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Outsourcing Trends and Concerns

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Outsourcing Trends and Concerns

Agenda for Today

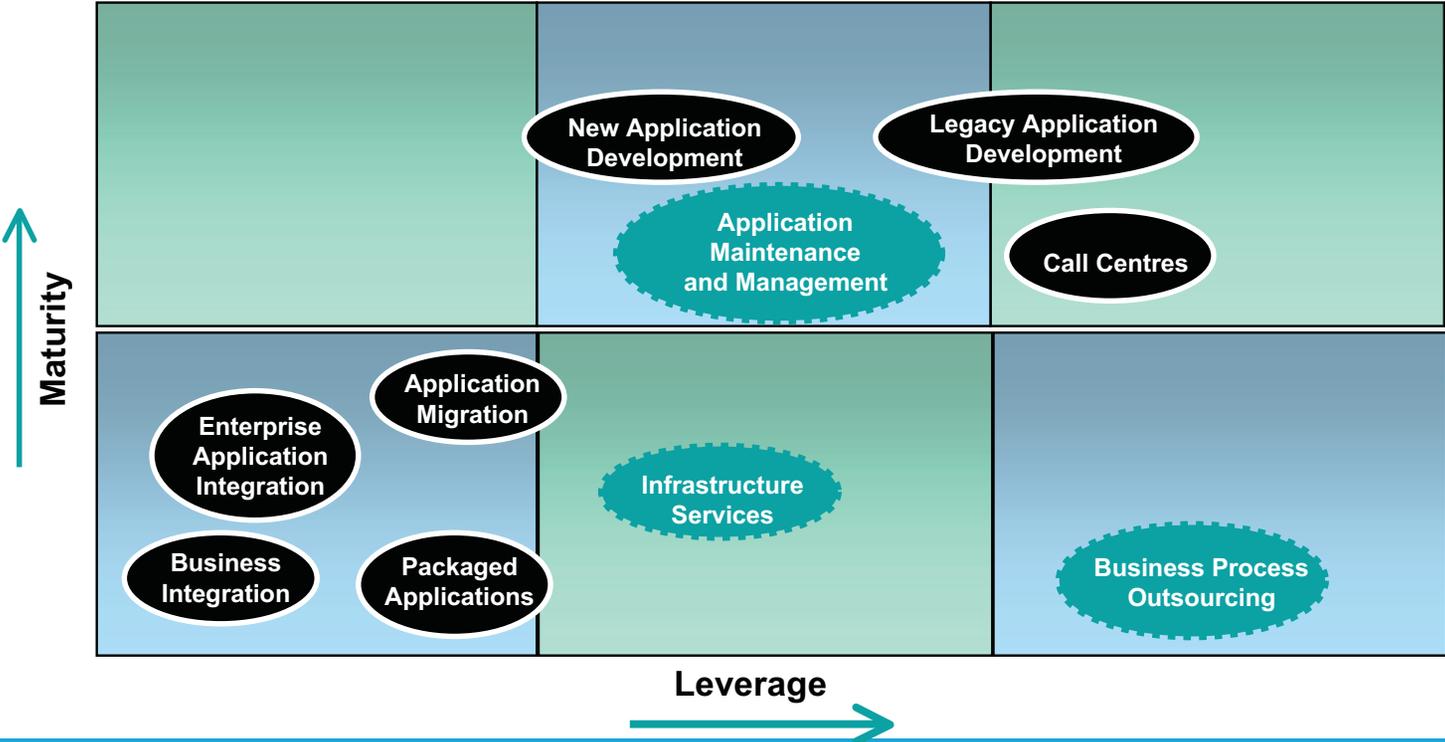
- Quick Definitions
- Business rationale for outsourcing and important considerations
- Outsourcing risks, concerns and controls
- Emerging Trends
- Ernst & Young's Outsourcing Service Offerings
- Some useful Appendices

Quick Definitions

- **Outsourcing**
 - refers to work contracted to an outside firm; offshoring is the shift of work abroad
- **Nearshoring**
 - Nearshore outsourcing or 'nearshoring' is outsourcing within nearby territory, accessible by short travel, or telephone in the same or neighboring time zone.
- Worth \$130 billion globally
- Examples:
 - **Backup and disaster recovery**
 - **Security monitoring**
 - **System development**
 - **Application Service Provision:** renting applications and related services over the Internet. Examples include email, payroll processing and ERP applications **e.g. www.salesforce.com**
 - **Business Process Outsourcing (BPO)**
outsourcing of back office and front office functions typically performed by white collar and clerical workers.
 - **Customer Products Retail and Distribution (CPRD)**

Trends in Outsourcing

-  Evolving areas of outsourcing
-  Traditional areas of outsourcing



Why Work with Third Parties?

Economies of Scale

Research has predicted that 2 million jobs will be outsourced from western economies by 2008 due to cost savings of up to 40%

Internal capacity constrained by increasing market demands

Competitive Advantage

Capital Investment

The desire to cut costs and minimize risk are both stimulating moves to outsource

Put simply, the cost benefits of setting up remote or shared service centres in the Philippines are enormous
- CyLynx

