

Offshoring in high-tech and telecom

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The high-tech and telecom industry continues to experience unprecedented changes from both market and technology advancements, which force companies to continuously improve their business model and keep up with innovation. To sustain and thrive in this market, companies cannot avoid these changes. The primary challenge and main focus in the high-tech and telecom industry are the availability and efficient administration of resources. Customers demand more and improved services at lower prices with shorter time to market. As one option toward improving efficiency, high-tech and telecom companies take a global reach and source their products and services offshore. Some have gone beyond that and use offshoring as a way to enter new markets and access new capabilities not available in-house or onshore.

Contact centers, innovation services, and information technology are key offshoring activities in the high-technology and telecom industry

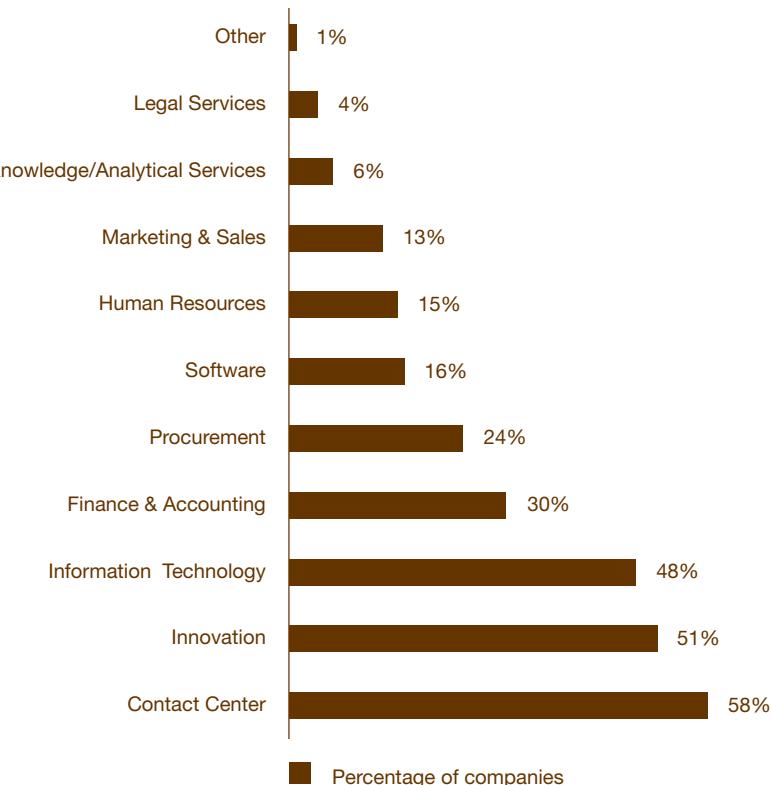
In addition to the extremely dynamic market, cost optimization remains a top priority for this industry. Despite their complex processes and legacy IT systems, companies need to accelerate their pace of innovation while meticulously reducing operational costs. At the same time, companies face the challenge of maintaining their existing customers. Accordingly, providing great customer services, keeping prices competitive, and offering new products and services to keep the existing customers are the core of their business.

Given these characteristics of the high-tech and telecom industry, it is not surprising that we observe in the results of the Offshoring Research Network (ORN) survey¹ that a contact center, innovation services, and information technology are the top three offshoring activities among companies in this industry. As shown in Chart 1, almost 60 percent of high-tech and telecom companies have offshored their contact center operation, while approximately half of participating businesses are offshoring their innovation and information technology services. According to the ORN data, contact center offshoring in the high-tech and telecom industry started to take off around 1999 and has grown very rapidly since 2001 (see Chart 2). The majority of contact center offshoring by high-tech and telecom companies goes to Latin America (26 percent); other Asia, especially the Philippines (18 percent); and India (16 percent) (see Chart 3).

