HRO TODAY Offshore BPO Supplement

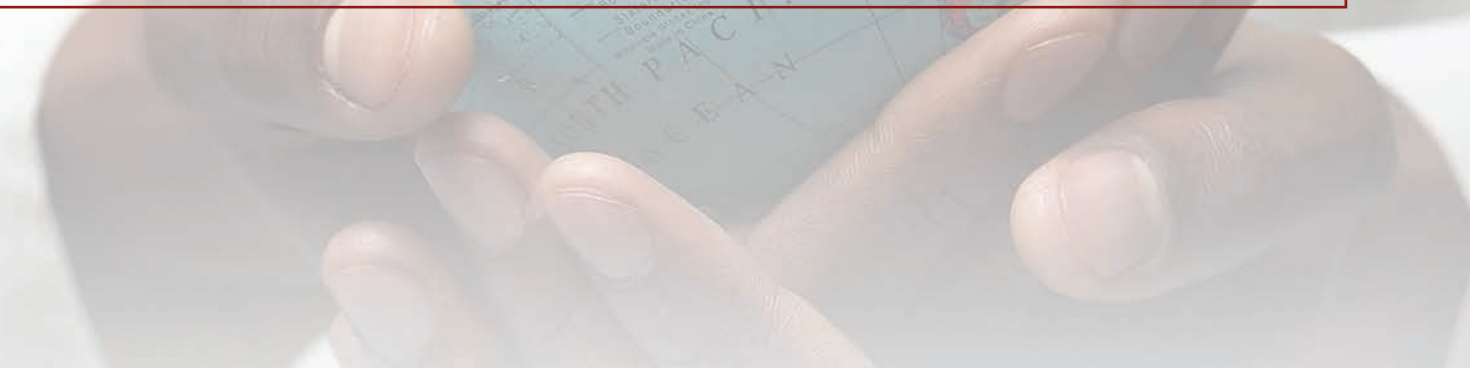
INSIDE THE SUPPLEMENT

Perhaps no single word is more synonymous with outsourcing than offshore. And yet this pairing is often misapplied, especially in a few emerging BPO areas such as HR. The percentage of BPO services that is being shifted to offshore service providers remains small, albeit growing.

Market penetration aside, the offshoring of services is still one of the most least understood methods of outsourcing, especially considering the complexities surrounding compliance, liability, security, costs, geographies, and myriad other issues. Although the common perception is that transferring services to overseas facilities can produce big savings, that's not always the case if the arrangement isn't constructed and executed well.

Where should you consider offshoring? How can you tell if the savings are worth the risks? What are the dangers of moving services to a different country, where privacy laws may be different from those in the U.S.? How can you maximize the savings? These and other pressing questions should be weighed carefully before you incorporate an offshore strategy.

This special offshore BPO supplement provides the answers to these and other questions you might have as you consider moving services to another market. You'll get the expert perspective from some of the industry's most astute authorities on offshore services and learn what it took them hundreds of thousands of air miles to garner—a truly first-hand comprehension of the offshore outsourcing market. Enjoy.



Managing Legal and Operational Risks in Offshore Outsourcing Deals

The potential for liability is great, but with the right risk strategy in place, offshoring can be managed as easily as domestic outsourcing.

By Bill Bierce

Childhood fable "The Wizard of Oz" recounts the cultural and aspirational surprises that Dorothy encounters after a tornado sweeps up her house. Similarly, the management of legal and operational risks in offshore outsourcing requires a 360-degree view well before the tornado takes the house. The lesson is that the steady state is only temporary and that offshore outsourcing is a permanent Land of Oz.

The offshore outsourcing strategy fits within a broad sourcing strategy that enables rapid scaling of some standardized processes in HR administration, financial administration, information technology, and other operations; accelerates time to market; standardizes functions; reduce costs; and share or shift risks. Outsourcing should not be used for tasks that are truly innovative and create core competencies for the enterprise. Rather, outsourcing should be used to support the internal resources that provide the engine for innovation and competitive advantage.

Like Dorothy's travels through Oz, key differences in the business, cultural, economic, and legal environments need to be identified when offshoring. These differences will evolve from when outsourced operations begin. Thus, careful planning and management are required of enterprise employees who must define, mitigate, shift, and manage the operational risks arising from such differences. Over time, managing these changes will require resources by both parties. Offshoring requires continuing vigilance to shifts in the ground rules, and Table 1 examines the unique requirements in managing global BPO services.

UNIQUE RISKS FOR GLOBAL SERVICES

Legal and operational risks fall into a few categories based on the relevant constituency whose legal and business interests are affected by the enterprise's operations. These include suppliers, licensors, customers, government regulators and enforcement agencies, shareholders, employees, retirees, lenders, joint venturers, and other special interests (environmentalists, unions, and consumer groups).

Within the enterprise, such risks are mitigated and managed through process management (manufacturing, design, customer relationships, etc.), legal compliance management, supply chain management, financial transactions management, business continuity management, and corporate governance. A prudent plan for managing offshore outsourcing must address each of these constituencies and operational frameworks.

• **International Competitive Risks.** Outsourcing poses a number of typical risks affecting the enterprise customer's

TABLE 1: UNIQUE RISK PROFILE OF GLOBAL BPO SERVICES

RISK MANAGEMENT	• Competitive risks, including process maturity • Financial risks, including currency exchange rate fluctuation, insurance, creditworthiness • Political risks, including embargoes, inconvertibility, corruption • Operational risks, including intellectual property, business continuity, disaster recovery, security, country concentration of systemic risks • Conflicts of law, enforcement, extraterritorial application of domestic and foreign laws, international taxation
SPECIAL CONSTITUENCIES	• Investors (and auditors) • Customers and consumers • Third-party suppliers and licensors
MULTI-COUNTRY SOURCING	• Special local laws and operational rules in countries where services are used by the enterprise customer • Conflicts of law • Tools for ensuring enforcement of contract

Source: Bierce & Kenerson, P.C.

competitive position. At risk are the goodwill of the enterprise's brand, its customer loyalty, and knowledge capital including both human capital and intellectual capital. These risks are accentuated by offshoring, particularly for any customer-facing service (such as customer relationship management and helpdesk operations) and even for supplier-facing services. Such risks are managed through limiting the scope to low-risk services, ensuring effective transitions from the insourced to the outsourced operation, tailored service level agreements (SLAs), service level credits, termination rights, and ongoing performance management and relationship governance.

In BPO, it is axiomatic that the customer needs to rely on a robust process delivered by the provider. In offshoring, this axiom requires the customer to carefully evaluate the provider's ability to identify, adapt to, and deliver timely business processes that comply with changes in legislation and administrative interpretation of laws outside of the provider's homeland. In HRO, the provider may need to consult with specialized legal counsel on the conditions applicable to employee benefits administration including, as a recent example, the December 2006 HIPAA regulations on non-discrimination in employee wellness and health benefits. In FAO, the provider will need to comply with Basel II risk management regulations and new bulletins issued by the Financial Accounting Standards Board.

