

Off-shoring in retail and consumer goods

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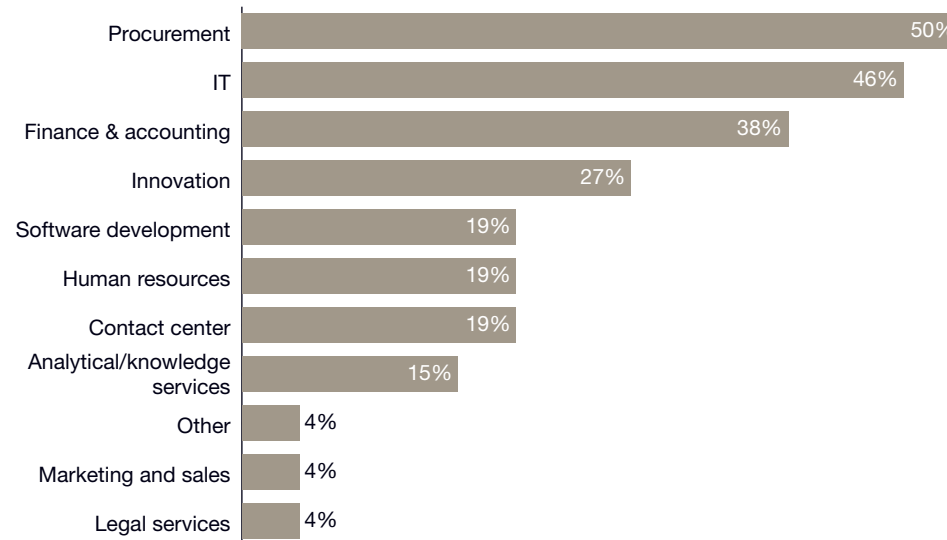
As the global economy crawls out of a recession, access to credit is limited, capital is not readily available, and companies are trying to curb costs. Retail and consumer goods companies are no exception. Amid the challenges they face in today's business environment, they are trying to maintain and grow profit margins. To do this, many of them are expanding into the global market seeking lower-priced products and services. As their reach spreads farther around the globe, the supply chain becomes more complex but also offers opportunities for cost savings, better provider relationships, and enhanced operational performance. As a result, the retail and consumer goods industry now finds itself heavily influenced by global sourcing and concentration of power.

Results of the 2009 *Offshoring Research Network (ORN)* survey show that procurement and information technology (IT) are the two largest areas of off-shoring in the retail and consumer goods industry (see Chart 1). Half of industry participants said they off-shore their procurement activities, and 46 percent said they off-shore their IT needs. Given the significant role procurement and supply chain management serve in the industry, this finding clearly represents retailers' effort to increase cost efficiency. Most

procurement work is more difficult to standardize than other business process outsourcing and requires specially trained service providers. In addition, the promise of cost savings is constantly challenged by the incremental cost of upgrading procurement technology and finding and retaining staff with the necessary expertise. This tight coupling between procurement and IT might explain the rapid growth of both procurement and IT off-shoring in the retail and consumer goods industry (see Chart 2).

Chart 1: Distribution of functional implementations by retail and consumer goods companies

Source: Duke University/The Conference Board Offshoring Research Network 2009 survey

