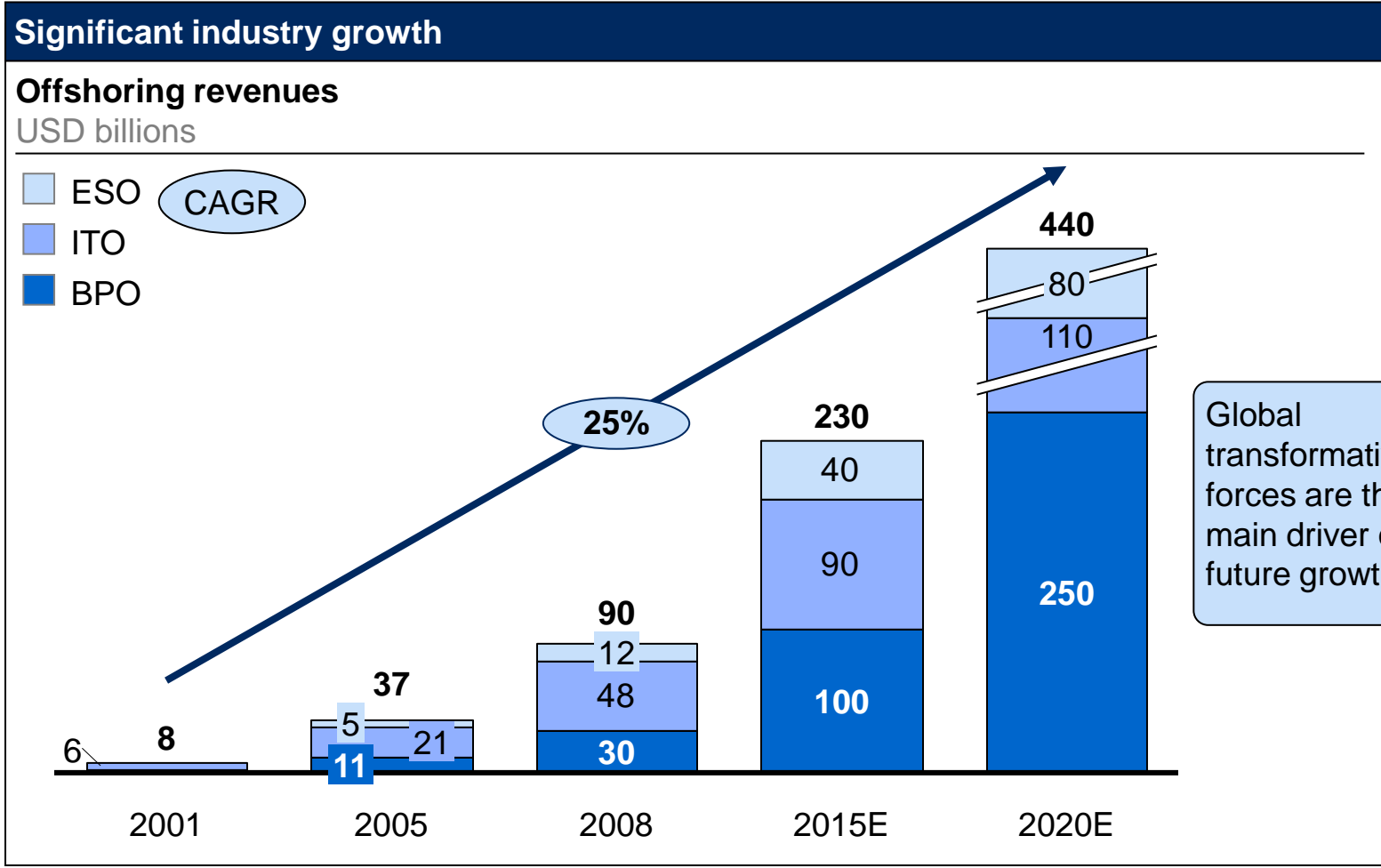
Headcount changes



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

Growth of O&O continues keeping fundamental momentum



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

5 global transformative forces

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

Global Grid

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

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

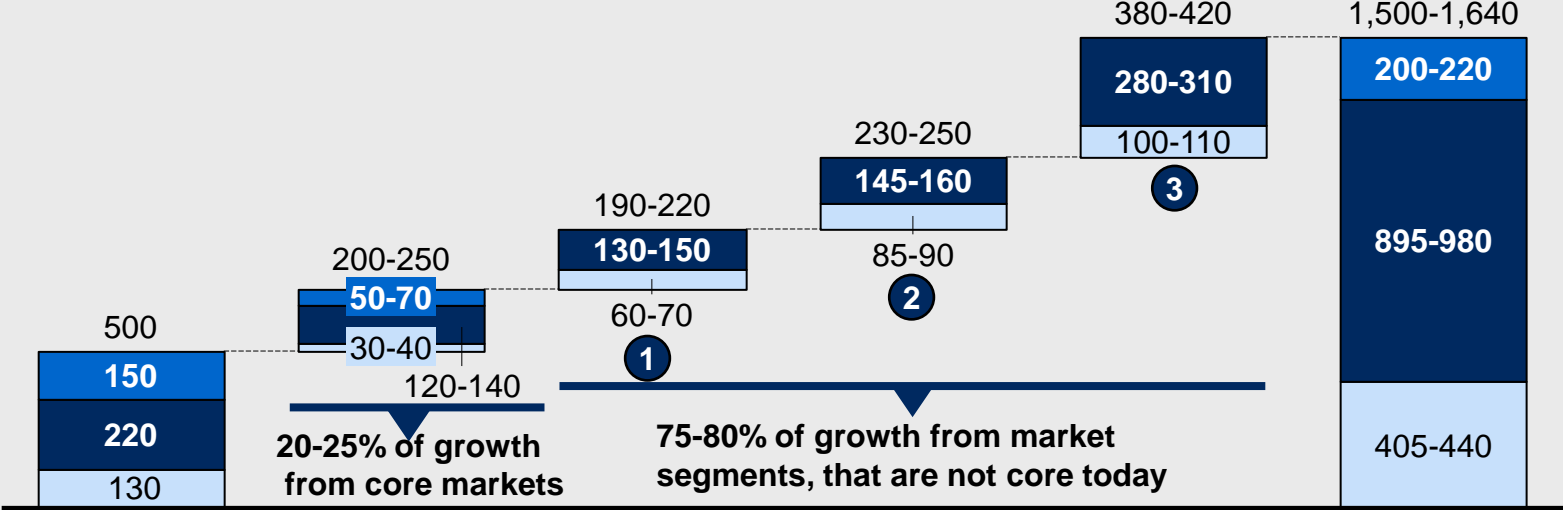
- Erosion in existing segments from
 - Automation
 - Cannibalization of existing services (e.g., SaaS replacing production support)
 - Spend consolidation
 - Slowdown in adoption due to greater regulatory control

