

# Confidence in the face of turmoil\*

Making sourcing decisions in an economic downturn





# Contents

<b>03</b>	The sourcing decision
<b>05</b>	Situation analysis
<b>07</b>	Impact of the economic downturn on new outsourcing arrangements
<b>08</b>	Exhibit 1: The Impact of Foreign Exchange Volatility
<b>11</b>	Impact of the economic downturn on those renewing outsourcing arrangements
<b>12</b>	Conclusion
<b>13</b>	How PricewaterhouseCoopers can help
<b>14</b>	Contacts

# Overview

Difficult economic conditions around the world have encouraged many executives to look at alternative service delivery models like outsourcing and offshoring as a means of addressing various short- and long-term business concerns.

We believe that these models provide significant opportunities, but recommend taking additional care to assess and understand the complexities of an increasingly volatile market. Only then can executives make effective decisions that will stand the test of time.

# The sourcing decision

Effective business strategies are typically created with both long- and short-term views in mind. They are expected to bridge the gap between reality and vision, prudence and opportunity. The true test of these strategies—and the tactics employed to inform and implement them—is whether they stand up during periods of dramatic and unanticipated change.

The financial crisis that began in the debt markets has now escalated into a global economic downturn, affecting developed and developing countries alike. Stock markets around the world are in constant, unpredictable flux, causing a significant erosion of shareholder value. Volatility in the currency markets has exacerbated the situation and, from a macro-economic standpoint, growth in many industrialized countries is already in decline.

Confronted—and often confused—by a plethora of unprecedented challenges, organizations typically “freeze” in an effort to minimize their risks until more stable times. They focus on immediate operational and tactical issues, and defer mid- to long-term growth opportunities or improvement initiatives. Executives clearly realize the importance strategic planning plays over the long run in reducing costs, improving quality, gaining flexibility, securing talent, and remaining competitive, yet few can resist the internal pressure to retrench.

Over the past few weeks, we have seen many organizations:

- Put a temporary hold on most of their discretionary spending initiatives
- Review their operational areas to identify any cost-cutting opportunities
- Initiate workforce reductions

Though prioritizing and reducing expenditures on IT, finance, human resources, and other back-office functions is prudent during economic downturns, it is also important to realize that cutting jobs in these areas is not a sustainable approach, unless the underlying work activity is also redesigned or eliminated. Failure to make the necessary changes will lead to disruption and productivity losses, and can also leave companies at a long-term competitive disadvantage.

Over the past five years, many of our clients around the world have embraced offshoring and outsourcing as a valuable means of reducing costs and streamlining back-office operations. The mechanisms that support the globalization of service delivery have also matured, accelerating this process. As confidence has risen, organizations have routinely tapped into service and supply capabilities around the world—using a mixture of insourcing and outsourcing arrangements in both onshore and offshore locations—to secure cost savings, efficiencies, and other benefits.

