



Global Sourcing (GS)
Market Update: December 2006 – Preview Deck

**Topic: Evaluating Risks from Outsourcing and
Global Sourcing**

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- **Risks from outsourcing are extremely complex due to multiple nuances and this complexity has impacted the growth and the success of the outsourcing market**
 - The complexity in understanding outsourcing risks arises due to factors such as
 - Differences across buyer organization levels and stages of the outsourcing lifecycle
 - Wide range of risk dimensions at each level and stage
 - Variation across industries, geographies, and functions
 - Mismatch between real and perceived risks
 - This risk complexity has hindered the understanding of risks, resulting in inadequate responses and multiple outsourcing issues and failures

- **With the mainstream adoption of Global Sourcing (GS), the complexity has become higher**
 - Risks such as transition, network complexity and data security have been amplified
 - New risks such as dealing with little understood legal systems have been added to the plate

- **A best-practice risk-management approach shows how organizations can address the complexities and practically manage risks**
 - Creates a pan-organization picture illustrating risk creation and dependencies
 - Helps identify and detail the key risks at individual initiative and overall enterprise levels
 - Provides a mechanism to measure and prioritize risks (e.g., a probability-impact analysis)
 - Highlights the organizational and process changes and tools required to mitigate and continuously monitor risks (e.g., creating new positions or governance organizations)
 - While the approach generally holds true across both buyers and suppliers, there are some key differences for suppliers (e.g., managing risks for customers in addition to own risks)

Risks from outsourcing have always involved high complexity, making them difficult to understand and manage

Factors driving complexity

Examples

1. Different levels/stages of assessment

- Initiative versus enterprise risks
- Strategy and design stage versus execution stage in the outsourcing lifecycle

2. Wide range of dimensions

- Initiative-level risks such as financial, operational and legal
- Enterprise-level risks have varied dimensions for buyers and suppliers
 - Buyer dimensions: locations, suppliers and operating models
 - Supplier dimensions: locations, buyers and labor

3. Heterogeneous and difficult to quantify

- Wide variation across industries, functions and geographies
- Many risks tend to be subjective and qualitative, such as cultural fit and customer resistance

4. Mismatch between real and perceived risks

- Operational risks tend to get less focus than strategic risk, but are more often the cause of failures

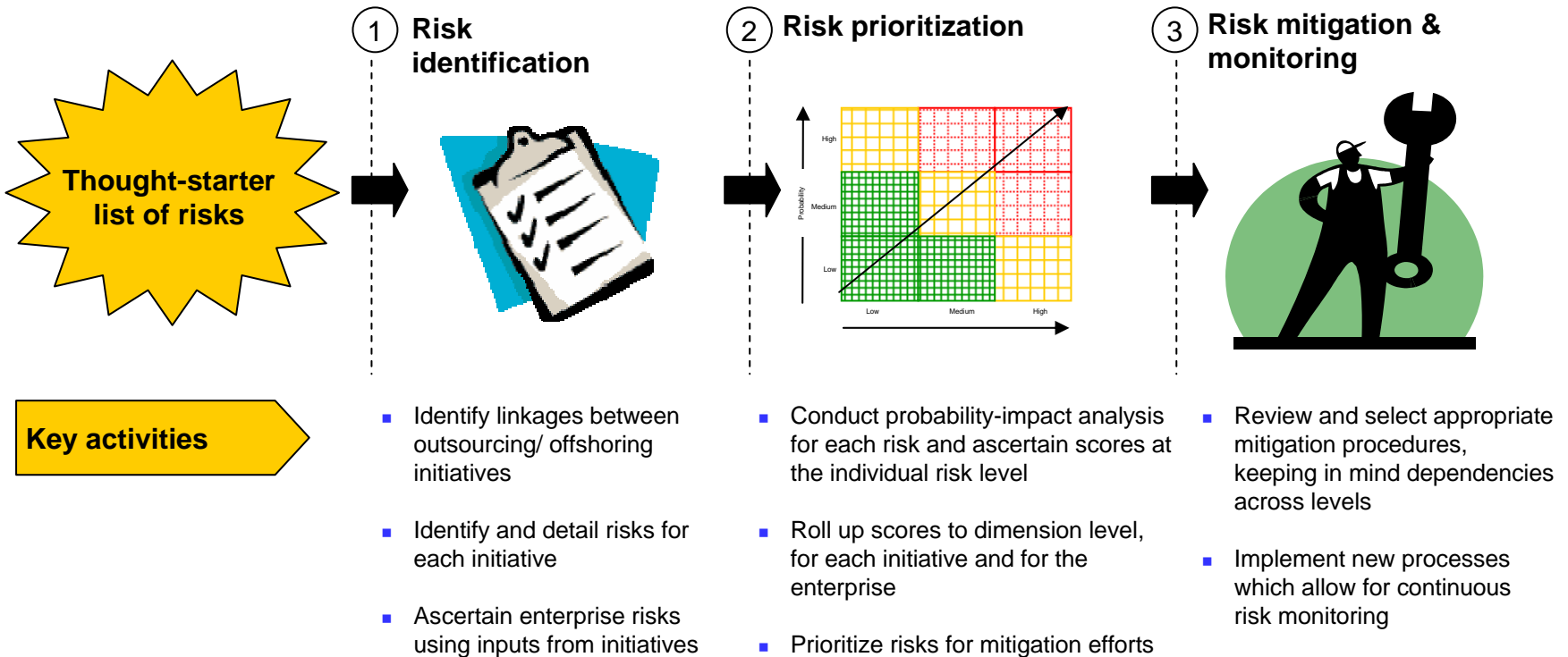
The advent of Global Sourcing has brought in a new set of considerations which has altered the outsourcing risk set

