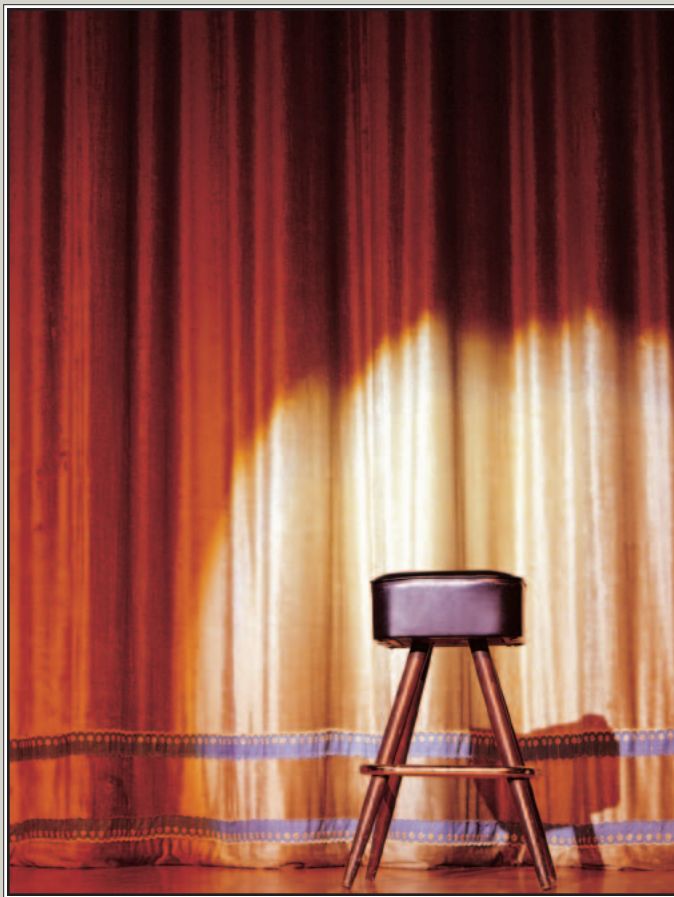


VOLUME VII NUMBER 3

*Third Quarter 2004*

EXECUTIVE  
**AGENDA**

IDEAS *and* INSIGHTS *for* BUSINESS LEADERS



OPERATIONS:  
*Ready for Center Stage*

**ATKEARNEY**

**FEATURES**

- It's a Scary (But Resilient) World** ..... 5  
A dynamic planning process helps leaders adapt their operations to the vagaries of today's global environment.
- Shifting Your Supply Chain into Reverse** ..... 17  
Returned products don't simply move backward. Read how to boost your bottom line by tightening the reverse supply chain.
- When Your Suppliers Talk... Listen** ..... 29  
Looking for new ideas? Want to know how you stack up against your rivals? Recruit a new source: your suppliers.
- Streamline Your Style** ..... 39  
When your best price isn't good enough, it's time to get faster, better and cheaper—again. Managing complexity in the design phase might do the trick.

**VIEWPOINT**

- The *Real* Offshoring Question** ..... 49  
The debates over the costs and benefits of moving jobs are raging. But this is no time to talk; it's time to act.

**WORLDVIEW**

- Check Your Mindset at the Border** ..... 57  
Success in China depends little on Western business acumen and largely on understanding the Chinese perspective.

**DEFINING MOMENT**

- Healing Mexico's Health-Care System** ..... 69  
Supply chain improvements, a time-tested tool for corporate health, helped Mexico deliver medicine more efficiently.