India is the king as far as outsourcing is concerned
- Suresh Senapathy, Wipro

Potential Cost Savings

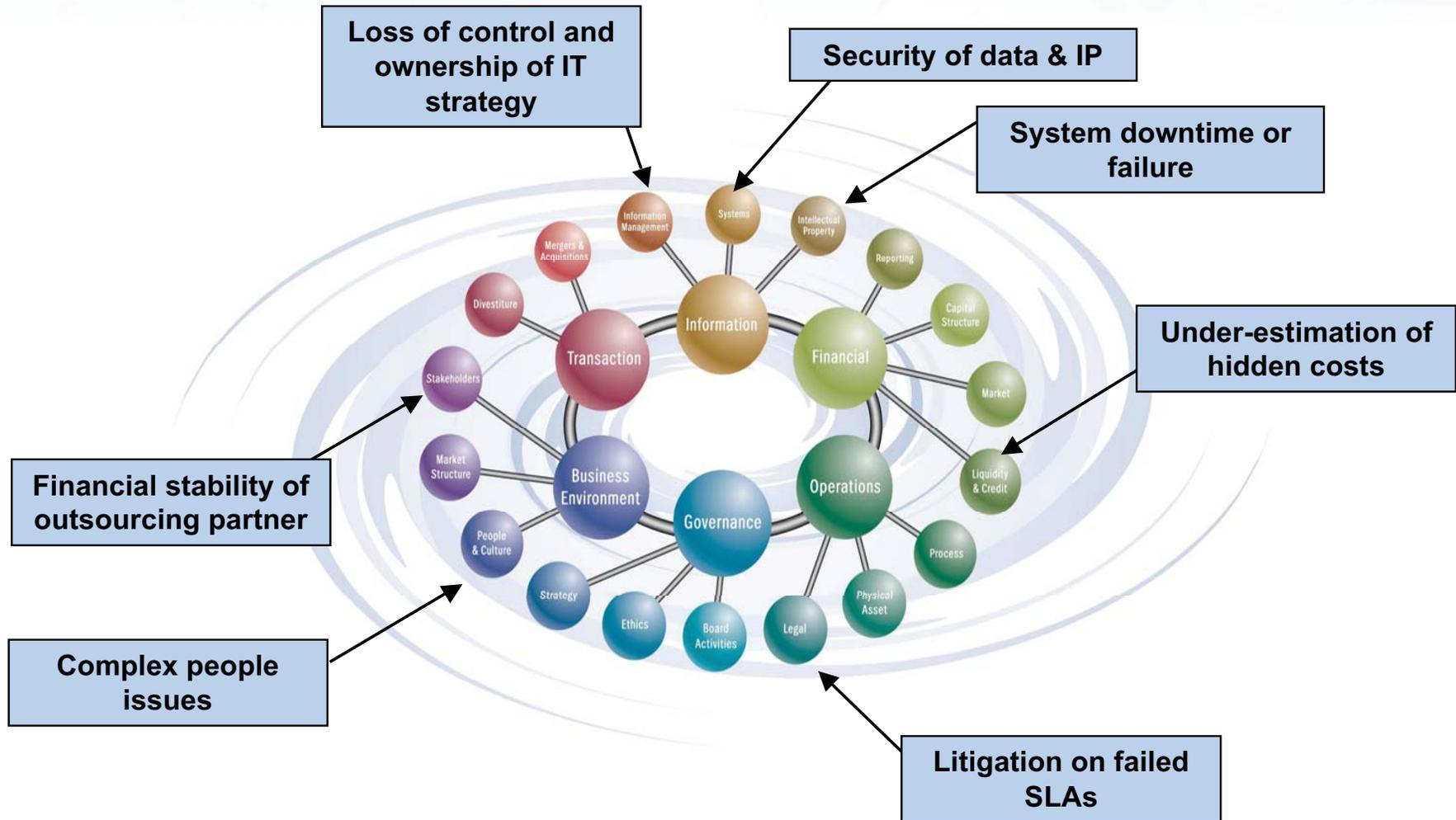
Better Quality Service

New regulations are forcing firms to outsource functions previously untouched

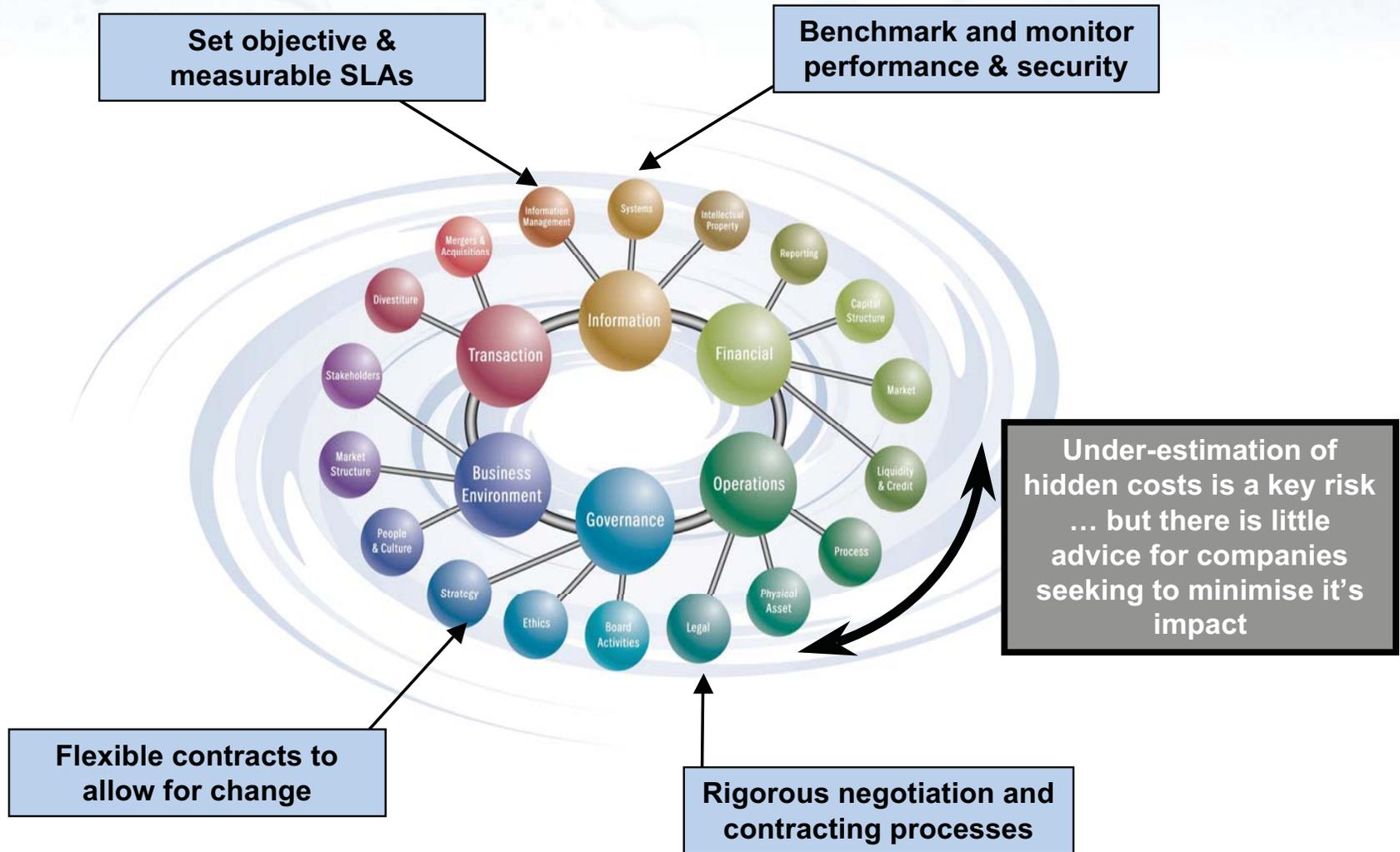
Access to Skills

