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Outsourcing Survey Report

2008

An Op2i Report, in association with:

Invest Northern Ireland
International Outsourcing Forum
KenCall
Sourcingfocus.com
Buffalo Communications
SPW Accountants

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Op2i Ltd





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About Op2i

Op2i is a Business Improvement Firm Specialising in Outsourcing.

We provide and combine advisory and implementation services throughout the sourcing lifecycle. Advisory services to get the sourcing decision right and implementation services to get the most from outsourcing, complemented by training to ensure our client organisation's personnel are fully abreast of the outsourcing process and equipped to drive the outsourcing programme within the organisation.

We leverage our experience, tools and relationships to ensure clients outsource the right processes / functions for the right reasons, to the right location and to the right service providers.

We provide intermediary services to pre-screened service providers which help clients' go-to market quickly, at reduced cost and risk.

We offer managed outsourcing solutions with services ranging from undertaking programme management on behalf of our clients to fully managing the outsourcing contract on a client's behalf.

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Context of survey

In October 2008, Op2i launched a survey to understand the state of the outsourcing market, given the current economic downturn and perceived view that there was a fundamental shift from Outsourcing 1.0 to 2.0.

The survey had already gathered views from industry gurus - (Outsourcing 2.0 practitioners so to speak).

The survey sought views from individuals from various parts of their organisation who are: key decision makers, implementers or advisors for outsourcing within their organisation, together with industry advisors and suppliers within the industry.

The online survey has been complemented with interviews with industry leaders and specialist commentators.

This report will contribute to industry best practice and aid firms in making better, informed decisions on their outsourcing activities. Globalisation, convergence and competition are all set to intensify over time. Outsourcing and in particular offshoring are no longer only for the few, but will over time become a competitive tool for all organisations.

I am grateful to all the survey participants, the industry experts who provided the Outsourcing 2.0 view, the interviewees and our sponsors.

With best wishes, Bharat Vagadia

Executive summary



It would be an understatement to say we live in challenging times and no doubt the next 18 months will continue to be difficult. It is at such times that innovation thrives, whether this is through new products and services or new business models or tweaks to old models. It is likely that outsourcing and in particular offshoring will see continued growth, both in terms of the types of activities being outsourced and the companies contemplating such business practice.

The general consensus appears to be that the outsourcing industry will benefit from the looming recession. However, the industry must improve its success rate, if it is to convince the wider population that outsourcing and offshoring are sufficiently mature to be considered a viable business strategy. The fear is that with the current economic climate, the focus will be brought back to simply cost cutting, without the necessary strategic focus being given to the wider opportunities presented by an outsourcing programme.

For companies to reap the significant benefits that outsourcing and offshoring can provide there needs to be considerable focus on:

- Defining what and why activities should be outsourced
- Better and smarter SLAs and measurement systems
- Selective use of specialist advisors
- Flexible contracts
- Management of relationships (communication and culture)
- Going beyond just labour arbitrage
- Ensuring multi-disciplinary teams to manage the programme
- For suppliers, either have scale, deep knowledge or both - competing on the strength and depth of their talent pool, knowledge, technology enabled infrastructure and client relationships

Outsourcing – the background



Why Outsource?

The activity that distracts someone from their core business is the core business of an outsourcing service provider – that means treating it as a profit centre, not a cost centre.

For the last decade it has become apparent that future organisations will be different. If most large organisations were to start anew, most wouldn't build the organisational model they have now. Outsourcing gives companies a framework to re-engineer themselves using a model that is in tune with today's technology enabled and converged environment.

As one respondent commented: *"I know from my work as an Independent Director with client / buyer organisations and also my advisory roles with developers and suppliers, that there are substantial differences in their understanding of outsourcing strategies, needs and operations (of which only a small part is off-shoring of course). The most experienced business boards are always looking for new ways to select and align suppliers with their own required outcomes, looking realistically at the investment and delivery capabilities of potential partners and the management and governance structures required to coordinate (and scorecard) core capabilities, captives and partner / supplier outsourced services to create a 'whole' and effective organisation for the benefit of their own stakeholders (customers and investors etc)".*

Outsourcing functions

Information Technology Outsourcing (ITO) was the original and still marginally leads in terms of outsourcing market size.



Business Process Outsourcing (BPO) has emerged as an effective sourcing strategy for organisations seeking to reduce their operating cost base while also improving service delivery and support for their customers, suppliers and employees.

Knowledge Process Outsourcing (KPO) is the new wave. It is different from BPO in terms of the value proposition to the client, which leads to a clear demarcation in process complexity, the amount of intellectual intervention in the process, the skills required and the ability to scale.

Types of outsourcing models

Onshoring - outsourcing in the same country - offers modest cost benefits through employment of staff from less economically developed regions and the removal of industry specific benefits.

Inshoring - where a function is performed without the involvement of a third party (similar to shared services). This term is also sometimes used to describe bringing previously outsourced processes back in-house.

Nearshoring - the transfer of business functions to a different country but one that is either adjacent or relatively close to the organisation's home country.

Offshoring - The process of working with an offshore partner for service delivery, usually where the partner is a third party, but this term also applies to offshore services delivered from within the same company (a captive unit). It does not automatically mean outsourcing.



Rightshoring / Multisourcing - outsourcing to a combination of onshore, nearshore and offshore destinations, having identified the best location and service provider for each service.

Shared service - Consolidation of a service provision point by one part of an organisation or group where that service had previously been found (and provided) in more than one part of the organisation or group. Bringing together of similar services between one or more organisations (that are normally non-competitors in the same area).

Offshoring destinations

Whilst offshore outsourcing is currently just a small part of the overall outsourcing industry, it is dramatically changing business economics through its significant impact on costs, quality and the availability of huge talent pools.

Offshoring is a widely understood concept, at least within the sourcing community - what is not so well understood are the top destinations for offshoring.

Mention offshoring and almost all (British business), will mention India, but should organisations wishing to offshore, only think about India?

There is no question, India was the first destination, which viewed outsourcing as a sector in its own right. India still leads when it comes to sheer volume, however many question whether the country is suffering from its own success.



There are new destinations coming up, which may offer a better “deal” for offshorers. These new destinations may also be superior in offering services where India has been weak.

We have also seen the large Indian service providers adopt a global operating model, adapting to the needs of client organisations which seek multishoring, but not necessarily multisourcing. Many of these heavyweights have setup shop in Northern Ireland providing onshore and nearshore services to its client base.

Types of firms outsourcing

Clearly in a battle when facing a corporation with significant resources at its disposal - an SME with somewhat limited resources (human, technical, legal, financial and global reach) may find the battle somewhat difficult and short lived.

However, the time has now come, when (operationally at least) the many David’s of the world can compete with the few Goliaths that have dominated the markets till now. With the increasing availability of outsourcing and offshoring to the SME market, times are changing.

Outsourcing is nothing new - probably as old as the David and Goliath story. Most large corporate organisations within the UK and wider Europe, have embraced outsourcing in one form or another.

Mid-market companies must embrace outsourcing and offshoring now as both a means of survival and as a means to level the playing field with their larger competitors - who in most cases already benefit from outsourcing and offshoring.



Although the benefits and drivers for outsourcing are pretty clear, operational execution and risk mitigation strategies are more difficult for the Mid-market to comprehend.