CURRENCY RISK

Price predictability confronts currency volatility in international services agreements. The strength of the U.S. dollar and the Euro as currencies highlights the value of using the same monetary units both domestically and internationally. The enterprise customer wants predictability, so it prices the services in its local currency. The service provider wants to mitigate this risk, so it will seek pricing adjustments that respond to currency fluctuations. Exchange-rate adjustments become potentially significant for each side, especially for long-term agreements. Currency risk applies to all financial operations, including payment of service fees, service level credits, insurance indemnities, and any other financial flow.

Foreign service providers may have relatively small pocketbooks to respond to claims of significant direct damages in case of non-performance. Generally, foreign providers need to show the same creditworthiness as domestic providers. The customer needs to monitor any emerging credit risk problems abroad, which may be more difficult than at home for privately held service providers.

Foreign service providers typically have shallow financial pockets in the customer's country. The enterprise customer may address this issue through suitable financial security measures.

Insurance is a contract for the payment of a loss arising from an event that is not certain to occur. The outsourcing contract typically will require that the enterprise customer be named an insured on certain insurance policies of the service provider, that the carrier has a threshold rating, and that notice of impending cancellation is provided. If the offshore provider is covered by a foreign insurer, the outsourcing contract should address the insurer's rating and ability to pay a loss outside the country where it does business.

The enterprise customer may also take out its own insurance on business interruption, business owner liability, and other perils.

International trade involves certain political risks. Foreign governments may regulate or establish embargoes on delivery of services, and the customer's home government might embargo receipt of certain foreign services (such as from Iran and North Korea and formerly Libya). Except for "safeguard" measures, such regulations and embargoes generally conflict with global free trade rules under the World Trade Organization.

Financial managers understand the risk that a foreign currency may be inconvertible by reason of government fiat. So long as the customer is paying in hard currency, such risks are irrelevant.

In hiring a provider to deliver services, the enterprise customer exposes itself to the risk that the provider might engage in local bribery abroad. Federal law prohibits foreign corrupt practices by agents of U.S. companies, with one exception being small tokens to expedite the issuance of a document as a matter of right. A national culture of corruption could disqualify consideration of certain locales.

Earthquakes, wars, floods, power outages, brownouts and other events can prevent a business from operating. Such acts of nature at the service provider's facilities could cripple the enterprise customer. The well-conceived outsourcing relationship will anticipate not only the likelihood of such events but also the measures needed to respond to and mitigate the impact of all disasters. Offshoring requires planning for multi-site—perhaps multinational—business continuity measures.

The release of millions of personal records in the U.S. by the federal government, department stores, and credit card processing service companies has focused political and legal attention on identity theft and economic crime. The Federal Trade Commission's enforcement actions have raised the bar on security in collection and storage of personally identifiable information (PII). Some foreign countries have adopted strong rules on data protection; others have not. Regardless of location, security may now require greater investment in vulnerability assessment procedures, encryption, database security, log monitoring, and intrusion detection. Ironically, the costs of good security can be high, making the case for economies of scale and, thus, more outsourcing. In short, security is a most critical factor in determining where, how, and why to outsource a function that involves any PII. Security issues need to be addressed in the contract.

Under the Basel II guidelines, the world's banks need to engage in risk management. In selecting an offshore service provider, redundancy across borders and "flight plans" need to be defined. If the provider has facilities located in only one foreign country, systemic risks would need to be managed through scope definition, mirroring, avoidance of exporting the servers for data repositories, and other practical solutions.

A conflict of laws arises when two legal regimes apply to the same operations, and a difference makes it impossible to fully comply with both. Some countries, including the U.S., adopt local laws intended to be enforceable outside its jurisdiction. These include laws

Gravitas. You will hear the word in investor and management circles to describe someone who attracts others—a magnet for success, maybe even a bit of charisma. You will hear it used around OPI's CEO Clarence Schmitz.

When the founder of Bangalore-based itAccounts, Kishore Mirchandani, merged his operations with KPMG's Business Process Outsourcing group in 2002 with the help of Trident Capital, OPI was born. And 25-year KPMG board member and business unit leader Schmitz was the unanimous choice to head the merged operations. A longtime Los Angelino, Schmitz also served as CFO of Beverly Hills investment bank Jefferies Group and co-founder of Golenberg Schmitz Capital Partners, a merchant bank focusing on investing in early-stage companies.

But as deep as Schmitz is in the investing and M&A world, he is a skeptic of investors making a successful venture alone.

"Many believe if they build it, customers will come," Schmitz said. "But investing money is the easy part. The most difficult tasks are garnering revenues and the confidence of paying customers, then building credibility by delivering service. Before we started OPI, a half-dozen investor groups spent $160 million attempting F&A outsourcing. They tried and failed. Some spent enormous money building shared-services centers, but they failed to get any revenues." Schmitz credits that lesson—revenues rule—as the singular focus that has led OPI to its leadership position in the enterprise finance and accounting outsourcing (FAO) industry.

"It's not about how much software you have or how many seats you have in your service center," he concluded.

While Schmitz is hardly an investor chauvinist, he is a big believer in the power of the capital markets to smell winning strategies.

"Fact is, the stock market today is giving BPO firms big multiples," he observed. "The BPO firm valuations are much higher than the consultancies with BPO practices embedded inside. Go to Yahoo! Finance, do research, and you'll see the point. Unlike the consulting-based firms, the BPO firms have stronger growth opportunities, and the markets now expect strong growth from BPO. That puts FAO at a tipping point. Several companies—some public and some with intentions to be public—are all projecting and delivering substantial growth."

But in Schmitz's mind, the real expansion engine is not the capital markets, but a recent sea change in customer attitudes about FAO. Today, outsourcing finance and accounting is safe, acceptable, and routinely tactic.

"The more the field is studied and written about, the more companies gain confidence in FAO as a tool. Magazines like *FAO Today*, reaching 30,000 executives, help to drive the market," he said. "Unlike the recent past, offshore delivery of transaction services is now rarely an issue. It's a hurdle that's been eliminated. And as more customers proceed, more follow."

The OPI CEO observed that the recent surge of success stories has educated FAO buyers. Schmitz noted that most buyers now ask what he considers the three most important questions of potential vendors.

First, check the provider's client portfolio and the client's degree of satisfaction. "I'm a big backer of checking references," Schmitz said. "The ultimate buyer, ideally the CFO, should make the reference calls and really probe. Don't just go through the motions."

Second, look at the staff attrition rate on a vendor's staff. "Some vendors have some really shocking level of employee attrition, and if you're shocked, you're going to be disappointed in the service levels. If the provider is facing annual turnover rates of 30 to 40 percent, it's in trouble. For offshore staffs, people become more valuable the longer they're there, so attrition becomes more important."