New considerations	Examples of new risks	Examples of risk amplification
Utilization of remote locations	<ul style="list-style-type: none">■ Geo-political risks■ Time-zone coordination	<ul style="list-style-type: none">■ Co-ordination between centers more difficult due to increased network complexity
Significantly different cultures	<ul style="list-style-type: none">■ Inability of offshore workers to empathize with customers in buyer locations■ Accent problems	<ul style="list-style-type: none">■ Greater difficulty in communication of needs, team management, ongoing governance, etc.
Difference in legal systems	<ul style="list-style-type: none">■ Exposure to dealing with unknown legal systems in multi-source, multi-destination contracts	<ul style="list-style-type: none">■ Higher threat of data and IP theft due to weak law- enforcement systems in some developing countries
Developing economies of offshore locations	<ul style="list-style-type: none">■ Lack of robust infrastructure■ Relative instability of banking systems	<ul style="list-style-type: none">■ Higher wage inflation

The complexities in outsourcing risks often lead to inadequate risk response mechanisms

Response approach	Key characteristic of approach	Examples of approach	Limitations of approach
Set and forget	<ul style="list-style-type: none"> Use of standard, industry-wide mechanisms for addressing uncertainty 	<ul style="list-style-type: none"> Requirement for a standard "Disengagement Plan" Maintenance of a "Procedures Manual" 	<ul style="list-style-type: none"> Not meaningfully customized and often sub-optimal Often not reviewed/updated adequately to reflect changing market dynamics
Default to regulator defined framework	<ul style="list-style-type: none"> Following standard regulatory norms 	<ul style="list-style-type: none"> Fulfilment of minimal regulatory requirements for outsourcing/offshoring Focus on letter as against spirit of law 	<ul style="list-style-type: none"> May result in letting the regulator manage the organization's business risk May not reflect business risks unique to the organization
Last resort	<ul style="list-style-type: none"> Use of forcing mechanisms in the absence of any other issue resolution choices 	<ul style="list-style-type: none"> Benchmarking Termination for cause Arbitration 	<ul style="list-style-type: none"> Often creates a distraction from solving the underlying issues May result in an undesirable outcome for the parties involved such as the payment of a termination fee or litigation costs

Key steps to successfully approach enterprise-wide risk management for outsourcing and offshoring