The choices of Latin America and the Philippines as offshoring destinations for a contact center are interesting for further exploration. We explain this preference among high-tech and telecom companies as their attempt to avoid an offshoring hot spot such as India, which is now facing unsustainable wage inflation.

Chart 1: Distribution of functional implementations by high-tech and telecom companies (Percentage of companies offshoring function)

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



¹ The ORN survey tracks offshoring activities in all functions (e.g., administrative services, innovation services, and knowledge and analytical services) over time. The ORN database includes 1,445 companies from across countries (e.g., U.S., Europe, Asia, and Australia) and industries. The high-tech and telecom industry accounts for 9 percent of the overall sample. The results presented herein are based on responses from high-tech and telecom companies worldwide.

Chart 2: Cumulative percentage of implementations offshored in high-tech and telecom industry by function and year (Percent of total number of implementations over whole period)

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

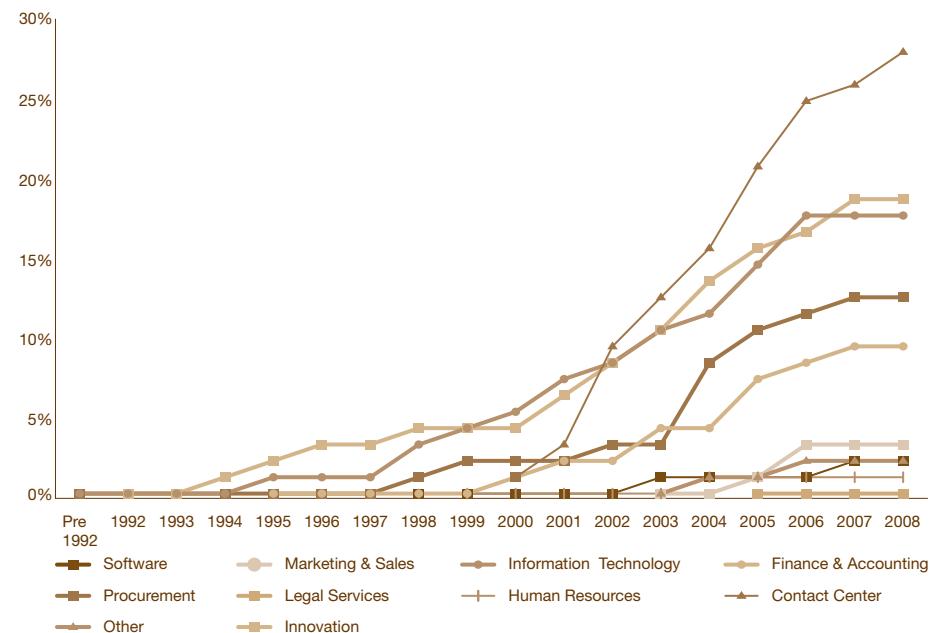
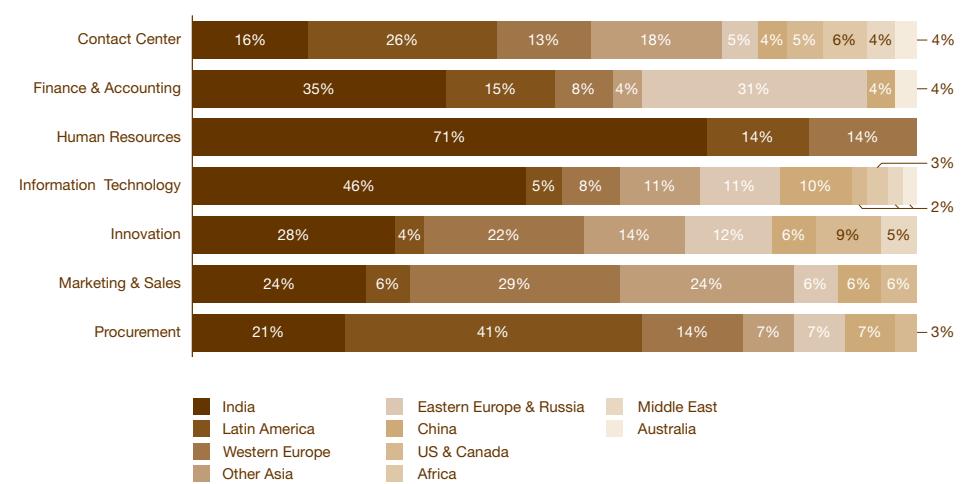