**What are the risks faced by outsourcers
(and their clients)?**

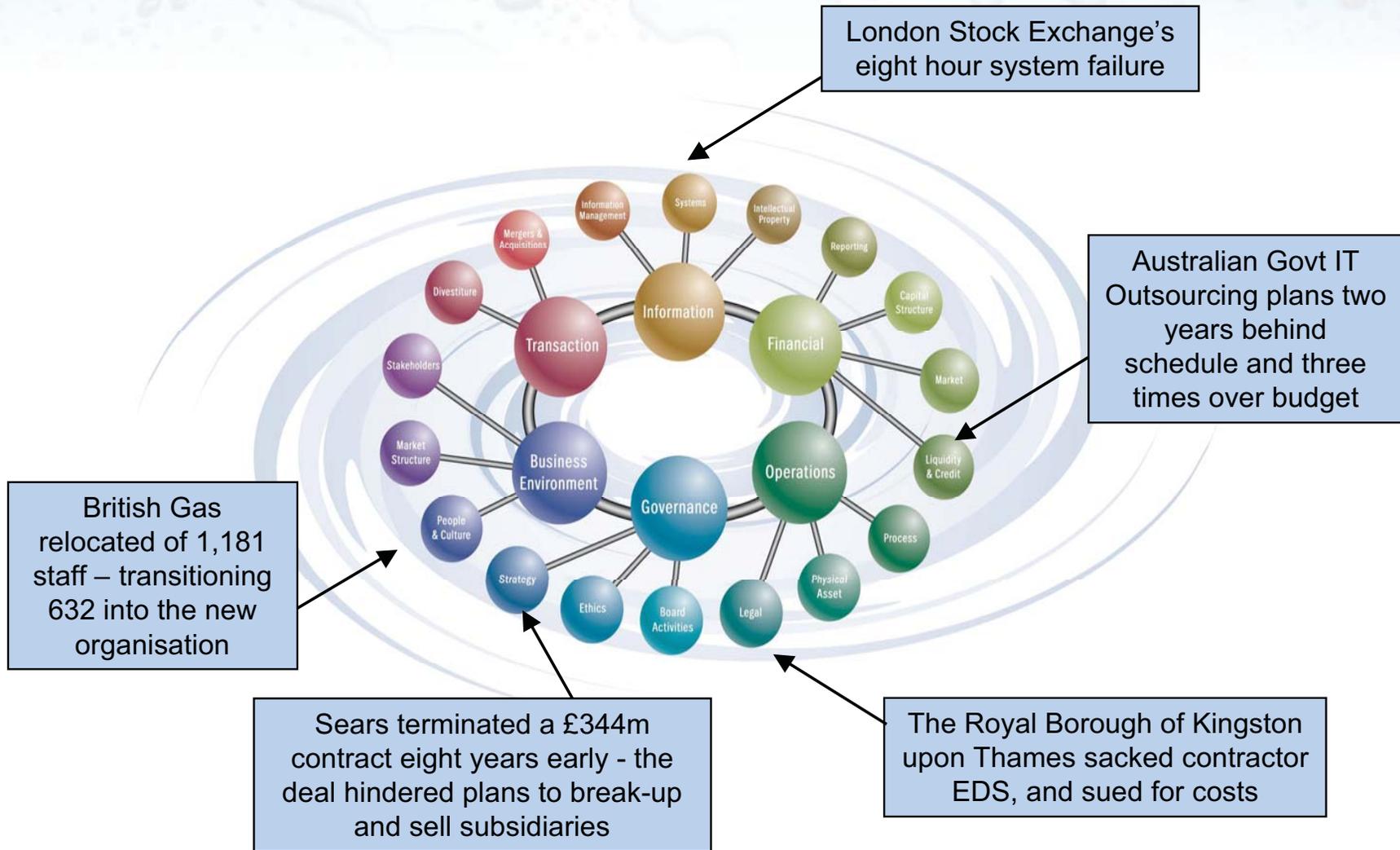
What are some of the key risk areas impacting outsourcers and their clients?



So how could the outsourcing clients respond?



So what are the key risk events that have taken place?



What are the Security Risks?

