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The Impact of an Economic Slowdown on Outsourcing

Jagdish Dalal, Managing Director, Thought Leadership, IAOP

Despite Washington's denial of the "R" word, clearly the economy is in a negative growth situation. There are many factors driving it; some are long-term — the U.S. national debt and oil prices — while some are short-term, like the sub-prime loan situation. Although this economic crisis is largely created by business conditions in the U.S., the world economy is not quite strong enough to offset its impact on the global economy. Economists everywhere are pontificating about it, so let us look at the impact of a slowing economy on the subject of our interest — outsourcing.



Buyer's point of view (A Mixed Environment for Outsourcing):

Businesses are beginning to see the impact of lower economic growth on their financial results, and we are seeing more stories about cutbacks on spending to retrenchment of expansion plans. Increased profit pressure on businesses will drive them to evaluate their cost basis and look for opportunities to reduce expenditures. For example, information technology (IT) spending is expected to be lower in 2008 than the previous year (see inset). We believe that similarly, other functions — human resources, logistics, real estate spending — will see a slowdown in budget growth for the coming year.

- **"In the U.S., budgets are still growing, at 2.3 percent, but that represents a drop from 3.1 percent in the last study." *Gartner Study, April 2008***
- **IDC is predicting that global IT spend will be lower by 0.5-1.0%. *December 2007***

What does this mean for outsourcing? We believe that the companies needing to lower costs will explore outsourcing as a means of achieving that goal. Additionally, the uncertainty of economic conditions will encourage them to lower their "fixed" costs and seek a "variable" cost basis provided by outsourcing. Uncertain market conditions will lead companies to examine capital spending and look toward outsourcing to lower investment requirements. Thus, we predict a mixed business environment where demand is smaller due to decreased spending, but increased transaction activities increase due to businesses' need to outsource more.

Major U.S. based outsourcing providers have predicted in their first quarter financial analyses stable growth for their businesses in 2008. However, experts believe that the uncertain business climate will slow corporate decision making. (See the interview with Atul Vashistha, chairman and founder of neoIT and a founding member of IAOP after this article).

Provider's point of view (A challenging environment for business):

It is unclear how much impact the economic slowdown will have on outsourcing providers. Lower demand due to reduced budgets may be offset by an increased demand for the benefits of outsourcing. However, it is clear that providers will face a tougher negotiating environment where businesses will try to maximize their benefits from outsourced work. This, coupled with their own belt tightening will reduce margins from the outsourcing work and force providers to look for alternatives for increasing their profits (See article by D. Davison and E. Kublanov of neoIT posted on Firmbuilder.com: *Navigating Economic Uncertainty: Leveraging the Services Globalization Advantage*).

Additionally, globalization puts another key economic factor into play for outsourcing providers — currency values. The U.S. dollar is near an all-time low, and the Indian and Chinese currencies are at an all-time high. This gap in currency translation will induce pressure on the labor savings projected by providers. To further complicate the profitability picture for providers, wages are not expected to drop significantly, and there will be continued pressure for wage increases. Rising prices of commodities and fuel will increase raw material costs (for example, rising utilities and transportation costs, short-term credit interest rates and postage rates) and impact cost and operations for providers, as well.

Summary:

So, what does this all mean for outsourcing? Turbulent times require companies to manage operations with great discipline, and we can expect companies to plan, negotiate, implement and manage outsourcing agreements more efficiently and effectively. As these stakes get greater, companies increasingly expect outsourcing to be handled as a new management science based on standards, proven methodologies, and industry best practices. This is giving rise to companies seeking to employ Certified Outsourcing Professionals (COPs) who understand and apply best practices in the marketplace. IAOP already has seen a dramatic increase in demand from companies (and individuals) looking to attend classes to become a certified professional.

One way that providers also can demonstrate sustained value for their clients is through greater attention to outsourcing's relationship to social issues. In today's environment, social responsibility is not only good policy, it's good business. It's one category of risk that companies can directly influence through their own actions. This "socially responsible outsourcing" is a new phenomenon, and IAOP will explore it further throughout the coming year and even dedicate a track to it during the 2009 Outsourcing World Summit.

We would love to hear from you: jag.dalal@outsourcingprofessional.org.

