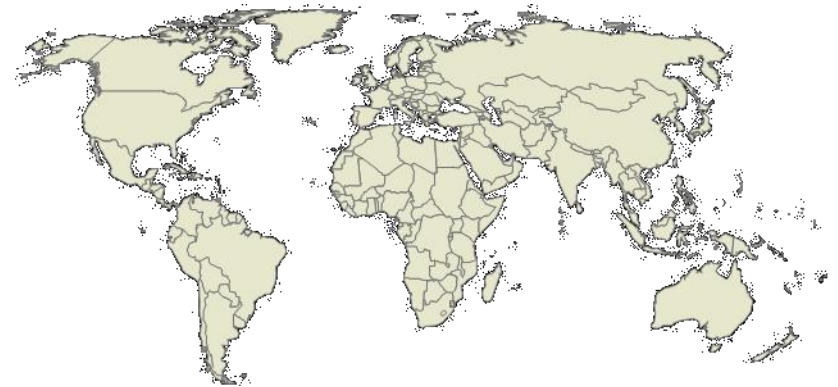




Increasing flexibility through outsourcing



Financial Shared Services

12th & 13th November 2009, Hilton Vienna Hotel, Vienna

Soeren Dressler, PhD
- Director -
Offshoring Institute

Vienna, Nov 13, 2009

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- ⇒ Business Process Outsourcing –
why has it not yet taken off in continental Europe
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BPO Takeoff in Continental Europe

Facts about the crisis



The United States – Homeland of the crisis

U.S. job losses accelerated in September and the unemployment rate climbed to 9.8 percent, the highest level since 1983. Payrolls dropped by 263,000, bringing total jobs lost since the recession began to 7.2 million, the biggest decline since the Great Depression.

Financial firms cut more than 180,000 jobs in the Americas in the credit crisis that brought down or forced the sales of Bear Stearns Cos., Washington Mutual Inc., Merrill Lynch & Co. and Lehman Brothers.

Examples of the crisis in the U.S.

7 October 2009 - There are now six unemployed workers for every job opening in America. .

The “disappointing” September (2009) employment figures indicate it will take the U.S. four years to recover all the jobs lost during the recession, according to economists at JPMorgan Chase & Co. in New York.

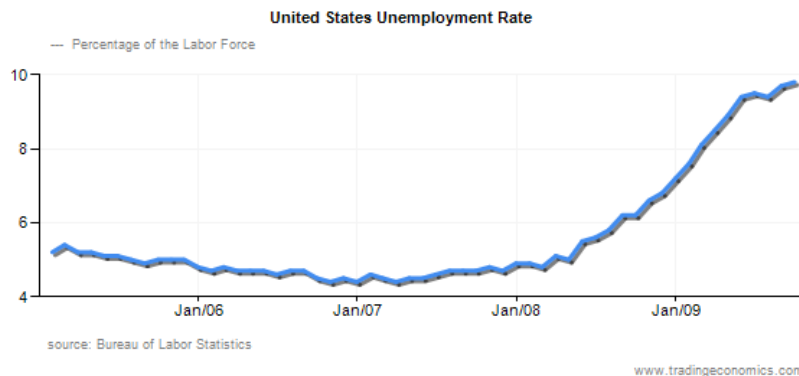
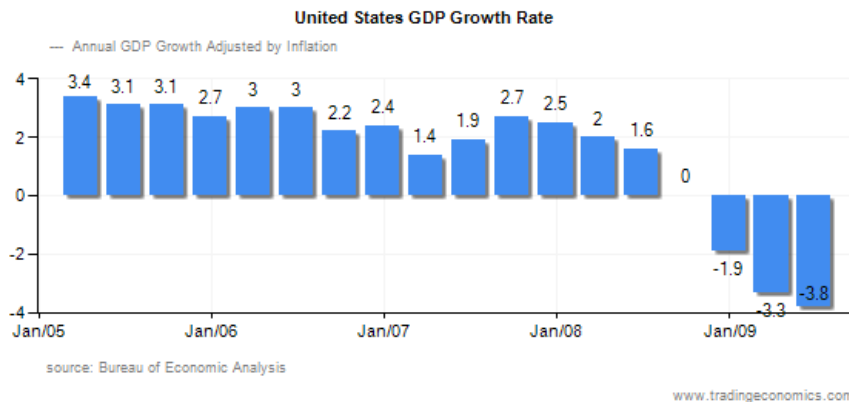
More than one million Americans have filed for bankruptcy in the first nine months of 2009, according to the American Bankruptcy Institute.

BPO Takeoff in Continental Europe

Facts about the crisis



Growth rates in the U.S.



Comments

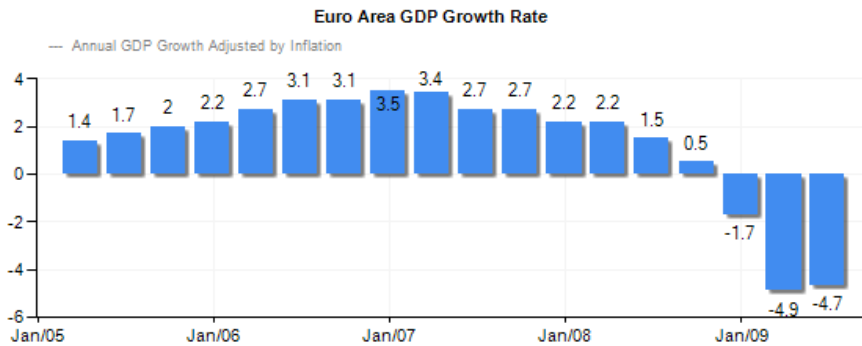
- Has the crisis reached its peak and is the worth over?
- Unemployment in the U.S. is dangerously high
- The sheer data do not show signs of a turnaround
- However, the confidence of businesses and consumers has risen lately