'Some vendors have some really shocking level of employee attrition, and if you're shocked, you're going to be disappointed in the service levels. If the provider is facing annual turnover rates of 30 to 40 percent, it's in trouble. For offshore staffs, people become more valuable the longer they're there, so attrition becomes more important.' —Clarence Schmitz

And third, look for a spirit of partnership. "Make sure you've got a provider who's not going to ding you on every little change order. This type of trust is an intangible in the marriage that takes place when you outsource the F&A function."

Schmitz's accounting background attracted him to FAO opportunity, but his private-equity experience taught him to avoid unsustainable business models. "As an investor, we would see 5 to 10 bad plans each week," he recalls. So Schmitz built OPI's FAO model for the long haul. That sustainability, coupled with educated customers, Schmitz observed, has proven a real draw for customers. "Adoption rates are up, and buying cycles are starting to compress. The cycles are now under six months and getting shorter each quarter. While most of our deals are sole-sourced, we are attracting more RFPs than ever via sourcing advisors." That's the result of gravitas at work. HRO

affecting national security (such as export of technical data under a governmental license) or public morals (such as bribery and political boycotts). In individual countries and the European Union, constitutions (or equivalents) resolve such differences. Internationally, conflicts of law may create a greater risk of inconsistent compliance risks. Where legislative and enforcement processes are not predictable (such as in China after its accession to the WTO), the risk of conflicts is greater.

Foreign governmental intervention may be a risk, too—either as a matter of regulation (publicly announced) or police interference (through the registration of all Internet Service Providers, as in China). The risk of an intrusion by a foreign governmental authority into proprietary databases of private records makes countries such as China not ready for prime-time BPO.

Enforcement of an outsourcing contract may be delayed or burdened if the parties fail to define the choice of forum, applicable law, between arbitration and courts, and consequences when a contractual provision is deemed to violate local law. These issues pose different challenges and special international solutions in each case.

TAX ISSUES

Outsourcing can increase costs by attracting sales, use, and value-added taxes. From an income tax standpoint, the service provider must pay its own taxes on revenues from services, but an insourced operation does not. Outsourcing may also attract sales, use, value-added, and other taxes.

Foreign taxes have an impact on the selection of a locale for service delivery and on pricing. Enterprise customers should be aware of the foreign tax climate, including laws on tax holidays, exemptions for exportation of services, and international tax treaties. While international taxation can be complicated, it can also be neutral or favorable to offshore services. Thus, offshore captives and their domestic affiliates must allocate income between them for purposes of determining local tax burdens. Under new OECD guidelines and new model income tax treaties, the allocation of revenues is deemed to flow from the allocation of risks and value created by affiliated enterprises. Under a 2006 IRS revenue procedure, "back office" functions are merely cost centers that do not add competitive value and thus can be billed between companies at cost.

Under the Sarbanes-Oxley Act, the CEO and the CFO of public companies whose shares are traded in the U.S. are liable for lack of audit and control mechanisms. This liability translates into full flow-downs of audit and control responsibilities internally and across the entire global supply chain. Offshore outsourcing must not only meet these rules on audit and compliance but also set forth procedures (such as SAS 70 Type II audits), standards compliance, and other procedures to avoid financial reporting compliance liability for the enterprise customer.

Most publicly traded companies identify the fact that in a global economy, they are dependent on third parties to ensure their ability to deliver goods and services to their customers. This is intrinsic in all business. In outsourcing, disclosures relating to offshoring must alert the average investor about the nature of the risks. Thus, offshore outsourcing might be a material event requiring a separate disclosure.

In BPO, the service provider's liability for injury to customers may be unlimited in respect to certain risks, such as loss of PII, infringement, loss of confidentiality, and similar items. These risks are often carefully negotiated.

Outsourcing requires integration of an external service provider into the supply chain. Suppliers typically provide confidential information that may be copyrighted, patented or under a trade secret. Foreign intellectual property laws may be inadequate without enhancements through employment agreements that ensure the enterprise customer retains appropriate legal rights. The enterprise customer must carefully address ownership and use of all flows of intellectual property in the supply chain, whether from suppliers, customers, licensors, or the offshore service provider. The nature of such protections may vary according to variables such as the location of the servers, the degree to which the BPO services involve the creation or preservation of rights in intellectual property, and local laws.

Where the service recipients, the service providers, or both are located in multiple countries, the parties may need to adopt multiple levels of "master services agreements" (MSA's). It is axiomatic that commercial parties lack autonomy contractually to negate binding public policy in any country. The lawyers for both parties need to ensure that any mandatory provisions of foreign law that may affect the transactions are identified and that suitable contractual allocations of costs, risks, and obligations adapt to the local legal landscape. Experienced outsourcing lawyers may have different solutions to adapting an MSA to local conditions.

SUCCESSFUL TEAMWORK

The many legal and operational risks in offshore outsourcing call for a significant commitment for enterprise customers in risk identification, mitigation, and management. Virtually all outsourcing requires a retained team to monitor and manage the provider. As with any outsourcing, the retained in-house contract administration team should include representatives of administrative departments (legal, finance, accounting, internal audit, HR, information technology) as well as executives in the affected lines of business and a senior management sponsor.

The team needs a playbook to script its roles. Outsourcing contracts serve this purpose, but the process requires internal business assessment and process definition before the contract can be developed and negotiated. External advisors such as expert outsourcing lawyers and consultants can accelerate the process, help avoid mistakes, and coach the retained in-house personnel for the process.

Offshoring involves political, economic, social, cultural, and temporal risks that call for a specialized cadre of in-house relationship managers to apply specialized tools. HRO

William B. Bierce is a principal in Bierce & Kenerson P.C., an international law firm specializing in outsourcing representation for buyers and providers. He can be reached at wbierce@biercekenerson.com.

Weighing Offshore Hubs for Business Process Outsourcing

While India, Canada, and the Philippines are proven destinations, new markets may turn out to be lucrative alternatives. By Atul Vashistha

From the Americas to Central and Eastern Europe (CEE) and Asia, offshore business process outsourcing (BPO) is an emerging and fast-growing trend. Many companies that began offshore outsourcing with IT processes are now expanding into business processes—perhaps testing the arrangement with a customer service call center or data processing and then moving on to more complex, high-value processes such as HR and business analytics.

In the past few years, we've seen the emergence of a number of BPO hubs—offshore locations where organizations have successfully outsourced business processes. Ranked in order of most attractive BPO hub to least, the locations are: India, the Philippines, Poland, Canada, the Czech Republic, and Hungary. Table 1 highlights the particular BPO competencies of each location.

• **India.** With a cost competitiveness, a large, highly skilled labor pool, and suppliers' high level of service maturity, India continues to dominate the BPO landscape. An early-mover advantage, a huge college-educated, English-speaking workforce, strong government support, good infrastructure, and an inherent cost advantage all contribute to India's position as a preferred offshore sourcing destination for BPO.