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

- Engineering services/R&D
- Business services
- Technology services

Total addressable market for global sourcing and domestic outsourcing, 2020

USD billions



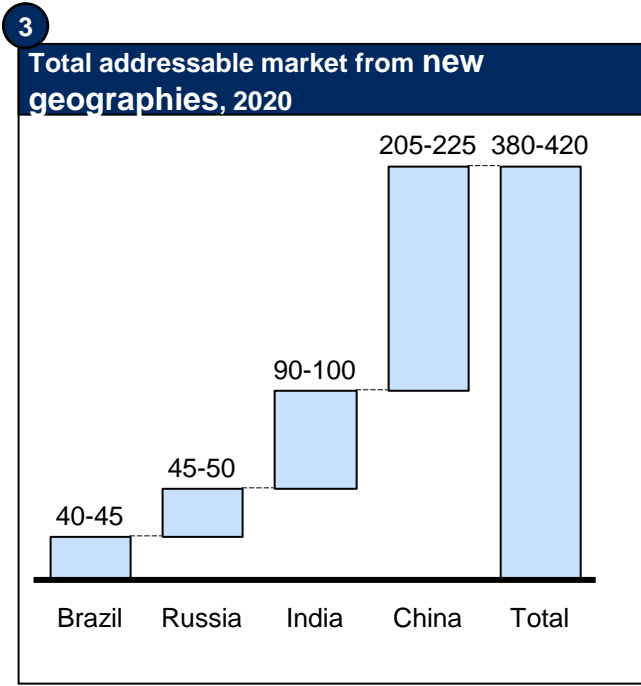
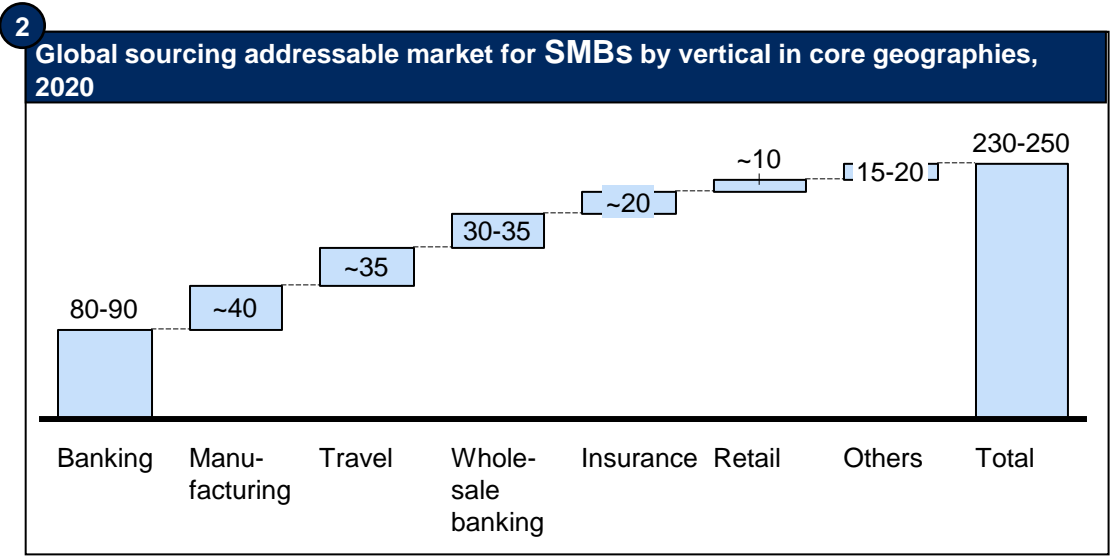
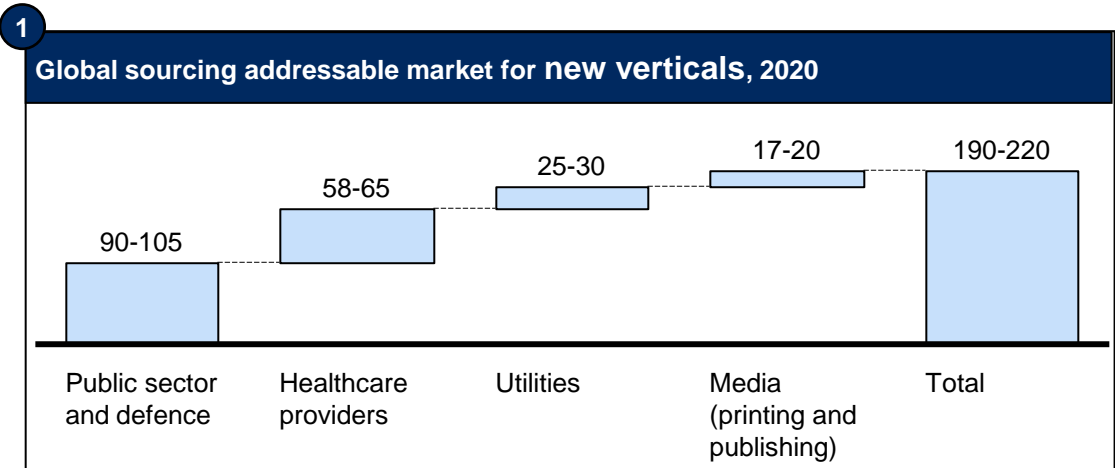
Core markets 2008	Growth in core markets	New verticals in developed countries	New customer segments	Domestic outsourcing market in new geographies	Total addressable market in 2020
<ul style="list-style-type: none"> ▪ 6 verticals (BFSI, telecom, retail, pharma, manufacturing, travel) ▪ North America, Western Europe, Japan ▪ Large enterprises 	<p>20-25% of growth from core markets</p>	<ul style="list-style-type: none"> ▪ Public sector ▪ Healthcare ▪ Media¹ ▪ Utilities 	<ul style="list-style-type: none"> ▪ SMBs 	<ul style="list-style-type: none"> ▪ Brazil ▪ Russia ▪ India ▪ China 	<p>1,500-1,640</p>

Innovation can further expand the addressable market

¹ Printing and publishing

Sources of new market growth by 2020 are: ① Four additional verticals, ② SMBs across numerous verticals and ③ Domestic BRIC outsourcing

USD billions



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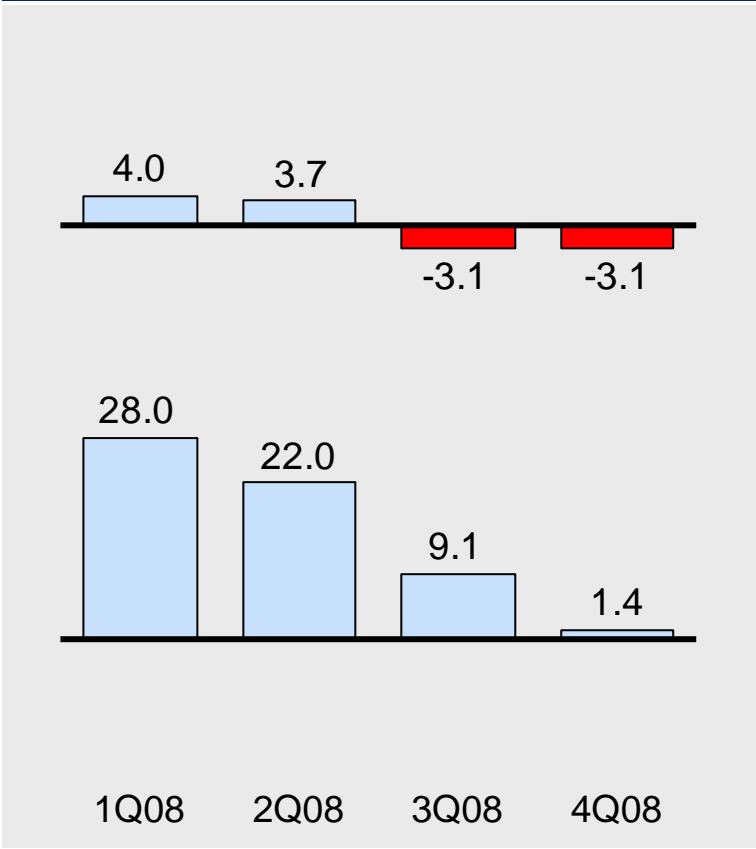
Overall revenue and profit performance of leading Indian O&O players worsened in 2008

