Emerging Trends: Global Sourcing

The Big Questions: January 2008

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by Tim Wright

Q&A

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Tim Wright is managing partner of Pillsbury's London office, where he focuses on outsourcing, offshoring and other complex sourcing projects. He was a key member of the Pillsbury team which advised the Inland Revenue on the ASPIRE project, a hugely complex second-generation IT outsourcing agreement.

Q: Should the economy slow dramatically in the UK and globally, what would the implications be for the outsourcing industry world-wide? Some U.S. commentators believe that America has already entered recession...

Wright: Companies will look to reduce costs in all areas of their business, and decreased cost will become one of the major drivers for outsourcing, displacing other drivers, such as service improvement and quality, to some degree. In addition, we expect, in business transformation outsourcing, some movement away from the high up-front investments seen in some deals recently, with customers looking to smooth significant transformation charges over the life of the deal.

Q: In which areas might this occur?

Wright: Sectors to watch include financial services, which is more strongly affected by losses resulting from the credit crunch, and we can expect to see an even greater degree of offshoring as companies attempt to reduce costs further. On the supplier side, a slowdown could drive increased M&A activity with divestment by providers of under-performing business units, and further consolidation by the more aggressive players who see the opportunity to buy increased market share.

Q: We're starting to see lay-offs in some multinationals. It seems inevitable that many client companies may outsource 'in anger', as it were, to slash costs in non-core areas, rather than strategically as part of a considered and strategic business plan. Can this in any way be a good thing, and what might the risks be of short-termism?

Wright: Clearly any 'knee-jerk' outsourcing reaction is not advisable. Companies risk losing control of non-core services and, where cost is the driving force, there may be a potential degradation in service quality. Inevitably, companies will seek to change to a variable cost model to enable them to match costs with business volumes. In cost-driven deals, customers still need to focus on compliance issues, such as ensuring adequate security of customer data, as well as paying careful attention to the ongoing (and sometimes hidden) management costs entailed by outsourcing.

Q: On a more positive note, what does your firm believe the real growth areas for outsourcing will be in 2008?—First, in terms of vertical sectors, and, second, in terms of discipline or business function (e.g., BPO, HR, CRM and so on)?

Wright: The financial services sector was the focus for the mega-deal in 2007—for example, Royal & Sun Alliance, Prudential, Resolution and Co-operative Financial Services—and this is expected to continue in 2008, as evidenced by Marsh's outsourcing of its back office support systems to Capita in a £200 million deal this month.

Sector-specific BPO (such as insurance administration) will increase as the market matures and companies become more confident with providers. BPO and IT outsourcing will continue to grow as companies look to cut costs and move more services offshore, and all types of outsourcing are set to increase due to the marked return of cost pressures in 2008 as the most significant outsourcing driver.

The sub-prime credit crunch and other factors of globalisation, such as currency movements and relentless increases in energy and other fixed costs, come increasingly into play. In addition, the life sciences industry will see more outsourcing in 2008 as it focuses on reducing expenses to maintain expansion.

Q: With all this in mind, are there any indicators of what the next 'hot' offshore destination might be?

Wright: India is likely to continue as the destination of choice for BPO, due to the English-speaking population—although rising currency and increasing wage and real estate costs will make other countries attractive offshore destinations. China will continue to grow, although the lack of an intellectual property protection framework is still a concern. Vietnam could be popular as a cheaper destination with 9,000 new IT graduates entering the labour market each year, and Singapore has strong intellectual property protection and has made significant investment in creating a large biotech presence. In addition, Egypt is actively promoting itself as an offshore service location for BPO services. However, its proximity to the Middle East may deter some companies.

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