Firms in the Indian BPO industry have matured far more quickly than their ITO counterparts. Despite its successes, however, the Indian BPO industry is beleaguered by high rates of attrition—a problem that has pushed many BPO firms to relocate to Tier 2 cities where the rates of attrition are much lower (although business infrastructure costs are higher in these locations).

Knowledge Process Outsourcing (KPO), involving higher-end skills as well as higher margins than in the volume-driven call center or data processing sectors, has demonstrated strong growth in the last few years. KPO jobs are perceived by Indian employees as respectable with promising career paths.

• **The Philippines.** This island nation has proven its expertise as a BPO destination. The country's success is driven by superior English language proficiency, strong cultural affinity to the U.S., and knowledge of American business processes. The Philippines has a pool of accountants trained in U.S. accounting standards, helping to make finance and accounting outsourcing the driver of BPO industry growth in the Philippines. The country is also a very popular destination for offshore call center operations, with many Global 2000 firms preferring this destination over India.

• **Poland.** A relative newcomer to the offshore supply market, Poland has moved rapidly into the outsourcing industry. The country's accession into the EU, relatively large pool of skilled labor, reliable telecommunications infrastructure, political stability, geographic proximity to Western Europe, strong work ethic, and linguistic and cultural connections with Western Europe have contributed to its success in the BPO industry.

• **Canada.** The lure of Canada's BPO industry stems from the country's geographical proximity to the lucrative U.S. market, its high level of service maturity, a skilled labor force, and an excellent infrastructure and business environment. Canadian providers offer quality services on par with those of the U.S. and present

TABLE 1: BPO COMPETENCY-DESTINATION MATRIX

	INDIA	PHILIPPINES	POLAND	CANADA	CZECH REPUBLIC	HUNGARY
SALES/CUSTOMER CARE (CALL CENTER)	*	*	*	*	*	*
CONTACT CENTER	*			*		
CLAIMS PROCESSING	*	*	*	*		
FINANCE AND ACCOUNTING (F&A)	*	*	*	*		
HUMAN RESOURCES (HR)	*	*	*	*		
PAYROLL PROCESSING	*		*		*	*
KNOWLEDGE PROCESS OUTSOURCING (KPO)	*					
MEDICAL TRANSCRIPTION		*				
TECHNICAL SUPPORT	*	*	*			

It is fair to say that Eric Selvadurai is a growth guy in a growth company in the heart of a growth industry. When he was Asia managing director at Hays Plc, a FTSE 100 company, Selvadurai was in charge of designing and managing large BPO contracts in the U.K., U.S., Continental Europe, and Asia. He also advised governments on promoting the fast-growing Asian BPO industry. So as the man leading WNS' efforts to deliver triple-digit growth for the third straight year, Selvadurai is well-versed in the challenges of rapid expansion.

He is also someone who pays close attention to market data. And the numbers say that there continues to be a very low penetration of F&A offshoring in the U.S. and other developed markets, alongside increasing customer acceptance of offshore alternatives. He agrees with analyst projections of the FAO market growing at an annual rate of about 40 percent.

"Our discussions with [dozens of] CFOs," Selvadurai says, "confirm our views on market penetration and on benefits to be captured from F&A offshoring."

The combination of small penetration, increasing customer comfort, and proven cost-effectiveness has resulted in strong sales. For Selvadurai, this combination also explains WNS' capital market performance.

"There is a strong market belief on pure play BPOs with strong and broad process credentials to continue to succeed," he says. "This is evident in the strong valuations that recent listings such as WNS have enjoyed."

While the market potential is great, the frequent-flying Selvadurai admits that market size alone does not guarantee success. Staying in close touch with customers and execution are the keys for major providers such as WNS to staying on top. He points to three lessons in particular.

First on his list is the need to get inside your customers' heads.

"Think from a CFO's mind," he says. That means providing broad and deep capability across all F&A processes that are offshoreable. And it means an intense devotion to customer and employee satisfaction. CFOs, as it turns out, like as many of their F&A processes performed in one place as possible, and they intensely dislike surprises either in performance or in rapid staff turnover.

Second on Selvadurai's list is to focus on managing outcomes rather than mere output.

"Output-focused" services are only for simple transactional processes such as accounts payable "but not as one advances up the ladder to more complex, higher-risk transactions such as financial planning and analysis," the WNS CEO says. "This approach will require companies such as WNS to build a radical and creative approach to improve controls and manage business risks in the offshoring context. Develop people to take total ownership of the process and move into managing the outcome—not mere output through SLAs."

This second factor—managing outcomes—is, in Selvadurai's mind, the key to building more high-value-added offshore services.

"Most of the work offshored so far has been less complex and transactional in nature," he observes. By focusing on the CFO's complete set of management needs, "we are witnessing a growing need with CFOs wanting to offshore even more judgmental work such as cost accounting and treasury."

The third factor, he says, is in convincing global giants to abandon their current paper-based processes in favor of process automation.

"The best of leading companies of the world manage most processes with paper transactions," Selvadurai notes with a hint of surprise. "This does not work in the offshoring context, and vendors will need to offer a distinctive IT solution in parallel, which will step beyond the connectivity issues and step into the realm of scanning, workflow, ERPs, etc."

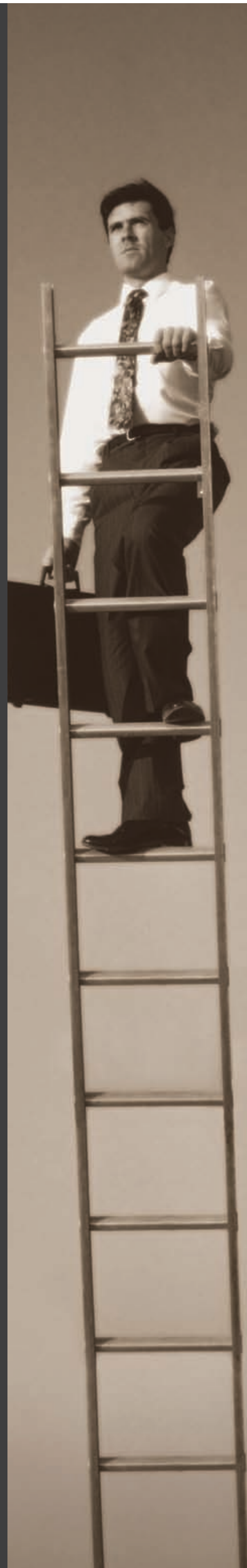
'Some vendors have some really shocking level of employee attrition, and if you're shocked, you're going to be disappointed in the service levels. If the provider is facing annual turnover rates of 30 to 40 percent, it's in trouble. For offshore staffs, people become more valuable the longer they're there, so attrition becomes more important.' —Eric Selvadurai

In sum, Selvadurai points to high customer satisfaction as his company's sustaining competitive advantage. He has identified six key elements to customer happiness amid fast growth.