SPW an accountancy firm based in London, serving the SME market, commented "at this present time, even with the economic downturn, our clients haven't as yet been swayed into following the outsourcing route, however these are relatively small clients and within the accountancy area, labour costs even within the UK are relatively low now, and therefore the labour arbitrage opportunity does not play a big role as it may have done in the past".

Market size

IT service outsourcing spend in 2007 was the largest and fastest growing category of IT services, at over US\$ 183bn (nearly 37% of the total IT services spend) - a growth of over 7% from the previous year. The total ITO offshore market was estimated to be worth around US\$ 37bn.

Worldwide BPO spend was approximately US\$ 462bn in 2007, a growth of nearly 10% over the previous year. Key segments include logistics and procurement at US\$ 224bn, sales and marketing at US\$ 167bn, with others such as customer management, F&A and HR following behind with US\$ 30bn, US\$ 19bn and US\$ 16bn respectively. All apart from sales and marketing saw double digit growth rates in 2007.

Growing at more than 35% over the past three years, BPO is the fastest segment of the overall offshore market, and is currently estimated to be worth around US\$ 28bn.



Consolidation / Global reach

The outsourcing services provider market has witnessed significant changes in the past few years. In addition to establishing captive BPO centres, customers now have a substantial choice of third party vendors to engage from different regions. Several hybrid sourcing models like BoT (Build, Operate, Transfer) and virtual captives are also being used. The market has witnessed increased M&A activity as providers are looking to build scale and acquire new capabilities rapidly; particularly to increase geographic reach and acquire service segment capabilities.

Many Indian companies are creating global reach and attempting to cater for those European clients which desire onshore or nearshore presence by opening up offices in Northern Ireland.

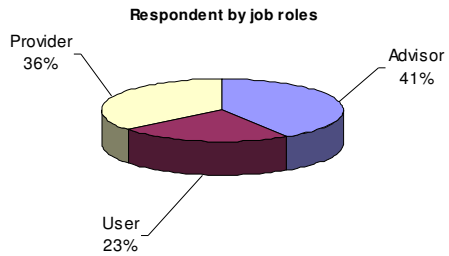
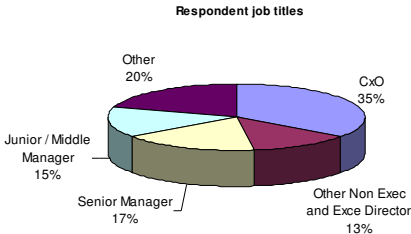
For instance, First Source has created around 1,000 jobs. HCL has 2000 employees at its contact centres. Polaris, an Indian software development company is creating 158 jobs in Belfast over the next three years. The most recent investment is by Tech Mahindra which has set up a centre of excellence for the design and implementation of business solutions in Belfast.



Survey findings

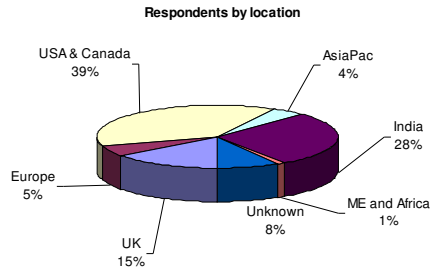
Survey sample

Just over 100 respondents participated in the survey between the periods October to December 2008. The majority of respondents were CxO level executives (nearly 50% were director level and above).

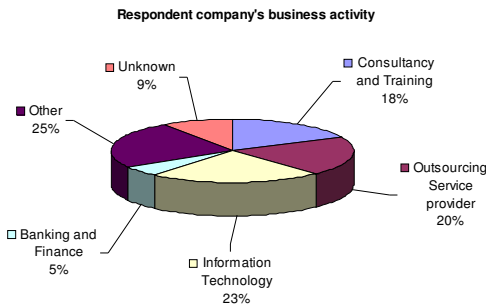


There was good representation of suppliers, users and advisors.

Three geographic locations dominated: USA, India and UK - representing the top three outsourcing regions globally.



There was also a good representation in terms of company size, with a mixture of small, medium and large companies.



Consultancy, IT and general outsourcing service provision companies featured strongly.



Economic effects from outsourcing / offshoring generally positive

The general consensus appears to be that interest in outsourcing has increased with the economic downturn (51% of respondents). 40% believe the downturn has either had no impact or a negative impact.

One respondent commented "We feel that outsourcing tends to be counter-cyclical particularly in the financial services sector. The current economic climate should see businesses looking to generate greater levels of profit through cost reduction rather than greater revenue generation".

Another respondent noted "Investment avoidance (credit crunch) and closer correlation between sales and overheads (transactional pricing) are powerful drivers in this phase of the cycle". Another banking respondent noted "In the banking sector, specifically our organisation, it is clear that we will utilise outsourcing where there is no internal resources available to do the work - the official line is that cost is not the driving force. In the current economic climate, there is an issue with cash injection into projects and not an issue with resource availability, hence not an increase in outsourcing. However, with the current financial crisis this position may change and cost may overpower the bank".

Based on Op2i's experience, many companies who would be potential outsourcing candidates are delaying their decision making process and therefore, interest in outsourcing is on hold. It also clearly depends on the type of outsourcing being considered - any deal that would require sizeable upfront investment will clearly find it more difficult than a proposition which reduces costs, without significant capital investment.



One of the issues the survey was also trying to establish was if there had been considerable shift in focus from Outsourcing 1.0 to Outsourcing 2.0 - from a pure transactional, tactical approach to a more strategic partnership approach.

Bruce Keith, a Director with 3i Growth Capital, responsible for BPO investing across 3i, noted *"Things will slow down dramatically once the order book dries up, but most scale players will be fine as they have sufficient existing long term business to keep them going - in addition, the pricing model will need to change from the cost plus models (which all the big vendors do) to transactional or outcome based pricing models. The smarter mid market vendors will operate this way first - if they have expertise, depth in their niche, they will have the data to be able to work out the right outcome based pricing model - they have the chance to steal a march on more traditional competitors"*.

"Deals will either get pushed back or cancelled. However, because there is enough in the pipeline, suppliers are not currently moving to this pricing model, and in many cases suppliers just don't have the right people to implement such a new model.

"It is easy to go from cost plus to gain share, but it is a tougher step to rip up the old cost plus model or gain share model and start on a transactional basis - i.e. an outcome based model. Most of the companies that have historically come up with outcome based models haven't necessarily thought of themselves as BPO companies".

Louise Crawford, Business Development director with Invest Northern Ireland during the interview noted *"Global economic uncertainty remains, but the outsourcing market could be the first to benefit*



as companies in Europe and the US seek to reduce costs. We have already seen the divesting of major MNC captives to Indian vendors and that pattern is likely to continue.

However, mid-size corporates need to be convinced that completely offshoring is the way forward and there are increasing opportunities for blended nearshore and offshore solutions, an area where Northern Ireland has significant success with Indian vendors such as HCL and Firstsource as well as major European and US companies such as Teleperformance, Teletech and Stream. Outsourcing is not just about cost: retention and satisfaction of customers is of equal importance. Those who strike the balance will succeed with a blended solution.