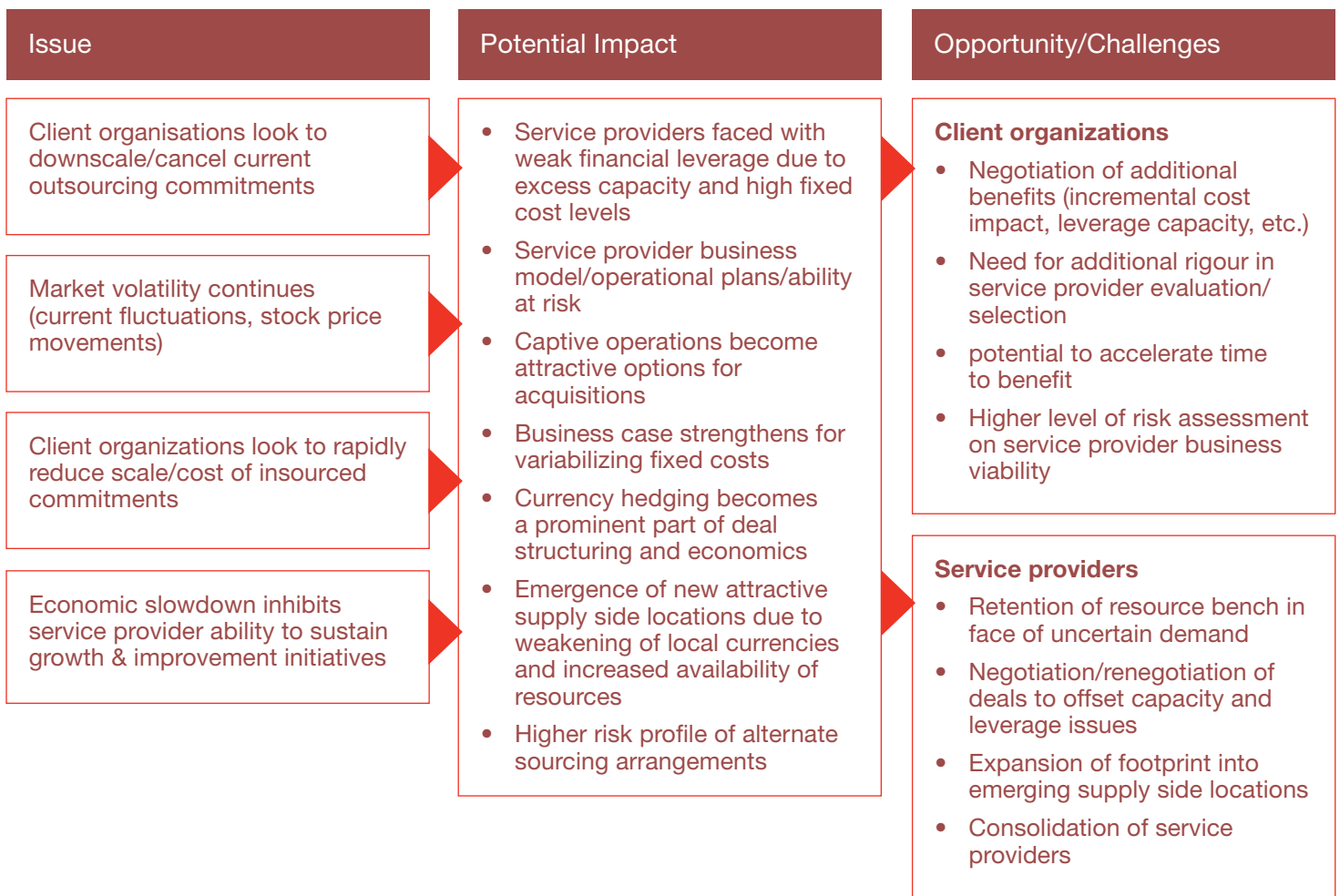
But now times are tough, and the current economic and market conditions have had both a direct and indirect impact on these sourcing practices. As a result, the decision-making process within many organizations appears to be in a state of paralysis.

We anticipate that although it appears that many organizations are currently “on pause,” the countervailing pressure to take action will drive many to do so in haste and without adequate assessment of the affect the additional complexity and opportunities created by the current market conditions will have on their long-term business strategy.

For organizations already seeing the benefits from outsourcing/offshoring and for those looking to enter into these arrangements, the dilemma is clear: both the opportunities to extract value and the risks involved in alternate service delivery models have increased. In our view, standing on the sidelines is not an efficient response to these uncertain times and we urge organizations to adopt a structured approach for evaluating and implementing suitable alternate service delivery strategies.

# Situation analysis

So what should these organizations do? Figure 1 highlights key areas to consider and identifies the potential implications for companies on both sides of the alternative service delivery arrangement.



Even in the best of times, outsourcing solutions require careful planning and structuring to deliver full value. The temptation now is to move quickly to extract additional value. But in the face of growing economic uncertainty and increasing market complexity, outsourcing arrangements demand a higher level of scrutiny and focus. Acknowledging the need for caution and due diligence, there are nevertheless specific actions that organizations can take to review, refresh, and reshape their sourcing strategies, contracts, and relationships to reflect new economic and market realities.

# Impact of the economic downturn on new outsourcing arrangements

Organizations looking to enter into new outsourcing arrangements should consider the following imperatives in the current market environment:

Key decision factor	Imperatives in the new economic realities
Scale & Scope determination	Determine and/or validate the scale and scope of work appropriate for outsourcing arrangement, with additional emphasis on options
Service provider evaluation	<p>Ensure evaluation of potential service providers includes a thorough assessment of the impact of the current crisis on current and future operations to understand the risk perspective as well as additional value extraction opportunities. Focus on service providers ability to service debt liabilities and fund required investments as well as any potential impact of commitments made to and or by other clients within their portfolio.</p> <p>Consider currency hedging as an important aspect of your business case assessment. See Exhibit 1: Impact of Foreign Exchange Volatility</p> <p>Enhance focus on risk assessment and mitigation early in the evaluation process. A more detailed due diligence process may be required with potential partners and service provider</p>
Structure of the arrangement	<p>Consider new locations (nearshore/offshore) that may now offer an attractive proposition to structure the delivery model</p> <p>As service providers are moving towards periods of slower growth, encourage profit sharing and performance based incentive arrangements</p> <p>Consider cost of financing leverage (access to capital at more attractive terms than service provider) to structure cost effective payment terms</p>