- High levels of domain expertise;
- Retaining skilled talent;
- Tightly managing performance;
- Adding value with process improvements and re-engineering;
- Performance reporting;
- Constantly aligning delivery to customer expectations.

For sure, this is a fast-growth formula—and much easier to write than to do. That is all the more reason to have a growth guy in the driver's seat. HRO

HOW FAR YOUR COMPANY GOES DEPENDS ON HOW FAR YOU CAN EXTEND IT.



As a leader in business process outsourcing, WNS has a simple mission: help clients reach their goals. We do it by providing a unique combination of deep industry expertise and operational excellence.

Essentially, WNS Extends Your Enterprise.

EXPERTISE. Our focus and experience in select industries and processes have enabled us to develop deep domain and functional knowledge. We are true partners for our clients.

EXECUTION. From ramp-up to 24/7 implementation, we are committed to operational excellence. We monitor our services against multiple performance metrics, continuously seeking to improve them.

LEADERSHIP. Our record speaks for itself. Industry rankings consistently rate WNS among the top BPO providers. Our global operating model allows us to provide the best services in the right location to provide the best value for clients, many of which are industry leaders themselves.

Expertise. Execution. Leadership. It all adds up to one thing: results for our clients. To discuss your BPO needs, please contact us at 1-212-599-6960, or visit our website: wnsgs.com

WNS
Extending Your Enterprise

minimal risk (the result of language and cultural compatibility factors, geographic proximity, a strong business environment, and world-class infrastructure).

On the downside, Canada's cost-saving allure is relatively small (15 to 20-percent cost savings over domestic U.S. operations) compared with destinations in Asia and CEE.

• **Czech Republic.** The Czech Republic is part of a growing group—including Hungary and Poland—of emerging contenders in the BPO market. Its strengths include low costs, geographical proximity to Western Europe, and language and cultural compatibility with Western Europe (the Czech workforce has good proficiency in English and German, and the need for accent neutralization is less than in some other destinations).

• **Hungary.** Hungary shares many of the advantages of other emerging CEE countries, but it lacks the critical element of skilled labor resources. It may prove difficult for Hungary's small population to meet increasing labor demands in the future. The country's higher wage rates also make it a less attractive destination than Poland or the Czech Republic.

THE FUTURE STATE

The BPO industry in each of the six hubs is constantly evolving. Table 1 highlights the direction to which the industry in each hub may be headed (the size of each bubble represents the size of that destination's BPO market).

• The Indian outsourcing industry is currently entering a new stage of evolution. Facing increasing competition from emerging low-cost destinations in Asia and CEE, Indian suppliers have begun to look for an advantage beyond cost competitiveness. Firms there are working to build capabilities and competencies to increase their value positions.

Indeed, the leading Indian suppliers have global plans—setting up offices across the world and acquiring other companies overseas. While it is certainly capable of global operations, the industry must take care to maintain industry-specific knowledge and a presence near its target markets.

While domestic competition and growth could eventually dampen India's status as an attractive outsourcing destination, India will continue to be a leader among outsourcing destinations for a long time to come due to a proven ability of suppliers there to evolve and the existence of an excellent outsourcing ecosystem. Watch for higher-end KPO services to grow rapidly.

• Second only to India, the Philippines is already a leader in BPO. But to continue its success—and compete with emerging lower-cost destinations (especially on non-voice projects)—Philippines-based service providers will have to penetrate English-speaking markets other than the U.S., improve their service maturity, and work with the educational system to develop a more highly skilled labor pool in areas such as HR, procurement, and other vertical domains.

• Already a successful BPO service destination with high levels of cost competitiveness and excellent educational systems that breed a skilled workforce, Poland will continue to develop itself as an ideal outsourcing location for Western Europe. It leads the other emerging CEE countries, including Hungary and the Czech Republic, in BPO activities as it has a larger labor pool and a higher level of service maturity than the other two.

Improved policy support from the government will solidify Poland's status as a top outsourcing destination in the years to come. If Poland develops the unique advantages of its BPO markets and separates itself as superior to competing CEE nations, and if it is able to scale up with a highly skilled labor pool, then the future is bright for the country's BPO industry.

• As an early mover in the outsourcing industry, Canada possesses a high level of service maturity, offers a wide range of services, and boasts excellent infrastructure and skilled workforces. But service providers in Canada are not cost-competitive with those in destinations such as India, the Philippines, and the CEE nations.

As service maturities improve in lower-cost countries, Canada's narrowing advantages will slim even further. To retain its competitive advantage as a nearshoring destination, Canada must continue to market its strengths: low risk, high maturity, compatible business culture, highly talented labor force, and geographical proximity to the U.S. It must also work to develop high-end niche markets—within which cost is less of an issue than in the general sourcing market.

• The outlook for the Czech Republic is promising since its accession into the EU. But the future of the outsourcing industry is closely associated with that of neighboring countries, as many clients see the entire CEE bloc of nations as a single entity with little or no difference between individual countries. The Czech Republic will have to carve out a separate identity for itself based on its unique strengths and market that difference to potential clients. It will also need to build up its labor pool and enhance service provider maturity.

• To better compete with other CEE nations such as the Czech Republic and Poland, Hungary will have to work hard to penetrate the Western European market, particularly Germany and France (leveraging cultural compatibility with those countries). It will have to work to build up its relatively small labor pool, improve service maturity, and develop its infrastructure.

Countries with inherent advantages for BPO success—such as the Philippines with a culturally compatible, English-proficient workforce and India with its previous success in ITO—continue to lead the group of established and emerging offshore BPO hubs. And while a first-mover such as Canada still retains unique advantages—particularly relating to its cultural and geographic proximity to the U.S.—its inability to compete on cost with other hubs will further reduce its popularity.

In the future, we'll see those established countries—India, the Philippines, and Canada—evolve to leverage their own unique advantages to remain competitive in spite of increasing costs. And we'll see emerging lower-cost destinations such as Poland, the Czech Republic, and Hungary take a larger share of the offshore BPO business as their industries mature. And keep an eye out for other rising destinations such as South Africa, Brazil, Russia, China, Romania, Malaysia, and Mexico. HRO

Atul Vashistha is CEO of neoIT, a leading management consultancy since 1999 focused on independent, objective, and actionable advice to enterprises that seek to transform their organizations by capitalizing on services globalization.

Understanding and Managing Offshore Outsourcing Savings

Before moving services abroad, consider the real risks and benefits.

By Stephen Dunn and Sheetal Bahl

Offshoring is now a well-established global phenomenon, with widespread and ever-increasing adoption across geographies, industries, and processes. The offshoring of business processes and IT has shifted from a marginal idea a few years ago to a $63 billion market, according to our research.