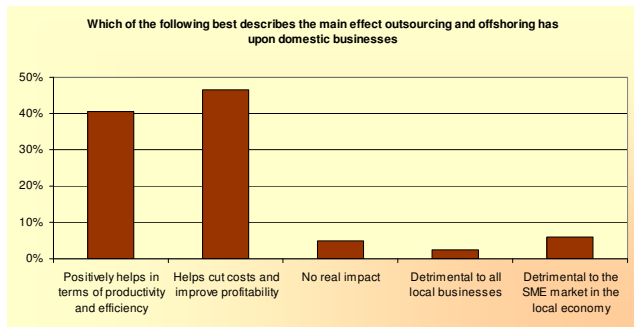
Companies are looking to grow in the most cost competitive and efficient manner - both outsourcing and offshoring offer solutions that meet this criteria. Yes, outsourcing will undoubtedly increase in the coming year and I believe it will have a positive effect on the domestic economy as companies will be able to focus on core functions as opposed to non core functions. Having said that, many companies who have typically outsourced in the past are now really questioning the return on investment from their outsourcing contracts and are demanding more flexible agreements.

In relation to offshoring, it seems like many companies are increasingly keen to keep functions closer to home during times like these (i.e. within the UK or Western Europe) due to previous issues in other typical offshoring locations surrounding risk, loss of management control, poor customer service quality and data protection issues.



A new report by Gartner predicts the current economic slowdown will accelerate the offshoring of IT jobs in particular. In this report, Gartner recommends that companies considering offshoring work to countries such as India look at branching out their offshoring facilities to more countries due to annual wage increases of 10-15%.

The majority of respondents believe outsourcing has a positive effect on domestic businesses, with only around 10% saying the effect



would be negative. 40% believe it helps in terms of productivity and efficiency with over 45% believing it helps cut costs and improve profitability. This would suggest the industry has now matured to a stage where the proposition is not simply one of cost cutting, but about additional value add.

Bruce Keith noted "Unless you embrace outsourcing / offshoring, you're not taking advantage of all the competitive weapons that are out there - if you don't do it, someone else will and they are going to beat you on price and you're going to be in a difficult place. Offshoring will make UK organisations stronger companies on the international stage. Offshoring is definitely the way forward for UK companies. If you're offshoring for labour arbitrage only, you're missing the opportunity to access talent anywhere on the globe - no longer are you confined and dependent on the immediate



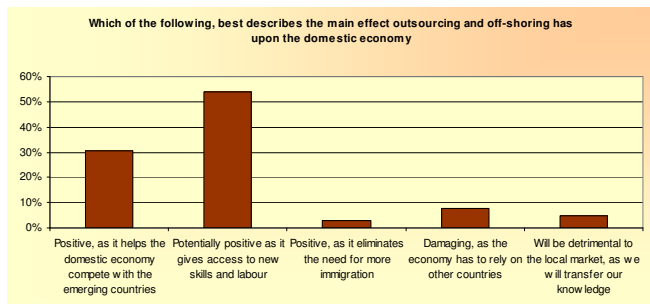
workforce around where you happen to be based, but in Latin America, India, wherever. I don't think businesses will think of it as offshoring, but business as usual for those thinking of growing. Offshoring equates to globalisation in many senses".

A senior public sector procurement executive, during the interview said: *"The economic downturn means it's more difficult for new initiatives to take off, especially where you need financing - clearly existing deals are not affected. Within the public sector there is increased pressure to provide a diverse set of services - not necessarily just a cost issue".*

Professor Leslie Wilcocks, Professor of Technology Work and Globalisation at the LSE: an academic guru in the outsourcing space, commented *"that the economic downturn will have mixed effects - decisions are being put on hold and focus has yet again shifted to cost cutting".*

An opposing view from one of the respondents noted *"as organisations collapse due to the current financial crisis, I think that fewer organisations will trust 3rd party suppliers and centralisation will be back on the agenda - time will tell".*

Nearly 90% of respondents believe outsourcing and offshoring generally have a positive effect on the



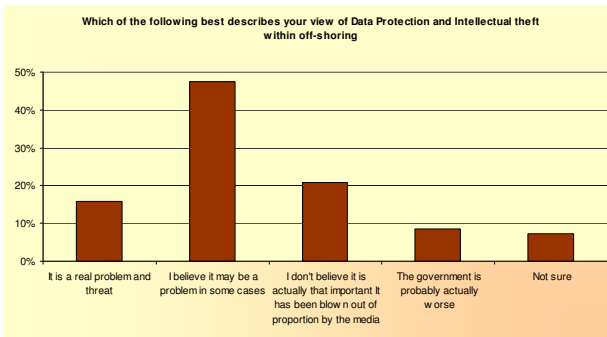


domestic economy. The majority (50%) thought it was potentially positive as it gives access to new skills and labour. Over 30% thought it helps the domestic economy compete with the emerging countries.

Given the aging population of developed economies and specific skills shortages in some high technology areas, it should not really be a surprise to find such a positive reaction to offshoring.

Data protection still a concern

The majority of respondents, more than 60% believe data protection and intellectual theft may be a problem when it comes to offshoring. The number of respondents believing it is has been



blown out of proportion by the media is around 20% while less than 10% see government posing a greater threat to data security.

The industry must continue to address the real concerns of organisations wanting to offshore, if the industry is to continue to grow. As Invest Northern Ireland commented "Outsourcing is largely about cost reduction, but without putting clients at risk. Alongside, client satisfaction and cultural compatibility, the need to give clients confidence on how data is managed and processed is an increasing global issue. As part of the UK and European Union, Northern

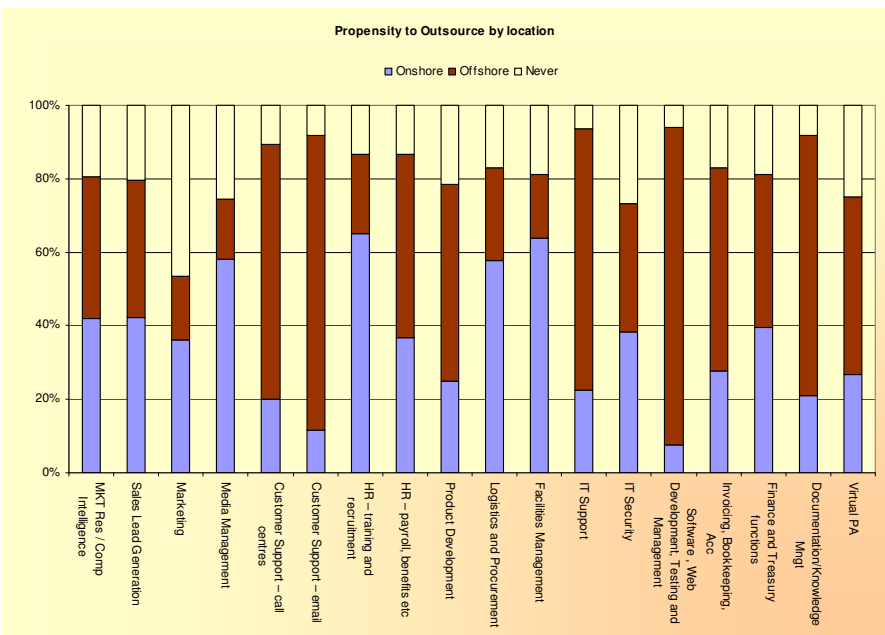


Ireland has some of the most stringent data protection and security legislation”.