# Exhibit 1: The Impact of Foreign Exchange Volatility

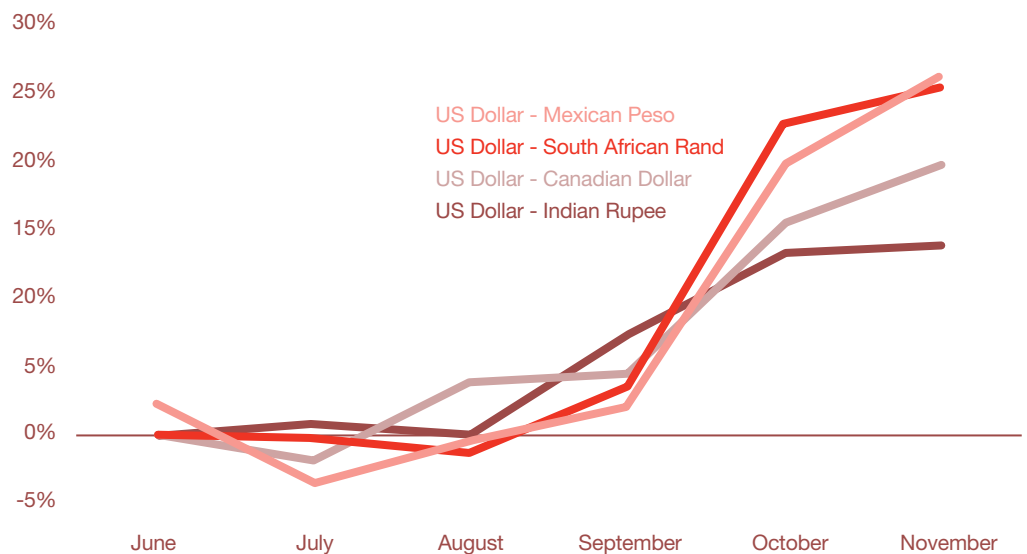
Consider the role currency hedging now plays in your business case assessment.

Sourcing arrangements involving cross-border transactions often increase an organization's exchange rate exposure. Most organizations respond in one of four ways:

- They enter into a contract in their home currency, leaving the risk to the service provider
- They assume that their hedging exposure is countered by other areas within their business
- They put short-term hedging arrangements in place
- They use contract terms to address special situations

However, in the current economic environment, exchange rates are fluctuating so dramatically that it is essential to monitor the situation carefully. Since June 2008, many currencies have weakened against the US dollar (as shown in the table below) increasing their attractiveness as destinations for outsourcing/offshoring.

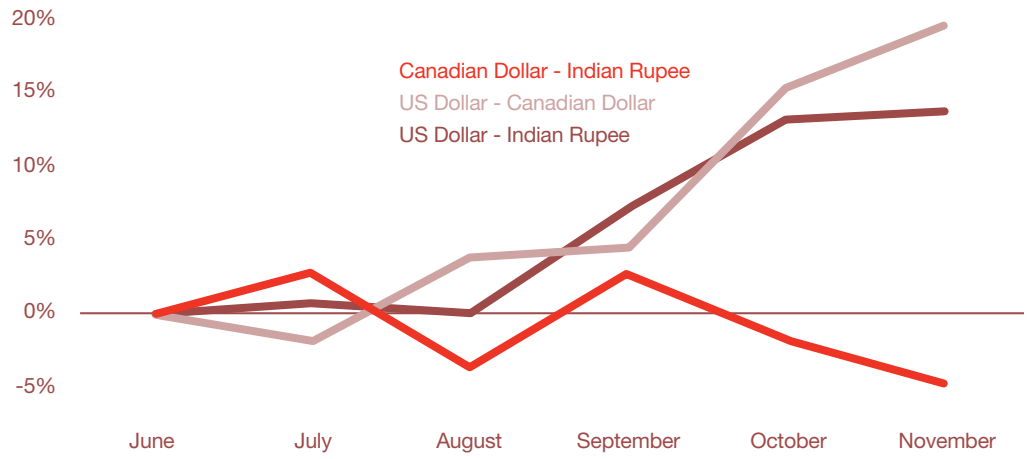
To illustrate how currency volatility could impact the economics of an outsourcing arrangement, consider the scenario where an organization is evaluating the option of transacting either in the local currency or in US dollars.