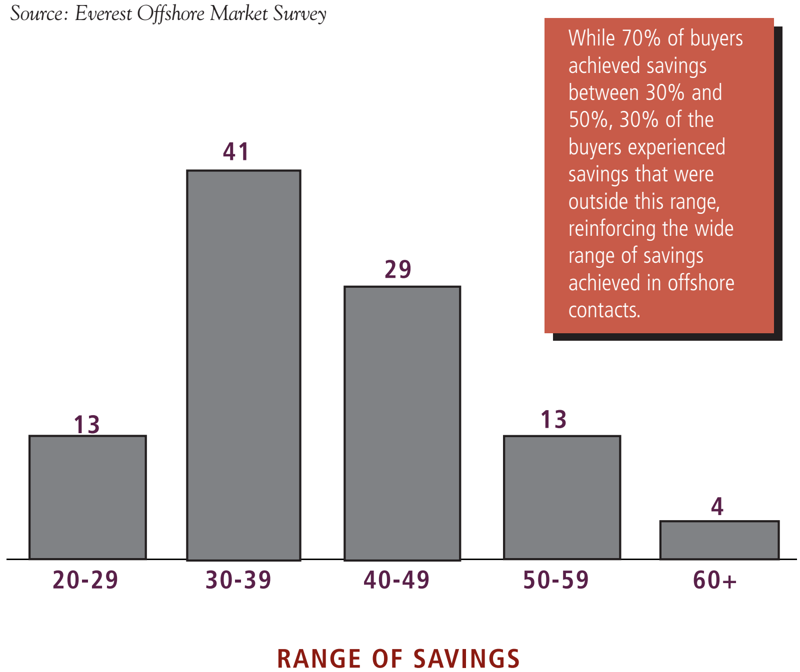
Further, offshoring is now central not only to sourcing decisions but also to overall business strategies, as it is a key means of reducing costs in an increasingly competitive environment. In such a scenario, it is extremely important for businesses to understand and estimate their savings from offshoring to ensure accuracy and predictability in their business plans.

THE RANGES OF SAVINGS

Given the widespread use of offshoring today, one might expect that it would be easy for senior management to clearly define and quantify expected cost savings and benefits. In Everest's experience, the opposite is true. For many reasons, there is little agreement or clarity in published sources as to the scope of savings and other benefits. Further, the ranges of savings reported by different studies are also extremely wide, limiting their usefulness.

FIGURE 1: BUYERS ACHIEVING SELECT RANGE OF SAVINGS (AS A PERCENTAGE)

Source: Everest Offshore Market Survey



For example, a Goldman Sachs report estimated a savings range of 25 to 75 percent, while a McKinsey research piece indicated a range of 45 to 70 percent. Similarly, CIO Magazine cited Meta Group and others when estimating that hidden costs range from 15 percent in the best case to 57 percent in the worst. In another case, Deloitte estimated savings from offshore spanning from 15 percent (its typical case) to 47 percent (its best possible case, though apparently the best realized was 24 percent). Everest, too, conducted its own analysis on 24 case studies drawn from a survey of leading suppliers and came up with similarly disparate results (see Fig. 1).

The problem with these savings estimates is that they leave a lot of room for error—imagine presenting a business case predicated on achieving a range of savings somewhere between 15 and 75 percent. The fact that these reports are all true in some way probably does little to comfort the senior executive having to make a decision.

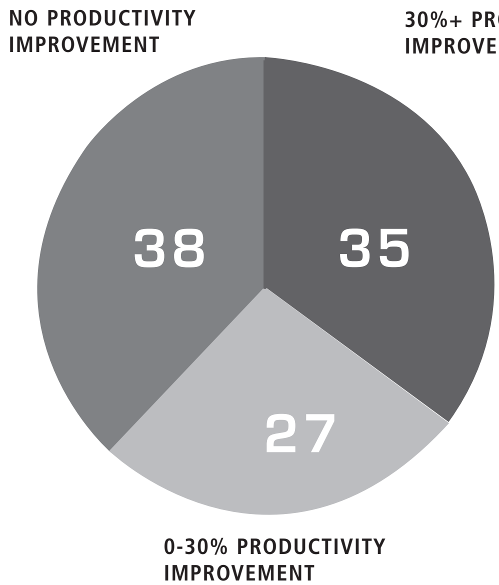
IMPACT OF SAVINGS VARIANCE

Lower-than-expected savings for buyers can affect both current benefits and future potential benefits. The variance can impact buyers in four areas:

- Financial planning risk—inaccurate budgeting/financial planning leading to operating financial risks and strain;
- Conflict with suppliers—this could further hamper operations and savings;
- Loss of credibility—this and increased backlash can occur both internally and externally;
- Loss of future savings—potential loss of savings from offshoring of other functions and processes.

All these areas are extremely impor-

FIGURE 2: ANNUALIZED PRODUCTIVITY IMPROVEMENT (AS A PERCENTAGE)



NOTE: Productivity improvements were derived by measuring a wide range of relevant productivity measures such as average call handle time, number of invoices processed per FTE, claims per hour, agent utilization, reduction in development time, etc.

SAMPLE SIZE: 30 TRANSACTIONS

Source: Everest Offshore Market Survey

tant, thus driving the need for a detailed understanding of what produces savings, what are realistic expectations of savings, and what buyers can do to manage them from offshoring.

Savings disparity occurs partially due to the variation in definitions and complexity of calculations. There are many other factors that also drive cost savings, and there can be significant variations in those as well. As a first step to understanding the savings disparities, let's examine these drivers in detail.

■ **Labor Arbitrage.** Arbitrage refers to the savings gained during offshoring due to the difference in the labor costs between the source and destination locations. Labor arbitrage generally ranges from 20 to 80 percent, depending on the location, contract negotiation, business model (captive or third party), etc. Savings are lower if the offshore operation was originally located in a lower-cost region such as Canada or the Midwest in the U.S.

■ **Percent of Services Offshored.** This factor is critical for two reasons: labor arbitrage can only reduce costs for services sourced offshore and the scope of services offshored is the most important factor under the control of the buyer. While labor arbitrage is important, its range of potential results is much narrower.

Two variables typically drive the percent of services offshored: the process offshored and the company's sourcing strategy. The result typically yields between 20 to 90 of services offshored.

■ **Potential Productivity Improvements.** This area is dependent primarily on the existing organization's performance level and thus the opportunity to further reduce cost through automation.