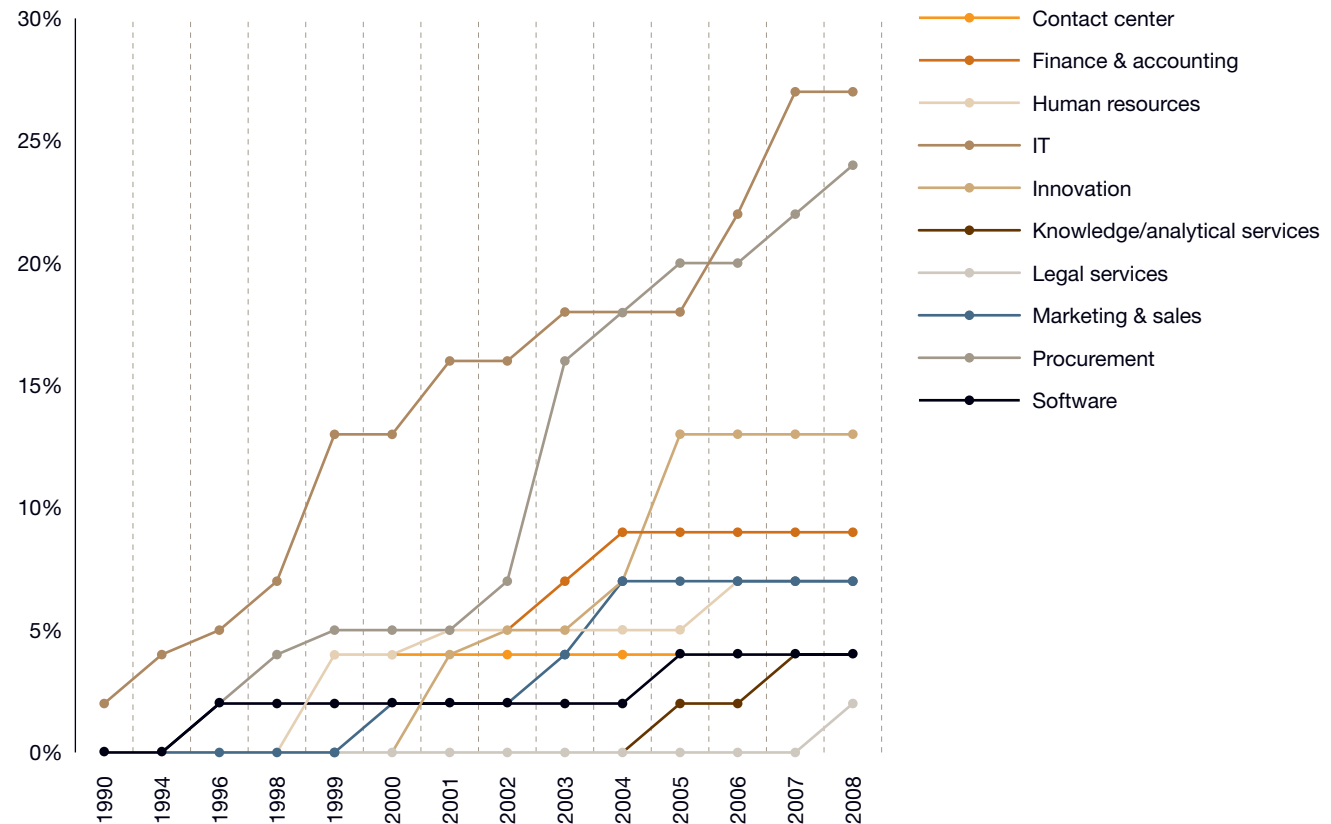


Interestingly, most procurement off-shoring by retail and consumer goods companies is sent to service providers in China (28 percent) and Eastern Europe (17 percent). In contrast, India has only an 11 percent share of procurement off-shoring within the industry. When asked about key underlying factors for selecting off-shore destinations, survey participants indicated low labor costs (68 percent), geographical proximity (67 percent), and an effort to co-locate with existing business

process facilities (67 percent) (see Chart 3). Across all industries, a low-cost location is undeniably the most common choice for off-shoring, but among retail and consumer goods companies we observe a much stronger interest (almost double) in geographical proximity and co-locating off-shoring with existing business process facilities. This is because by its very nature, logistics and transportation are key factors in cost efficiency and operational excellence for this industry.

Chart 2: Cumulative percentage of implementations off-shored in manufacturing industry by function and year

Source: Duke University/Archstone Consulting Offshoring Research Network 2005 US survey and Duke University/Booz Allen Hamilton Offshoring Research Network 2006 US survey and Duke University/The Conference Board Offshoring Research Network 2007/8 US survey and Duke University/The Conference Board Offshoring Research Network 2009 survey