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Interview with a Certified Outsourcing Professional (COP)



We asked a leading outsourcing expert and COP for his views on the economy and its global impact on outsourcing. **Atul Vashistha** is chairman and founder of neIT and a founding member of IAOP.

Do you think the current economic climate will lead to an increase or decrease in outsourcing?

The current economic climate is unclear, so that makes companies hesitate. This leads to delayed decision-making. At the same time, firms realize that cost management is important. This tug of war will probably result in a short-term decrease, but will not impact medium to long-term growth.

What, if any, effects will the economic climate have on offshoring to India? Other regions?

India has a compelling cost advantage and will continue to benefit. But the issues related to availability and competition for talent, wage increases and attrition issues are making clients look to geographic diversification as a risk mitigation strategy. Also, as complexity of what is being globalized grows, it creates opportunities for India and other regions.

Will the current climate influence the size and scope of outsourcing contracts?

While companies want to reduce costs, the current climate tends to make companies cautious, and will probably reduce the size of deals in less globally experienced firms, but will accelerate deal size in highly globally experienced firms.

What new opportunities may emerge for outsourcing professionals in this climate?

Complexity and uncertainty increase the need for knowledge. Additionally, risk mitigation increasingly requires a well thought out approach. These create opportunities for professionals with experience and process knowledge in the outsourcing field.

For more information on the Certified Outsourcing Professional (COP) program, [click here](#).

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Outsourcing's Next Wave: Consumer Outsourcing

Michael Corbett, Chairman, IAOP and Pam O'Dell, Director, Program Innovation, IAOP

Consumers have always been the direct beneficiaries of outsourcing. Outsourcing results in lower cost products and services, better quality, greater competition, more capital dollars for investment in research and development, and higher returns in stock portfolios and 401(k) plans.

So, it's no surprise that today's consumers are going to the next level and taking outsourcing into their own hands. Consumers are increasingly outsourcing a growing list of personal tasks ranging from math tutors for their children, to designers for wedding video graphics, to having local specialists put up and take down their holiday decorations, and — in what's commonly called medical tourism — having both elective and life-saving procedures performed at fully-accredited hospitals in countries like India, Mexico and Singapore.

Whatever one might call it or think of it, the age of *consumer outsourcing* has arrived and many think it is set to explode. There are already hundreds of online sites offering consumer outsourcing services. Market researcher Evalserve projects that the small-business end of consumer outsourcing will reach \$2 billion by 2015 and experts predict that the medical tourism industry could grow to \$40 billion by 2010.

In many ways, consumer outsourcing mirrors corporate outsourcing. Although the scope and complexities may be

polar-opposites, many of the reasons and steps are similar.

Consumer outsourcing often is driven by cost and frequently takes advantage of the same labor-arbitrage as do corporate deals. A math tutor in India providing services over the Internet can cost \$2 to \$3 an hour versus \$40 to \$50 an hour in the U.S. An Egyptian web designer can set up a personal website for about one-tenth what a Western designer would charge. The average charge for coronary bypass surgery in the U.S. is \$75,000 versus \$11,400 at the Fortis Mohali hospital in India — including roundtrip airfare.

But as with corporate outsourcing, consumer outsourcing is not simply about saving money — and we all know that trading off cost for quality is a no-win proposition. Consumers also are outsourcing to gain access to talent they just can't find locally, to free their time for things more important— shall we say — to focus on their personal core competencies, and, simply to deal with the volume of demands on their time, especially around peak periods like the holidays or one-time special events like weddings.

And the process, although again far less complex than in the corporate world, is similar. For consumer outsourcing to work well, individuals need to think in detail about what they want to have done and why. What in their lives makes sense to outsource and what doesn't? What are they good at and what do they enjoy doing? Once these questions are answered, they then need to locate and research possible providers, evaluate bids, enter into an agreement, manage the relationship, assess the value received and determine next steps — a process that sounds all too familiar to any outsourcing professional.

There are a number of reasons for outsourcing professionals who work in the corporate world to start paying attention to consumer outsourcing.

First, as consumer outsourcing grows it may begin to influence and shape some aspects of the corporate outsourcing marketplace. Many companies that provide corporate outsourcing services are already beginning to test consumer services, and the lines between them naturally will blur over time. In fact, consumer outsourcing and small-business outsourcing are already merging through sites like Elance.com, Guru.com, Virtualemployee.com, and Rentacoder.com. Third-party organizations like these and others to come will shape consumer behavior, and in some cases, even change how large companies “go to market” in the consumer space. Considering that approximately two-thirds of the U.S. economy is consumer-driven, if consumer outsourcing grows as projected, its impact on the overall outsourcing industry is inevitable.