Mixed feelings about employee transfers

There was a mixed reaction to employee transfers. Roughly equal proportions stated that it would be difficult, not a major issue or would be seen as a benefit.

Clear trend in functions likely to be outsourced onshore / offshore



Marketing, media management, IT security and virtual PA functions are the least likely activities to be outsourced - all representing critical organisational knowledge, or brand identity activities, which are typically central core competencies of an organisation.



Six activities dominate the offshoring space: 1. Software, Web Development, Testing and Management, 2. IT support, 3. Email customer support, 4. Documentation and Knowledge Management, 5. Call centres and 6. Invoicing, Bookkeeping and Accounting - all activities which are discrete and technology enabled.

Activities most likely to be outsourced onshore include: HR recruitment and training, Facilities Management, Logistics and Media Management - all either requiring physical contact or in depth local knowledge.

Bruce commented *"KPO is interesting - its really just high end BPO - but in many instances less scalable. KPO has worked well for us, where in the local jurisdiction, there's been a lack of available local talent to deliver that service, or in multi-jurisdictions, such as research or reporting, where you have similar jobs - centralising somewhere means you don't get duplication and start to utilise your knowledge base better. I suppose LPO will take off quicker than other KPO activities - for no other reason than changing legislation that will introduce private equity into law firms over the next 12-18 months, which will force those businesses to think about what they do and how they do it - there will be a change in emphasis and the way the legal profession operates - however, I'm not sure LPO will be as large as people think. Two other areas which I think are important and more immediate are in Publishing and Engineering - talent is increasingly important whether its high end F&A or KPO, however you want to define it. For contact centres it's mainly a labour arbitrage proposition"*.

Professor Leslie appeared to agree in this respect, *"Probably within the KPO area it will be professional services such as LPO*



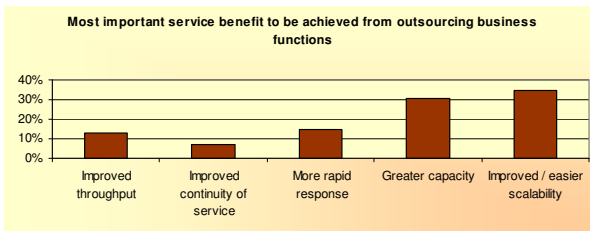
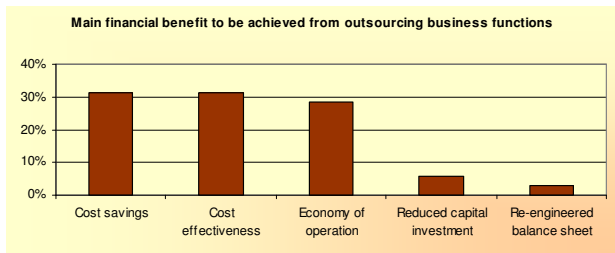
which will be the next wave - we will also probably see more inroads in HR outsourcing and further back office functions being outsourced".

Our Invest Northern Ireland interviewee commented "Knowledge work or business which requires judgements, the so called KPO industry, which embraces functions ranging from legal work to accounts payable and high-end analytics is increasingly going offshore, but the compliance and regulatory framework often requires some of this work to stay nearshore. Invest NI fully expects clients will ask vendors to pitch for a mixture of offshore and nearshore delivery".

Cost, Effectiveness and Economy are key benefits sought from outsourcing

The benefits being sought from outsourcing business functions include cost savings, cost effectiveness and economy of operation, all in roughly equal measures.

Transforming capital costs to operational costs, which was seen as a benefit



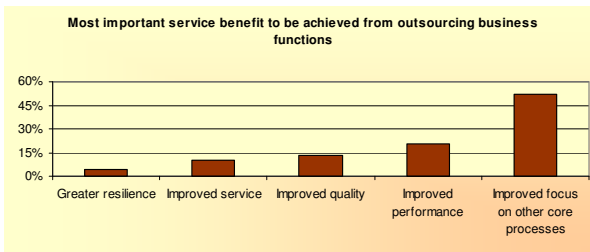
in the early days of outsourcing seemed to have been relegated, with less than 10% stating this as a primary benefit.



Two factors dominate in terms of the most important service benefit sought from outsourcing business functions: scalability (35%) and greater capacity (30%).

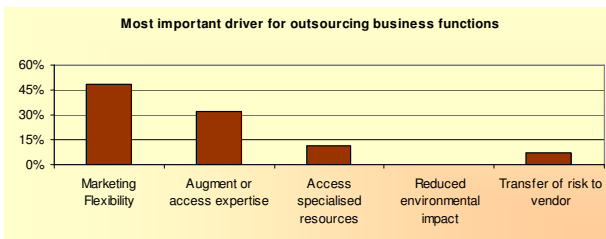
Improved focus on core competences was rated as the key benefit being sought from outsourcing (approx 52%), with improved performance following behind at 20%. Improvements to service or quality were not seen as major service benefits - it seems most are

happy to maintain their existing service and quality levels.



Flexibility and in-house augmentation key outsourcing drivers

The most important driver for outsourcing business functions was the greater flexibility it provides to meet changes in market condition (49%) followed by augmentation of in-house expertise and/or access to specialised labour (32%).



Access to specialist equipment and resources was ranked third with 12%. Reducing environmental

impacts was not seen as a driver for any of the respondents.

One respondent noted "One thing I have found is the 24hr clock is a myth. I have worked for 4 companies where they have attempted to implement around the sun outsourcing for everything from tech



support to development. The 24hr clock is not a catch all - you need to be diligent about what gets outsourced. This requires a more rigid process definition that a lot companies don't have. This means managers locally need to open new positions for people that truly understand this process and hire accordingly. We need to stop trying to hire outside firms that try to augment entire teams by claiming they can do it all. There needs to be core competency established locally and distribute work that should be off shored, not try to off shore everything in hopes that you will save a buck".

Another respondent noted "The primary driver is invariably cost reduction. The question then is what other benefits can be derived at the same time such as improved innovation and efficiency (which in turn drive cost benefits)". Another noted:"Unfortunately, cost reduction remains the principal driver, although it is not the only one".

Our senior public sector procurement executive commented "The government would use outsourcing as a means of transformation, if the vendor had the capabilities".

SPW went down the outsourcing route back in 2001; the primary driver then was a severe shortage of skilled accountancy personnel, roughly around 20%. The interviewee commented "Initially we used another outsourcing firm, but having got the experience we went directly to India and set up an agreement to have our own dedicated outsourcing department within a larger accountancy firm based there - we really wanted more control".

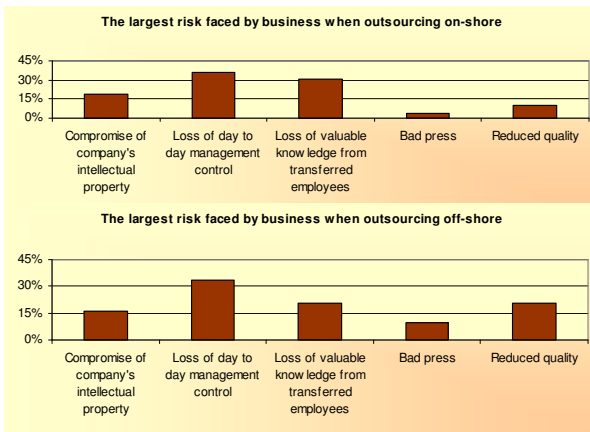


The interviewee commented *"there are many other accountancy firms that are now outsourcing, although most would not go down the route that SPW went down - most are liasing with large offshore accountancy firms who have UK representatives, who then outsource the work. I believe most that have tried going direct, have found it to be difficult. Our positive experience of outsourcing accountancy has made us think what else we can outsource"*.