- Outsourcers must consider the risks and threats faced by any other organisation, particularly around their system security
- The EY security survey shows that 75% of organisations experienced unexpected unavailability of critical business systems.
 - 26% of respondents to the EY security survey attributed 3rd party suppliers as the cause of critical business failure.
 - Can outsourcers assure their clients that sufficient security and controls exist to minimise the risk to their organisations?
 - Does the security of their network expose their clients to excessive risk?
- Malicious damage from internal sources is increasingly problematic, particularly in the current economic climate as more employees are feeling insecure and dissatisfied – are there adequate logical access controls, segregation of duties and management of system change?
- Only 40% of organisations are confident that they would detect a systems attack.
- The range and complexity of viruses have increased dramatically, the risk to critical IT systems is becoming a key business concern.

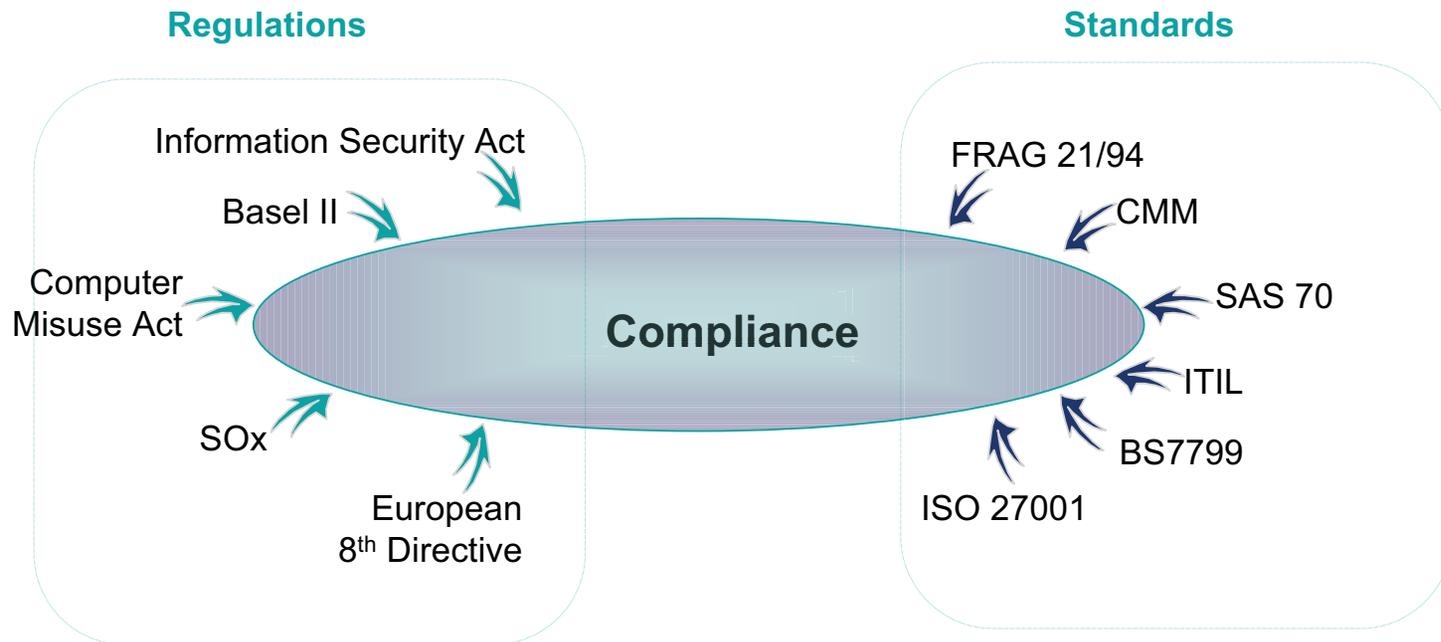
What are the costs being realised from security risks?

KEY RISK	AVERAGE COST \$USD (CSI/FBI)	SOLUTION
Financial Fraud	\$4,632,000 (Range \$1,000 – \$50,000,000)	Profiling & eDefense, ESM Diagnostic, Data Analysis & Forensics
Internal sabotage of data networks	\$541,000 (Range \$1,000 – \$10,000,000)	eSecurity Architecture, Profiling & eDefense, ERP Integrity
The loss of one or more critical business systems	\$297,000 (Range \$1,000 – \$50,000,000)	Continuity & Availability
Virus Incidents	\$283,000 (Range \$1,000 – \$9,000,000)	eSecurity Architecture, Profiling & eDefense
External system penetration	\$226,000 (Range \$1,000 – \$5,000,000)	eSecurity Architecture, Profiling & eDefense, ERP Integrity