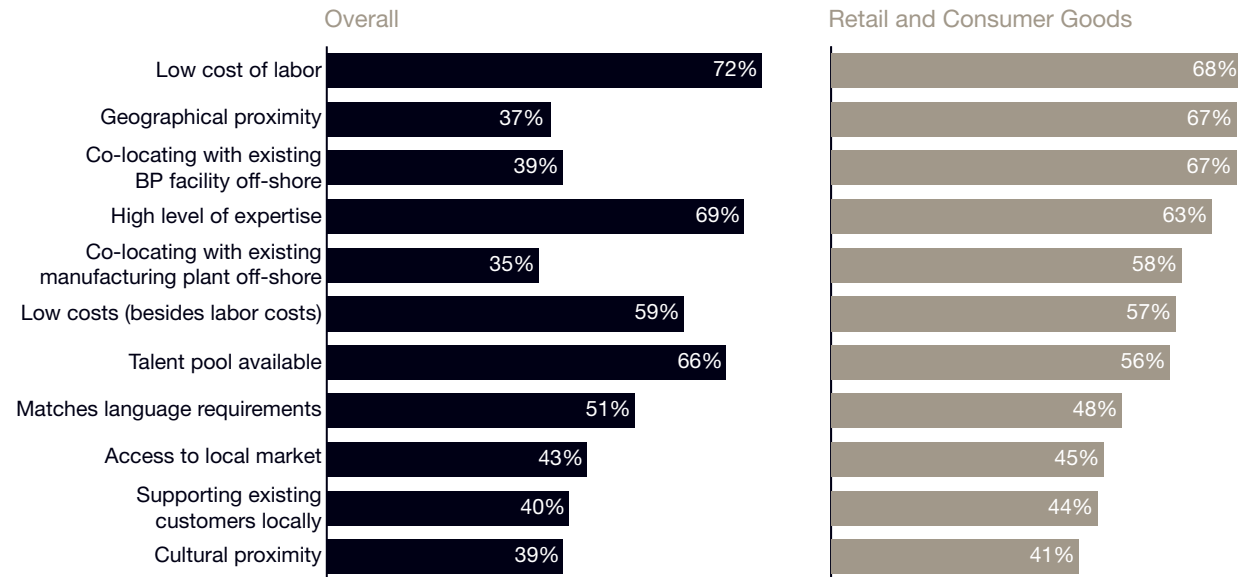


The distribution of off-shoring implementations by function shows that only 27 percent of retail and consumer goods companies off-shore their innovation activities (see Chart 1). However, that percentage is increasing year over year (see Chart 2), and China is cited as a main destination, accounting for 40 percent of innovation off-shoring implementations

(see Chart 3). Though it started slowly among these companies, off-shoring innovation could have a significant impact on market share and profitability. As retailers begin to recognize its potential, it could become the next game changer in the retail and consumer goods industry.

Chart 3: Percent of companies indicating factor as “important” or “very important” in off-shore location choice (overall versus retail and consumer goods)

Source: Duke University/The Conference Board Offshoring Research Network 2009 survey



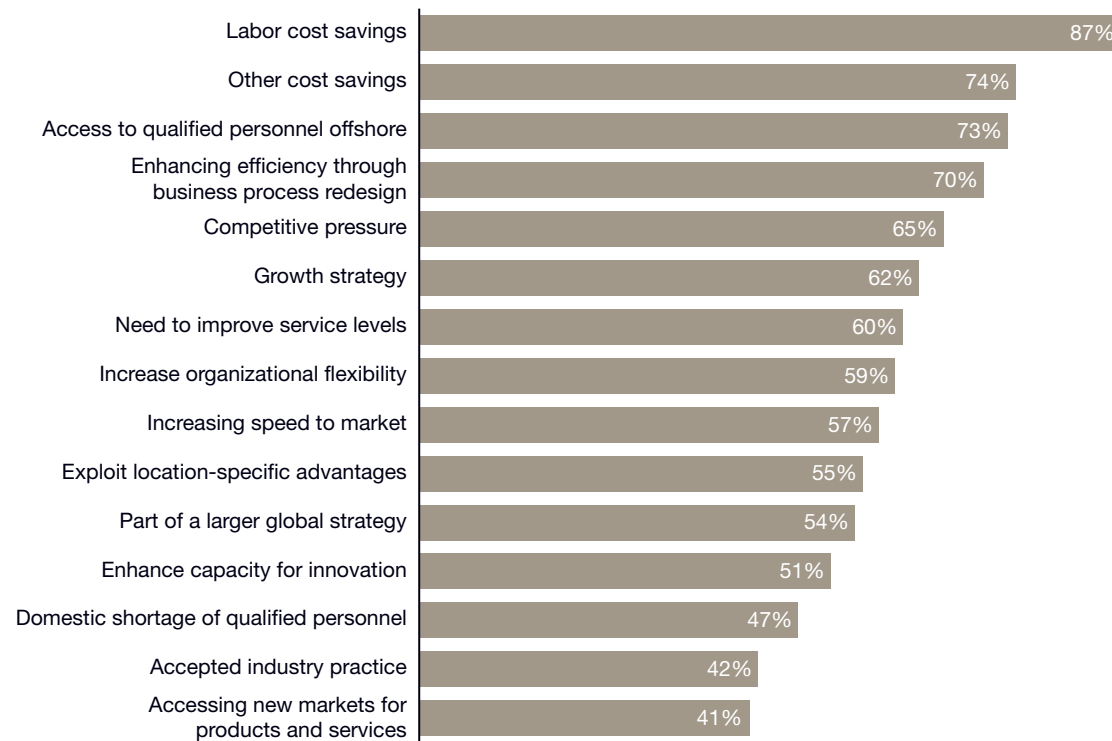
As companies strive for greater efficiency and market share in a dynamic, competitive market, they must be flexible and able to adapt quickly, especially until the economy makes a recovery. Off-shoring has brought a profound change in the way retail and consumer goods companies source and produce services and products.