BPO Takeoff in Continental Europe

Facts about the crisis

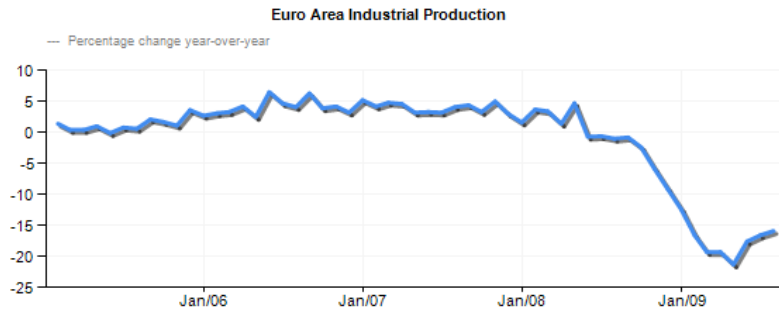


Growth rates in the Euro zone



source: European Commission

www.tradingeconomics.com



source: European Commission

www.tradingeconomics.com

Comments

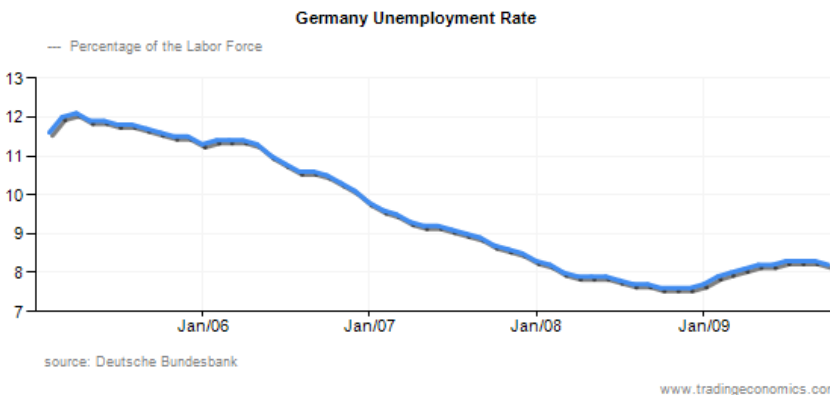
- The Euro zone has been impacted as well
- Production output appears to recover
- But, wrong government subsidy practices will hit the automotive industry in Germany in 2010
- There are lots of job losses expected in 2010

BPO Takeoff in Continental Europe

Facts about the crisis



Key indicators in Germany



| Comments |
|---|
| <ul style="list-style-type: none"> • Germany has reached a small increase in third quarter • This is mainly caused by government support programs • Additionally the unemployment rate has risen very slightly until now – also due to the support programs • But: the sustainability of the recovery is questionable |

BPO Takeoff in Continental Europe

Chances for BPO



What does it mean for the SSC and the Business Process Outsourcing industry

Fear of additional lay offs



Underutilization



Low priority for SSC and BPO



Risks of BPO



- Social partnership concepts in continental Europe: in times of crisis no additional headcount will be reduced above the absolute required levels
- Resources in the back office are underutilized due to slower demand → no need for additional outsourcing activities
- Companies are struggling for survival → in times of crisis outsourcing projects range quite low in the prioritization
- Outsourcing is more risky than never → If BPO providers are been asked to take on fluctuating (and uncertain) volumes of companies they require risk compensation OR will deny potential deals entirely due to the current business risks → BPO markets are not functioning very well

BUT...

- ⇒ **In the mid-term companies will re-visit the back office cost structures**
- ⇒ **Companies have understood the urgent need for flexibility in the administrative processes**
- ⇒ **Shared Services have limits in cases of shrinking volumes (fix cost block!)**
- ⇒ **With a recovering economy BPO will experience stronger demands**

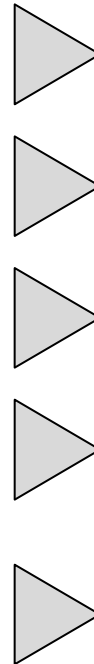
BPO Takeoff in Continental Europe

Challenges for BPO

There are many concerns regarding outsourcing in Europe – but most of them can be overcome with some convincing rationale

Typical roadblocks for outsourcing in continental Europe (selection)

- Intransparent pricing = lower quality but higher costs
- Risk of cultural clashes through cooperation with a non-sensitive global BPO provider
- Not sufficient maturity for outsourcing
- Nobody wants to be held accountable for the outsourcing success – too many negative stories around outsourcing in Europe
- Fear of job losses – strong position of unions, workers councils, strong public pressure



Convincing rationale

- Prices are usually lower than before (important: benchmarking prior to BPO assessment), quality needs to be monitored closely, i.e. through effective KPIs
- Find the „right“ player, there are global/national, large-scale and small providers
- Not a question of maturity – a matter of the right „can-do-spirit“
- Search for contact to BPO providers and consultants – there are a number of real success stories
- Enthusiasm for outsourcing – those in charge for BPO engagements enrich their jobs and will not be at risk of losing a job

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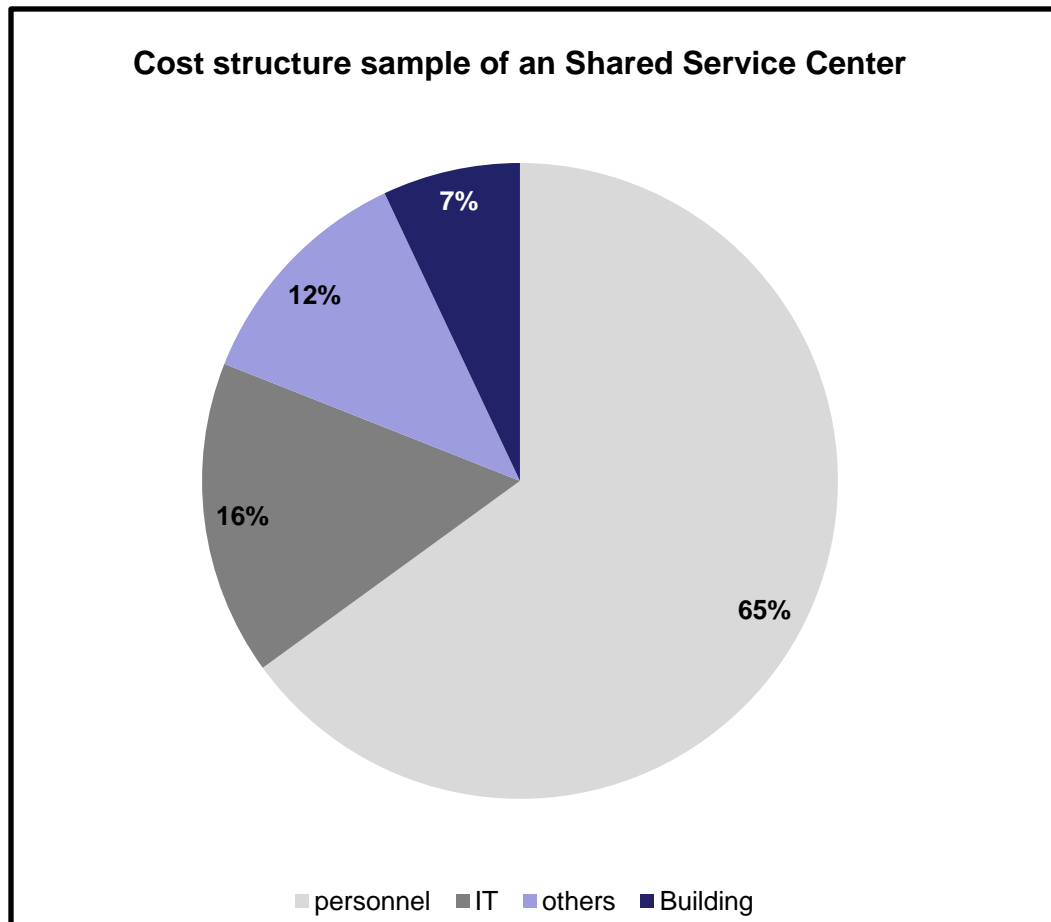
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Challenges of Shared Services