Percent

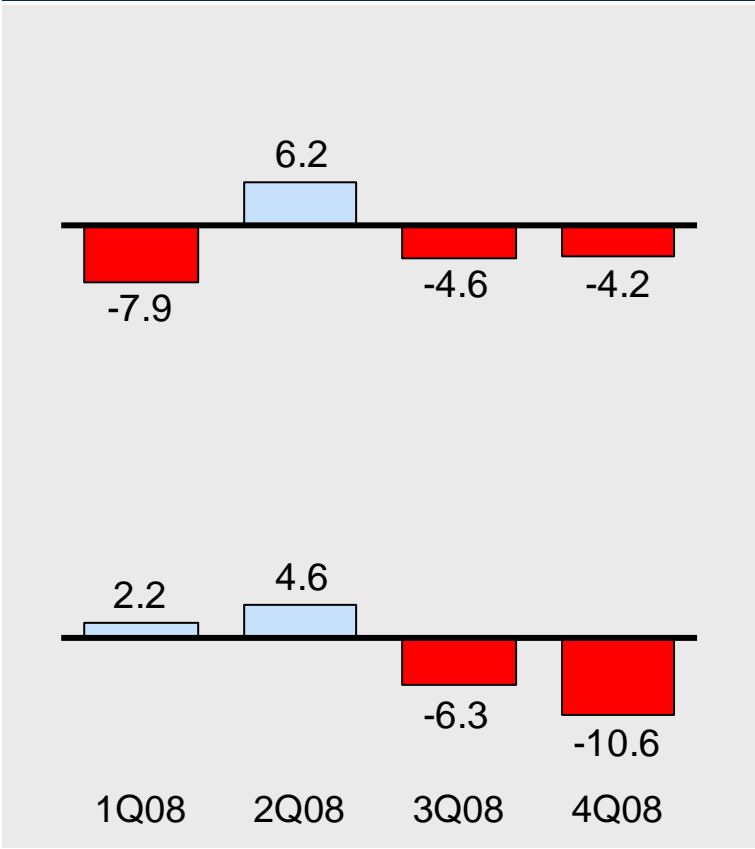
Sequential quarter change

Year-on-year change

Revenue growth for leading Indian O&O players¹

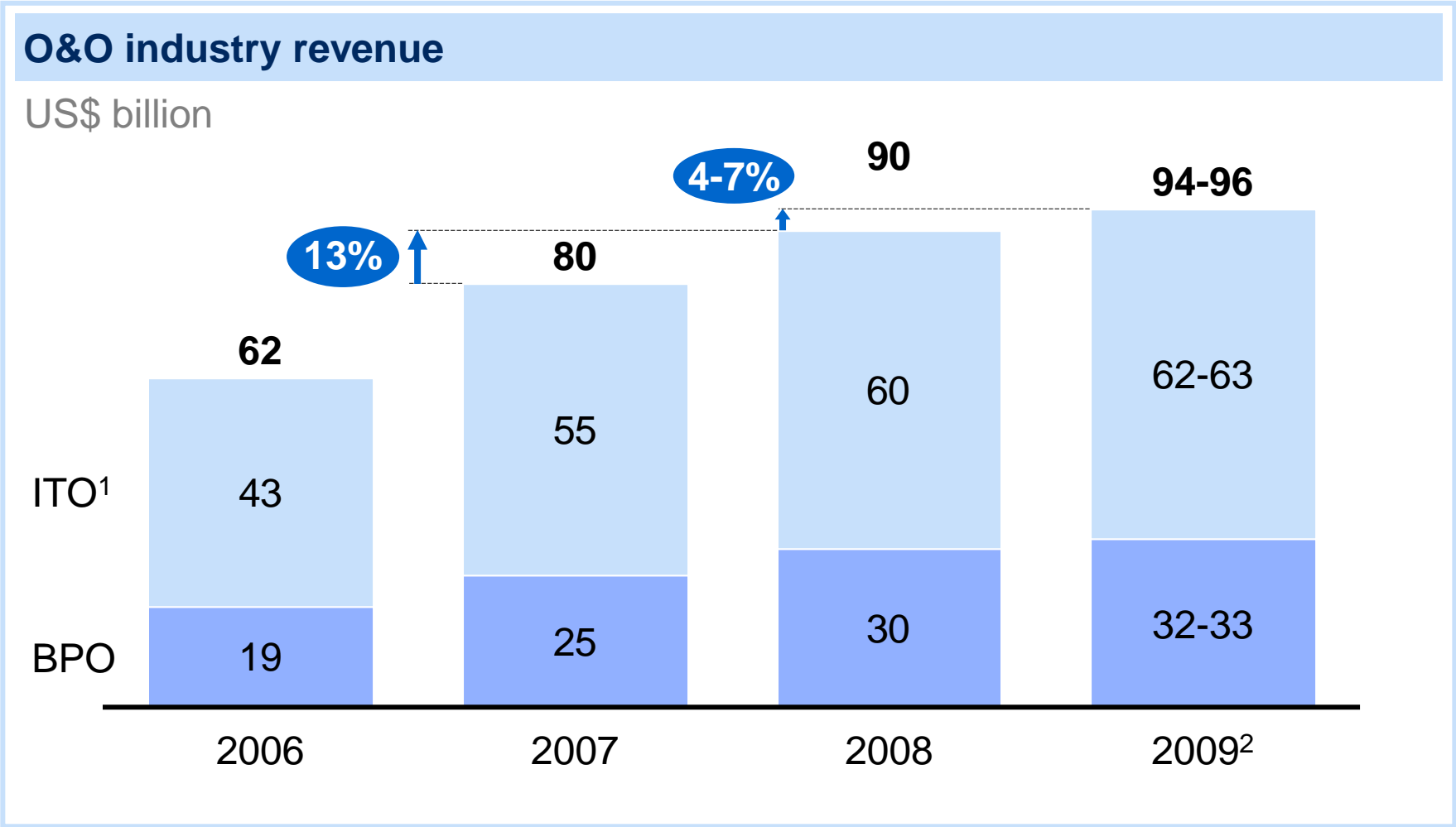


Net Profit growth for leading Indian O&O players



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

2009 expecting slowest growth in the history of the O&O industry

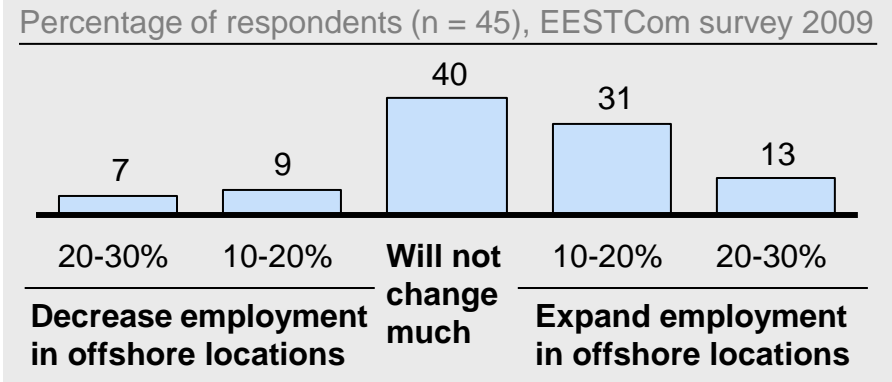


¹ Including ESO and High Tech R&D services

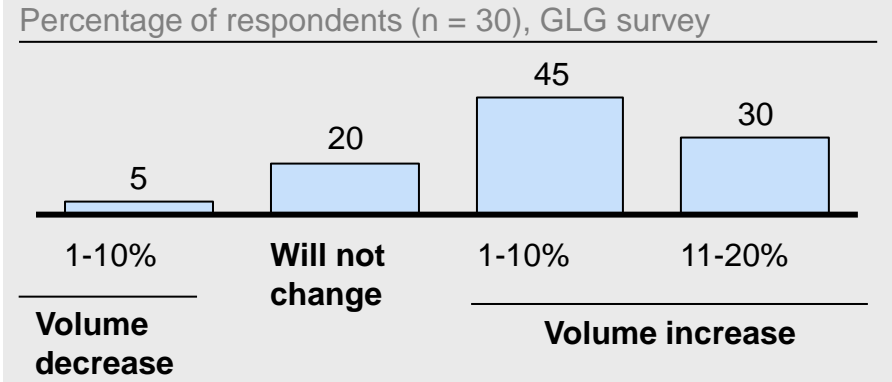
² Estimates

Decision makers have an optimistic view of their future O&O activities and expansion, with early signs of recovery evident even within 2009