- EXECUTIVE SUMMARIES** ..... 76



# VIEWPOINT

EXECUTIVE AGENDA

*Third Quarter 2004*

## The *Real* Offshoring Question

*Few words are more politically charged than “offshoring,” especially during this election year. One camp extols the benefits of labor arbitrage and a highly educated labor pool; the other decries sending vital jobs overseas. But U.S. companies shouldn’t get mired in the jobs debate—they should act decisively to develop and implement the strategies they need to remain competitive.*

Does offshoring deserve the bad rap it gets? The numbers suggest it doesn't. A recent U.S. Department of Labor study indicates that concerns about jobs moving offshore might be exaggerated—most outsourced jobs remain in the country. According to the report, outsourcing triggered 9 percent of nonseasonal layoffs in the United States in the first quarter of 2004, and less than one-third of that work went to other countries. During that quarter 4,633 workers were laid off in the United States because their jobs were moved to another country, less than 2 percent of mass layoffs, according to the U.S. Bureau of Labor Statistics (*see sidebar: Defining Outsourcing and Offshoring*).

In the software sector, a lightning rod in the offshore discussion, there were 2.35 million jobs in the United States in 2003. That's four times the software jobs in India and nine times the jobs in China.

In addition, a study on global sourcing of computer and software services by the Information Technology Association of America found that by 2008, real GDP is projected to be US\$124 billion higher than it would be if these services were not sourced globally. The study also found that while some IT jobs will move overseas, total employment will rise in the United States. By 2008, the economic benefits gained from global job sourcing in this sector will spur the creation of 317,000 net new jobs.

And employment has become increasingly global. Companies based in Asia and Europe—from Honda to ABN AMRO—employ more than six million Americans. In New York alone, 200,000 people work for non-U.S. companies. Job churn in the United States is two million jobs per month. This trend will continue since companies must remain competitive globally.

This also brings new opportunities. For instance, consider a new consumer segment in India: the Zippies. They are 15 to 25 years old, motivated (there's a “zip” in their

stride, according to the magazine *Outlook*) and 555 million strong. They want to earn money, and are eager to buy everything Western, from Gap jeans and Starbucks coffee to Nestlé chocolates. Those who say they will take some jobs once held in the United States, such as call-center agents, are right. But they also represent an enormous new market for American companies.

There are other positive signs on the offshoring front as well. Some companies are taking steps to prepare employees whose jobs may shift overseas by retraining them.

---

## Defining Outsourcing and Offshoring

Ask a dozen people for definitions of outsourcing and offshoring, and you'll get at least that many answers.

We define outsourcing as when a company assigns its activities, and sometimes its people, to a third party. Outsourcing can be conducted onshore; for instance, Florida recently outsourced many of the state's human resource functions to Convergys, a Cincinnati-based company that provides billing, employee-care and customer-care services.

Outsourcing can be a near-shore proposition, where U.S. jobs move to Canada, Mexico or the Caribbean.

It can also be offshore, involving countries such as India, Singapore, Ireland and the Czech Republic.

Our definition of offshoring is the search for a lower cost location for business processing. It could include migrating existing processes or augmenting a current global footprint. When a company looks at an offshore location for its business processes, it can outsource to a third party, establish its own operating unit, called a captive, or create a joint venture with a local low-cost operator.

Many of the largest corporations have established

captives. A captive enables a company to maintain control, create its own culture and ensure confidentiality of information. But there are disadvantages too: Captives require scale to be financially feasible, noncore processes are sometimes better handled by an outsourcing provider, and the breakeven is typically longer than it is for outsourcing.

Business-process offshoring includes a wide range of activities, from highly technical, white-collar jobs, such as engineering and reading radiology reports, to more routine back-office functions, such as call centers and account reconciliation. ●

For instance, IBM formed the Human Capital Alliance, a US\$25 million fund that will help workers train for new positions, ideally with IBM or its business partners.

#### A MATTER OF ECONOMICS

To the objective observer, it's clear that offshoring has its benefits. But framing the debate in "I win, you lose" language obscures an important reality: Offshoring is not going away. And it's not about politics—it's about economics, as British economist David Ricardo wrote almost 200 years ago.