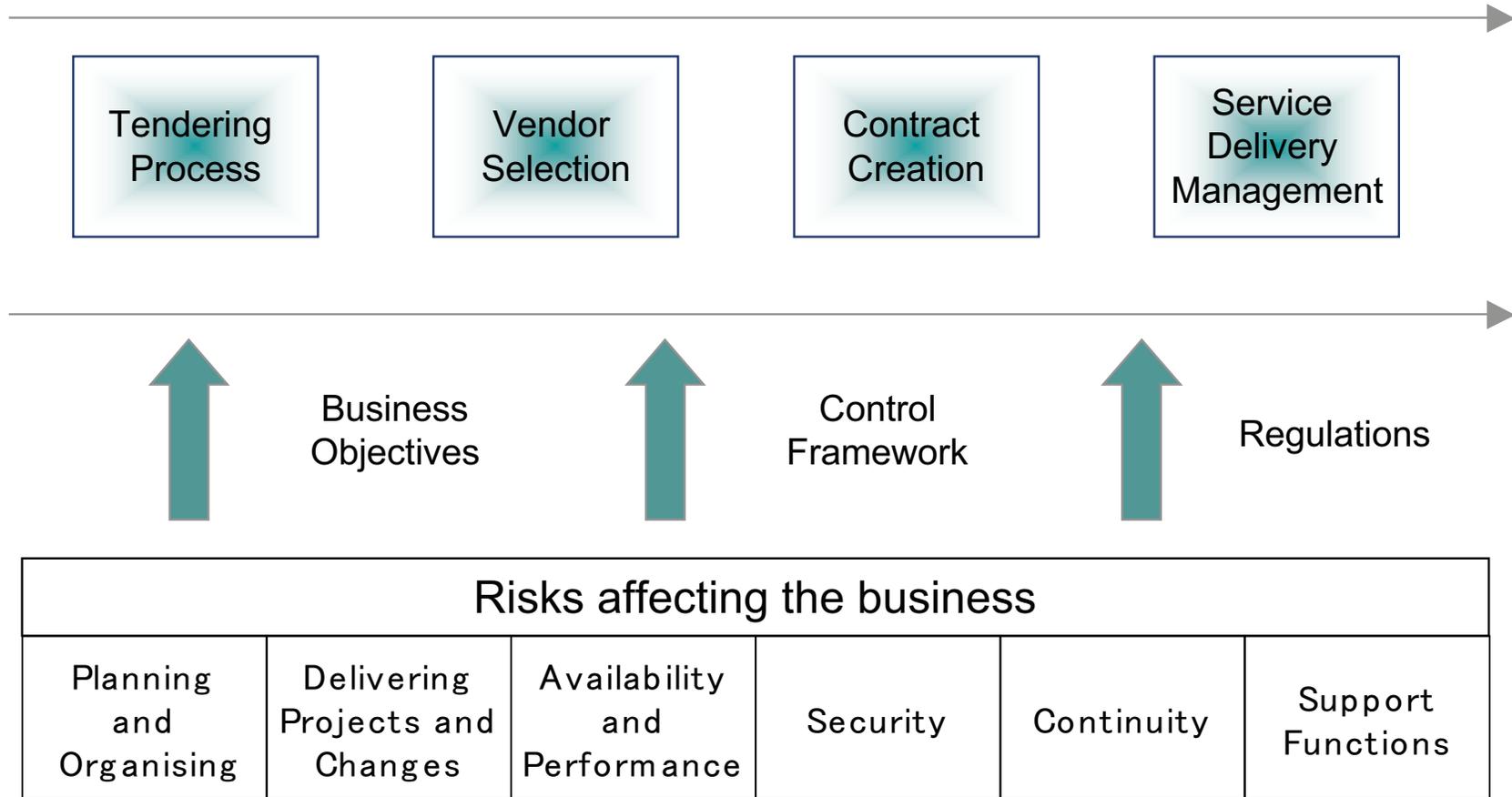
Managing outsourcing risks – challenges

- Understanding your own company's risk profile
- Managing the 3rd party relationship
 - Right to audit
 - Access to information
 - Culture / geographical factors
 - Managing confidentiality risk
 - Communication protocols (internal / external)
 - Cost and Timing
 - SLAs / KPIs
- Regulatory Compliance (FSA)
 - Impact Assessment
 - Systems and Controls
 - Vetting of the Supplier
 - The contract with the supplier
 - Contingency Planning