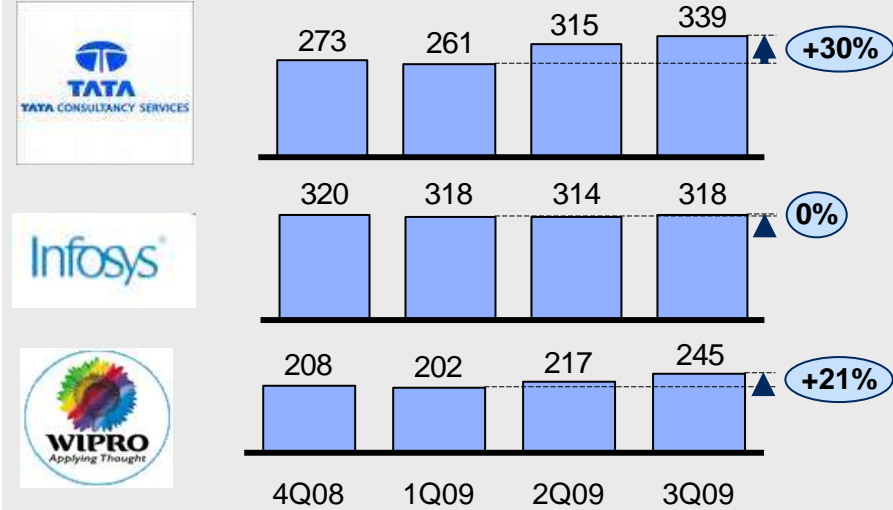
What are your growth plans for captive offshore locations in the next 12-18 months?



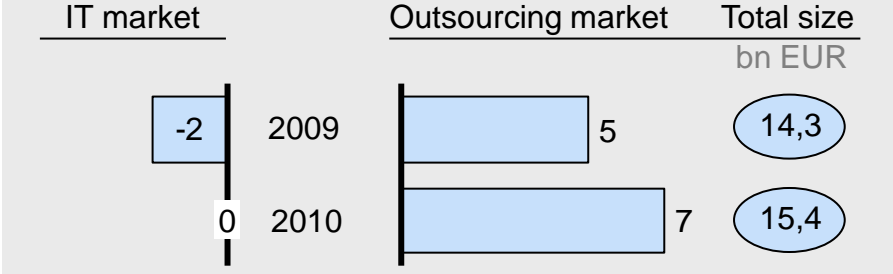
In percentage terms, how would your outsourced FTE volume change in the next 1-2 years?



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



German market growth (estimates in %)



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

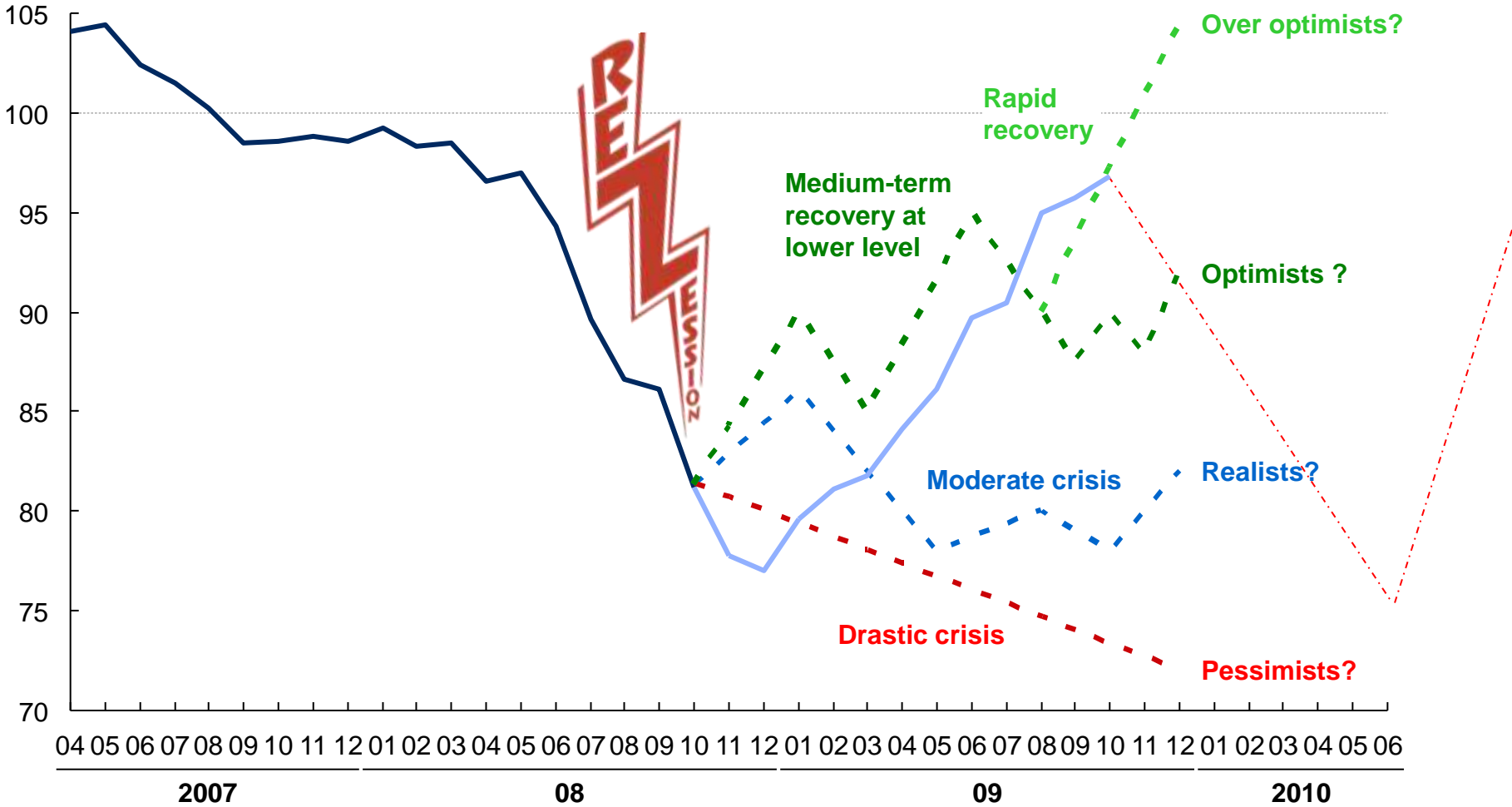
High uncertainty of so far unseen recent crisis situation best addressed via scenarios