One of the most provoking results of the ORN survey is the change from 2007 to 2009 in significant factors underlying off-shoring decisions among retail and consumer goods companies. In 2007-08, survey participants cited growth strategy as their primary goal in off-shoring, with 75 percent

saying it was an “important” or “very important” driver underlying their off-shoring decisions (see Chart 5). The latest ORN survey shows at least 70 percent of participating providers said cost savings and enhancing efficiency through business process redesign are the most important reasons for out-sourcing (see Chart 4). However, more experienced companies are off-shoring to increase speed to market, improve service levels, and enable access to new markets. Almost 70 percent of respondents revealed that they expect off-shoring to improve speed to market, up from 42 percent in 2007-08. The importance of gaining access to new markets through off-shoring has doubled from 16 percent in the

Chart 4: Percent of service providers rating drivers as “important” or “very important” reasons for their clients to out-source

Source: Duke University Offshoring Research Network 2009 service provider survey

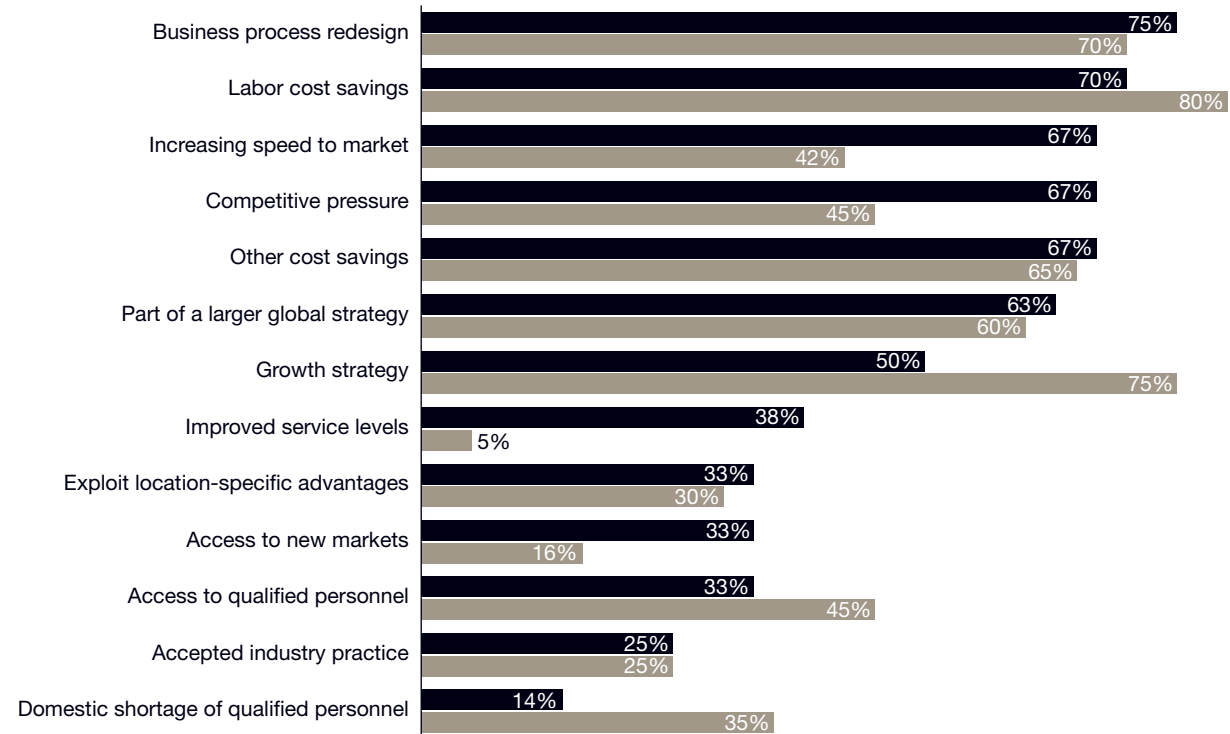


previous survey to more than 33 percent in 2009. Improved service quality also has increased dramatically as an off-shoring driver, from 5 percent in 2007-08 to almost 40 percent in 2009. Similarly, a much larger number of retail and consumer goods companies turn their focus to competitive pressure when making off-shoring decisions: Competitive pressure is rated as an “important” or “very important” factor by 67 percent of participants. These findings suggest that in a crowded, increasingly competitive market, retail and consumer goods companies are leveraging off-shoring in efforts to lead their industry.