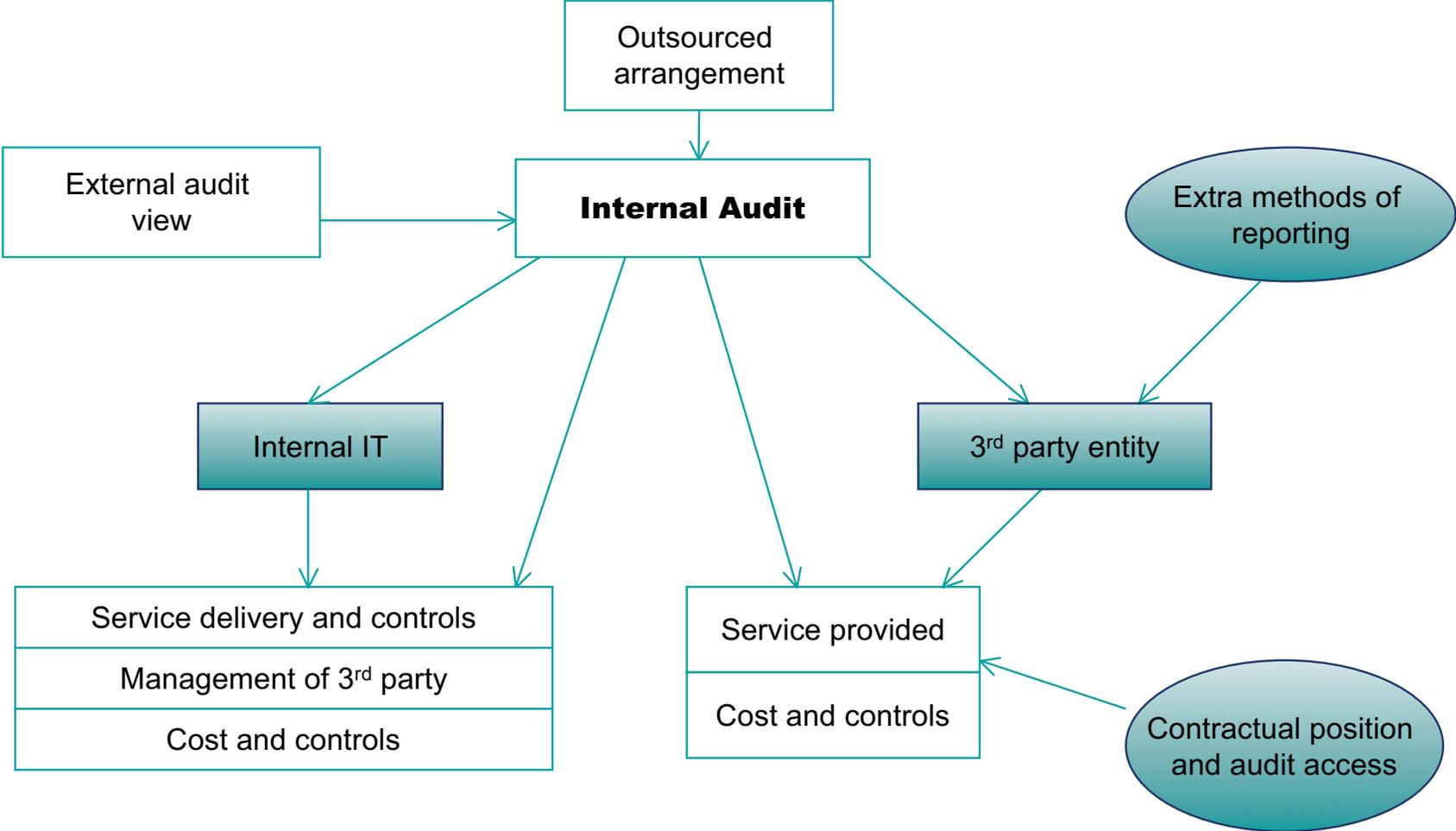
Regulations / Standards



Internal Audit Lifecycle of Outsourcing



Internal Audit within Outsourcing



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Emerging Trends

Globalization

- Increased competition: cities in China are overtaking their Indian counterparts as top destinations for offshore global delivery.
- Other players: Brazil, Russia, India, developing nations such as Egypt and Poland
- Driven by specialisation as smaller players seek to distinguish themselves in an increasingly crowded marketplace
- Offshoring is increasing in Africa and the Middle East, but political instability poses ongoing challenges there
- Nearshoring trends: British companies are now moving to Malta, EU companies are moving to old-communist Europe countries
- Labour arbitrage is out; “intellectual arbitrage” is in

Person-to-person (P2P) offshoring

- Redeployments of a much smaller scale; small businesses and even homes
- Examples of services outsourced in this way include
 - online tutoring,
 - Web and software development, and
 - writing and translation services. Customers for these services can be small businesses or even individual consumers.
- ‘Evaluserve’ says revenue for this sector stood at more than \$250 million between April 2006 and March 2007, and it predicts that the value of the P2P offshoring market will rise to more than \$2 billion by 2015

Virtual Worlds

- The rise of virtual worlds such as *Second Life* is making it easier for companies to justify hiring offshore workers for tasks that may include building virtual offices or even working as virtual-world "meeters and greeters."
- Over the longer term, customer contact jobs, including those for help desk and call center services--could migrate into virtual worlds, where customers can be both informed and entertained.



Consolidation

- Competition for outsourcing contracts is more cut-throat than ever, with a huge expansion in the number of suppliers, hence some significant consolidation.
- Industry experts are predicting more merger-and-acquisition activity in this sector over the next year or two.



Cecil Rhodes
"all of these stars... these vast worlds that remain out of reach. If I could, I would annex other planets"

Multisourcing

- Multi-vendor approach, incorporating the services of several best-of-breed vendors to meet IT demands; bringing together a cadre of competing outsourcers to work together.
- Managing the problems:
 - dedicated staff oversee each vendor relationship and establish regular reviews of vendor performance
 - as part of the contracts, vendors should cooperate and refrain from blaming each other
 - qualified staff with financial as well as technical skills track all outsourcing agreements.

Insourcing

- Delegation of operations or jobs from production within a business to an internal (but 'stand-alone') entity (such as a subcontractor) that specialises in that operation.
- A business decision that is often made to maintain control of certain critical production or competencies.
- Includes transferring jobs to within the country where the term is used, either by hiring local subcontractors or building a facility e.g. foreign companies locating facilities in the United States and employing U.S. workers.
 - Nike insources order processing, packaging and delivery to UPS (so Nike concentrates on designing gear),
 - Toshiba insources laptop repairs to trained UPS staff (hence faulty parts can be repaired locally by UPS staff, resulting in significant time savings)

The Kenyan Scenario

The near future

- The East African Marine Systems (TEAMS) undersea cable connecting to UAE to commence in 2008

The current situation

- Advantages: High literacy levels, clear English accents
- Infrastructural hurdles: outdated satellite system

On call centre offshoring: *'No matter how clear the Kenyan accent, the irritation of an echo on the line is bad for business'.*

Kenya wants to grab piece of outsourcing pie. July 07. Zdnet

Some advice

- Don't make any steps toward transitioning the work to the outsourcer whilst in negotiations; you will be handing over more power over the negotiating process to the provider.
- **There are 'hidden costs'**: Depending on what is outsourced and to whom, studies show that an organisation may end up spending 10 percent above that figure to set up the deal and manage it over the long haul. That figure goes up exponentially—anywhere from 15 to 65 percent—when the work is sent offshore. These include:
 - the cost of benchmarking and analysis to determine if outsourcing is the right choice,
 - the cost of investigating and selecting a vendor,
 - the cost of transitioning work and knowledge to the outsourcer,
 - the costs devolving from possible layoffs and their associated HR issues, and ongoing staffing and management of the outsourcing relationship.

And if it doesn't work

- Causes:
 - no good business case for it in the first place, or
 - the business environment changed.

- Options
 - renegotiate and reorganise contracts and relationships,
 - Backsourcing (bringing an outsourced service back in-house) .

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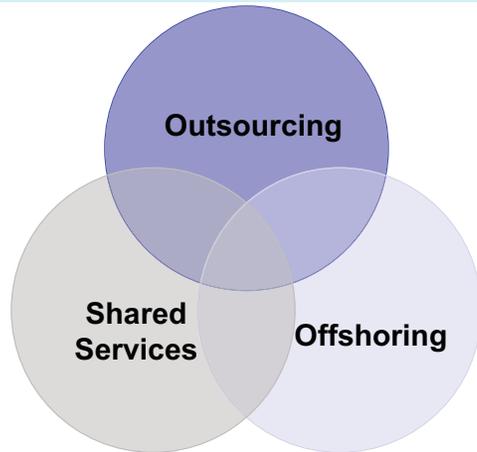
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What is Ernst & Young doing?

