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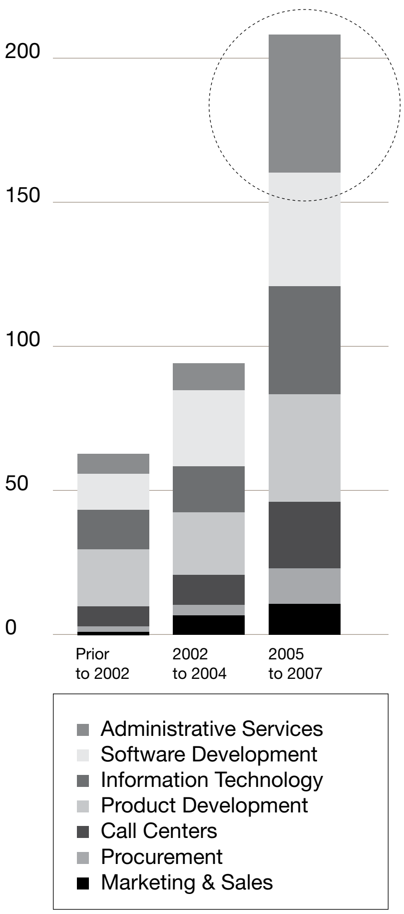
Global sourcing trends

Can politicians reverse trends in global sourcing?

Growth of new offshoring projects 2002-2007



Source: Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey

Figure 1

PwC point of view

Economic and social drivers such as labor arbitrage and tax incentives, as well as access to global talent and global markets, have fueled off-shoring during the past 20 years. Today, as cost containment becomes a primary objective given the harsh economic conditions, the off-shoring trend seems ready to accelerate rather than reverse itself. In spite of claims to the contrary, it is unlikely that a policy will be able to reverse the offshoring wave, given the benefits that can be achieved and the need to remain globally competitive.

Given the search for global talent along with the current economic climate, which is forcing many companies to seek ways to cut costs, off-shoring appears to be increasing. Recent research from PwC and the Duke Offshoring Research Network (ORN) reveal that most US companies with an existing offshoring strategy intend to expand both the scope and scale of their offshoring efforts.

Some history

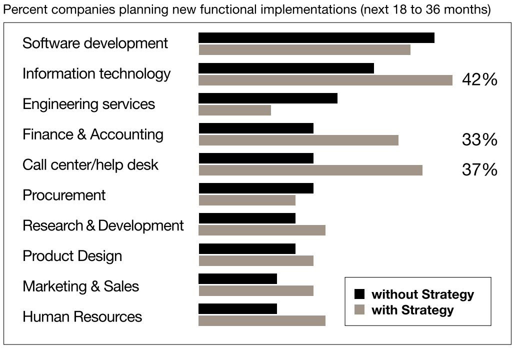
Two decades ago, a handful of US-based companies set up offshore captive centers.Those initial forays have evolved into the extensive and maturing offshoring landscape we see today. Fueled by a growing, global communications infrastructure, these pioneers primarily off-shored data entry, application development, and maintenance at the outset and later expanded their scope to include contact centers and routine, rules-based activities such as accounts payable processing. Y2K and the 2001 economic slowdown that followed soon after led to an increased use of offshore-based information technology and transaction processing resources. That trend has ramped significantly from there as offshore capabilities have matured in India and elsewhere. Figure 1 highlights the massive increase in new offshoring projects.

Scope and scale of offshoring

We note that once companies have experience in the offshoring of transactional processes, they frequently offshore judgment-based or even mission-critical processes. These commonly include high-end finance and accounting activities, research & development (high tech and engineering companies in particular have offshored these activities), equity research and analytics (financial services firms) and private label manufacturing (home improvement products). Figure 2 depicts the areas of highest growth in offshoring plans.

Companies with offshoring strategy (75% large companies) have aggressive plans for new IT, F&A and Call Center operations offshore

Percent companies planning new functional implementations (next 18 to 36 months)



Source: Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey

Figure 2

While companies have been expanding the number of processes they offshore, there has been a corresponding, demand-driven growth of alternative locations and providers. Only a few years ago, India was often the first and only location considered, but now Eastern Europe, the Philippines, China and Latin America are often included in a company's short list of potential locations. These additional alternatives serve to further mitigate some of the risks that sometimes accompany the movement of activities to a remote location and to keep the labor market price competitive.

Can offshoring be slowed?

Although US job losses are a primary economic concern in these distressed economic times, offshoring policy alternatives are limited. Incentives for companies retaining jobs in the United States might be effective, but only for a limited time. Tax incentives likely would have a short-term impact because other countries could simply respond in kind, negating any relative benefit to companies enlisting that approach. Alternatively, tax penalties for companies offshoring is probably not a viable option either, because it will reduce the ability of US-based companies to compete globally.

Although offshoring is a very effective strategic lever, certain core processes for US-based companies require extensive customer interaction, are key to competitive differentiation, and/or may have regulatory requirements making them generally unfit for offshoring. Presuming offshoring is here to stay, this begs a question: Which processes will typically be retained in the United States and which will be "offshored" to the United States from other countries over the coming years? Will it be primarily innovation-focused activities or will it extend beyond those? Also, how will any changes in tax policy affect global sourcing? Given the new incoming administration has not been specific about implementing any changes, we cannot be certain about how new tax laws or policies could impact offshoring.

Summary

All indications are that offshoring by US companies is not only here to stay but also will accelerate during the next few years. Although there is quite a bit of political discussion at the moment, the options available are limited, and market forces—not policy—will drive companies' global sourcing strategies.

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