Second, the same services that a consumer benefits from can benefit a company's employees, as well. Administrative services, contact database maintenance, research and analysis are just a few examples that can have a very real impact on employee productivity. Consumer outsourcing is also beginning to impact how companies design employee benefit programs, especially in health care. Companies and insurers are beginning to test medical outsourcing as a way to control the rising costs of health care for organizations and employees. IAOP and FORTUNE magazine are working to produce a special advertising section on this subject for the magazine's July 7, 2008 issue. [Click here](#) for more information.

Third, as consumer outsourcing grows it will impact the public's perception. The issues will not completely go away, but it may be a little harder to make the argument that outsourcing is “bad” if consumers increasingly see the “good” it's doing in their lives. A growing trend toward consumer outsourcing creates another angle for outsourcing professionals to use when trying to improve outsourcing's overall brand image.

Finally, consumer outsourcing may well open up new career directions and opportunities for professionals already working in the field. For example, it is reasonable to expect that major U.S. hospitals will either create their own centers for medical tourism or team with existing offshore providers. These types of changes will bring new classes of services and the organizations that provide them into the outsourcing industry. So whether it's new areas within current companies, becoming part of a fast-growing company in a new industry segment, or even launching a company in the consumer outsourcing space, consumer outsourcing will create new opportunities for outsourcing professionals.

Everything we're seeing right now suggests that consumer outsourcing is poised for rapid growth over the next few years. As always, IAOP will closely follow this trend and is already looking ahead to developing insights, programs, and services of value to members interested in this area. You can help by sending your ideas, opinions, and suggestions to Pam O'Dell, IAOP's director, program innovation, at pam.odell@outsourcingprofessional.org.

References:

To help you get started, the following are just a few online resources offering additional insight into consumer outsourcing:

[Outsourcing Your Life, The Wall Street Journal](#)

Consumer Outsourcing: Quick Facts:

What is consumer outsourcing?

It's outsourcing of personal services — from help with the kids' homework to having a coronary bypass operation performed in Singapore.

How big will it get?

No one knows for sure, but tens of billions of dollars by 2010 is a safe bet.

What is IAOP doing in this area?

We're watching the trend, developing information on the topic, and working with partners like FORTUNE magazine to help shape its direction.

What does consumer outsourcing mean for outsourcing professionals?

It opens up new opportunities and may even help change the way people think about outsourcing.

My Outsourced Life, Esquire Magazine
More cash, less time means holiday outsourcing, MSNBC.com
Employers made a push for 'medical tourism', FORTUNE Small Business
The Personal Outsourcing Olympics, The Blog of Tim Ferriss

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Chapter Perspectives

Dallas Chapter • Washington, D.C. Chapter • Global Human Capital Chapter

Are We In Recession? What Impact Will Recession Have On Outsourcing?

Thomas Tunstall, Ph.D.

At the April 14 meeting, the IAOP Dallas Chapter used a panel format to discuss whether or not the U.S. is in recession and, if so, what impact that might have on the outsourcing industry. The following is a summary of the panelist's insight into this issue:

Panelists:

Joseph Sifferman, PepsiCo Global Sourcing
Gary Claytor, BDP Partners
Michael Bieler, CSC Advisor Relationships

Is the U.S. in recession or heading into one? Most people surveyed indicate that we are already in a recession. Unfortunately, by strict economic definition, we usually find that we're in a recession only either after the fact or when it's nearly over. Regardless, it's worth noting that the impact of a recession will vary by region and by industry. It's also very likely that a recession will impact outsourcing activity and practice.

Since the discussion of the potential impact of recession was held in Dallas, it's probably worthwhile to highlight some differences between Texas and the rest of the U.S. For example, in 2007, job growth for the U.S. as a whole was 1.0 percent, while the job growth rate in Texas was 3.1 percent. The national unemployment rate as of December 2007 was 5.1 percent, while in Texas it was only 4.5 percent. The Texas economy also contains some countercyclical elements. Case in point: the Federal Reserve referred to Texas as the global epicenter for a prosperous energy industry. Further, in the past few years, the population of Texas has grown twice as fast as the rest of the country.