Loss of control and knowledge, key risks associated with outsourcing

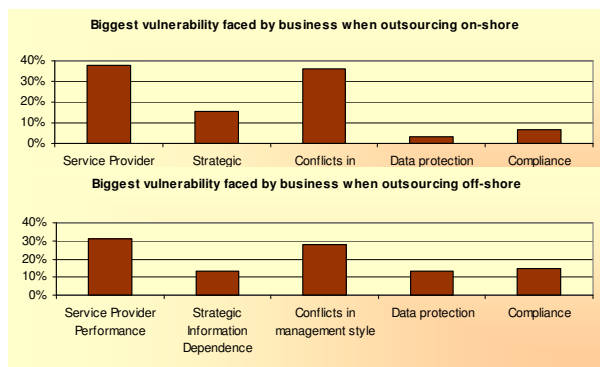
The largest risk faced by business when outsourcing, whether it is onshore or offshore, appear to be loss of day to day control and



the loss of valuable knowledge from transferred employees.

Third on the list includes the fear of reduced quality. Bad press, as you would expect is a greater concern in offshoring.

The biggest vulnerability faced by businesses when outsourcing onshore or offshore includes: dependence on the service provider for performance and conflicts in communications and management styles.



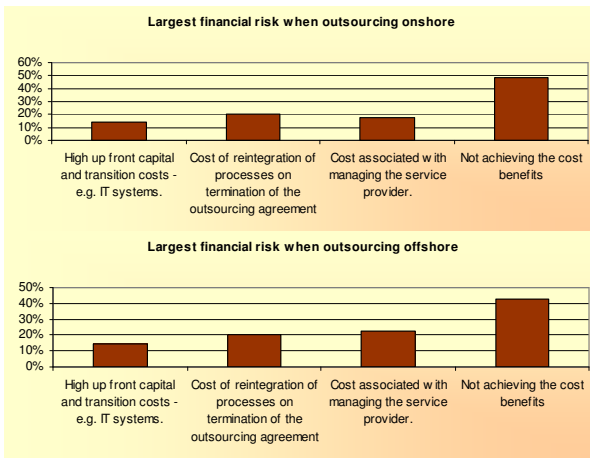
The third factor for onshore includes, dependence on service provider for strategic information.



For offshoring, Regulatory and legal compliance is ranked third. Data protection is a material concern for offshoring, but not for onshore outsourcing.

The greatest financial risk remains the possibility of not

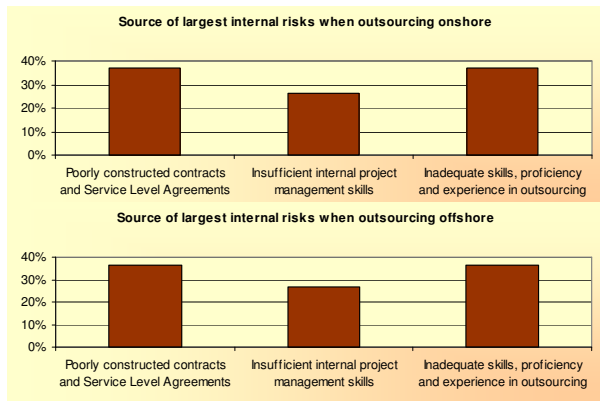
achieving the cost benefit, followed by cost of reintegration of processes on termination of the outsourcing agreement.



For offshoring, costs associated with managing the service provider rank higher than up

front capital and transition costs.

There seems to be a consensus for both onshore and offshore outsourcing that the two largest sources of internal risks are a). Inadequate skills, proficiency and experience in outsourcing (37%)



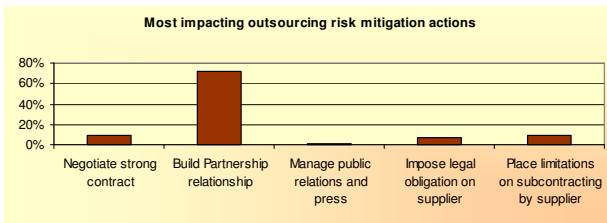


and b). Poorly constructed contracts and Service Level Agreements (37%). The uniformity in onshore and offshore experience is remarkable.

Insufficient internal project management skills are ranked third at around 26% for both onshore and offshore outsourcing.

Partnership approach seen as key risk mitigation strategy

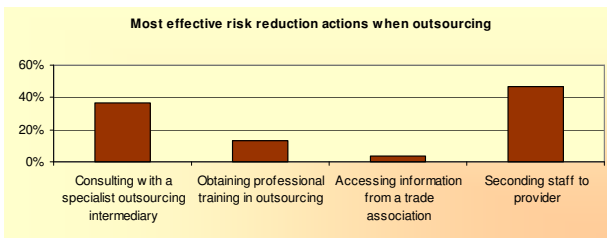
The best approach to reducing the risks from outsourcing is the development of a partnership relationship between customer and



supplier - easier said than done however. Strong contracts and limitations on subcontracting follow, but

significantly dwarfed by the partnership approach.

The most effective strategies to reduce risks when outsourcing are to second staff to the service provider and consulting with a specialist outsourcing intermediary.



Training and trade associations follow behind - these are probably "useful" sources of information, but

do not address the practical issues of outsourcing on a day to day

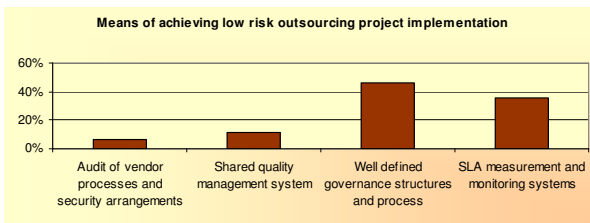


basis. Given that most respondents viewed the greatest source of risk being inadequate internal skills, proficiency and experience in outsourcing, the use of outside help is understandable.

SPW estimates that it only cost them around £10K to set-up the outsourcing agreement, but in reality it took around one year to train the staff through secondments and site visits.

The interviewee commented *"I think the operation is performing well, but probably can be more efficient. We also don't seem to have as much control as we hoped, but in reality we don't spend much time (a few hours a month) managing the relationship. Overall, we wouldn't want to be without our operation out there, and although labour augmentation was the original driver, we have saved around 60% on staff costs by doing this, which goes straight to our bottom line"*.

The best means of achieving a low risk outsourcing project implementation requires a combination of having a well defined governance structure and process (46%) and sufficient SLA measurement and monitoring systems (36%). Third in the list is



having a shared quality management system.

Auditing vendor processes and security

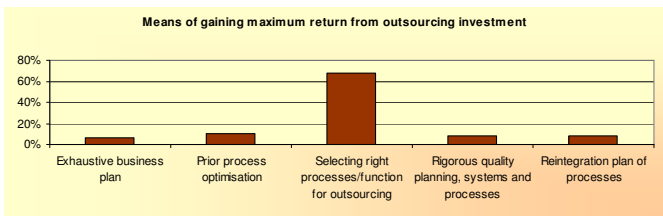
arrangements is ranked relatively low at 4%.