ILLUSTRATIVE

Ifo-Index in points, year 2000 = 100

Dealing with high uncertainty ...

... via 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

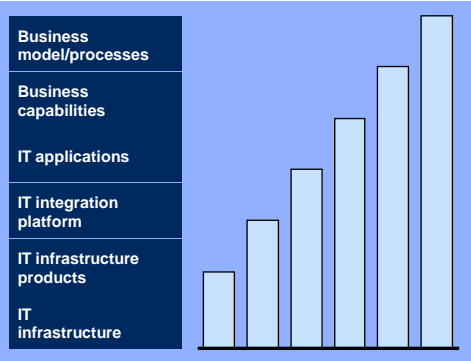
Determine posture

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

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

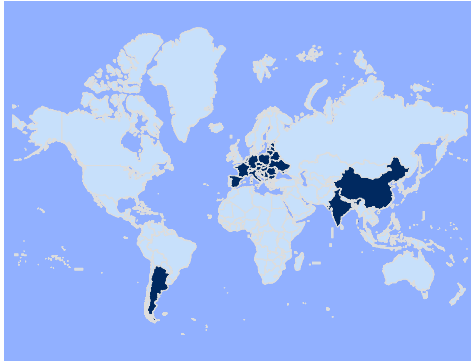
Multi-sourcing (exempl.)



- 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

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



High degree of offshorability

Healthcare provider	Sub-function	Share of employment	Theoretic maximum share of function that can be outsourced
		Per cent	Per cent
Patient care provision	Physician, practitioner services	19	4
Nursing services	Nursing care provision	25	0
Other professional healthcare services	Operating room	20	-
	Diagnostic laboratory etc.	5	70
	Radiography/nuclear medicine	10	-
	Case management	10	10
	Pharmacy	5	-
	Respiratory therapy	15	-
	Physical therapy	15	-
	Transport	10	-
Hospitality functions	Other health professional clerical	10	-
	Housekeeping	30	-
	Plant operations and maintenance	30	-
	Security	10	-
	Laundry/linen	15	-
IT services	Food services	15	-
	ADM	60	60
G&A	Hardware operations ¹	40	-
	General management and legal	20	40
	Purchasing	10	40
	Patient billing	10	50
	Finance and accounting	15	50
	Personnel/HR	10	25
	Planning	5	-
Medical records	10	75	
	Admissions	20	10

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

1 Hardware operations not included

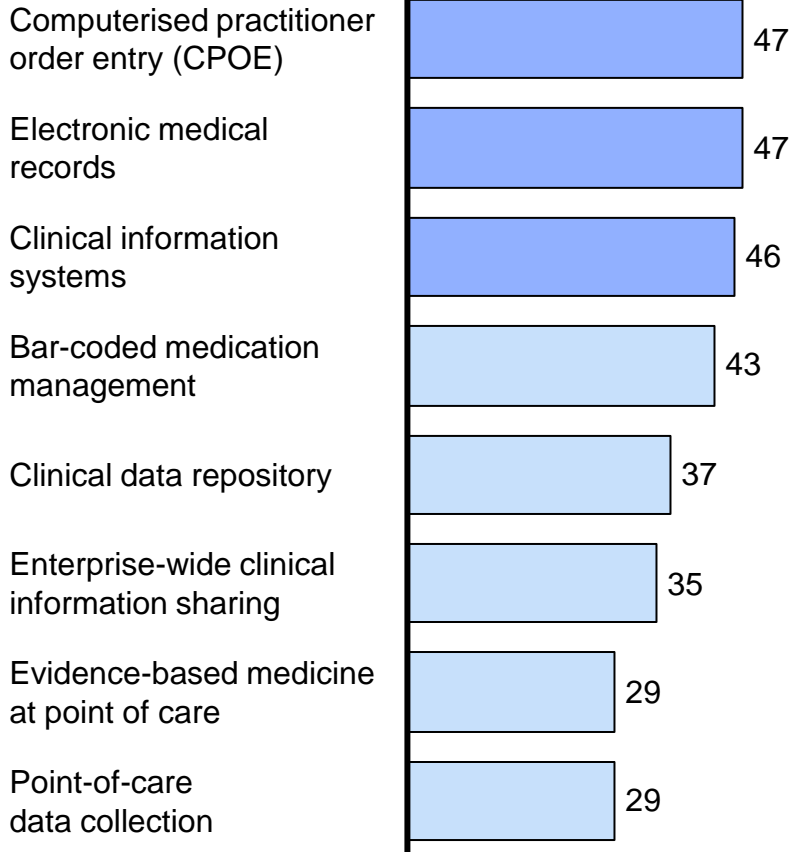
Potential technology and business services offerings for healthcare providers



