

# DESERT ISLAND RISKS?

The 'offshoring' of IT services to Asian and eastern European economies has enjoyed a steep and sustained growth curve in recent years, but can the good times continue to roll amid changing commercial priorities and economic volatility?

Like Marmite, Jeremy Clarkson, and the last Indiana Jones film, the concept of IT and Business Process offshoring tends to somewhat polarise popular opinion. You either love it or you hate it. And the camp into which you fall depends largely on your point of view.

The horrid, spirit-sucking, soul-crushing, rather-eat-your-own-flesh-than-ever-go-through-it-again nightmare of dealing with your high street bank's foreign call centre offers one, albeit restricted, perspective. The undoubted commercial allure of cheap, flexible, skilled, and cost- and efficiency-effective external infrastructure and resource provides quite another.

While both pigeonholes have their appeal, the fact is that neither makes any odds in the real world – where the offshoring bandwagon hit top gear years ago and has been steadily gaining pace and momentum ever since.

They do however, add some spice to the question of how the sector might cope now that, for the first time in its short history, it has hit some serious traffic – to wit, the worldwide economic downturn. Will the juggernaut find an alternative route, go cross-country and somehow manage to maintain course and speed, or will it become just another victim of the global economic tailbacks?

India, for instance, has been the offshoring sector's dominant player for several years now. But how will it fare as firms err towards alternative outsourcing locations and strategies like nearshoring? Will its customers try to negate the logistical and empathic issues associated with far-off offshoring centres by replacing them with alternatives in closer geographical proximity? And if so to what extent? ↪



Overall, the global recession will accelerate the adoption of outsourcing and offshoring as strategic business tools, says Stan Lepeak, MD of Global Research for sourcing advisory firm EquaTerra, particularly as organisations respond to economic adversity with a forceful push toward cost-reduction. There will however, be casualties.

To start with, he says, while EquaTerra expects India to remain the top-ranked offshore destination for the near term, the face of the country's offshoring sector could undergo a pronounced shift.

"In light of recent terrorist attacks and financial scandal (in India), wary buyers may shift more work to larger, more established Indian firms and away from second-tier players, while first-time buyers may want the added assurance of offshoring with top-tier western-based firms with extensive Indian operations. As such, we anticipate heightened scrutiny and greater safeguards being built into new and existing contracts – but with India retaining its lead in the near future due to its many advantages, including language, talent and experience."

From a wider perspective, the company sees globalisation continuing to act as an offshoring accelerant, but that the pace will slacken. "Numerous factors, including the severe global economic downturn, repeated product health and safety scares related to Chinese goods, a collapse of commodity prices (which is critical to supporting many emerging market economies) and the election of a new US administration concerned with the loss of domestic jobs, will slow globalisation and one of its key manifestations – the global sourcing of services."

Accordingly, says EquaTerra, there will be a "reassessment" of outsourcing strategies and destinations as buyers shift their focus to cost reduction and cost avoidance, with firms carefully analysing current and future outsourcing efforts (and partners) to ensure services are being sourced from the most cost-effective locations.

What is termed "the compelling business benefits of global sourcing – especially in tough economic times" will continue to drive growth however.

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Further influencing issues are predicted to include volatility in foreign exchange markets, a factor which Lepeak believes outsourcing buyers (and sellers) must become more effective at hedging against. The seesawing values of the dollar and sterling as well as other key world currencies will make calculating the true costs of offshoring much more complicated, "...challenging buyers and service providers to plan for and project longer-term pricing, cost and profitability levels."

Salary levels in offshoring markets will likely be another important fiscal driver, with wage inflation abating, at least temporarily, to help outsourcing destinations remain competitive as "western markets pause to digest events and determine go-forward strategy" leading to a temporary slow-down in demand for offshoring services.

## OFFSHORING TRENDS

Key findings from the Q4 2008 Business Process Outsourcing (BPO) and IT Outsourcing (ITO) Pulse survey from EquaTerra:

- **Demand for BPO/ITO and other outsourcing services dipped by 5% quarter-on-quarter in Q408.** EquaTerra's advisors in the Americas – where the severity of the economic crisis has been felt earlier and in which organisations are further into the downturn – were more likely to cite increased demand for outsourcing than those working in Europe.
- **Projections for Q109 demand up –** 53% of the service providers polled expect an increase in demand next quarter, up 14% from Q308.
- **Public sector a bright spot –** Demand in government and the public sector remains strong for IT outsourcing, back-office process improvements and support for deploying shared services. But service providers are also winning contracts for training, operational support and supply chain management.
- **Buyer's market developing –** The deteriorating economy has a positive side for organisations seeking to expand their scale/scope of work. Outsourcing service providers feeling the impact of the downturn are focused on increasing market share by expanding existing accounts, providing savvy buyers the opportunity to use the downturn to make great strides toward transforming their business, accomplishing more, faster and with fewer resources.
- **Emerging markets –** Service providers financially able to expand into new market niches will find increased opportunities with global pharmaceuticals, particularly in research and development, financial analytics, document services, facilities and real estate management and logistics services

All in all then, the next year or so will be a critical time for both offshore and nearshore players, says Kate Craig-Wood, MD of UK-based hosting company, Memset. Indeed, she believes that current economic uncertainty could be a blessing in disguise for outsourcing concerns based nearer to home.

"The offshore hosting of IT resource is not a viable option for (most) companies since 1) there are latency issues if you have to connect to another country via the Internet and 2) there are data protection issues with shipping data across national boundaries. Additionally, in the current climate, the previous cost savings that could have been had have now been eliminated by the weakness of the pound."

This, says Craig-Wood, is leading to rapid growth in UK-based outsourcing; Memset, for instance, has seen growth of more than 800% over the last 5 years, putting it among the Deloitte UK Technology Fast 50, and its continued growth even in the recession bears out Equaterra's earlier analysis.

But what about local factors? What specifically has changed locally to drive home offshoring markets forward? Mainly, she says, the growing collective reliance on large amounts of computer resource for everything from data storage to enterprise resource management, combined with dramatic improvements in the efficiency of large datacentres.

Craig-Wood also cites developments such as virtualisation – which enhance operational efficiency, but are somewhat complex and need a competent IT team to manage and maintain – as further key factors in the increase in the popularity of nearshoring.

This putative surge in the attractiveness of nearshoring and 'home' outsourcing may also though, suggest Equaterra, be thanks to the continuing evolution of the outsourcing business model itself.

It suggests, for instance, that buyers will continue to shift away from project-based contract offshoring labour in favour of longer term, more formal outsourcing relationships.

"By committing to longer term and larger scale deals, buyers can get better pricing from service providers, better levels of service, and lock-in longer term cost savings strategies."

There is also set to be a move towards much more flexible offshore service delivery models as businesses wise up and seek to acquire the in-house skills they need to manage their sourcing more successfully, says Lepeak.

"As buyers gain outsourcing/offshoring management experience, they will seek greater flexibility in service delivery models to fit form to function and tasks. The result will be a mix of domestic, nearshore, and offshore shared services and captive centres and other outsourcing efforts that will evolve with the marketplace. Organisations will also place greater emphasis on defining, acquiring, and transferring skills needed to successfully govern outsourcing/offshoring efforts."

Whatever the near and long term future holds then, it is sure to be complex, and that means some steep learning curves for buyers and providers alike. Love it or hate it though, offshoring is there – and here – to stay. ■

## iQ Insights: OFFSHORING

[FEATURE]

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