Our senior public sector procurement executive believes "there is no best practice model / one size fits all model, out there because you will be forcing a square peg into a round hole. It really does depend on the complexity of what you are dealing with and the skills of both sides to make the relationship work".

Bruce commented that "the biggest mistake is not having the CEO 100% behind it and vocally so. If you have this, it puts you on the front foot for making it happen. You also need to bring people to your team (advisors, seconded people etc) - people with knowledge and experience".

Selecting the right process and functions to outsource in the first place (67%) is seen as the best means of getting maximum return



from the outsourcing investment - the core competence argument.

Prior process optimisation (10%), rigorous quality planning process and reintegration plan (8% respectively) follow behind.

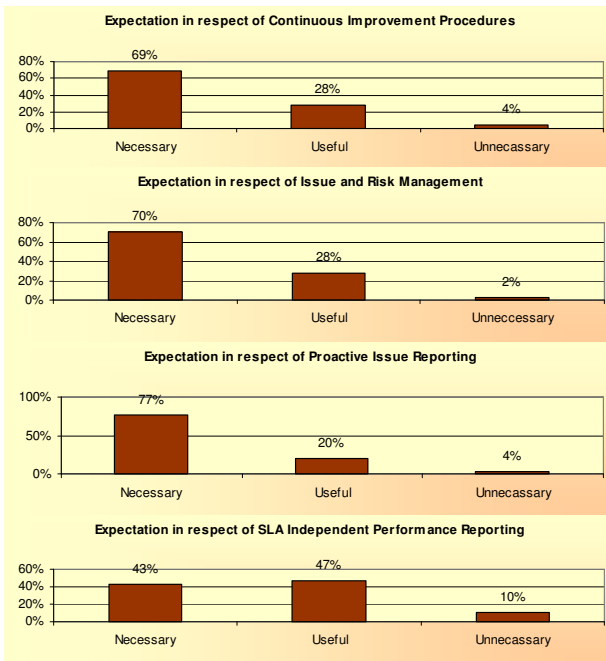
Service quality expected to remain the same or higher

Most respondents expect a higher service quality over the term of the agreement, whilst most expect it to remain the same in the first year. Around 9% seem more realistic and expect degradation in service quality in the first term.



Continuous improvement, issue / risk management and proactive issue reporting seen as being key requirements from service provider

A significant majority (69%) believe it is necessary to have continuous improvement procedures in place. Most (77%) believe it necessary to have proactive issue reporting. 70% believe it necessary to have issue and risk management.



Only 43% believe it necessary to have independent SLA performance reporting, with 47% stating it would be useful.

Our public sector procurement executive stated "because today there is more experience in the market, SLAs have got more crystal and clear. Today people understand benchmarking more

than 10 years ago, there is a lot more stuff that has happened that you can benchmark against. Benchmarking however is still in its early stages".

Professor Leslie commented that "SLAs haven't changed much, but there is a tension in SLAs, in terms of:

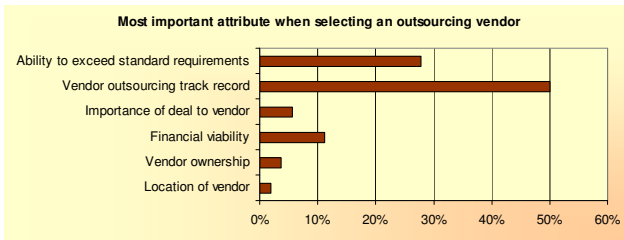


- *Focus not on the key measures;*
- *Many organisations haven't made the jump from technical measures to business measures;*
- *Users try to measure too much and the significant measures get lost in the detail;*
- *There is tension about how we measure the critical measures and how you can let the suppliers get on with the detailed technical details behind them;*
- *Benchmarking is another problem - generally this is not done well. Problems of benchmarking are huge. In most cases its ensuring the benchmark data contain apples and apples, so you can compare like with like;*
- *Benchmarking firms haven't yet managed to do this for most IT or BPO activities. The data is not that good, but at least the data that is there, helps point in the right direction;*
- *Benchmarking has not improved materially in the last few years - knowledge and experience often forms a better benchmark than the data you see;*
- *Without reliable benchmarks, companies do not really know if they are getting the best deal - they just find similar peer group companies to review, or get outside advisors, or simply evaluate in house costs and compare these against the vendors".*



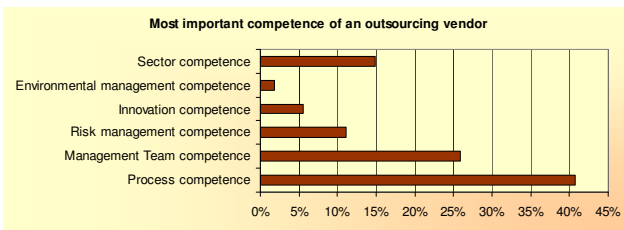
Track record and ability to exceed standard requirements are seen as being key attributes for selecting a vendor

The key themes repeated by respondents as the most important criteria when selecting a vendor were: sector / domain expertise, competitive pricing, credibility, proven track record, service quality and financial stability.



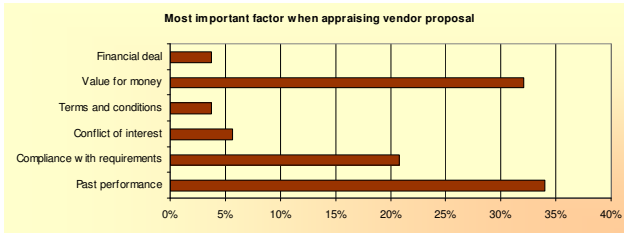
The two key criteria cited in the survey for vendor attributes were its track record (50%) and the ability of the vendor to

exceed standard requirements (28%). Following significantly behind at 11% is the financial viability of the vendor - for some (as highlighted above) this appears to be a gating factor.



The most important competence of an outsourcing vendor is process competence (41%) followed by

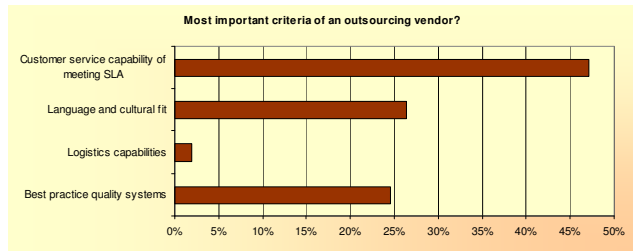
management team competence (26%), sector competence (15%) and risk management competence (11%). Innovation was not believed to be important.



The three top factors when appraising vendor proposals include: past performance (34%), value for

money (32%) and compliance with requirements (21%) - in line with the general comments as noted above.

The key criteria of an outsourcing vendor includes: customer service capability of meeting SLA (47%), language



and cultural fit (26%) and best practice quality systems (25%) .

Our public senior sector procurement executive stated *"The problem within the public sector is that there are only a limited number of vendors that bid for work"*.