Top-3 priorities

Most important technology services applications¹

Per cent



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



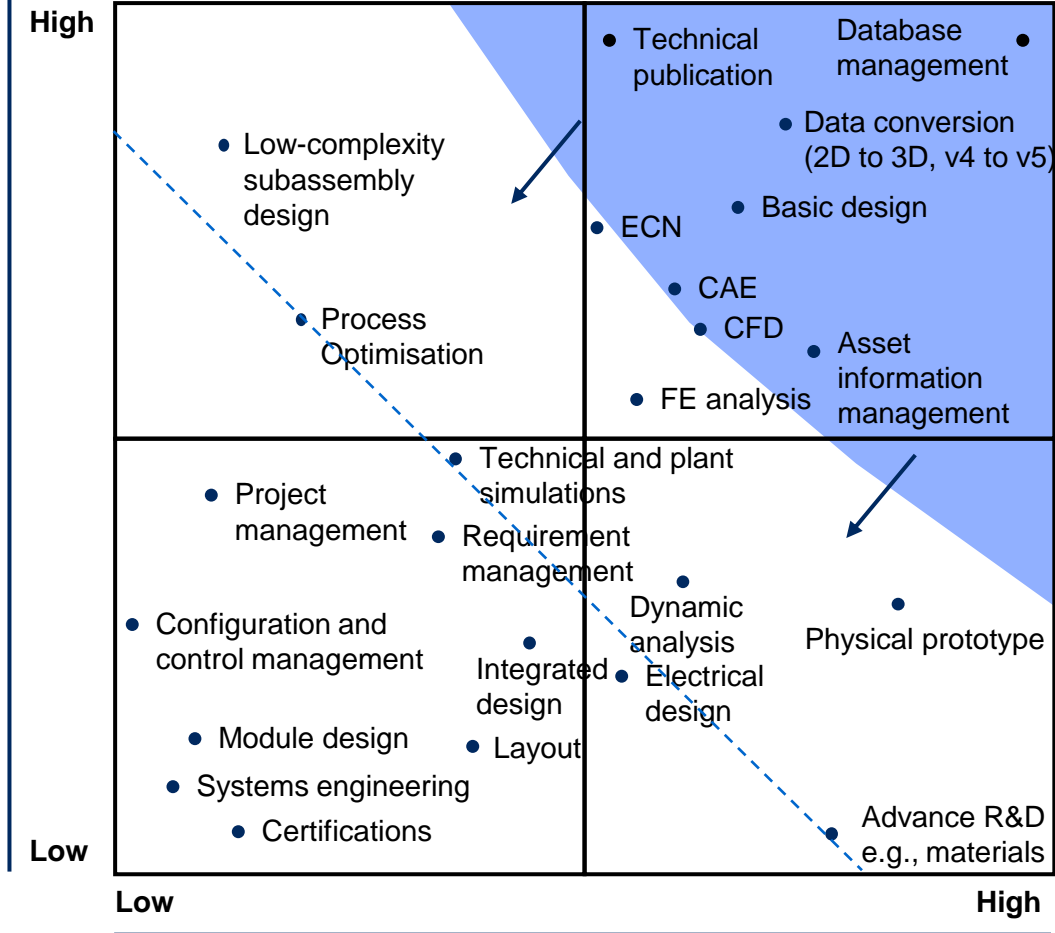
- German company providing disease management counselling for chronically ill patients

¹ 2007 HIMSS leadership survey of hospital CIOs

Product design market will expand as companies globally source increasingly complex activities



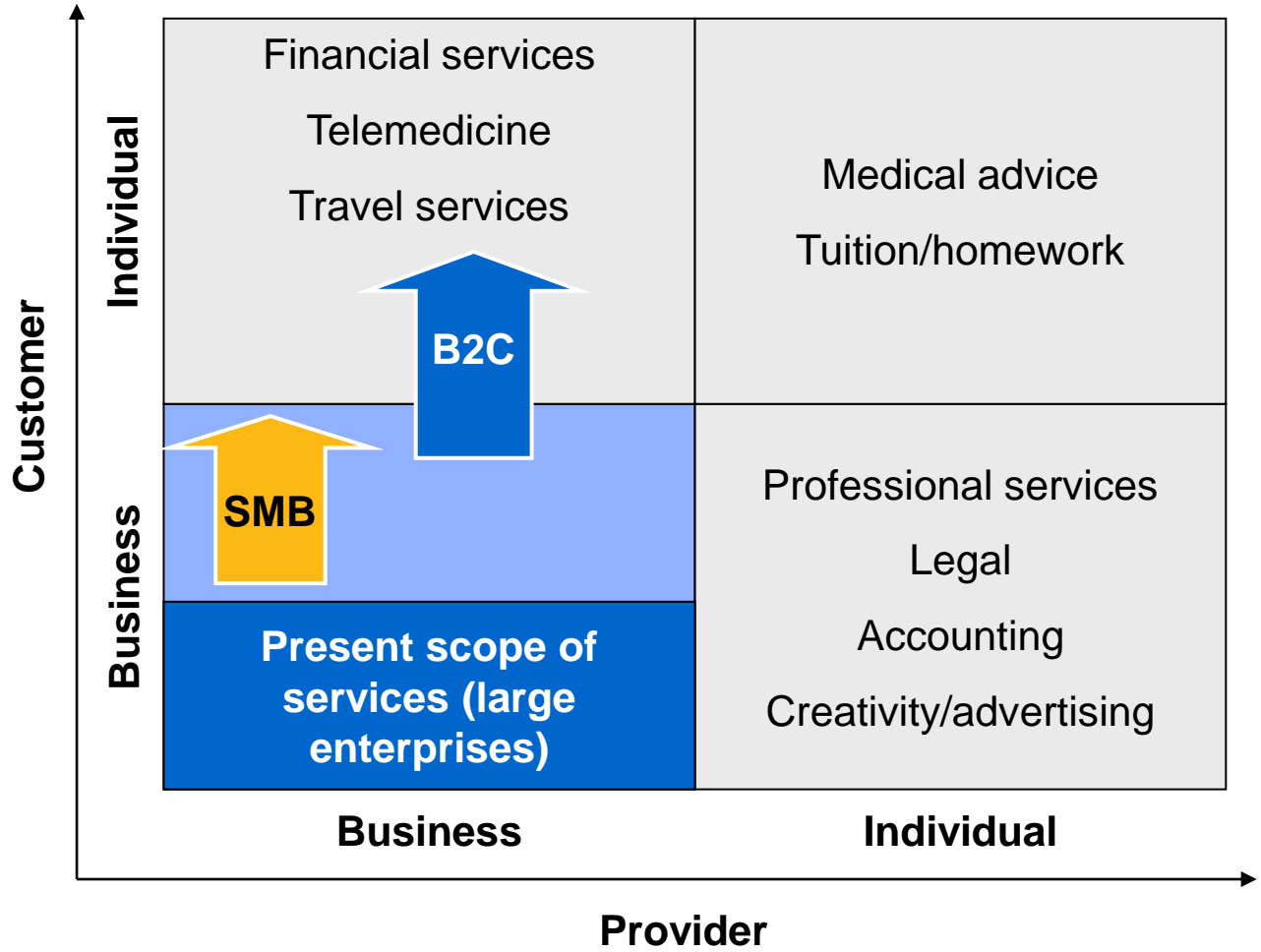
- Ability to manage risk**
- Criticality/risk associated with process
 - Source of competitive advantage
 - Requirement to retain in-house skills



Modularity

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

Consumerisation of technology will stimulate adoption of global sourcing by SMBs and even individuals