In today's business environment, companies must develop and exploit a global footprint to remain competitive. Offshoring today is a strategic advantage; tomorrow it will be a competitive necessity. Now that leading companies have revamped their cost structures by significantly decreasing labor costs, adding new capabilities and improving productivity and quality, organizations that don't follow suit will lag behind.

The offshoring trend is one of the fastest growing in the marketplace. American companies project they will save more than US\$25 billion by 2005 through the use of lower cost locations. Even Hollywood is in on the act. During the making of *Lord of the Rings: Return of the King*, more than 20,000 people were hired in New Zealand—extras, actors and technicians, among others. When it outsourced the production of Middle Earth, the film trilogy became the country's largest private-sector employer.

Figure 1: *Highlights from A.T. Kearney's 2003 Offshoring Survey*

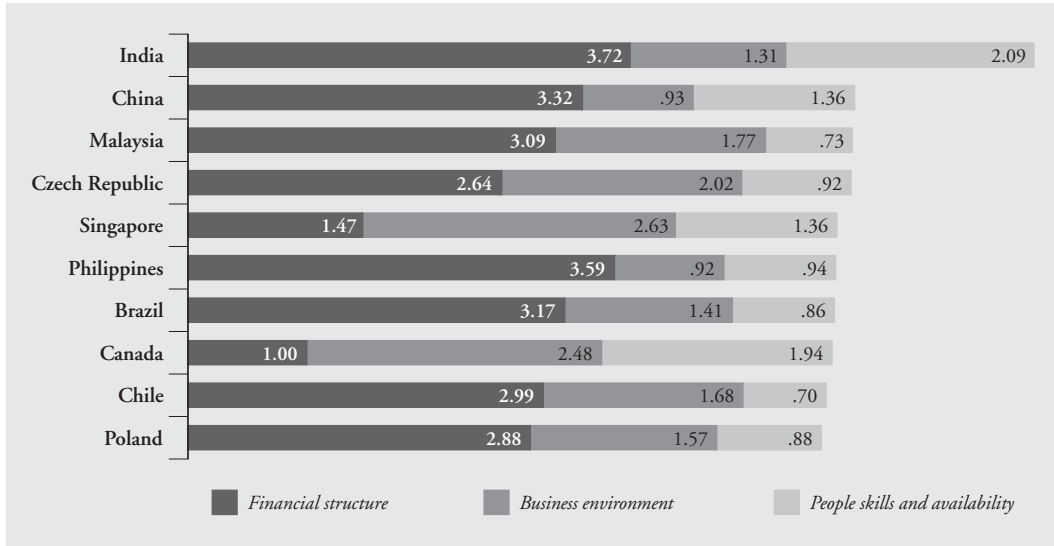
- 70% of companies have started to offshore business processes
- Top five reasons for offshoring:
  - Cost reduction (92%)
  - Enhanced service quality (55%)
  - Expanded skills and capabilities (55%)
  - Support of customers' global footprints (55%)
  - Improved productivity (45%)
- 40% of companies indicated that their offshoring initiatives have met corporate goals and objectives; 40% indicated "exceed," 20% indicated "too early to tell"

Source: A.T. Kearney

What makes offshoring so attractive? A.T. Kearney conducted several surveys across a range of industries, including automotive, pharmaceuticals, consumer products, financial institutions, high tech and communications. Survey respondents pointed to cost savings as a top reason to send work offshore (*see figure 1*). But they also cited a host of other benefits, including productivity improvements, better quality and increased flexibility.

Offshoring is about innovation, and North American businesses have long been known for seeking novel approaches to running businesses efficiently. Companies are under pressure to maintain the lowest cost structures they can and simultaneously to meet world-class standards for quality. The reality is that it's just not possible for one company to excel at everything. Simply put,

Figure 2: A.T. Kearney's Offshore Location Attractiveness Index, 2004 Results\*



\*The numbers in the bars are index numbers. The weight distribution for the three categories is 40:30:30, meaning that the financial structure is rated on a scale of 1 to 4, and that business environment, and people skills and availability are on a scale of 1 to 3.