Chart 3: Distribution of offshore destinations chosen by high-tech and telecom companies for particular function (Percent of implementations offshored to region)

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

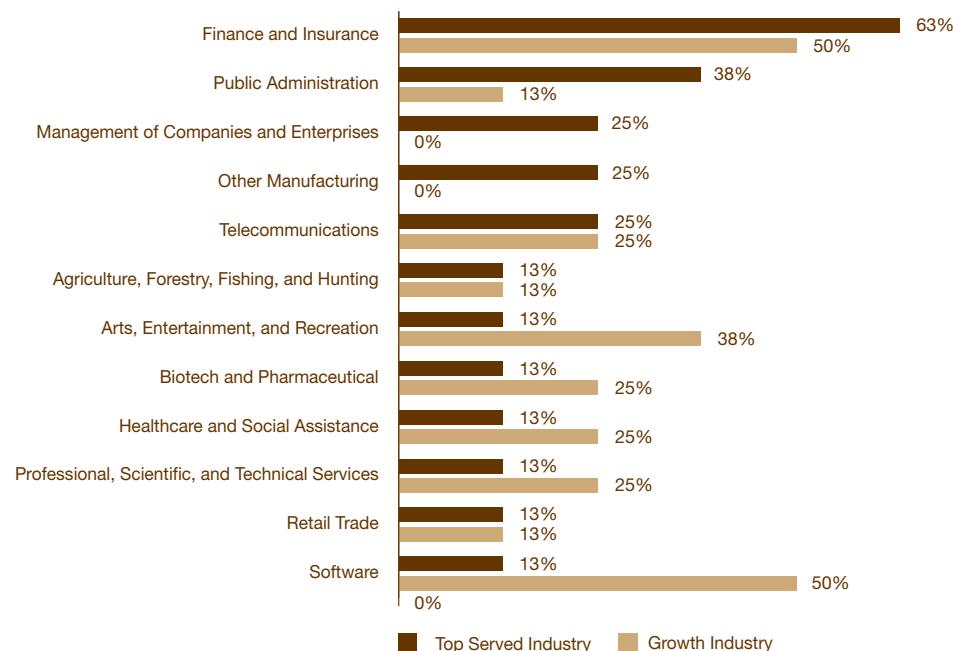


Latin American service providers also indicate, in the 2009 ORN service provider survey, that telecommunication companies are among their top five client industries and expect continuing high growth (see Chart 4). In an attempt to compete with an incumbent player like India, both governmental and business bodies in Latin America express their commitment to build up their strength as a hub for contact center offshoring. A focused interview with a major service provider in Colombia shows that the company expects rapid growth in the demand for next-generation contact centers and customer services. So the company has invested in infrastructure and training for the advance nonvoice contact center, which will gradually replace the traditional (voice) call center.

Although customer services and contact centers are critical in the high-tech and telecom industry, offshoring of innovation and information technology is also in an important focus. The participating companies in our sample indicate that their innovation and IT offshoring operations trace back prior to 1992, much earlier than contact center offshoring. However, their growth is more moderate and, hence, lags contact center offshoring since 2001 (see Chart 2). While IT activities of most high-tech and telecom companies (46 percent) have been operated by Indian service providers, Western European providers take a relatively large portion of the pie in innovation offshoring—28 percent of innovation offshoring was sent to India and 22 percent to Western Europe (see Chart 3). This finding shows the potential for Western European providers to develop as a cluster for innovation service offshoring, especially for high-tech and telecom clients.