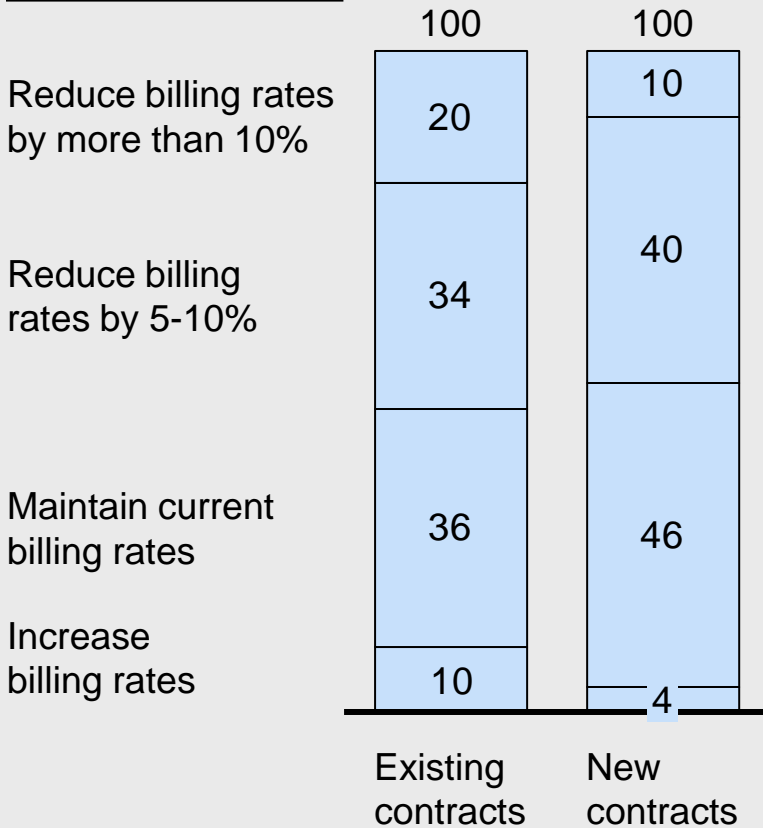
Pricing pressures likely to continue, but potentially with increase in volumes



What is the likely change in technology and business services billing rates in 2009?

Percent respondents, n = 29

2009 outlook



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%**.

– Subramanian 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

Dual sourcing ADM Outsourcing deal as challenging model of a next generation multi-sourcing arrangement



EXAMPLE

- OpCO untouched or no OpCo
- OpCO ADM outsourced to vendor A
- OpCO ADM outsourced to vendor B

- 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

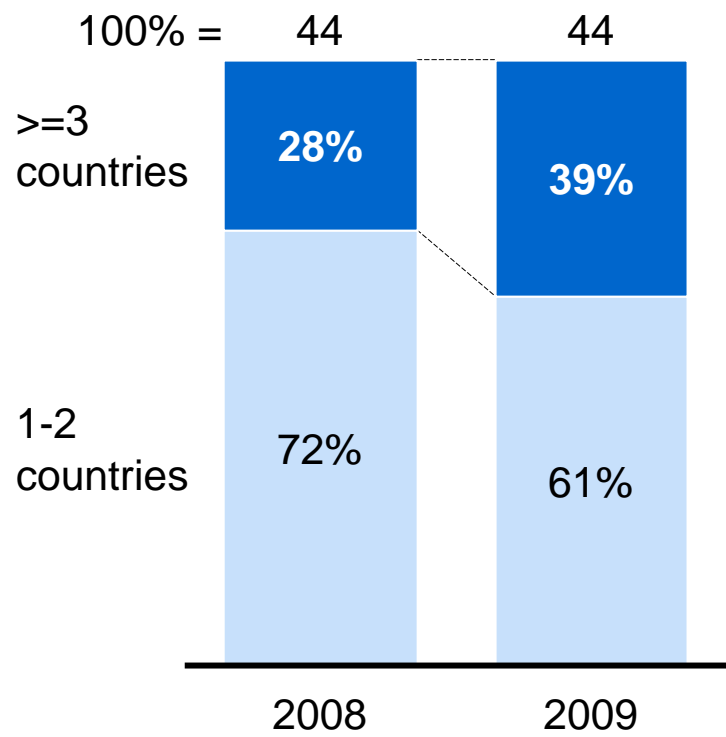


Companies diversifying location footprints with established locations losing share