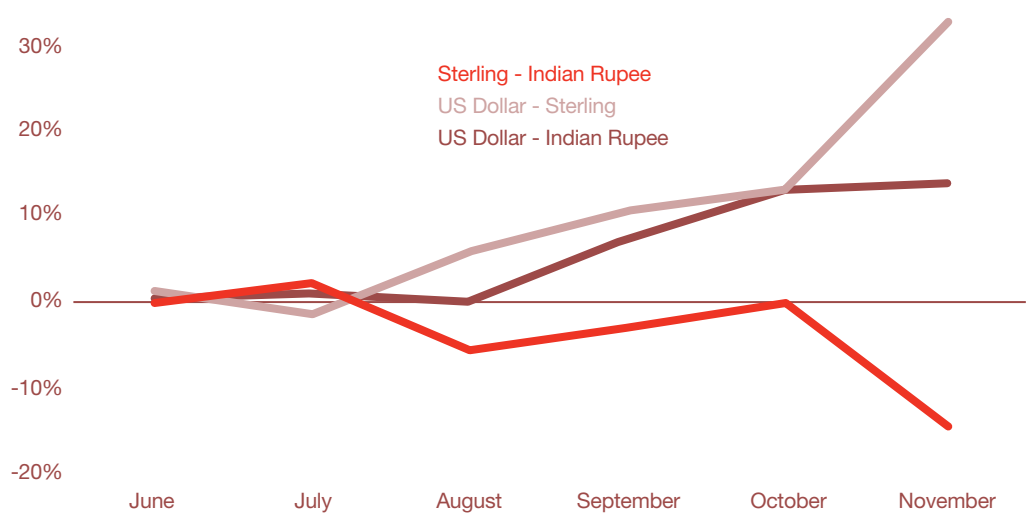
A contract denominated in the local currency of the buyer organization (Canadian dollar [CAD], British pounds [GBP]) would have resulted in no additional exposure from an outlay to the buyer organization, whereas the service provider would have taken an economic hit (CAD to Indian rupee [INR] and GBP to INR movements respectively)—unless, of course, the contract was properly hedged. However, if the contract were denominated in US dollars, the clients would have taken the economic hit, while the service provider would have gained when translating the receipts into its local currency.

The currency impact to both sides can be minimized when contracts include a clause that allows for periodic adjustments in response to currency fluctuations. The absence of these types of clauses results in disproportionate and often unintended financial treatments, and can lead to tension in the sourcing relationship. Companies should seek expert advice on foreign exchange exposure to make sure that all options have been considered (such as using derivative contracts and performing simulations of foreign exchange fluctuations) in the terms of the agreement with the service provider to allow for a fair treatment of gains and losses for both client and provider.

**Illustration 1: organization in Canada, service provider in India**



**Illustration 2: organization in UK, service provider in India**



# Impact of the economic downturn on those renewing outsourcing arrangements

Organizations with existing outsourcing arrangements (e.g., those with outsourcing and insourcing/captive center models) should consider the following imperatives in the new market environment

Key decision factor	Imperatives in the new economic realities
Business Continuity	<p>Assess and understand the viability of your service provider as a going concern</p> <p>Review service provider expectations and commitments in existing arrangements and identify areas that need additional focus. Direct special attention to obligations requiring additional investments over next 12-18 months and consider alternative where appropriate</p>
Scope Change	<p>Assess whether the objectives of the original business model and business cases are still being met and that they have been adjusted to account for any change to your business strategy/requirements</p> <p>Consider the need to change the scope, scale, terms and focus of the current arrangement to reduce or increase commitment level</p> <p>Assess current and future impact of the downturn on SP and determine their ability to continue to provide service and value. Evaluate additional service providers to either augment or replace current service provider. Consider rationalising the number of service provider under contract. Remember though that any evaluation of service providers and the arrangement should allow for additional complexity factors.</p>
Termination / re-negotiation	<p>Assess the likelihood service provider arrangements will support evolving business needs in response to the downturn. Review and understand your contractual obligations and rights. You may not be able to exit without penalties. But in unprecedented times, both parties may be happy to re-negotiate the release and reallocate precious resources</p> <p>Consider opportunity to adjust location strategy in light of new opportunities</p> <p>Engage immediately with your service provider to find way to minimise the adverse impact of termination</p>

## Conclusion

### The author:

Madhav Murti is a Vice President based in the PricewaterhouseCoopers Toronto office and specializes in offshoring and outsourcing advisory services. He can be reached at: [madhav.murti@ca.pwc.com](mailto:madhav.murti@ca.pwc.com).