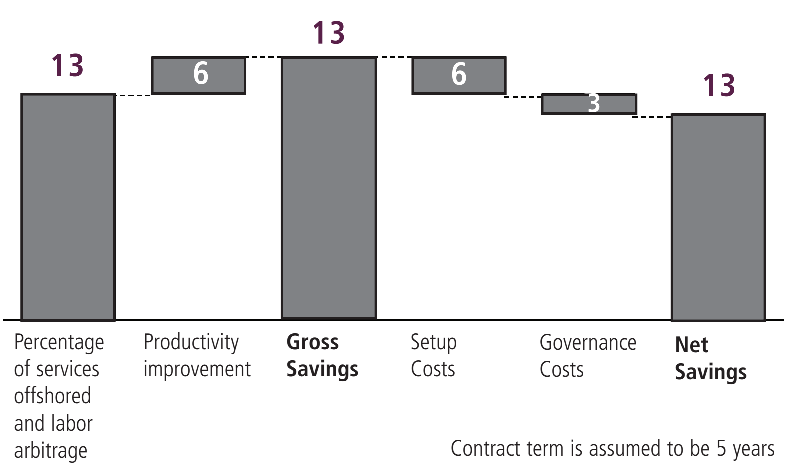
■ **Contract Term.** The term drives the period over which the buyer or supplier amortizes capitalized costs or the period over which net present value/internal rate of return (NPV/IRR) is calculated. More subtly, it also drives percent reinvested.

■ **Set-up Cost.** This can vary widely but generally ranges from 15 to 30 percent of the annualized spend before outsourcing. They include the cost of knowledge transfer, the cost of the procurement process (external legal counsel, third-party consultant, travel), software, etc.

■ **Governance Cost.** This is incurred by the retained organization to manage the outsourced relationship.

Each of the above drivers can vary significantly, depending on the buyer's focus and strategy, solution design, and success in execution. The resulting impact on the achieved savings can be very significant. An

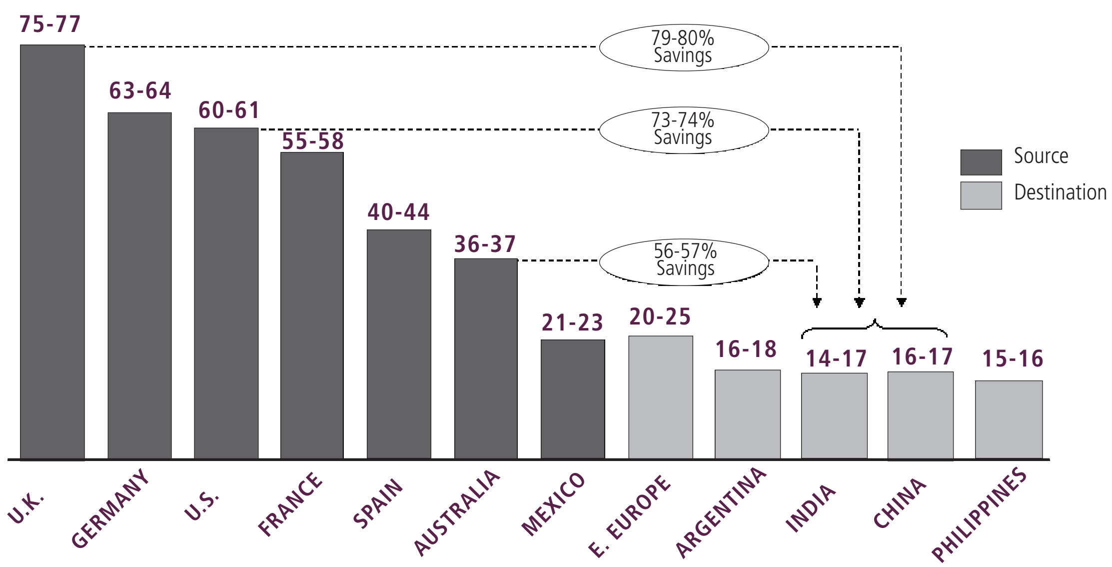
FIGURE 3: TYPICAL COMPOSITION OF GROSS AND NET SAVINGS (AS A PERCENTAGE)



Contract term is assumed to be 5 years

Source: Everest Offshore Market Survey

FIGURE 4: COMPARISON OF DIRECT OPERATING COST PER FTE FOR TRANSACTIONAL F&A WORK (PERCENTAGE)



Ongoing costs only; excludes margins/markups, centralized corporate overhead, initial investment, set-up costs, and travel costs.

Source: Everest Offshore Market Survey

Everest analysis of 30 offshore transactions showed that productivity improvements can vary by more than 30 percent, depending on the execution (Fig. 2). Given the variations and the impact, it is critical for companies offshoring work to design solutions that maximize returns given their risk profile.

ESTIMATING SAVINGS

As described in the previous section, there is a multitude of factors driving savings. While the exact relationship between these factors can be quite complex, they can still be woven together in a simple fashion to estimate annualized savings over the term of a typical offshoring deal:

Gross savings = (percent of services offshored x labor arbitrage) + percent productivity improvement.

Net savings = Gross savings—(setup costs/length of contract)—governance costs.

It is worth noting that other factors can affect the estimates, such as portions of the savings that might be reinvested into the business or quality improvements in the processes, which can eventually translate into savings, too. Further, macro-economic factors such as inflation and exchange-rate fluctuation will inevitably affect savings over time. These other factors notwithstanding, the formulae outlined above can provide fairly robust estimates of savings in most cases and can be widely used by buyers and suppliers to set the correct expectations up front in an outsourcing deal.

Using this approach to estimate savings and combining that with the understanding of the various factors and their variations, Everest conducted a detailed analysis across a number of situations to determine the typical realistic expectations from offshoring. The analysis shows that while the numbers may vary significantly with different situations, gross savings in a typical offshoring situation can be upwards of 40 percent, with more than 30 percent in net savings. Fig. 3 outlines how the different factors contribute to these savings.

CONTROLLING SAVINGS

To realize the savings potential that offshoring offers, buyers need to proactively work on controlling the various factors that drive savings. While the presence of some extraneous limitations is natural in any situation, buyers actually have a very wide range of tools and processes they can use to control the savings factors and, in turn, maximize their savings.

For example, let's examine the various drivers of labor arbitrage and see what buyers can do to maximize the arbitrage while still meeting their requirements. The key factor that affects labor arbitrage is the choice of the offshore location; buyers often tend not to focus on this, leaving the decision to the suppliers. The location choices can, however, make an immense difference to the buyer, not just in terms of immediate savings but also in terms of long-term potential and outlook. Hence, buyers need to actively participate in the location decision. Fig. 4 shows the extent of the labor arbitrage opportunity available for transactional finance and accounting (F&A) work between some of the high- and low-cost locations.

Other than locations, buyers can also control a number of other drivers that impact labor arbitrage: contract negotiation, deal structuring, ability to recruit skilled labor at market rates (in the case of captive

Compare the so-called "Big Four" Indian outsourcers with a Google news search, and you will find that Infosys, a 25-year stalwart of the Indian IT industry, has gathered more business media mentions than any of the other three. On the BPO front, CEO Amitabh Chaudhry has had something to do with the increased attention. In 2003, he was named Infosys BPO chief operating officer. Responsible for much of the unit's growth, he took over the CEO role in 2006. The company started in BPO five years ago with three clients and $4 million in revenues, and today it quotes $140 million and 29 clients.