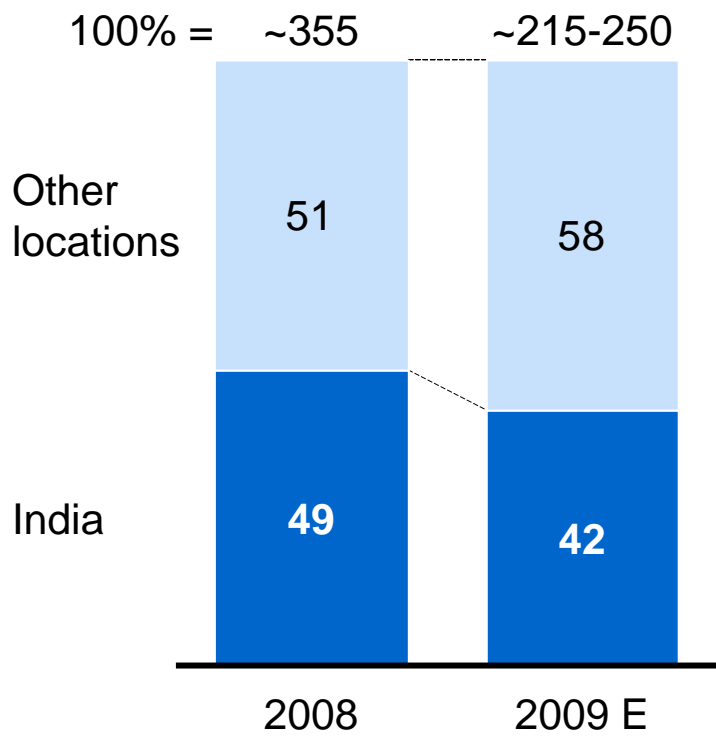
Country footprint

of companies in the sample

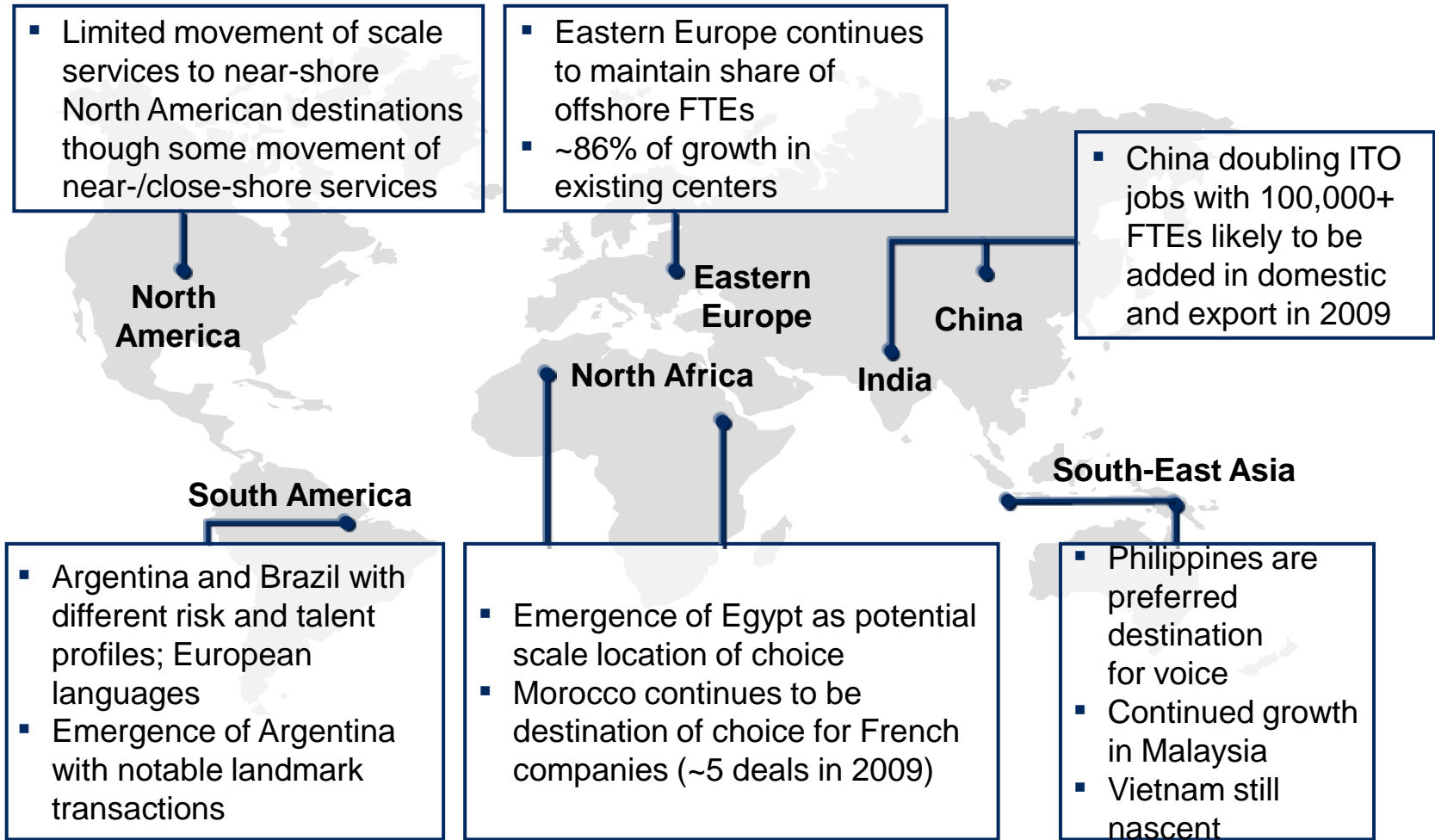


Share of growth in seats for BPO & ITO

100% = thousand FTEs

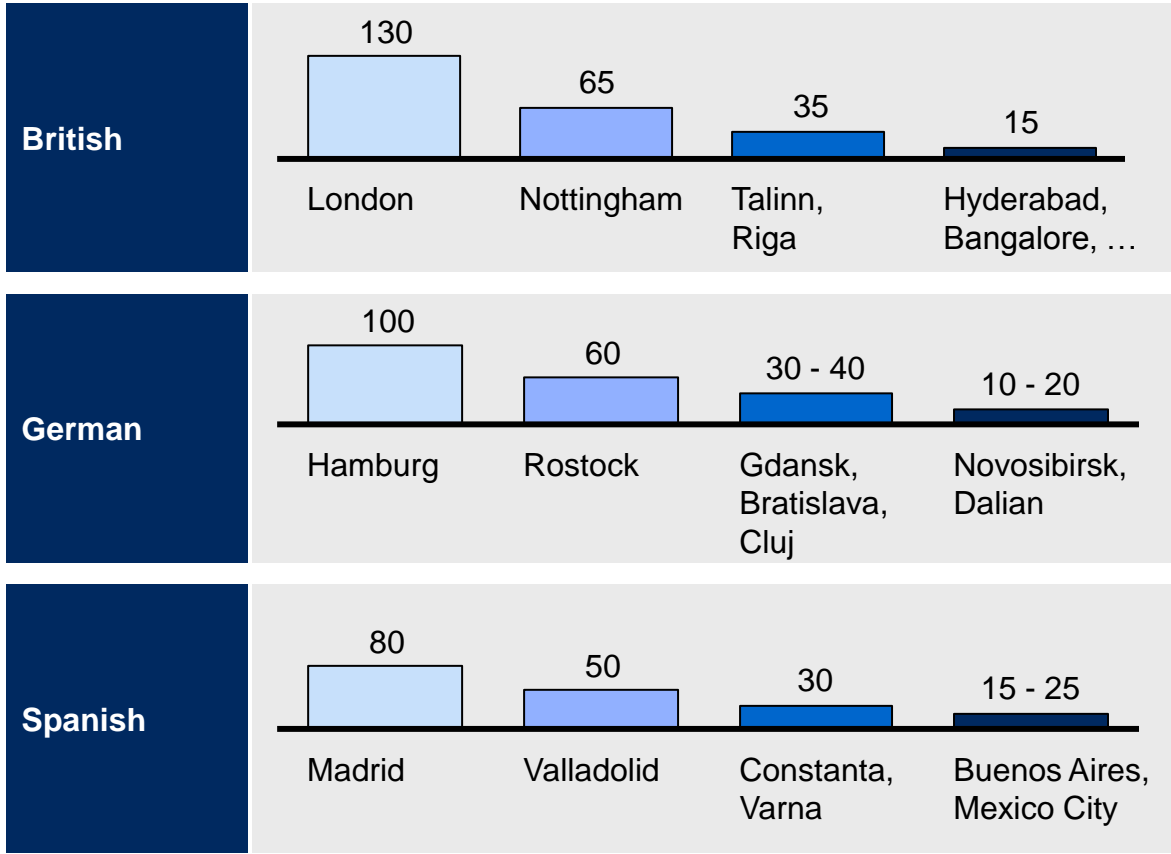


Strong momentum seen in the growth of emerging offshoring destinations, based on strong performance in niche areas



Global sourcing is happening at various shores

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



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

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



Egyptian government



Information Technology Industry Development Agency

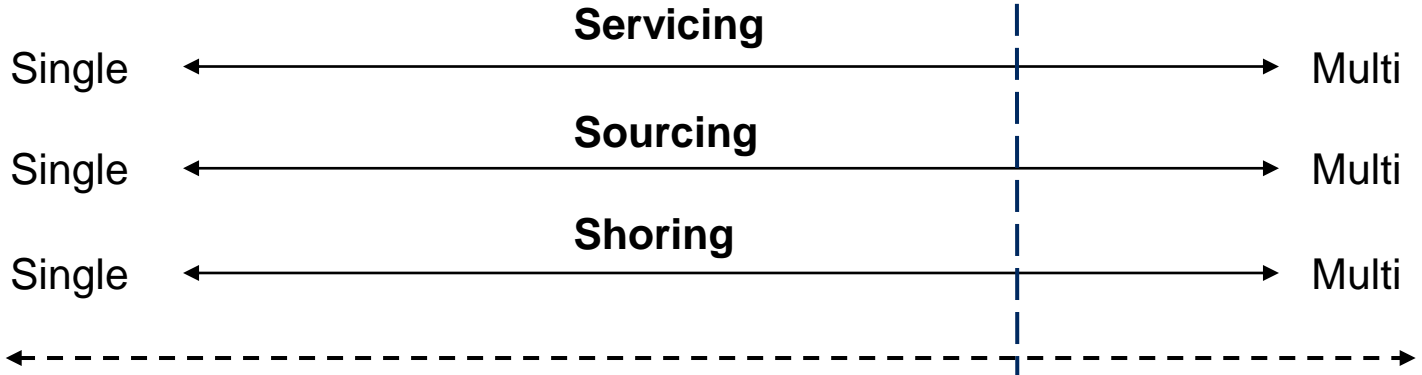


Information Technology Institute & ITIDA

- 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

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



CORE:
Complexity
Reduction

COPE:
Complexity
Performance
Enhancement

- 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**

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