Access to qualified personnel and a domestic shortage of qualified personnel have become less influential (33 percent and 14 percent respectively) in decision-making regarding off-shore services. Interestingly, the challenge of finding talent and skilled workers ranked high in the 2007-08 survey. However, companies seem to have shifted their focus to addressing efficiency and performance during the past year in an effort to survive the economic downturn.

Chart 5: Significance of off-shoring drivers identified by retail and consumer goods companies by survey years

Source: Duke University/The Conference Board Offshoring Research Network 2007/8 US survey and Duke University/The Conference Board Offshoring Research Network 2009 survey



Captive spin-off and new product development through innovation off-shoring is high on the agenda

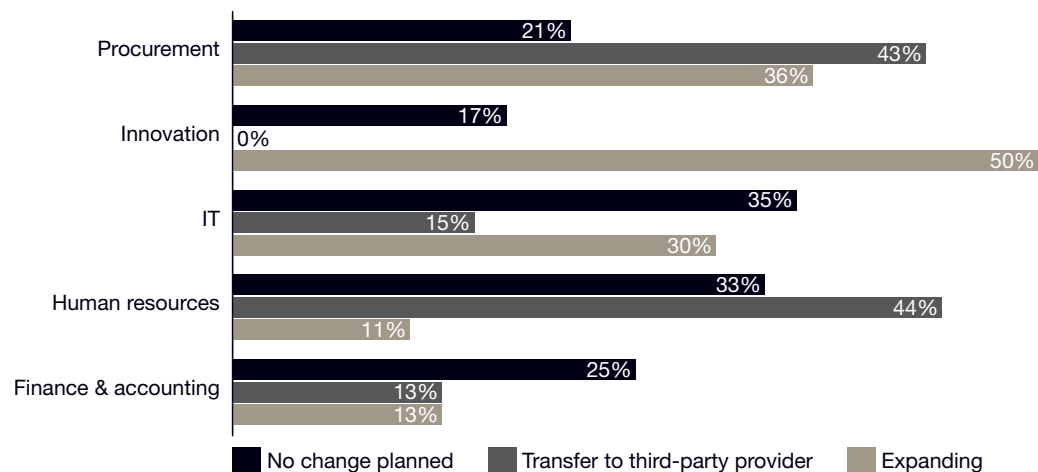
An examination of plans to expand off-shoring applications or initiate new ones during the next 18 to 36 months reveals that retail and consumer goods companies' expectations and plans vary across different off-shoring functions and that the outlook for off-shoring in the retail and consumer arena is robust.

Thirty-six percent of reporting retail and consumer goods companies expect to expand their off-shoring activities. However, 43 percent indicate that they will spin off their captive procurement operations to a third-party provider (see Chart 6). Follow-up telephone interviews with companies planning to spin off their captives suggest that keeping procurement operations as a captive unit incurs considerable costs and risks, both

of which companies are trying to avoid during this time of economic turmoil. Companies increasingly recognize that they cannot match third-party providers' economies of scale and scope, continual service improvements, and superior capabilities in attracting and managing the workforce. Human resource off-shoring is another function many retail and consumer goods companies expected to transfer to third-party service providers in an attempt to reduce costs and increase efficiency. Forty-four percent of participating companies said they plan to spin off their human resources captive operation in the next 18 to 36 months. However, during the same timeframe only 11 percent of companies expect to expand their human resource operation.