Not only can we expect to see regional differences, but is likely that some sectors and industries will be affected more than others in an economic downturn. The effects will not be uniform. Capital-intensive industries, along with travel, transport, and construction industries would seem to be the most likely impacted from an economic downturn. Energy companies are likely to continue to benefit.

The other major development that IAOP members would find of interest is that we should expect to see an increase in the use of outsourcing as a response to an economic downturn. This increase seems likely to occur as executives drive the mandate to lower costs and improve operations into the organization. Once this message takes hold, organizations will, in turn, engage outsourcers for additional activities. History tells us this — recessions have in the past caused an increase in outsourcing activity. Companies use outsourcing both to save money and improve quality. A good example of this is the way outsourcers take advantage of advances in technology to speed up transition times (e.g., getting servers up and running used to take a day, but now can be done in 30 minutes).

The size of the enterprise may be a factor in determining how organizations respond to recession. Many mid-cap companies rely on outsourcers because suppliers can more easily keep up with technological advances and provide capital for new technology. From an economic stratification standpoint, it is possible that recession will benefit high-end and lower-end market oriented companies and depress those targeting the middle-class markets.

From a delivery standpoint, there is a growing movement by many suppliers to set up or bring contact centers back to the U.S. in lower cost of living areas. Mexico is likely to become a more attractive delivery location for both onshore and offshore suppliers because of similar time zones and language capabilities for the fastest growing segment of the U.S. population.

We also are starting to see more second and third generation deals. A lot of outsourcing deals are coming up for renewal or re-bid at least the second time, and there is less focus on cost savings and more emphasis on innovation. As a result, we can expect that outsourcing deals will become more output/results based, as opposed to input or wage arbitrage based. A good measurement of value-add will be key. Customers increasingly are asking for transformation solutions, not lift-and-shift, or your-mess-for-less. It will be important for outsourcing suppliers to bring industry knowledge, domain expertise and innovation to the table.

Offshore providers are looking to expand beyond application development and maintenance into other areas, which may include growth through acquisition. There is growing interest from offshore organizations to purchase stable small-medium outsourcing companies in the U.S. As India-based companies target the U.S. market, it will get interesting for the traditional established players.

Inflation continues to be a real concern. The price of fuel and raw materials is rising rapidly. Demand for corn is rising, for example, due to greater use of bio-fuels and overall worldwide demand. Because of the growing demand for building materials, food, and energy, we should expect to see China playing a larger role on the world economy in the years and decades ahead.

Some surprises, such as industry restructuring, are likely, as well. Who would have thought that Blockbuster would

make a bid for Circuit City?

The threat of recession is already causing management to factor that possibility into their planning/budgeting processes. Part of that process includes taking into account the weakness of the U.S. dollar, which has the potential to impact the marketplace, either positively, by making domestic services more attractive, or negatively, by increasing inflation (or both). Organizations will need to get more creative at leveraging partners to gain efficiency, i.e., cost savings in operations.

The green movement almost certainly will influence the nature of outsourcing activities. For example, information technology (IT) activity alone accounts for 2 percent of the energy usage in the U.S., and as much as 70 percent of environmental waste disposal issues are caused by batteries, plastic and microchips, which contain toxic components.

Look for the consolidation of outsourcing suppliers, which most customers would probably view favorably, because having fewer suppliers tends to simplify governance. Outsourcing suppliers have been and will continue to consolidate through an economic downturn. We can expect to see customers demand that suppliers provide more innovative solutions than they have in the past. This is in stark contrast to an earlier time when innovation was a bonus. Now it is becoming the price of admission.

Both organizations and individuals will respond creatively to an economic downturn and likely develop creative solutions to cope. We are already seeing people changing their driving habits and car buying preferences because of a \$4.00 gallon of gas. With forecasters predicting prices as high as \$5.00 during the summer, this trend will only intensify. We should expect to see outsourcing suppliers continue to pursue work-at-home models for service delivery as a way to deal with wage constraints, higher commuting costs, and staff absenteeism. In the final analysis, a big part of the equation will be how the government and innovative thinkers in industry react (or overreact or fail to react) that determines how deep or how long the recession turns out to be. Predicting the future is a treacherous business, but if we consider a variety of different scenarios, we will be one step closer to Pasteur's adage that "chance favors the prepared mind."