Invest Northern Ireland stated *"Vendors need to be positioning themselves for multi-location delivery and to be smart in how they put offerings to clients. Winning over the first-time outsourcers who have a strong focus on customers will require this flexible approach. Getting the skills required to deliver and to be up and running as quickly as possible will influence clients. Northern Ireland has a history of quick ramp up, with low cost delivery and diverse skill sets"*.

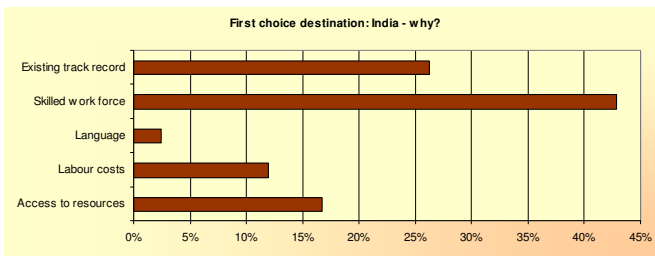


India, China, Philippines, UK and Ireland are leading offshore destinations – for different reasons

There are many different countries to choose as an offshore destination, some have been around for decades and some are trying to establish themselves, as Invest Northern Ireland commented: *“Northern Ireland is one of the oldest offshoring destinations in the UK and Europe. US companies in Business Services and ITES, set up in Belfast and Derry over 10 years ago and have evolved into major cost and delivery centres, which continue to expand even in these challenging times”*.

SPW made the decision to outsource in Sept 2000 and started the outsourcing activity in Feb 2001, short-listing five firms based on existing contacts and referrals. They chose India because as the interviewee commented *“India follows the same accountancy principles as the UK and they appear to be culturally similar to the UK”*.

India was ranked number one choice by a long way (this may have been biased by the large number of respondents located in India,



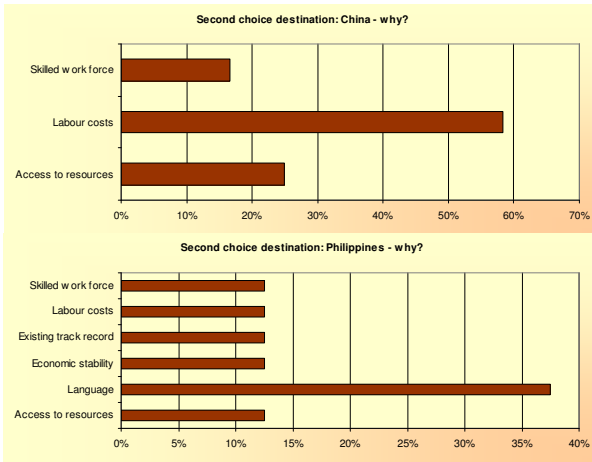
however that bias is not sufficient to alter the fact that India still leads as organisation's first choice

destination). The top two drivers are the availability of skilled workforce (43%) and India's existing track record (26%). What is surprising and bodes well for India, given its problems with wage



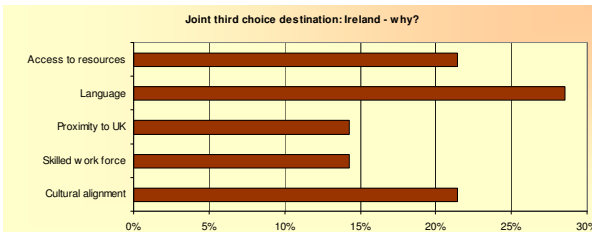
inflation and dollar exchange rates, is that only 12% choose India due to lower labour costs.

China comes a very distant second place as the first choice destination, with UK, Poland, Costa Rica, Philippines, Bulgaria and



Romania each figuring, primarily on the basis of availability of skilled workforces. China competes with the Philippines for second choice, but primarily driven by the search for lower labour costs (58%). Access to resources was a second driver (25%)

Most organisations choose Philippines for its language capability (38%) and would concur with a recent trend of call centre outsourcing heading towards the Philippines. Again only 13% of respondents rated labour costs as being a significant factor. Perhaps in both India and Philippines, the lower labour costs have become embedded in the decision to offshore and therefore are



simply assumed.

India (Skilled Workforce), Poland (Labour Costs, Cultural Alignment



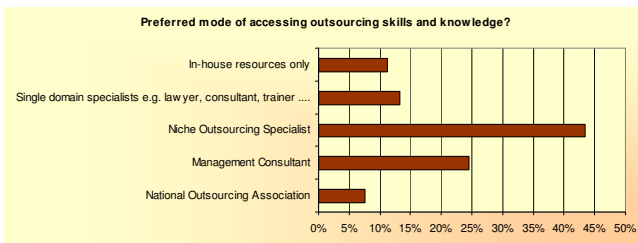
and Proximity to UK), USA (Cultural Alignment and Government Incentives) and Romania (Proximity to UK and Skilled Workforce) were the other main other contenders for the second choice destination.

Ireland/UK, China and the Philippines were clear equal third choices. The reasons for choosing Ireland are varied and show a degree of maturity of the country as an offshoring destination. Like the UK and Northern Ireland as destinations, Ireland's skilled workforce, proximity to UK, cultural alignment, language and access to resources all figure as strong drivers.

Mexico, New Zealand, South Africa, Israel, Lithuania and Ukraine were selected by virtue of cultural alignment. Turkey, Egypt, Vietnam and Malaysia were selected on the basis of their labour costs. Russia and Czech Republic were selected on the basis of their skilled work force. USA, Canada and Australia were selected for their economic stability. UAE (access to resources), Mauritius (Track Record), Singapore (Infrastructure) Spain (Proximity to UK) and Estonia (language) were also identified as third choice destinations.

Niche outsourcing specialist first port of call for advice

When it comes to accessing outsourcing skills and knowledge, niche outsourcing specialists (43%) and management consultants (28%) were



ranked highly. Just over 10% of respondents prefer to use in-house resources only.

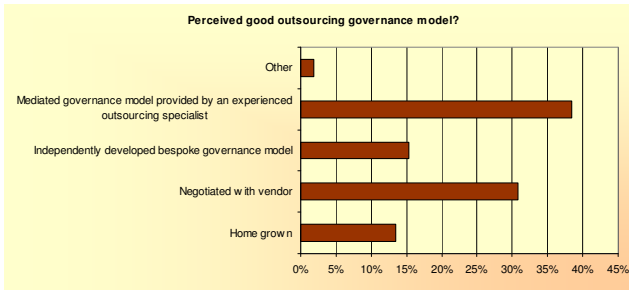


Two types of governance models seen as being important

Governance (whether this is monitoring SLAs, escalation procedures or dispute resolution procedures) is ranked highly both within the business and academic world as a determinate of success.

Two models appear to dominate as perceived good governance models:

- a) Mediated governance model provided by an experienced outsourcing specialist (38%), and
- b) Negotiated with vendor (31%).



Professor

Leslie

commented:

"Governance is in many cases a contract breaker - however there really isn't a

"model" answer. I am not a great believer that you apply best practice - best practice is best practice for someone else, but whether it's best for you is another question altogether. Considerable empirical evidence shows that best practice sometimes is not best practice for another organisation for which best practice is applied to. Best practice adoption doesn't help because you don't know why those best practices are in place and you don't know if its best practice for the questions you are trying to answer. Customers really need to develop an internal capability for developing governance practice that fits your particular requirements and suppliers need to develop governance capabilities which are relevant for the client, based on their collective experience".