Source: A.T. Kearney

the traditional business model—in which a company does everything from research to after-sales service—no longer works.

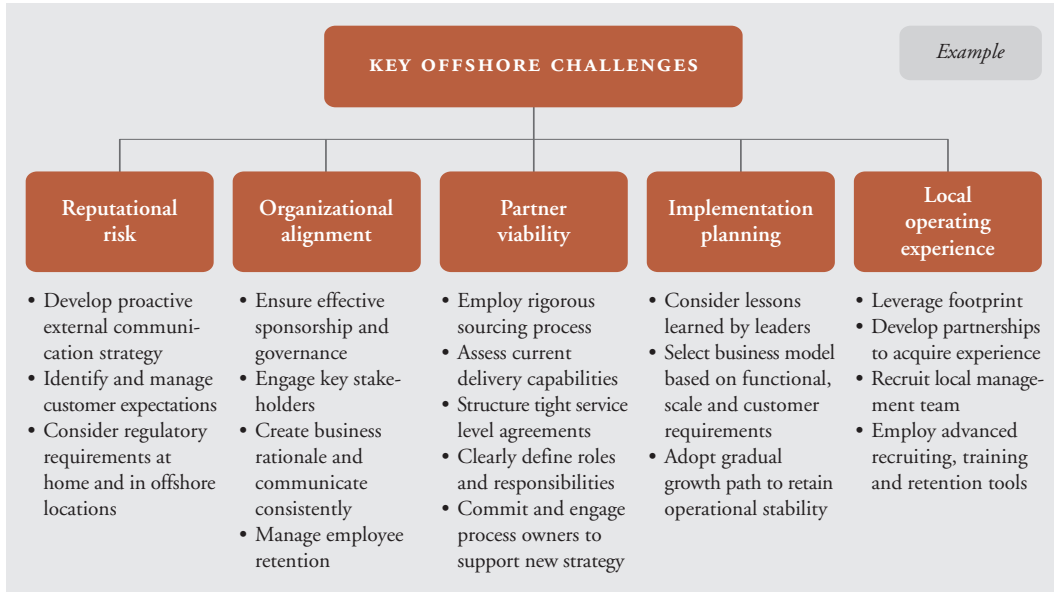
So offshoring, despite the protests of its detractors, is a logical step in the progression of efficient business models. And with countries such as India offering an excellent education system, and offshore third-party providers ramping up skills in new areas, the choice is becoming easier than ever. Of course, India is not the only attractive low-cost location. According to the 2004 A.T. Kearney Offshore Location Attractiveness Index, other top countries include China, Malaysia, the Czech Republic and Singapore (see figure 2).

Still, offshoring remains a tricky business. In fact, a study by research firm Gartner estimates that one in four offshoring deals will fail. Leaders in this area take a highly methodical approach to outsourcing. Top companies look first at strategic considerations, such as what functions are most appropriate to move offshore and which locations represent the best fit for the work involved.\* And they continue this rigorous approach through implementation (see figure 3).

Responsibility for decision-making varies by company but often we see the procurement organization taking the lead. A recent survey, conducted by A.T. Kearney

\* To read or download A.T. Kearney papers on these subjects, visit [www.atkearney.com](http://www.atkearney.com).

Figure 3: Lessons Learned—Offshore Challenges and Mitigating Actions



Source: A. T. Kearney

and CAPS Research, finds that procurement organizations were becoming more involved in initiatives such as offshoring. Many companies have successfully implemented a “center of excellence” approach to capture all of the aspects of offshoring: strategy, partner selection, contract structuring, transition and ongoing management (see figure 4 on page 54).