Our integrated outsourcing advisory services



We design as well as execute change across all or any of the phases of a project



Offshoring; outsourcing and shared services or a combination of all or any

A range of services are offered



We bring a powerful set of integrated technical advice designed specifically to assist our clients deliver sustained value from their initiatives

Outsourcing – Service offerings

Develop the strategy for outsourcing

- Define the high level target operating model around: Organisation Structure, Processes, Policies, Service Model, Data Models, Systems landscape
- Define high level implementation approach

Process & systems review

- Recommend and implement system and process changes that result in process standardisation, effectiveness and efficiencies
- Benchmarking studies

Post-Implementation

- Business Case benefits review
- Quality assurance review

Implementation

- Project manage: Plan, manage, monitor, co-ordinate
- Execute: hands on delivery
- Program / project assurance services



Design

- Future state processes leveraging and aligning to new (or legacy) system functionality
- New organisation design and supporting HR processes, procedures, skills and knowledge requirements,
- Development of SLAs
- Tax strategy and transfer pricing planning
- Location study and real estate advisory

Questions?

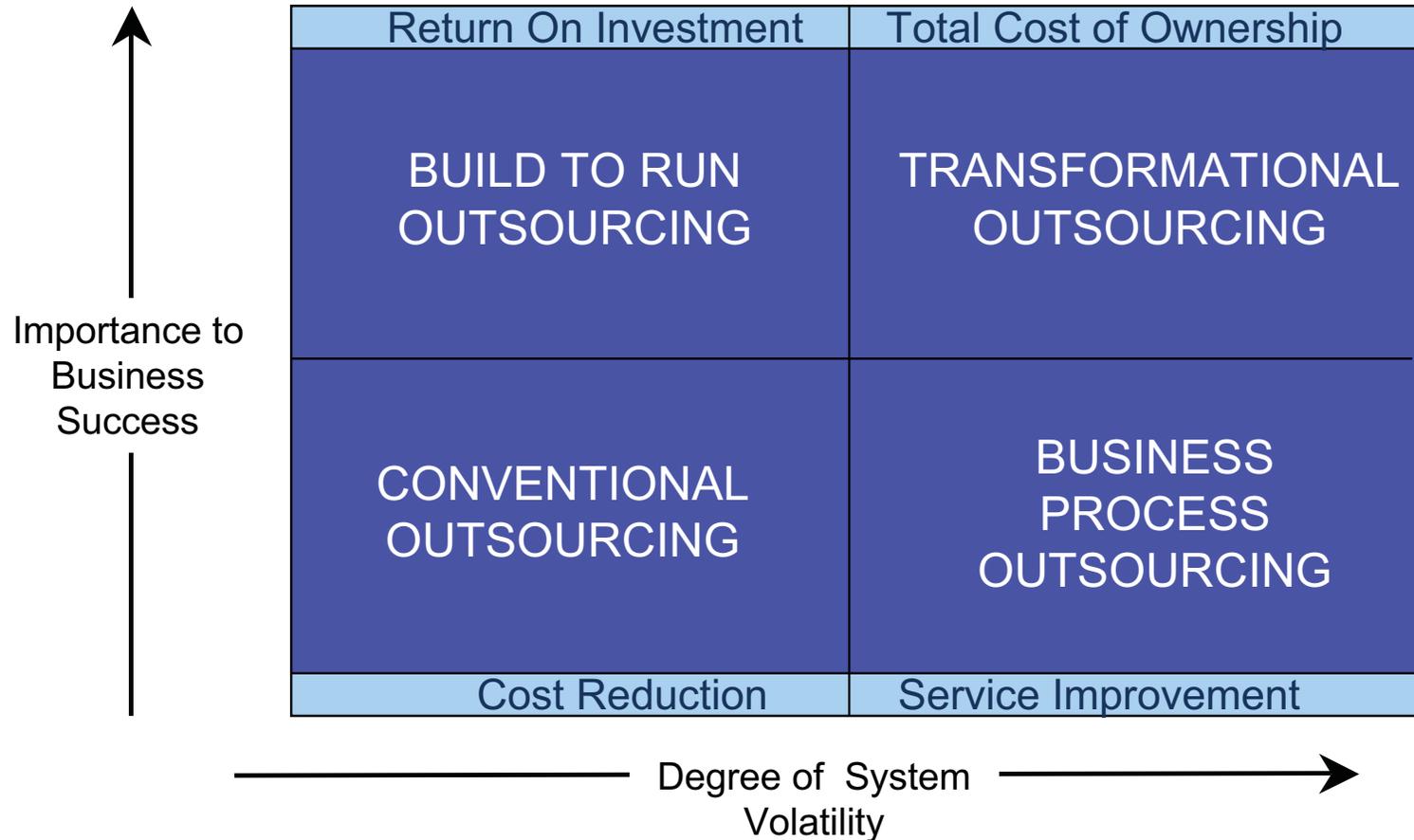
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Appendices

Typical Outsourcing Options and Business Drivers



Outsourcing - strategic consideration in the quest for operational efficiency

Benefits	Description
Skill enhancement/ Addressing skills gap	<ul style="list-style-type: none">• Extending from a choice of skills within the country to exploring a global market to source skills from the specialist locations
Reduced time to market	<ul style="list-style-type: none">• Using the time differential across locations to enable multiple shifts across locations to provide 24 Hour work day
Regulatory benefits	<ul style="list-style-type: none">• Using tax and regulatory benefits across locations to further reduce fixed costs e.g. utilising a more flexible wage policy
Consolidation opportunities	<ul style="list-style-type: none">• Reducing unit cost through consolidating volumes across businesses and across countries
Re-engineering related opportunities	<ul style="list-style-type: none">• Off-shoring involves a review of the base systems and in most cases results in re-engineering activities by the off-shore vendor
Quality improvement	<ul style="list-style-type: none">• Using the vendor experience and maturity in processes to improve quality of delivery
Normalizing Demand	<ul style="list-style-type: none">• Using off-shore vendors to deal with peak periods of demand while avoiding hiring personnel that will not be needed later
Focus on Core Capabilities	<ul style="list-style-type: none">• Using vendor to manage non-strategic activities frees up the management bandwidth to focus on core strategic imperatives
Technology enhancement	<ul style="list-style-type: none">• Using superior vendor skills on keeping pace with the latest technologies