Chart 4: Percent of Latin American providers indicating top industries served and high-growth industries

Source: Duke University Offshoring Research Network 2009 Service Provider survey



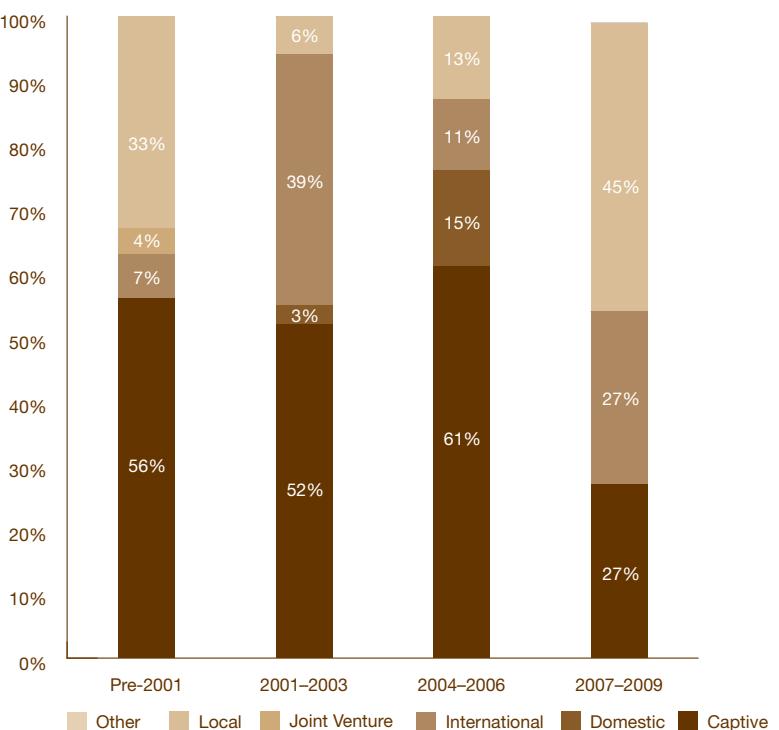
A shift in the governance model and rationales for offshoring reflects a strong cost concern

Consistent with the trend in the finance and insurance industry, we observed in the 2009 ORN survey a decline in the captive service delivery model². In particular, the results show that a captive operation had been a preferred choice for the majority of high-tech and telecom companies: More than half of participating companies deployed a captive offshoring model from prior to 2001 to 2006 (see Chart 5). However, the strong preference for a captive model has faded and shifted toward local and international service providers. The number of captive offshoring implementations dropped from 61 percent during 2004–2006 to less than 30 percent in 2007–2009. Many companies realized the operational costs of a captive operation and the difficulty in achieving consistent economies of scale, leading them to reconsider whether they should keep their captive operation or sell it off source products or services from third-party providers. The challenge of running a captive unit is even more profound in a dynamic industry such as high-tech and telecom, which frequently requires investments to keep up with complex, fast-evolving technology.

Another interesting shift in the high-tech and telecom industry is changes in the rationale for offshoring expressed in the 2009 survey. Chart 6, a comparison of offshoring drivers by year, suggests that in 2009, high-tech and telecom companies became very concerned about costs and pressure from tense competition in the market: of the six most important drivers of offshoring decisions, labor cost savings rose to 93 percent from 76 percent in 2007/08, and competitive pressure increased to 71 percent from 48 percent in 2007/08.