Cost structure



The total cost of Shared Service Centers are clearly dominated by staff cost



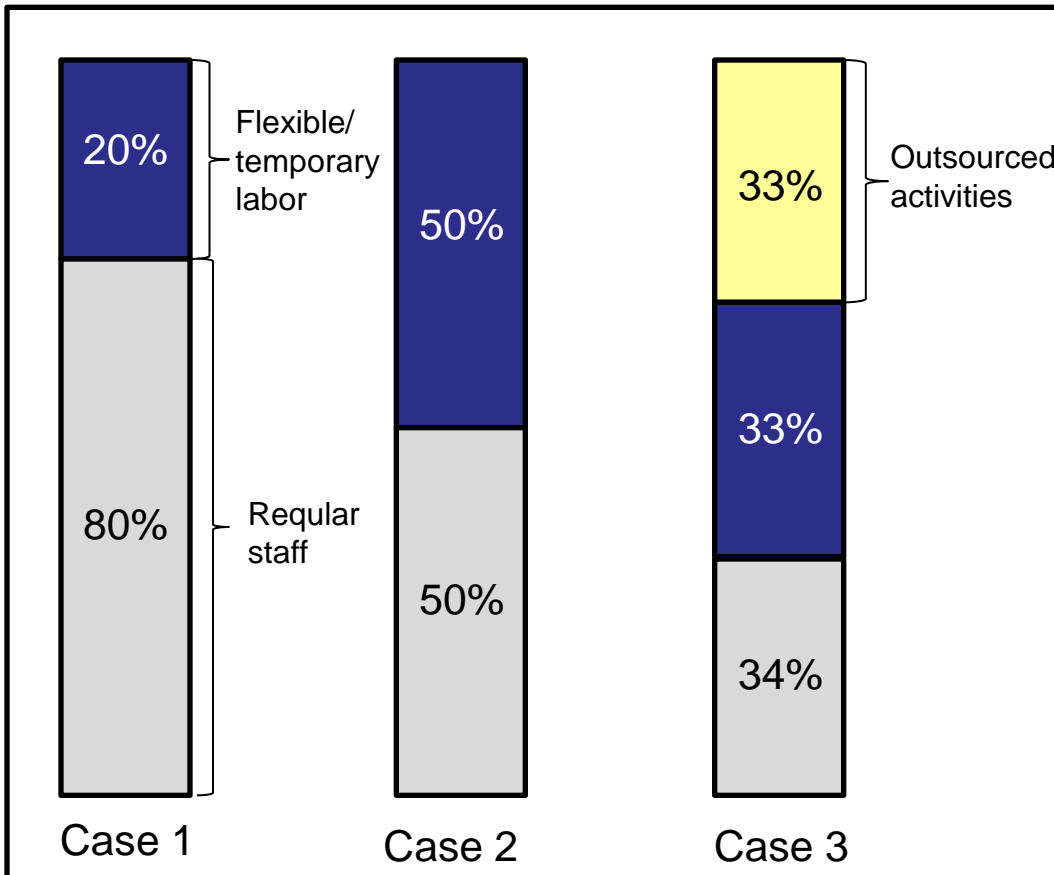
| Pressure through staff cost |
|--|
| <ul style="list-style-type: none">• Usually, the personnel cost are representing more than 60% of the total SSC cost• Especially in cases where SSC are developed historically by transforming existing centralized administrative functions, employees have long tenure with the firm and relatively high salary levels• In these cases the staff cost are to be seen more as fixed costs than as variable cost• Reducing work force is one of the major challenges in running an Shared Service Center with volatile quantities of work |

Challenges of Shared Services

Cost structure



Flexibility in personnel costs is one key to adjust the cost to the changing quantity of work



Pressure through staff cost

- Case 1 represents the typical result of a brown field transformation: most of the former centralized accounting department personnel is engaged in the SSC (fix contracts)
- In Case 2 the temporary labor has been increased and more employees are flexible plan according to the utilization
- Case 3 includes the opportunity of outsourcing; parts of the activities are handled by an third party provider; flexibility depends on contract details and pricing model (important: proactive provider management)