In Chaudhry's view, he credited a lot of the industry's growth to macro-market factors. After all, Gartner recently pegged the global BPO market at $140 billion, a figure which will increase by 30 percent by 2010. He noted that the Indian BPO market as tracked by NASSCOM is poised to grow by 40 percent in 2007 alone.

Chaudhry observed that the public markets have looked favorably on two pure-play FAO companies that recently went public—WNS and ExlService. It's a development that is likely to also benefit others who will test the public markets soon, including OPI and potentially others.

"I feel that the success of these IPOs is significant," he says, "because it firmly establishes the maturity or feasibility of offshore BPO delivery as a profitable and scalable operating model, and it denotes that the market expects that this industry will continue to innovate, scale, and gain market share."

But beyond market forces, Chaudhry is also willing to admit that Infosys can take a bit of the credit for its own remarkable BPO results. After all, Infosys is the most recognized outsourcing brand in India. As a result, Chaudhry says, "Our ability to attract and retain the best talent in the industry is unmatched. This is underpinned by our award-winning HR programs, which ensures a holistic development of our people and provides them with the best of the facilities and resources to achieve their career aspirations."

He also notes that during the past 25 years, Infosys has developed a scalable process model that has helped it achieve year-on-year growth.

"We have derived these processes, contextualized them for the BPO industry, and created a scalable growth engine," he says. "We have well-defined methodologies for transition, operations, quality management, risk management, and business continuity. The strength of our company could be judged by various certifications that we hold: TR19, BS:7799, SAS 70 Type 2, BS 7799, TR19:2005, and ETI certification."

Chaudhry credits four trends for Infosys BPO's remarkable growth, especially growth among American companies.

- First is the increased acceptance of global sourcing—service providers were able to develop the offshore value proposition and successfully deliver FAO from offshore locations.
- Second is the enforcement of the Sarbanes-Oxley Corporate Compliance Act, or SOX. Said Chaudhry, "This brought about a greater focus on compliance and control, and customers realized that they could use FAO as a faster means to achieve compliance."
- Third is standardization and best-practice adoption as clients used FAO to standardize processes across their global locations and learn from the experiences of the service providers.
- Fourth is evolution of technology enablers. "Systems like workflow, scanning, and remote access helped in addressing the security concerns of the client and provided the necessary impetus to the FAO industry," Chaudhry says.

While macro-market trends are clearly fascinating to the Infosys BPO CEO, he is equally as focused on the need to meet the unique demands of FAO customers. As one of the largest outsourcing companies in the world, Infosys has significant scale already. In BPO, however, Chaudhry recognizes that there are three important criteria that all his prospective clients demand. First is delivery of transformational business value that is measurable. That means rather than merely "lifting and shifting" existing processes, clients want best practices. Second is breadth of service, which means partnering with clients to deliver end-to-end solutions for the entire value chain of the business. And third is global reach, multinational, multicultural, multi-accounting standards.

As he concludes his comments, Chaudhry recalls that Everest Research reported that the FAO market has grown more than 45 percent in the past two years.

"Most of the growth in FAO," he says, "primarily came from U.S.-based customers. As service providers scale up and establish global reach to service global customers, we are seeing increasing interest in other geographies—EMEA and APAC—for adopting FAO, and this will sustain the high growth rate of demand." Furthermore, Chaudhry says, "Clients are finding it much easier to outsource enterprise-wide functions, and F&A is clearly the winner." HRO

'Our ability to attract and retain the best talent in the industry is unmatched. This is underpinned by our award-winning HR programs, which ensures a holistic development of our people and provides them with the best of the facilities and resources to achieve their career aspirations.' —Amitabh Chaudhry

set-ups), and attrition management.

Similar to labor arbitrage, all the other savings factors can be impacted to some degree at least, and comprehensive management of these factors can have a significant impact on the overall level of savings achieved by the buyer. Table 1 provides a high-level summary of some of the most important controllable drivers for each of the savings factors.

IMPLICATIONS FOR BUYERS

To quickly summarize, estimating savings from offshore can be a difficult task due to the complexity of definition as well as the wide variances in the factors that affect the savings in different situations. There are, however, a number of things that buyers can do to control the savings and improve the accuracy of their planning.

The key savings management implications that emerge for buyers as a result span the strategy formulation stage as well as the design and execution stage and are outlined below.

■ **Strategy Stage.** To maximize the likelihood of meeting expectations, the offshoring strategy needs to focus on:

- Processes with high opportunity for automation and improvement;
- Work taking place in high-cost locations;
- Ability to price based on transactions;
- Analysis of state of uncontrollable factors.

Given the widespread use of offshoring today, one might expect that it would be easy for senior management to clearly define and quantify expected cost savings and benefits. In Everest's experience, the opposite is true.

■ **Design and Execution Stage.** The buyer needs to line up internal support during planning and focus on the following:

■ **Percentage of services offshored.** Companies should set a conservative target here with a goal to increase the percentage to best practices as confidence in the supplier/captive builds during the vetting process.

■ **Percentage of labor arbitrage.** While the market sets the price, it is important to stage the process so that multiple pricing rounds are possible.

■ **Productivity.** Productivity improvements can contribute more than 30 percent of projected savings over the life of the deal.

Buyers often face a serious mismatch between the actual and expected savings when offshoring due to the complexities of the drivers and the estimation approaches. To help them avoid this "post-offshoring dissonance," they need to recognize the true nature of savings and focus on the controllable drivers during all stages of offshoring to accurately forecast, manage, and maximize their offshore-related savings. HRO

Stephen Dunn is managing principal, Europe, Everest Group. Sheetal Bahl is research director.

TABLE 1: CONTROLLABLE DRIVERS FOR EACH SAVINGS FACTOR

SAVINGS FACTOR	CONTROLLABLE DRIVERS
LABOR ARBITRAGE	• Choice of offshore location • Contract negotiation • Deal structuring • Ability to recruit skilled labor at market rates • Attrition management
PERCENTAGE OF SERVICES OFFSHORED	• Captive versus third-party model • Processes offshored • Sourcing strategy • Management support
POTENTIAL PRODUCTIVITY IMPROVEMENTS	• Focus on direct versus overall costs • Contractual agreement ensuring ongoing improvements
CONTRACT TERM	• Contract negotiation
SET-UP COSTS	• Choice of offshore location • Captive versus third party • Process changes (automation, etc.) • Control and smoothness of process transition • Cultural factors
GOVERNANCE COSTS	• Choice of offshore location • Captive versus third party • Deal structuring • Clarity of contractual terms • Strength of supplier relationship • Post-transition planning