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Thanks to Joe Sifferman, Gary Claytor and Michael Bieler, who provided much of the input for this article.

About the Author

Thomas Tunstall, Ph.D. is co-chair of the IAOP Dallas Chapter, advisory liaison at ACS and a business advisory board member for Insight Technologies. He is a former senior manager with BearingPoint (previously KPMG Consulting), where he had responsibility for the company's IT operations in Afghanistan. Dr. Tunstall holds a B.B.A. in marketing from the University of Texas at Austin, an M.B.A. in operations management and a Ph.D. in economics and public policy from the University of Texas at Dallas. His doctoral dissertation focused on financial indicators that are reliable predictors of outsourcing activity, which served as the basis for his recently published book entitled Outsourcing and Management (Palgrave 2007). He also served as technical editor for Outsourcing for Dummies (Wiley 2008).

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Economy's Impact on Outsourcing: Boom or Bust?

Jeffrey L. Swartz, President, Hundsun Global Services, Inc.

Speakers at D.C. Chapter Meeting Share Perspectives

During tough economic times, companies realizing the value proposition of outsourcing may increase their activities, a panel of experts from business and academia said at a recent IAOP Washington, D.C. chapter meeting.

Following the trend seen after the post 9-11 downturn, the panelists said that outsourcing and offshoring companies could potentially see increased volume in the event of a U.S. recession.

Jeffrey L. Swartz, president of Hundsun Global Services, Inc., and chair of the chapter, moderated the meeting on February 13.

Speakers included Erran Carmel, associate professor, Kogod School of Business, American University; Elizabeth Halaki, chief marketing officer, Océ Business Services; Robert Sherretta, chief executive officer, International Investors, LLC; Greg Retzer, director, Outsource Partners International; and Patrick Dine, chief executive officer, PSD Global, Inc.

The panelists said they believed that companies already outsourcing will continue to do so and, in fact, may look to increase their reliance on partners as a way to reduce costs, and drive efficiency and effectiveness.

However, companies considering new projects and vendors may delay decisions or put them off indefinitely. Middle market companies still will be ripe prospects for business process outsourcing (BPO), where the customer can realize a rapid economic impact.

"Our current economic state is a mild recession versus a major currency crisis, but pain in the U.S. credit markets will impact prices, employment and general business confidence," Swartz said in recapping the speaker's comments. "This certainly will impact business decisions to outsource, making the market more challenging than it has been of late."

Among other highlights of the panel discussion:

- The macro trends that continue to support outsourcing and offshoring are the weakened dollar versus the Indian Rupee, increasing wages in India, and softening wages in the U.S.
- Over the next two to three years overall industry growth will slow from the torrid pace of the past five years. And, at the micro level, there will be an increase of "back-shoring" to farm, rural and local home sourcing providers.
- Outsourcing vendors with a strong U.S. presence should look to find customers who may have an interest in expanding to overseas markets. A Chinese-based outsourcing provider, for example, could help U.S. clients access the China market. Service providers should also consider Western Europe and Canada for opportunities.
- Four of the five of the panelists believe outsourcing of U.S. jobs overseas will not be a significant political issue in the upcoming presidential election.

[Click here](#) for more information on the D.C. chapter event.

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How Will the 2008 Economy Impact the Outsourcing Professional

The IAOP Global Human Capital chapter also addressed the topic of how the 2008 economy will impact outsourcing professionals during its inaugural Webinar on May 13. To learn more about this meeting, [visit](#) the Global Human Capital chapter page.

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Navigating Economic Uncertainty: Leveraging the Services Globalization Advantage Dean Davison & Eugene Kublanov, neoIT

As the U.S. faces an economic downturn in 2008, many corporations are still running their globalization initiatives as if there was no sub-prime meltdown, as if the housing bubble had not burst, or as if inflation and unemployment rates weren't beginning to tell a story of difficult times ahead. Corporations have not yet aligned globalization initiatives to economic reality.



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Coming Next Month: Socially Responsible Outsourcing – What Does It Mean?

We are interested in your thoughts on this topic. If you would like to submit an article for consideration or even a paragraph on how this topic relates to you or your organization, please send your material to [Michael Forbes](#), managing editor by May 27.

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