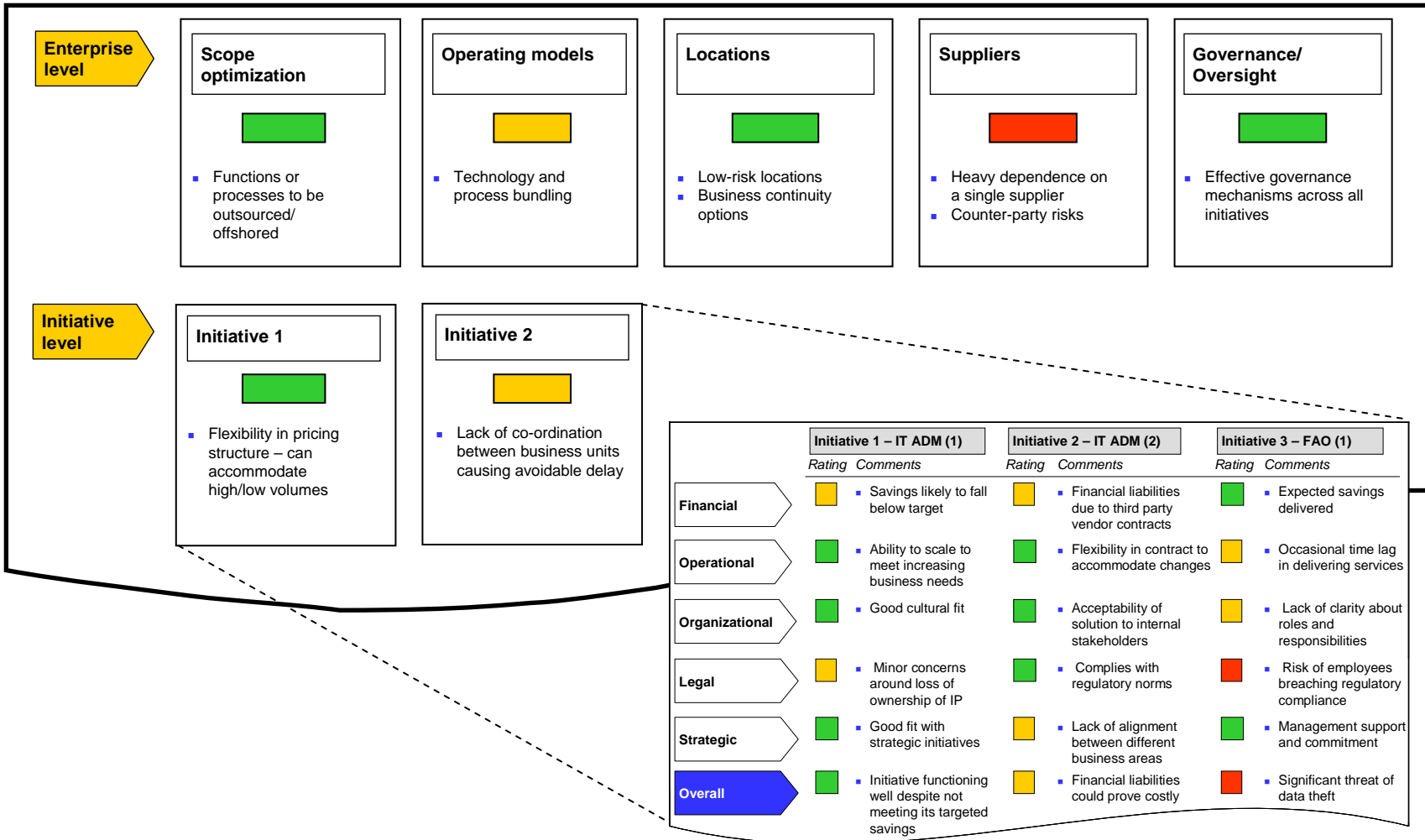


This approach is illustrated by taking the example of a large buyer organization with multiple outsourcing initiatives

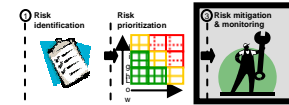
The outcome of risk identification and prioritization at the initiative and enterprise level will provide managers a dashboard of their risk exposure



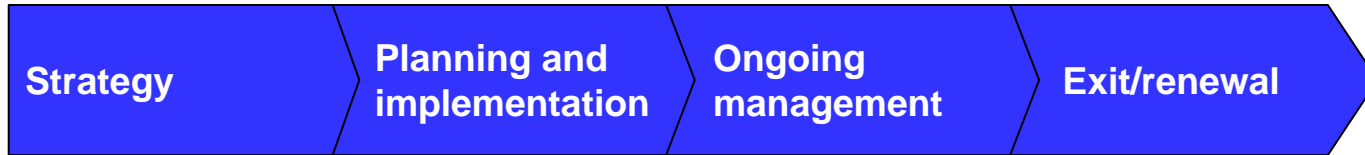
Dashboard of initiative and enterprise level risks





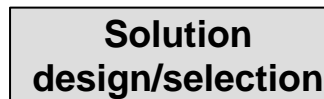
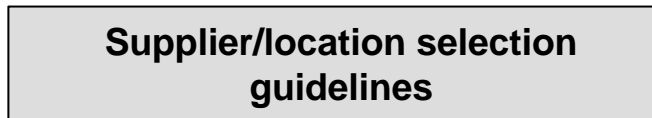
There are multiple tools available for risk management, all of which can be applied effectively at different stages of the outsourcing cycle



NOT EXHAUSTIVE



-  Risk monitoring (Ongoing response)
-  Risk mitigation (One-off response)



While the approach generally holds true across both buyers and suppliers, some key implications emerge for suppliers from a risk-management perspective

Implications for suppliers	Description
1. Understand risks of key customers	<ul style="list-style-type: none">■ Supplier success is now dependent not only on managing internal risks but also those of the buyers■ Suppliers accordingly need to invest in understanding and helping manage risks of their key customers
2. Gear up for much higher network complexity	<ul style="list-style-type: none">■ Not only are supplier delivery networks becoming more complex, buyer networks too are rapidly increasing in complexity, creating an exponential impact
3. Manage perceptions	<ul style="list-style-type: none">■ Perceived risks are often very different from real risks. Suppliers need to educate buyers to prevent unnecessary discord
4. Have multiple aggregation views	<ul style="list-style-type: none">■ Suppliers need to view risks not just along internal organizational lines, but also external lines such as contract/buyer/industry views
5. Differentiate from captives	<ul style="list-style-type: none">■ The threat is not just from other suppliers, but also from captives, which could gain ground as offshoring matures■ Suppliers need to actively understand the captive strategies of their client and manage associated risk (operational and strategic)

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