Chart 5: Service delivery model over time by size (Percent of offshoring implementations using model in high-tech & telecom industry)

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

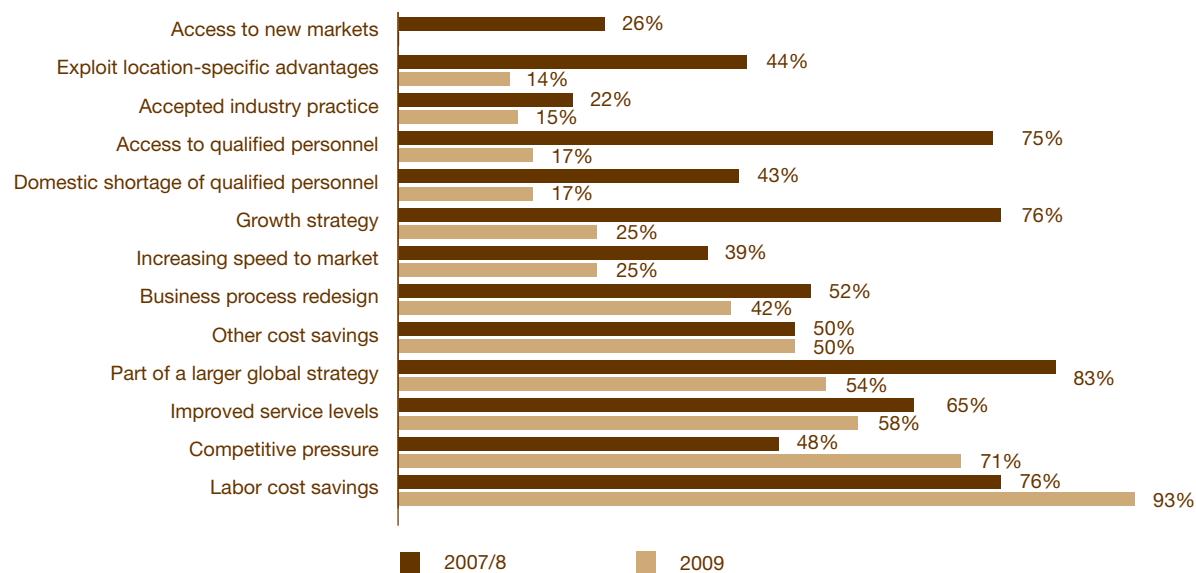


² Captive is a service delivery model in which the processes offshored are performed by a fully owned subsidiary—instead of a third party service provider—in an offshore location

At the same time, a focus on offshoring as a growth strategy, part of a global strategy, and to gain access to talent became less significant in 2009. The results show that the number of companies indicating their rationale to use offshoring was part of a larger global strategy dropped from 83 percent in 2007/08 to only 54 percent in 2009. The percentage of companies viewing offshoring as their growth strategy significantly decreased, from 76 percent in 2007/08 to 25 percent in 2009. Similarly, access to qualified personnel, one of the top four important drivers of offshoring in 2007/08, dropped to near the bottom of the list of important drivers of an offshoring decision, with only 17 percent of companies calling it “important” or “very important.”