Challenges of Shared Services

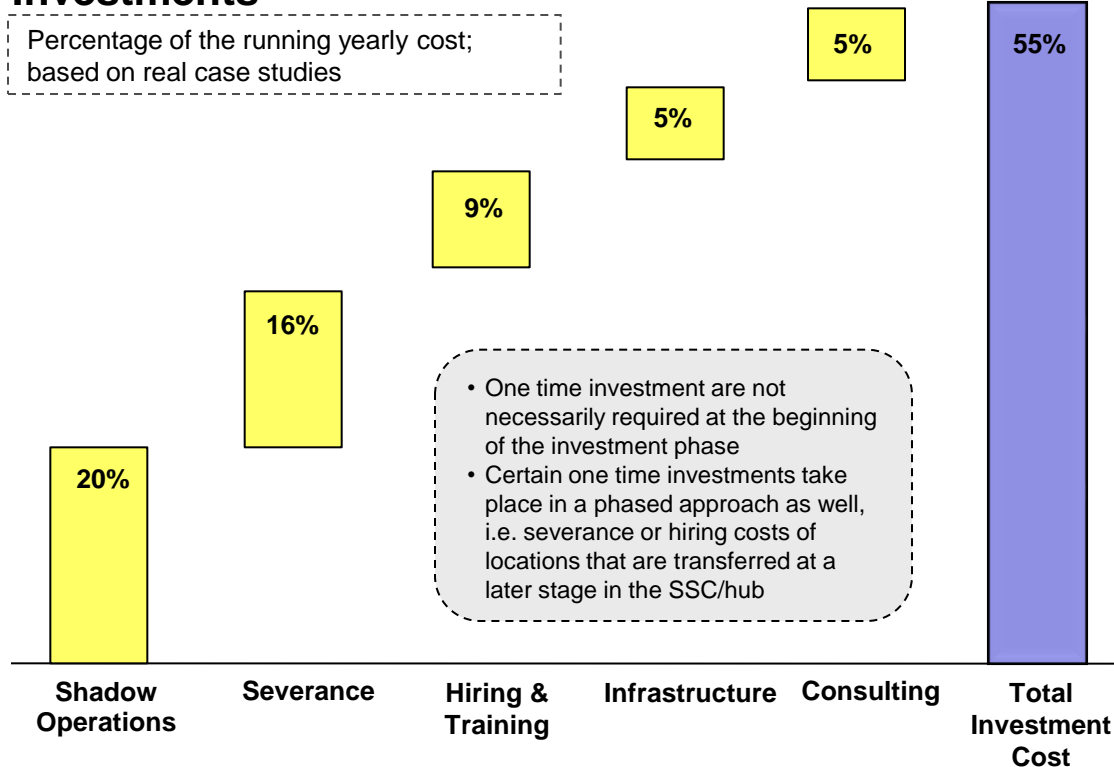
Cost structure



Determining the investments required is key to develop a proper business case and to determine the pay back period

Investments

Percentage of the running yearly cost; based on real case studies



• One time investment are not necessarily required at the beginning of the investment phase
 • Certain one time investments take place in a phased approach as well, i.e. severance or hiring costs of locations that are transferred at a later stage in the SSC/hub

SSC/BPO Investment Model - Key facts

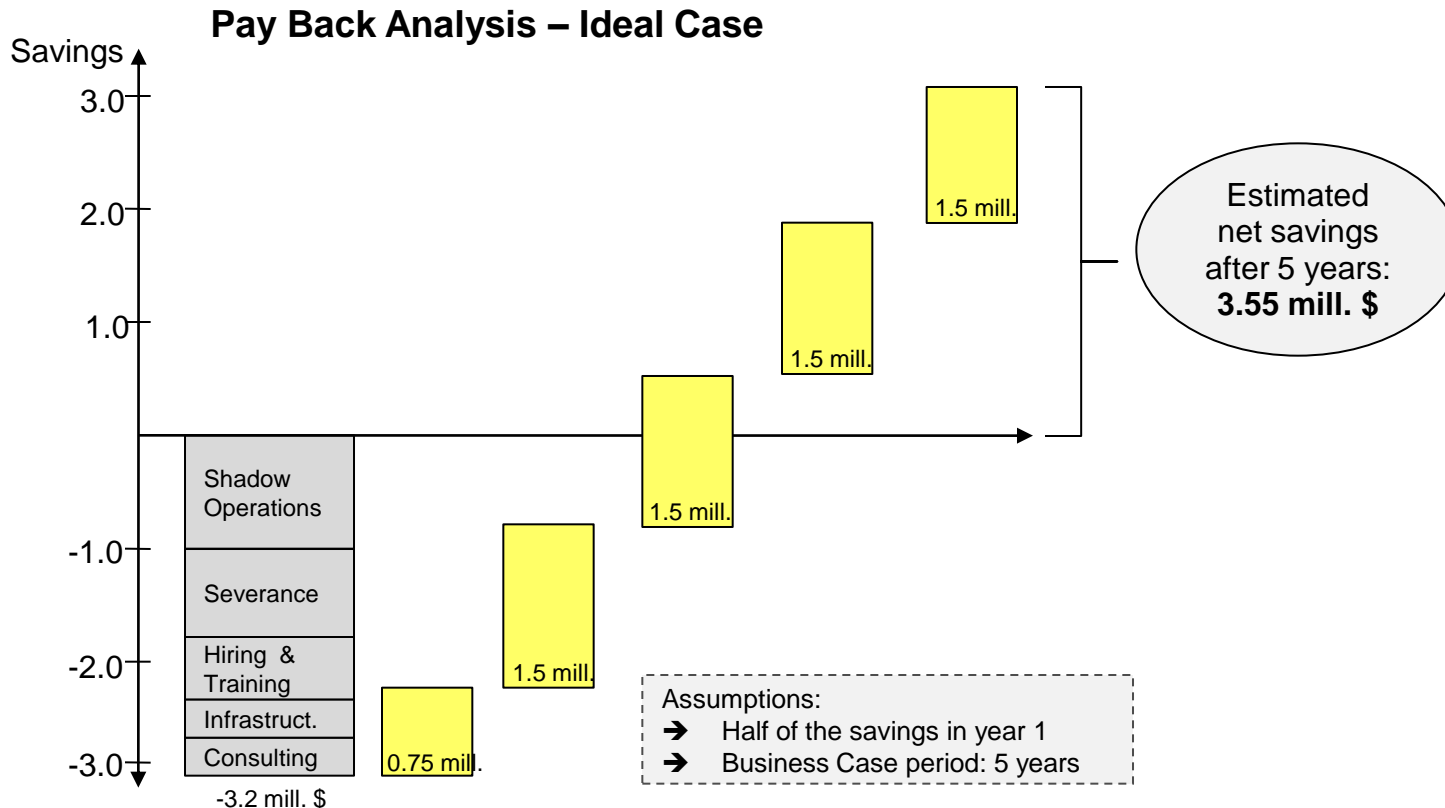
- Part of the Shared Services/ BPO Assessment Framework
- Purpose: assessing the required investments
- Each category is based on a specific rationale and project experiences
- Figures should be specified jointly with client as many data depend on the company's situation (e.g. severance packages)

Challenges of Shared Services

Business Case



Ideally, SSC/BPO initiatives reach a pay back time of less than 26 month – however, this depends on the migration strategy, scope, and locations