Key success factors for outsourcing

Key Success Factors for Outsourcing		
1	Strategic Focus	Ensure that the outsourcing initiative aligns with the overall business strategy and the vision for support services.
2	Compelling business case	Define your baseline costs and current service levels accurately so you can target and measure the success of your outsourcing.
3	Management Commitment	Obtain senior management commitment before you even think about starting implementation, keep the mandate throughout the migration for successful achievement of targeted results.
4	Implementation Strategy	Consolidate processes first and then adopt reengineering.
5	Service Delivery Model	Determine the role, scope and the split between the in-house and out-source with care. Identify the best operational model – captive, third party or hybrid – and support it by a relentless focus on customer service.
6	Leadership	Appoint a leader with entrepreneurial flair who will run it like a business with strong salesmanship and solid operational focus.
7	Risk Management	Evaluate locations with care, develop a comprehensive view on all operational and strategic risks and ensure the right governance structures.
8	Transformation Management	Outsourcing is a major business transformation and will radically change support services in scope - consider how to support and influence people whose jobs will be impacted.

The Fundamental Questions

When to outsource?

What to outsource?

How to outsource?

Stakeholders

- Market size and forecast growth for IT, applications and business process outsourcing services
- Local society/media reaction
- Legal implications
- How will the relationship with stakeholders be managed?
- Will this lead to redundancies?
- What will be the long-term impact result?
- What happens if the initiative fails?
- Will there be any change in the processes?
- Is the management doing it the right way? Are the benefits captured to the maximum extent possible?
- How is the transition planned?

Management

- Market dynamics and strategies
- What is the right time
- What will govern the strategy?
- Organisation structure change
- How business functions relate to off-shore partner?
- What should I keep in-house and what should I off-shore?
- Management control
- Identify the offshorable components
- Prioritisation
- Stakeholders' support
- What is the tiering model to off-shore?
- What engagement model?
- Measurement of performance
- Costs
- Mitigation steps to address risks

Employees

- When do I need to get involved in the off-shoring initiative?
- How will off-shoring impact me?
- What is required from my end to support the initiative?
- How do I collect the data necessary for deciding on off-shoring?
- Will the resources from off-shore partner understand our language and context?
- How do I conduct the knowledge transfer?

Some key risk areas and responses

Key area	Risks	Possible Industry Response	Major Risk Events
Systems	<ul style="list-style-type: none"> • Reliability & financial stability of outsourcing partner • Downtime and failure of systems • Persistent failure to meet SLAs • Data security 	<ul style="list-style-type: none"> • Rigorous negotiation and contracting processes • SLAs should be measurable and objective with penalties for non-compliance • Benchmarking and monitoring 	<ul style="list-style-type: none"> • London Stock Exchange stopped trading for eight hours as a result of technical failure after outsourcing IT • After benefits claims systems, outsourced by the London Borough of Southwark the % of claims processed within government guidelines fell from 97% to just 5%
Costs	<ul style="list-style-type: none"> • Hidden costs – underestimation of set up, redeployment, running and management costs • Time spent negotiating complex agreements • Litigation when SLAs are breached 	<ul style="list-style-type: none"> • Ensure that assets are identified properly prior to outsourcing • Dedicate time and resources to outsourcing contract management • Beware of overestimation of benefits and underestimation of costs 	<ul style="list-style-type: none"> • The National Audit Office of Australia found that the governments plans to outsource IT were two years behind schedule and three times over budget • The Royal Borough of Kingston upon Thames sacked contractor EDS three years into a six-year outsourcing contract and are now having to sue for costs
Strategy	<ul style="list-style-type: none"> • Divergence of IT strategy & day to day systems management • Less ability to respond quickly to strategic change • Control over knowledge & intellectual property 	<ul style="list-style-type: none"> • Build flexibility into contracts at an early stage 	<ul style="list-style-type: none"> • Sears terminated a £344m contract eight years early as the deal proved a hindrance to its plans to break-up and sell subsidiaries
People	<ul style="list-style-type: none"> • Skills – does the outsourcer have the correct specialist skills? • Culture – will new IT staff adopt the culture of the organisation? • HR time and processes as staff transition 	<ul style="list-style-type: none"> • Skills audit of potential bidders • Retain the correct internal staff to ensure continuity 	<ul style="list-style-type: none"> • British Gas's outsourcing contract involved the relocation of 1,181 staff. 35% opted for redundancy, but 632 people had to be transitioned into the outsourcers organisation

Advantage India

Outsourcing successes in India are not just about cost savings...

Peak work-load management	<i>India resources used to process peak period transactions</i>	Undertaking hitherto uneconomical activities	<i>Given lower cost thresholds, certain labor activities become economically viable in an India based delivery model. For instance, reconciliations</i>
Offshoring existing outsourcing work	<i>Work that is currently outsourced has sometimes been offshored first given relatively fewer change management issues</i>	Cost Reduction	<i>Replacing overseas team with Indian resources</i>
Cost Effective Expansion	<i>Using India for team expansion purposes without reducing existing team</i>	Skills Availability	<i>Using India as a delivery base to fill resource availability / quality gaps in other regions</i>
Capacity Release	<i>Work transferred to India to enable existing overseas team to focus on higher value activities</i>	One-off projects	<i>One off projects such as reconciliations, report preparation, delivered out of India</i>

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