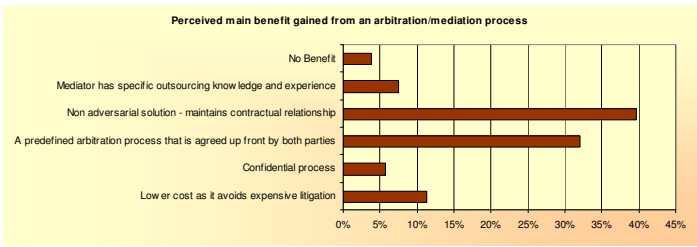


Bruce added "all too often, if you get the CEO to lead, it drives the programme through, but unless you have real senior level ownership and strong communication post contract/transition, in steady state, then things will under perform".

Arbitration and mediation seen as a key feature of good governance

Arbitration and mediation are sometimes alternatives used to alleviate the need to seek redress through the legal avenue. Over 30% of respondents believed arbitration / mediation was very important as part of the governance structure, with around 50% stating that it was important. Only 14% thought it was unnecessary.

The perceived benefit gained through arbitration / mediation was that it was a non adversarial solution - maintaining contractual



relationship (40%), followed by it being a predefined arbitration process that is agreed up

front by both parties (32%).

Bruce commented that "the legal document should sit in the bottom drawer and gather dust. I'm sure there is a role for arbitration / mediation. Things usually go wrong due to mismatched expectations, but when you are getting close to a legal dispute, I'm not sure mediation will help - it can help re-align expectations, but the relationship may have become so sour, that you will want to end it as soon as contractually possible. The British are not very good at

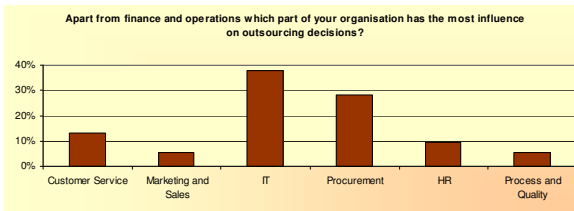


giving feedback - you really need to give real time feedback for the relationship to work over the longer term".

Professor Leslie commented "there is definitely a role for arbitration. You don't really want to get to legal disputes. Invariably what happens is that early on things are left unambiguous with a lack of clarity at the front end about pricing etc and you run into problems later. The answer is to get these solved at the early stage, rather than escalate too quickly. Anything is better than a legal dispute - it's hugely costly and damages people's reputations".

Wider scope of outsourcing decision makers

There are a number of stakeholders in the outsourcing process, yet the decision making has traditionally been limited predominately to the CEO and CFO. The survey indicated that IT and procurement were



two other key functions that influenced the outsourcing decision.

Professor Leslie commented *"traditionally it was just the CEO and CFO. Increasingly however outsourcing has a bearing on business strategy, so they should also be involved in the decisions. We have found that if its only made by the senior executives, they tend not to be good decisions, because they really need the experts from a specific field (IT, HR, Technology) to inform the decision - we have found empirically that a mixed band of decision makers, make better quality decisions in terms of the business outcomes from the*



outsourcing deal. Only including procurement can be dangerous, as they tend to busy themselves in the technicalities of procurement and can often lead to dysfunctional outsourcing if you're not very careful. The decision shouldn't just go to the power elite; it should be pushed to other parts of the organisation, rather than just being dictated by power structures. If the outsourcing deal touches upon the market and customers then you certainly need those voices in the decision making process".

In the public sector, as our senior procurement executive noted "there is no one decision maker, rather it's a series of collective recommendations, based on business requirements. The process is such that you constantly need to explain the approach, the business case, risks etc to a governance board all the way through the procurement process. As you would expect there is always a public relations angle to the evaluation and for big deals you need ministerial approval. Although the official answer would be that there is no difference between onshore and offshore vendors, the unofficial answer is that offshoring is not really an avenue that is worth the risks".

Contract lengths vary

Respondents indicated that contracts varied with minimum contract durations normally being one year (53%) or three years (29%). The maximum contract length also varied with five years being the dominant answer (44%), followed by three and ten years.

Our public sector procurement executive commented *"Contracts lengths need to be what ever is appropriate for the organisation and the work being considered. However, generally I don't think they are shortening. Clients whether public or private, want flexibility -*



continuity without commitment - always pushing for a shorter duration and the suppliers will always push back - that is the nature of the negotiations for hundreds of years".

Failure and contract termination all too common

Professor Leslie cautioned that "you need to be careful in the way you describe failure. Failure depends on the type of outsourcing and maturity of the client and the capability of the supplier. There are many factors that explain success /failure - the word failure is a blunt word - at what point do you say it's a failure?" A lot of surveys are perceptual studies - it depends on who you ask - you have a bunch of stakeholders and they will all have conflicting objectives for the same deal. Empirical academic studies have found that a third of the large-scale outsourcing deals are very often disappointing: a third have mixed outcomes and a third are relatively successful".

Professor Leslie suggested "I've seen people terminate a deal one year after signing when one senior executive leaves and another comes in and asks why the hell did they do that, and will terminate what ever the costs, without an economic or strategic rationale to it. It's a bloody affair to terminate and in a lot of cases organisations just go with the devil they know rather than go down the termination route".

Our senior public sector executive commented "in the public sector you terminate a contract when it catastrophically fails (doesn't deliver in a certain time and in a certain budget). Experience has shown that the deal may have been right, but some suppliers will do anything to win the deal and may actually lie about their capabilities. When you do your due diligence, it's extremely



difficult to uncover these until you start working with them - this is a big risk. Vendors assume because its public sector, they can submit a change control and request for further money 24 hours after signing a deal.

The public sector does not include the costs of re-integration into the original business case, because if you do, you are going into the deal negotiating with a view to failure. There is no actual way of including the costs of reintegration in the public sector - the treasury would not be too happy to see costs of reintegration included! There is no contingency for failure. To do so, would mean most outsourcing deals wouldn't get off the ground, and there would be a public outcry that it would be unfair, unethical and undermine the deal, as it would send the wrong signals to the vendor - that failure was in any way acceptable. Its not that the costs of re-integration are high, it is that the costs of not providing that service in the long term could be even more devastating".



Conclusion

Outsourcing has been gaining momentum in the last decade, with the emergence of more services, more company types engaging in and more destinations to choose for outsourcing. As Bruce noted *"outsourcing has become more interesting over time, but BPO investment has been around for many years. If you were to choose sub-sectors to invest your money, it is a good place to put your money, because you have contractual income, an industry where there will be growth over the long term. However, return on investment multiples are coming down and are becoming more realistic."*

There is no doubt the outsourcing industry is still learning and has yet to mature sufficiently for there to be a body of knowledge on what constitutes best practice - for a variety of firms.

Deciding what to outsource, where to outsource and identifying the right provider are simply the opening challenges. Making outsourcing happen provides further potential pitfalls - it calls for strong project, change and governance management skills that probably don't exist internally. Firms must start viewing outsourcing as a strategic partnership approach, utilising advisors to complement and enhance internal teams.

Challenging times will call for radical changes to business practice and business models.

Outsourcing 2.0 will require different business models, greater risk sharing, better management of SLAs / measurement systems and of the relationship itself - Is your company still a dinosaur when it comes to outsourcing?



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