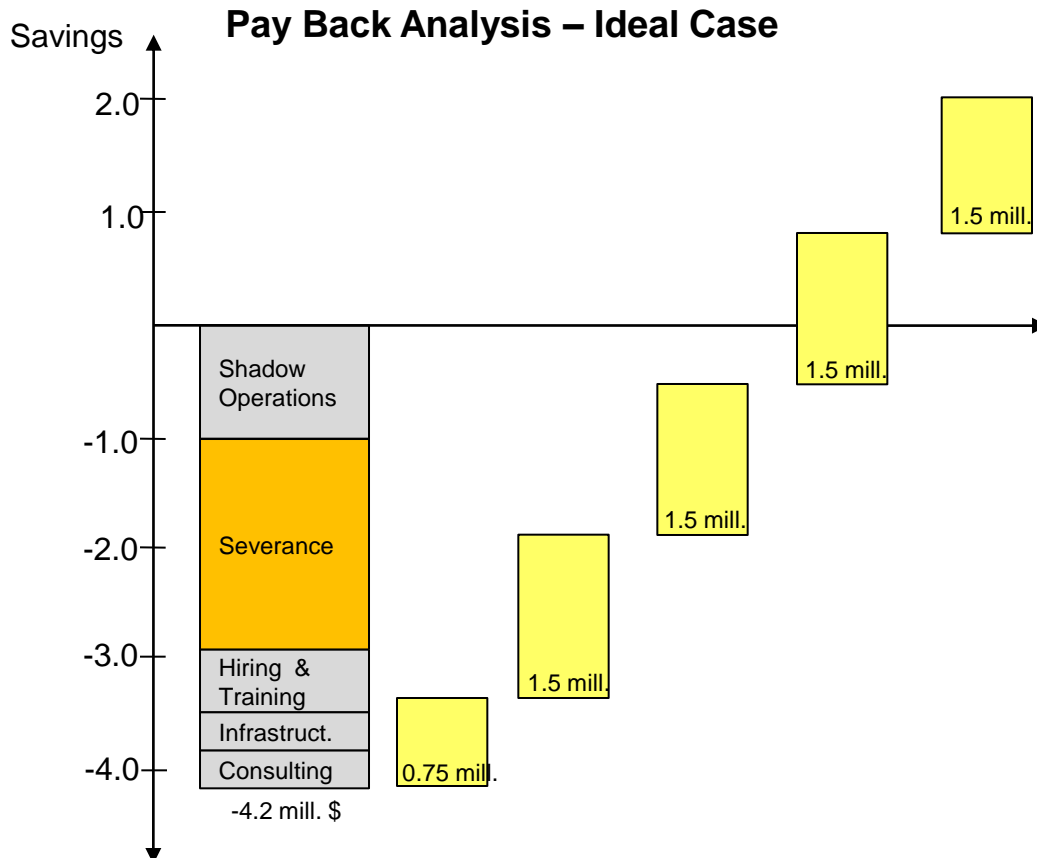


Challenges of Shared Services

Business Case



Severance regulations in specific countries and based on certain unions/ workers council agreements can postpone pay back periods significantly – and put entire projects at risk



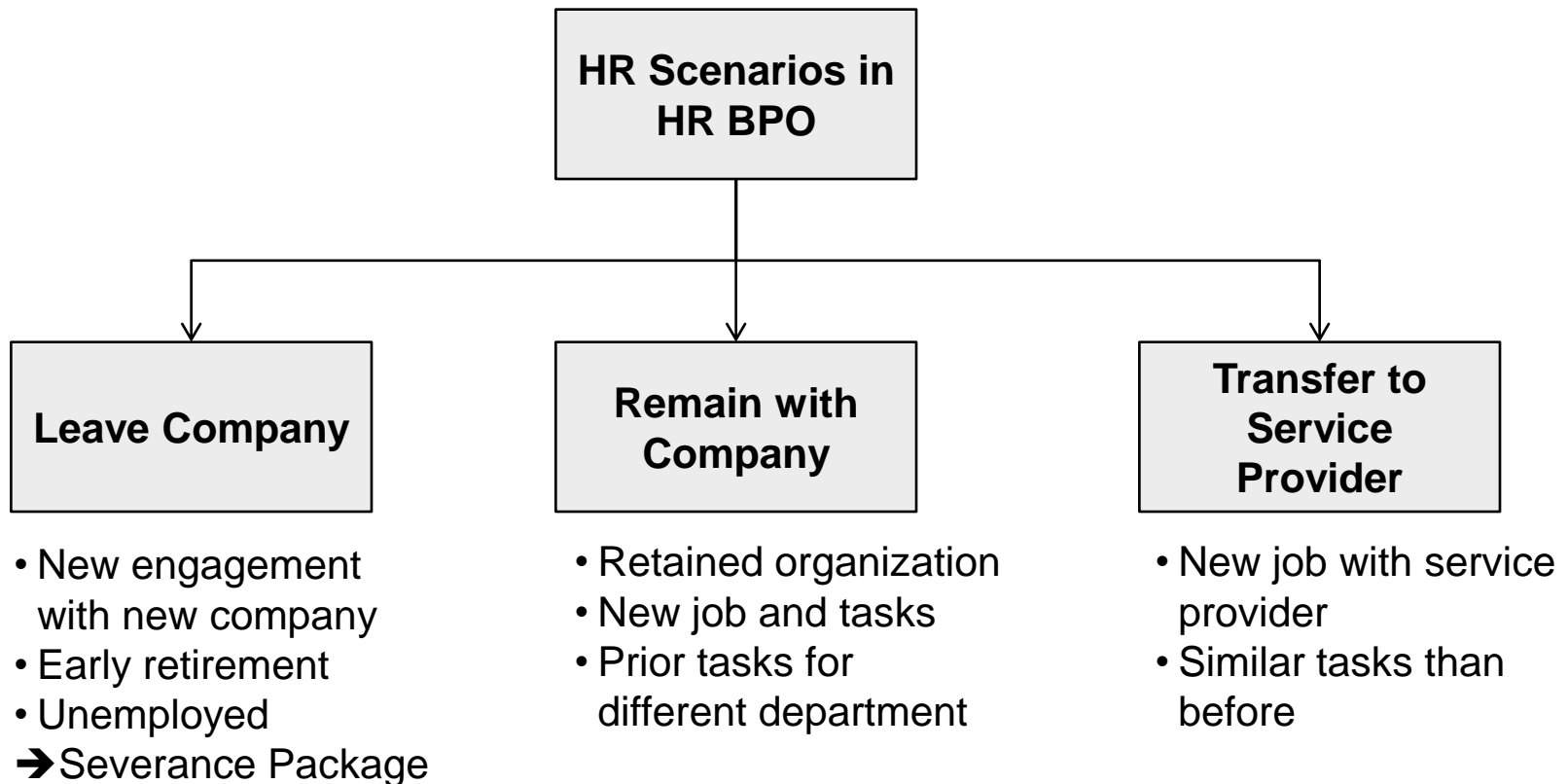
| Real Case |
|---|
| <ul style="list-style-type: none"> • Real case • 70 FTE in scope • Locations: Germany, France, Spain • 50 FTE to be laid off • Average tenure with firm: 11.5 years • Average gross salary (monthly): 3,300 EUR • Severance payments overall: 1.9 mill. • Extension of pay back period of almost one year |

Challenges of Shared Services

HR Transformation strategies



HR Transformation leads to various options for the employees—
however, most of them are concerned about losing the current job only