Chart 6: Offshoring drivers by year

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



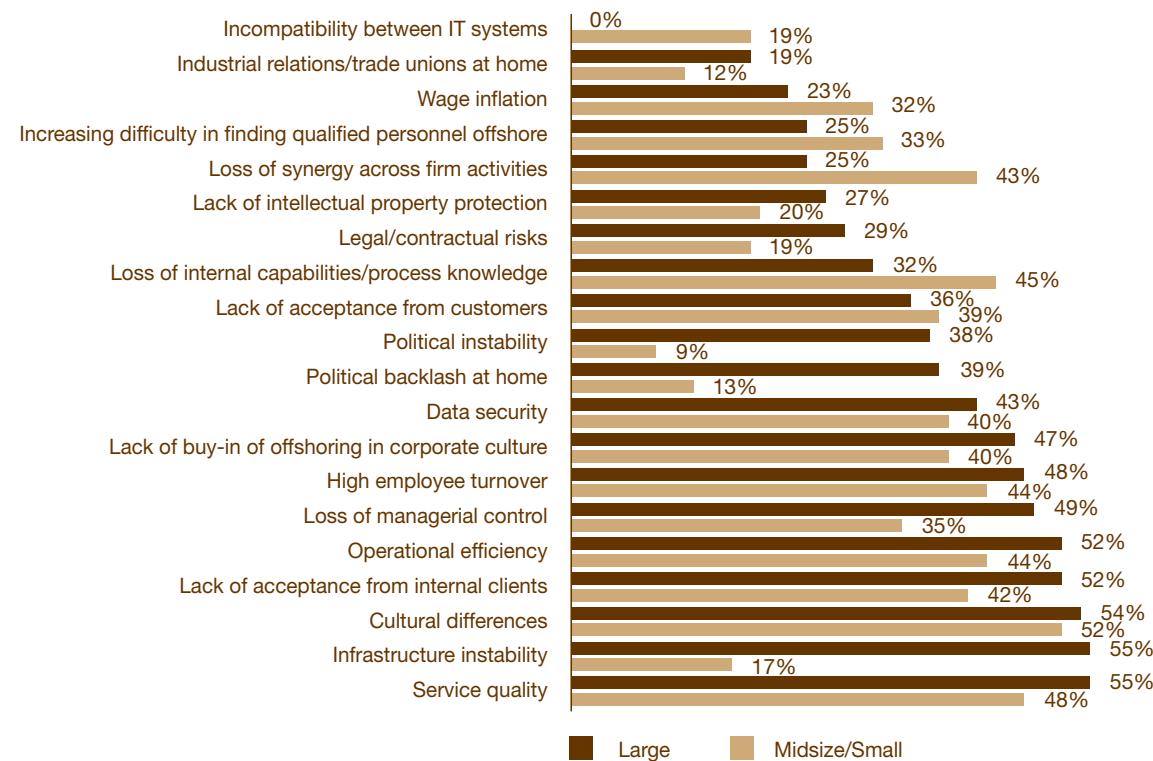
Given the long, slow economic recovery, these changes in offshoring rationale are not difficult to explain. Most companies have been pursuing the “safe mode” for their operations, including offshoring, and delaying their expansion or any aggressive plans. The reduction in the need to acquire talents offshore is also explained in part by a significantly high unemployment rate during the economic downturn. According to the latest report from US Citizenship and Immigration Services (USCIS), the H1B visa cap for 2009 was not reached, reflecting less domestic in shortage of skill and talents than the earlier years.

Differences in rationale for offshoring between large (more than 20,000 employees) and midsized (500–20,000 employees) or small (less than 500 employees) companies are another worthwhile point. According to the latest survey data, we observe that large high-tech and telecom companies are more vulnerable to political risks and instability of infrastructure than midsize and small companies (see Chart 7). Almost 40 percent of large high-tech and telecom companies say that political

backlash at home and political instability are the key risks for their offshoring operations, while less than 15 percent of midsize and small companies express their concern about these risks. Stability of infrastructure is rated by large companies as the most significant risk in offshoring (tied with service quality), while only 17 percent of midsize and small high-tech and telecom companies indicate a strong concern about infrastructure instability.

Chart 7: Offshoring risks by company size

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



Looking forward, high-tech and telecom companies will test various approaches to tackle their offshoring challenges

One of the best ways to gain insight into offshoring of an industry is to look into companies' future plans. The ORN surveys capture the data on companies' expectations and their plans for the next 18–36 months. The results from high-tech and telecom companies show that information technology offshoring is expected to grow strongly; 52 percent of high-tech and telecom companies are planning to expand their existing information technology offshoring operation in the near future (see Chart 8).