PricewaterhouseCoopers believes many organizations that are either already outsourcing or planning to outsource their back-office functions can reap significant additional financial and non-financial benefits under current market conditions. Although greater market complexity and risk are concerns that require serious consideration, they should not prevent organizations from taking steps that can enhance their flexibility and competitive strength once the economy recovers.

## How PricewaterhouseCoopers can help

Increasingly, value is created across a complex network of partners, suppliers, customers, regulators, and stakeholders, and success depends on collaboration among them. When it comes to outsourcing, the challenge for organizations lies in finding the time and skilled resources needed to manage complex and often risky global arrangements. Is your business equipped with the insight, skills, and resources to ensure success?

PricewaterhouseCoopers' Consulting team can help execute your business strategy with advice and implementation—locally and globally. As trusted advisors across the entire sourcing arrangement, we bring rigor and discipline to decision making, and drive value by fixing distressed deals, reducing risk in complex contracts, and building the partnership bridge between buyers and providers. We help our clients formulate and implement strategies, reduce costs, increase efficiency, drive innovation, and expand into new markets.

We take the time to listen and have the courage to debate different points of view based on independent and challenging insights, supported by facts and industry benchmarks. We give you the confidence to succeed in a connected world. Our global sourcing leaders, listed alongside, are ready to help.

## Contacts

Pat McArdle  
Global Sourcing Lead Partner  
PricewaterhouseCoopers (UK)  
pat.mcardle@uk.pwc.com  
+44 (0) 20 780 42024

Paul Horowitz  
PricewaterhouseCoopers  
(United States)  
paul.j.horowitz@us.pwc.com  
+1 (646) 471 2401

Paul Zanker  
PricewaterhouseCoopers  
(Singapore/Asia-Pacific)  
paul.j.zanker@sg.pwc.com  
+65 (0) 6236 3353

Robert van der Eijk  
PricewaterhouseCoopers  
(Belgium/continental Europe)  
robert.van.der.eijk@be.pwc.com  
+32 2 710 7271

Romek Lubaczewski  
PricewaterhouseCoopers  
(Poland/CEE & CIS)  
romek.lubaczewski@pl.pwc.com  
+48 502 184 319

John Y. Chang  
PricewaterhouseCoopers  
(Canada)  
john.y.chang@ca.pwc.com  
+1 (416) 869-2606

Ricardo Neves  
PricewaterhouseCoopers  
(Brazil & South America)  
ricardo.neves@br.pwc.com  
+55 (11) 3674 3250

Luis Garrido  
PricewaterhouseCoopers  
(Costa Rica & Central America)  
luis.garrido@cr.pwc.com  
+506 224 1555 ext. 102

Mark Gilbraith  
PricewaterhouseCoopers  
(China)  
mark.gilbraith@cn.pwc.com  
+86 21 2323 2898

Mike Roy  
PricewaterhouseCoopers  
(South Africa)  
mike.roy@za.pwc.com  
+27 (11) 797 4437

Hari Rajagopalachari  
PricewaterhouseCoopers  
(India)  
hari.rajagopalachari@in.pwc.com  
+91 80 4079 4002

Steve Kranes  
PricewaterhouseCoopers  
(Australia)  
steve.kranes@au.pwc.com  
+61 (2) 8266 8465

Alberto Kuri Monterrubio  
PricewaterhouseCoopers  
(Mexico)  
alberto.kuri.monterrubio@mx.pwc.com  
+52 (0) 55 5263 6000 ext 6137



[pwc.com/sourcing](http://pwc.com/sourcing)

The member firms of the PricewaterhouseCoopers network ([www.pwc.com](http://www.pwc.com)) provide industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 140,000 people in 149 countries share their thinking, experience and solutions to develop fresh perspectives and practical advice.

© 2009 PricewaterhouseCoopers. All rights reserved. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. \*connectedthinking is a trademark of PricewaterhouseCoopers LLP (US). DH-09-0347