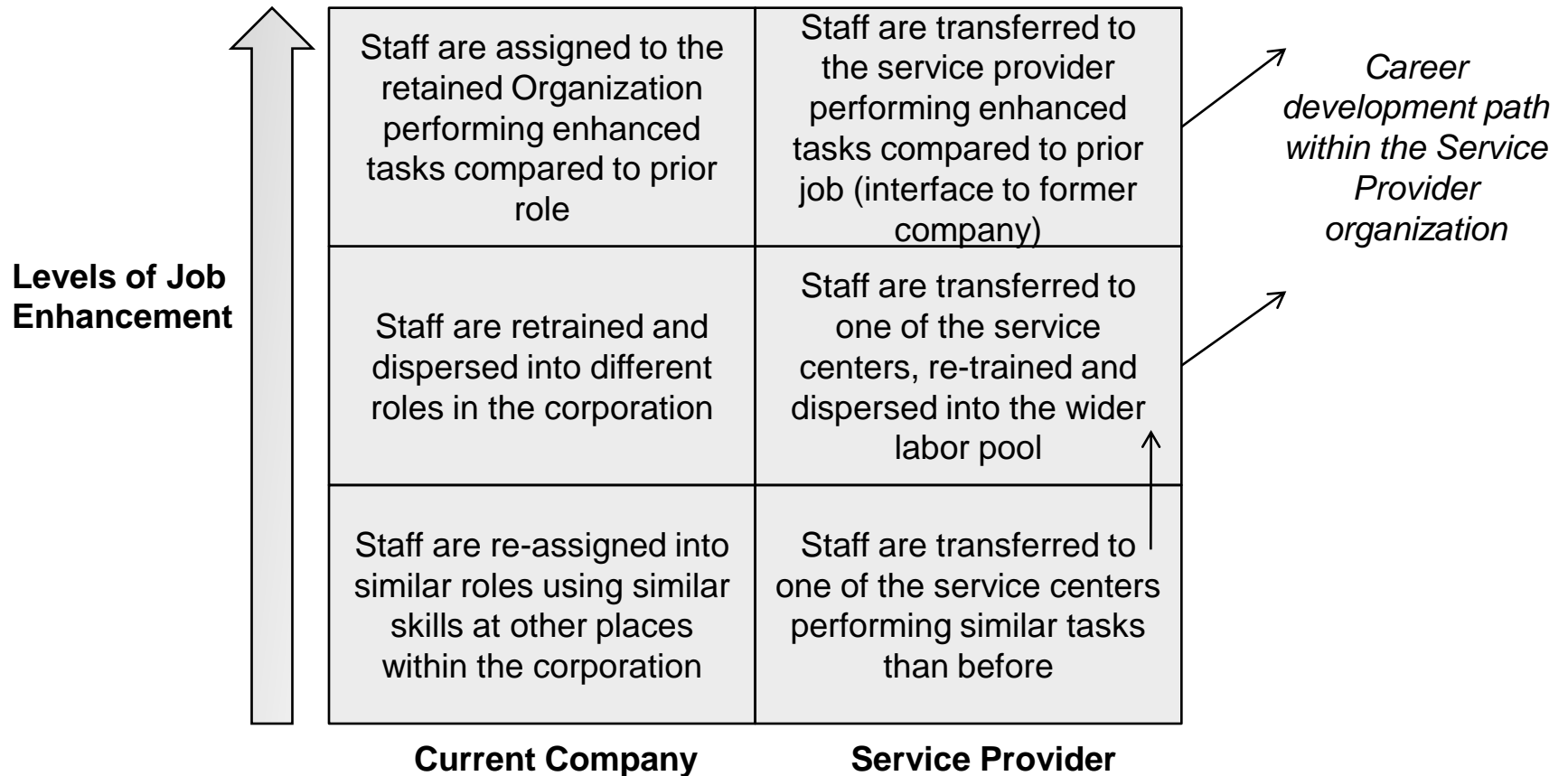


Challenges of Shared Services

HR Transformation strategies



For employees staying with the firm and/or service providers various options for job enhancement are possible