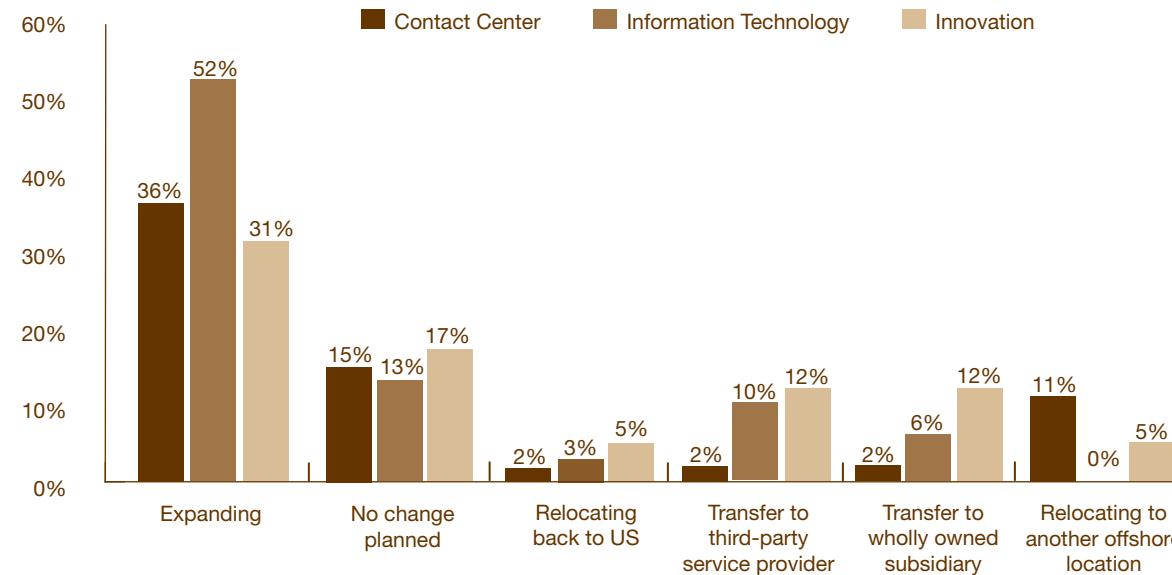
Consistent with the "safe mode" approach discussed earlier, the results from future plan questions suggest that a relatively large number of high-tech and telecom companies do not plan to make any major changes to their offshoring operations and simply want to sustain themselves

through the tough economic time. More than 15 percent of participating companies say that they have no change planned in their existing contact center and innovation offshoring over the next 18–36 months, and 13 percent say the same thing for the existing information technology offshoring operations.

Interestingly, as high as 11 percent of high-tech and telecom companies told us that they have a plan to relocate their contact center operation to another offshore location. The focus interviews with this group of companies yield several explanations for this relocation plan, including avoiding a "hot spot," moving to a near-shore location, and shifting their operations to a location with lower costs.

Chart 8: Future plans of high-tech and telecom companies

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



Apart from relocation plans in contact center offshoring, we see that a number of companies (10 percent for information technology and 12 percent for innovation offshoring) plan to sell their captive operations to third-party service providers. This captive spin-off is a trend we are also starting to see in other industries, such as finance and insurance and retail and consumer goods. It also speaks to the declining preference for a captive model shown in Chart 4. Nevertheless, more than 12 percent of participating high-tech and telecom companies expect to bring their innovation outsourcing team back into a wholly owned subsidiary. According to the follow-up interviews with these companies, most express their strong concern about data security and intellectual property issues in their innovation outsourcing.

From a macro perspective, competition has been fierce in high-tech and telecom over the past year, especially in increasingly saturated markets such as North America and Europe. Cash flow issues have become one of the major problems for many industry companies because of the increased difficulty to acquire new customers and the dried-up global credit market.

From a market perspective, we observe various approaches taken by companies to survive in this economic environment, including the consolidation of businesses (e.g., consolidation in the fixed-line phone market), continued capital investments to expand (e.g., expansion and upgrades of existing network in the broadband business), and scaling services and bundles to meet customer demand (e.g., in the wireless business).

In the pressure to quickly adopt emerging technology and create new products and services, offshoring is critical to high-tech and telecom companies' survival in the current global marketplace. Overall, the survey findings imply that the single best approach has yet to be found for high-tech and telecom. Companies are trying different approaches to progressively develop the organizational capabilities they require to efficiently manage their offshoring operations and gain the most from offshoring.

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