**EVERY DETAIL COUNTS**

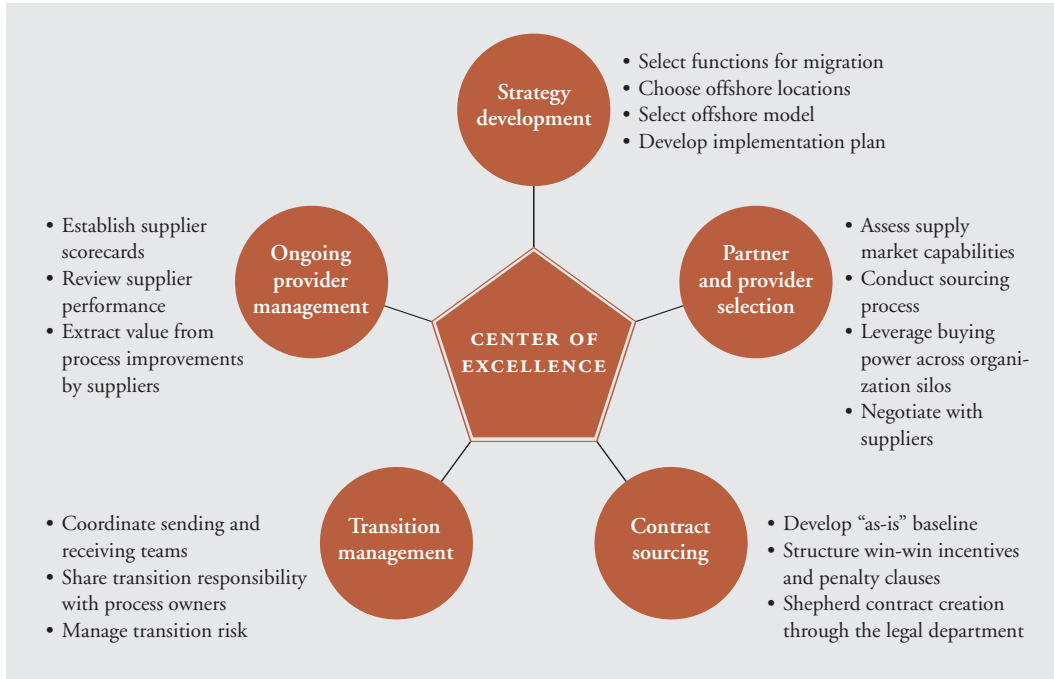
Successful businesses always pay close attention to detail. But the stakes are even higher in an emerging industry where lessons are still being learned. Just look at early high-profile forays into offshoring, and the potential to succeed—or fail—spectacularly becomes apparent.

One lesson is not to underestimate the time these migrations take. When we interviewed executives at the top captives and business-process suppliers in India, they said U.S. companies in particular tend to be in a rush. Executives feel a sense of urgency to save money and they make mistakes.

Dell is a well-publicized example. Early in its ambitious global outsourcing program, the company made three critical errors. It ramped up too quickly to maintain operational stability, underestimated training and retention challenges and did not properly segment its customer base. The company is now working hard to address these issues.

Many companies are making offshoring pay off. A leader is GE Capital, based in Delhi, which handles close to 500

Figure 4: Key Roles and Responsibilities of the Center of Excellence



Source: A.T. Kearney

processes for the entire company. Processes range from finance and accounting to sophisticated research. GE, which has been in India since 1996, focuses on Six Sigma and a host of other metrics to ensure quality. Others include Citibank, Microsoft and American Express. The leaders have achieved great depth and breadth.

The best performers have scale, and in most cases experience, in the local market. The supply market is expanding, with such companies as Daksh, WNS, eClerx, Wipro Spectramind and Exult offering services. However, the maturity relative to IT is still somewhat low. Domain expertise is limited but growing, so provider selection is key.

#### THE GALE CONTINUES

The United States has always been known for its innovations. While Thomas Edison was refining the light bulb, others were working on a candle that would burn for 24 hours. American businesses have openly embraced what Joseph Schumpeter calls capitalism—“the perennial gale of creative destruction”—finding new, better ways of doing business to replace the old. This dynamic environment has enabled companies to maximize output, and it has created significant wealth.