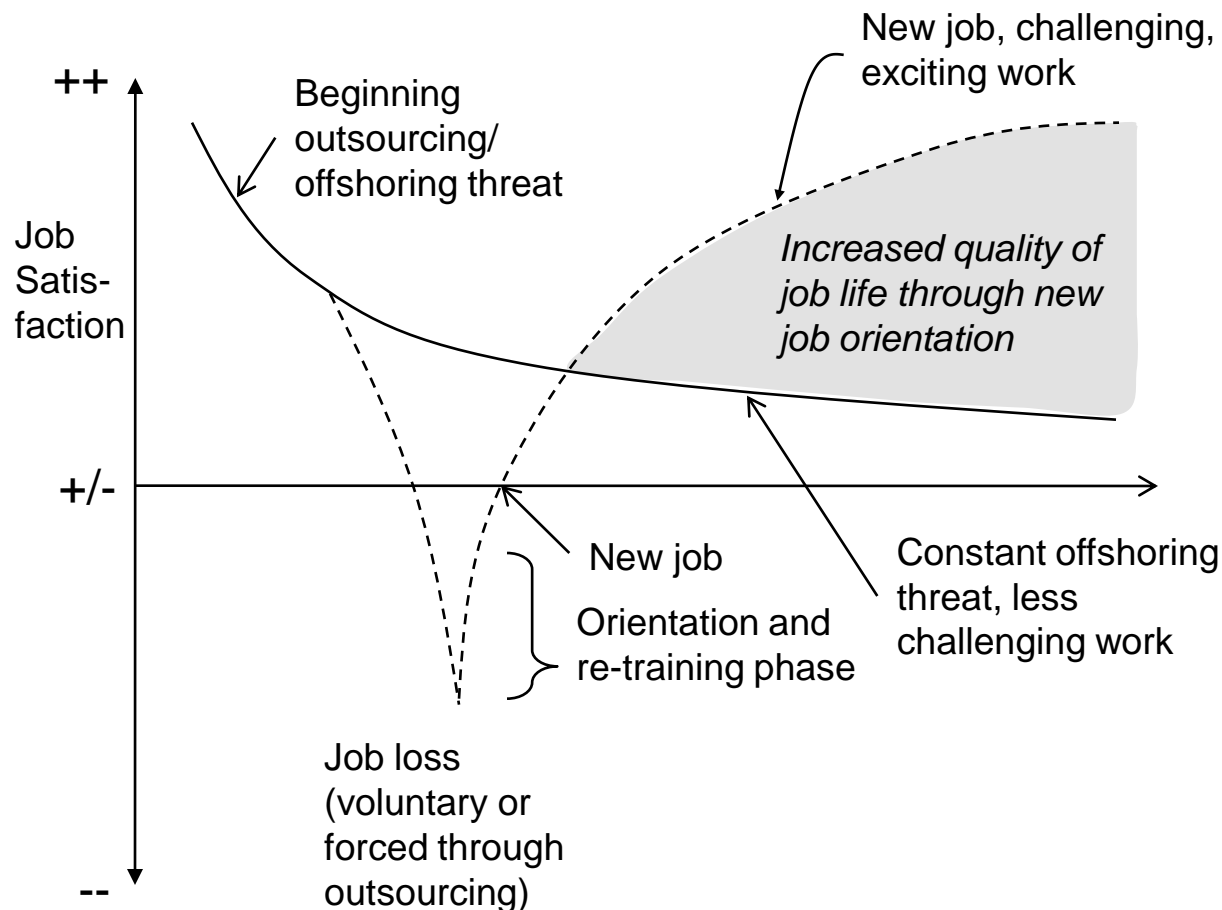


Challenges of Shared Services

HR Transformation strategies



Constant job threats are a major obstacle to Finance Transformations and hinder work satisfaction



- New organizational and psychological research suggests a higher quality of work life if the work is challenging and in line with the individual personal characteristics (see Bolles, Richard N., 2007)
- Many back office transformations leave employees in constant fear about their jobs, in particular since SSC or BPO are often major parts of the solution
- A proper and open communication strategy enables employees to start a new career orientation early in the process
- In the mid-term a clear cut creates higher satisfaction than living with constant job loss fear
- Therefore, early communication and a swift execution of the transformation are key to a successful implementation

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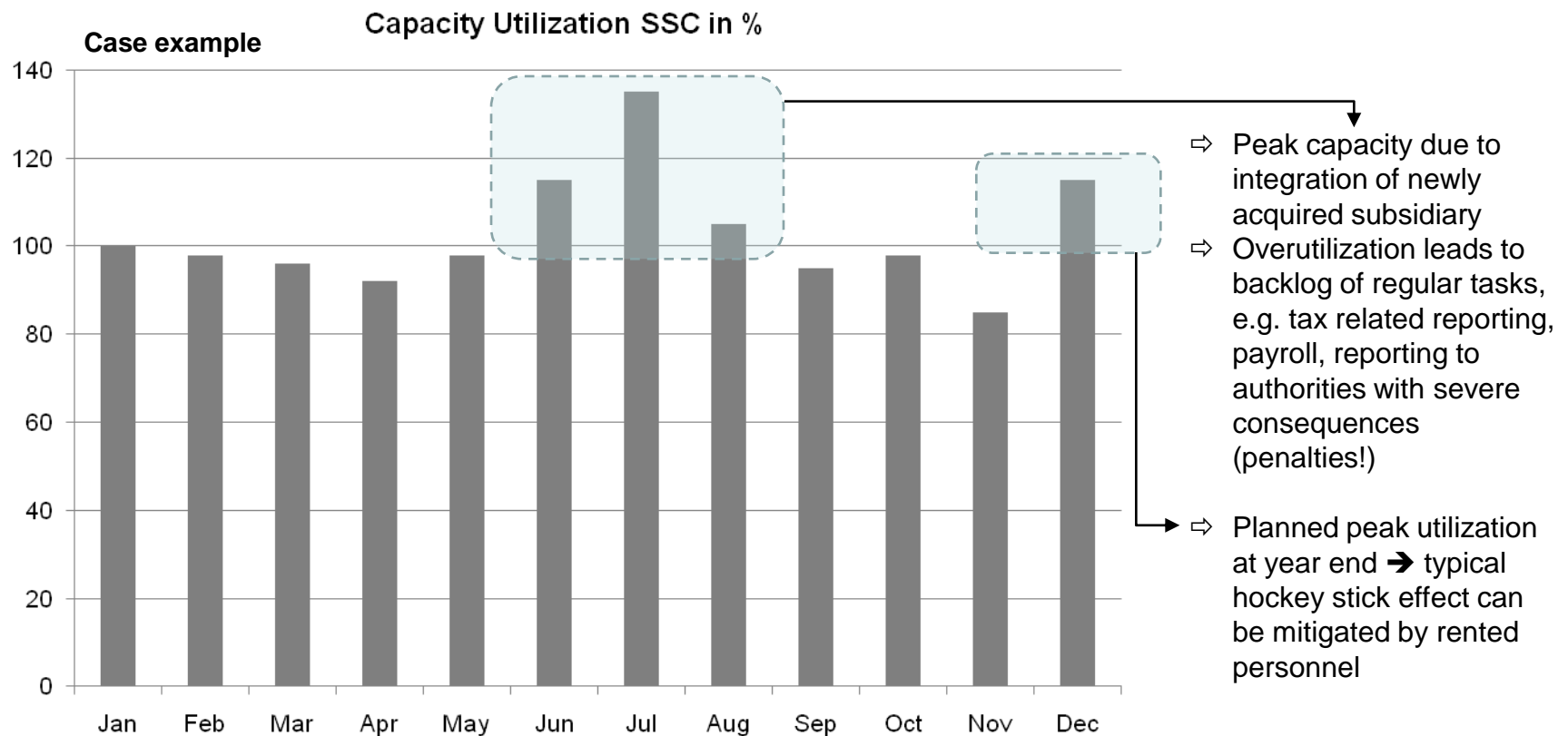
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Managing capacity peaks