Chart 6: Retail and consumer goods companies' plans by function

Source: Duke University/The Conference Board Offshoring Research Network 2009 survey

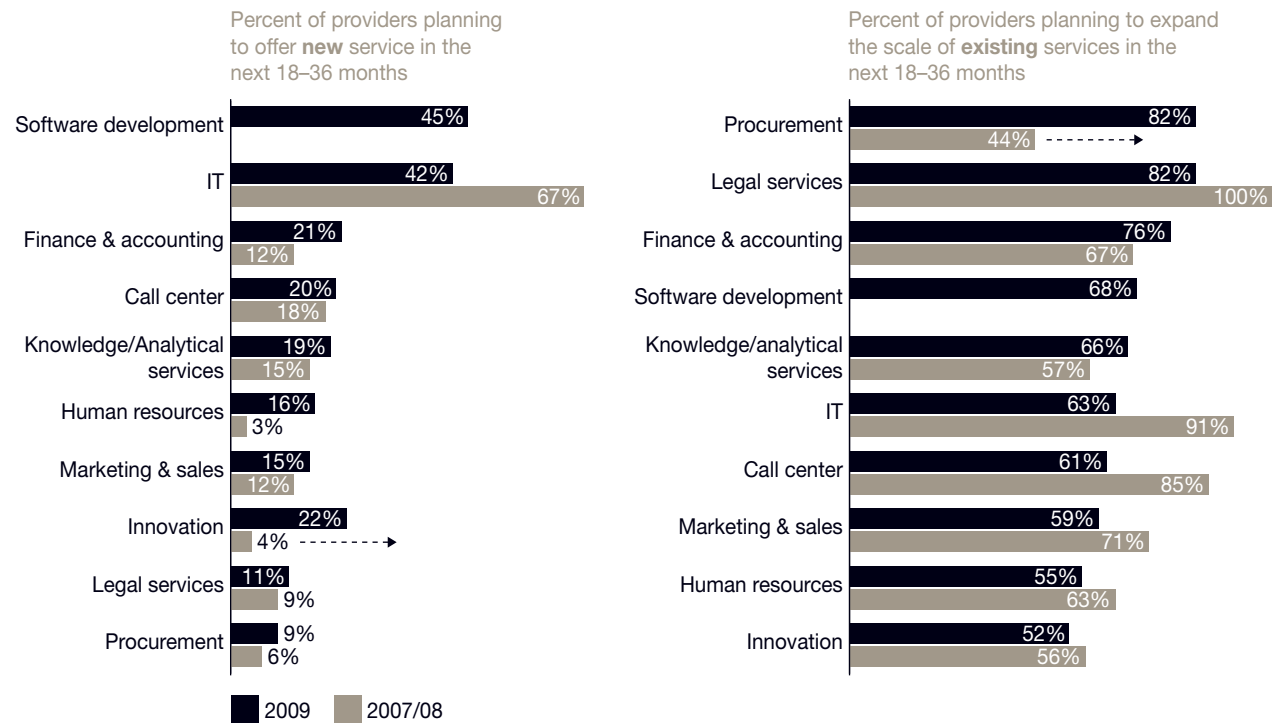


Finally, 52 percent of the companies that participated in the survey are planning to expand their innovation activities off shore during the next 18 to 36 months. This finding is consistent with the growing trend of innovation off-shoring illustrated in Chart 2 and speaks to the belief that new product development and innovation are seen as critical to growth and therefore have become a priority in the retail and consumer goods market.

Drawing on findings from the latest service provider survey (640 providers worldwide) for a more comprehensive explanation of the expected trend in the procurement and innovation off-shoring market, Chart 7 illustrates service providers' plans to offer new or expand existing service offerings during the next 18 to 36 months. Growth in innovation service offerings is more likely to come from new service providers (this could be a new service provider or an existing service provider who has not provided

Chart 7: Percent of service providers planning to offer new services versus to expand the scale of existing services in the next 18-36 months

Source: Duke University Offshoring Research Network 2007-08 service provider survey and Duke University Offshoring Research Network 2009 service provider survey



innovation service) entering the innovation off-shoring market (which offers much higher margins) while the growth in procurement services is more likely to result from existing service providers expanding their procurement operations.

What seems clear from the 2009 ORN survey results is that to be successful in this dynamic environment, retail and consumer goods companies must ratchet their adaptive capabilities while maintaining a sharp focus on maximizing efficiency and deepening relationships with customers and suppliers. While the majority of companies are recognizing the potential benefits of engaging in global sourcing, many of them are not taking advantage of all the benefits off-shoring operations offer.

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To have a deeper conversation about any of the issues in this paper,
please contact:

Charles Aird
PricewaterhouseCoopers
Phone: (704) 344-7651
Email: charles.l.aird@us.pwc.com

Derek Sappenfield
PricewaterhouseCoopers
Phone: (240) 481-5345
Email: derek.sappenfield@us.pwc.com

Bob Scheier
PricewaterhouseCoopers
Phone: (267) 330-2736
Email: robert.h.scheier@us.pwc.com

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