Behind all this is the entrepreneurial spirit of U.S. companies and the opportunity globalization permits. Offshoring is just

another example of a willingness to experiment with new products, technologies, markets and methods of doing business—and the ability to adapt as the environment changes. Business leaders are well aware, particularly in an election year, of the raging debates in offshoring. But they are tackling their own key question: How can they make the most of this emerging opportunity? Put the jobs where they will create the most benefit for the company and the economy will benefit, too. ■

---

#### CONSULTING AUTHORS

*Andrea Bierce is a vice president in A.T. Kearney's financial institutions practice. Based in New York, she has more than 25 years of experience consulting to the financial services industry. She works with clients in both the private and public sectors in areas of strategy and new product development, business planning and channel expansion. In 2003, Andrea was co-leader (along with Stefan Spohr) of the Offshore Business Process Leadership Forum for Financial Executives.*

*Bart Kocha is global leader of A.T. Kearney's technology and transformation practice. Based in the Chicago office, he has more than 20 years of industry and consulting experience, with a focus on business process outsourcing, shared services strategy, offshoring and large-scale change programs. He has worked extensively with clients in the public sector and with major corporations in the financial services and consumer products industries.*

*Stefan Spohr is a vice president with A.T. Kearney's financial institutions practice based in New York. In his 10 years with the firm, Stefan has worked extensively with global clients in the financial services, automotive, consumer products, high-tech and other industries to help them develop and implement business process outsourcing and offshore strategies.*

EXECUTIVE  
**AGENDA**

IDEAS *and* INSIGHTS *for* BUSINESS LEADERS

*Executive Agenda*® is published periodically by A.T. Kearney to offer fresh perspectives and encourage discussion on subjects of interest to senior executives and opinion leaders worldwide.

A.T. Kearney is an innovative, corporate-focused management consulting firm known for high quality, tangible results and its working-partner style. The firm was established in 1926 to provide management advice concerning issues on the CEO's agenda. Today, we serve the largest global clients in all major industries.

A.T. Kearney's offices are located in major business centers in 34 countries.

**AMERICAS** | Atlanta | Boston | Buenos Aires | Caracas | Chicago | Dallas  
Detroit | Los Angeles | Mexico City | Miami | New York | San Francisco  
São Paulo | Silicon Valley | Stamford | Toronto | Washington, D.C.

**EUROPE** | Amsterdam | Athens | Berlin | Brussels | Copenhagen | Düsseldorf  
Frankfurt | Geneva | Helsinki | Lisbon | London | Madrid | Milan | Moscow | Munich  
Oslo | Paris | Prague | Rome | Stockholm | Stuttgart | Vienna | Warsaw | Zurich

**ASIA PACIFIC** | Bangkok | Beijing | Hong Kong | Jakarta | Kuala Lumpur  
Melbourne | Mumbai | New Delhi | Seoul | Shanghai | Singapore | Sydney | Tokyo

**AFRICA** | Johannesburg

For information on obtaining additional copies, permission to reprint or translate this work, and all other correspondence, please contact:

A.T. Kearney, Inc.  
Marketing & Communications  
222 West Adams Street  
Chicago, Illinois 60606 U.S.A.  
1 312 648 0111  
fax: 1 312 223 6759  
email: [insight@atkearney.com](mailto:insight@atkearney.com)  
[www.atkearney.com](http://www.atkearney.com)

Copyright 2004, A.T. Kearney, Inc. All rights reserved. No part of this work may be reproduced in any form without written permission from the copyright holder. A.T. Kearney® and Executive Agenda® are registered marks of A.T. Kearney, Inc. A.T. Kearney, Inc., an EDS company, is an equal opportunity employer.

**ATKEARNEY**®