Flexibility through SSC and BPO



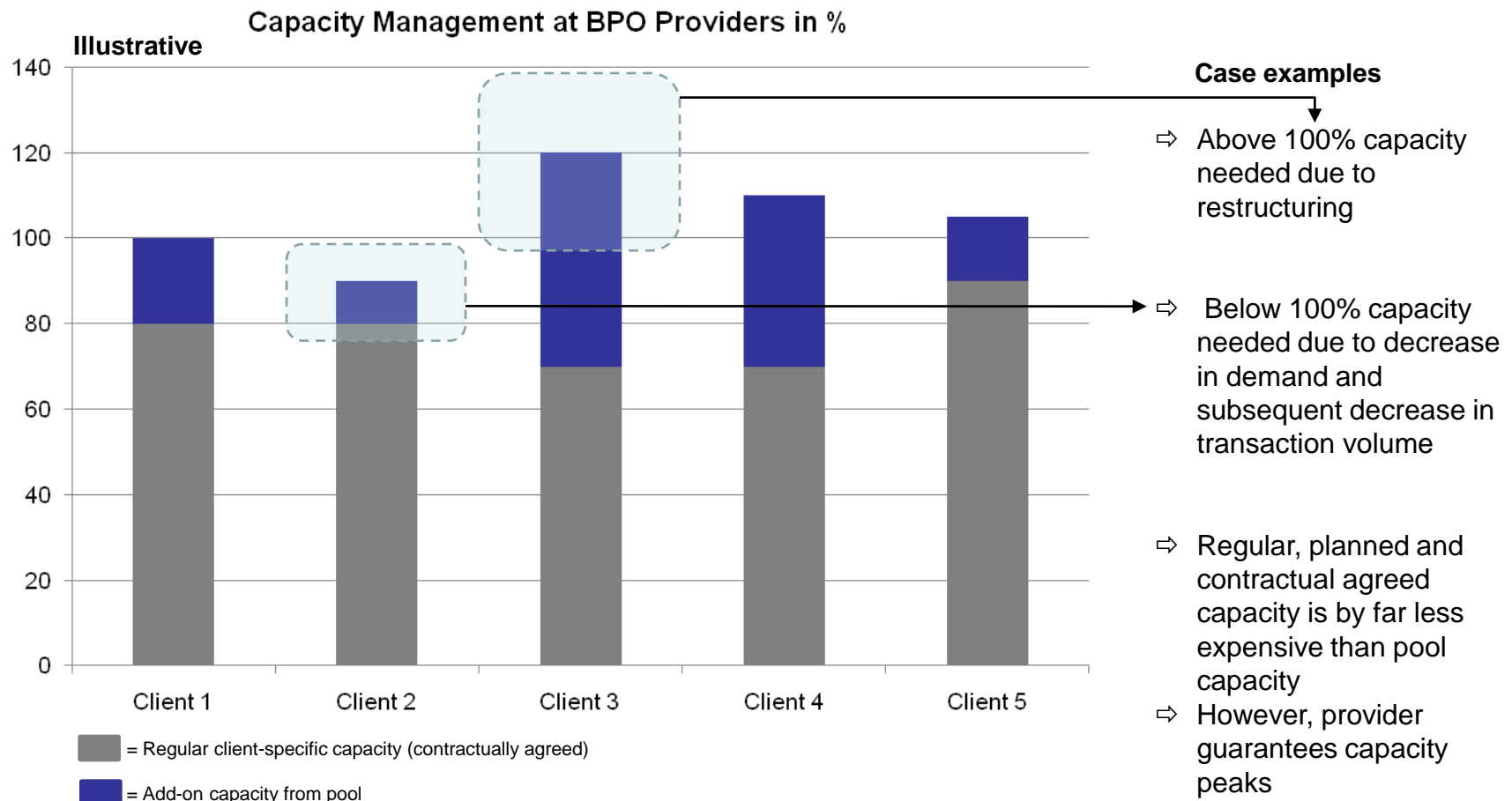
Fluctuating capacities are a specific challenge for smaller scaled SSC – peak utilization can not be managed effectively



Managing capacity peaks

Flexibility through SSC and BPO

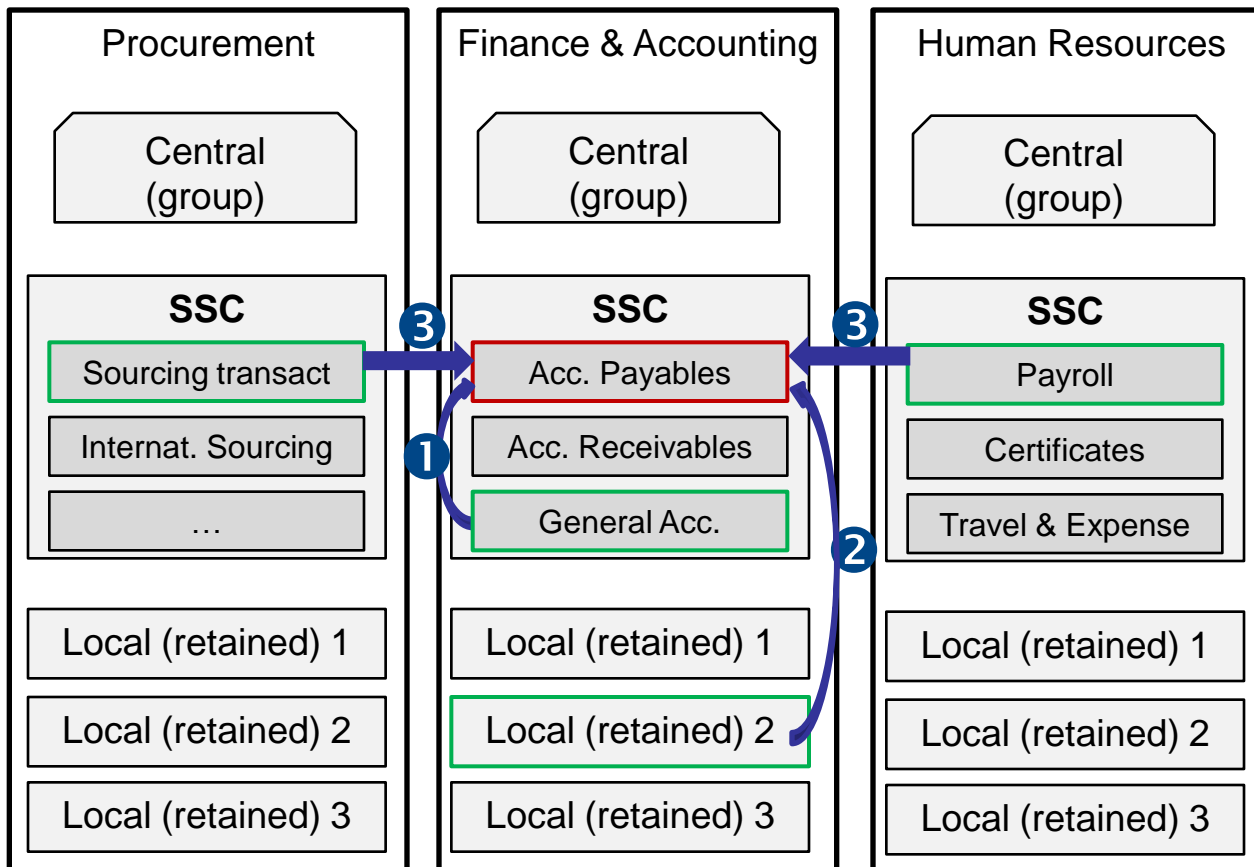
BPO providers usually apply pool-solutions in order to manage fluctuating capacity requirements as flexible and efficient as possible



Managing capacity peaks

Flexibility through SSC and BPO

Sources for additional capacities within the organization can be found vertically (same function) and horizontally (other administrative functions)



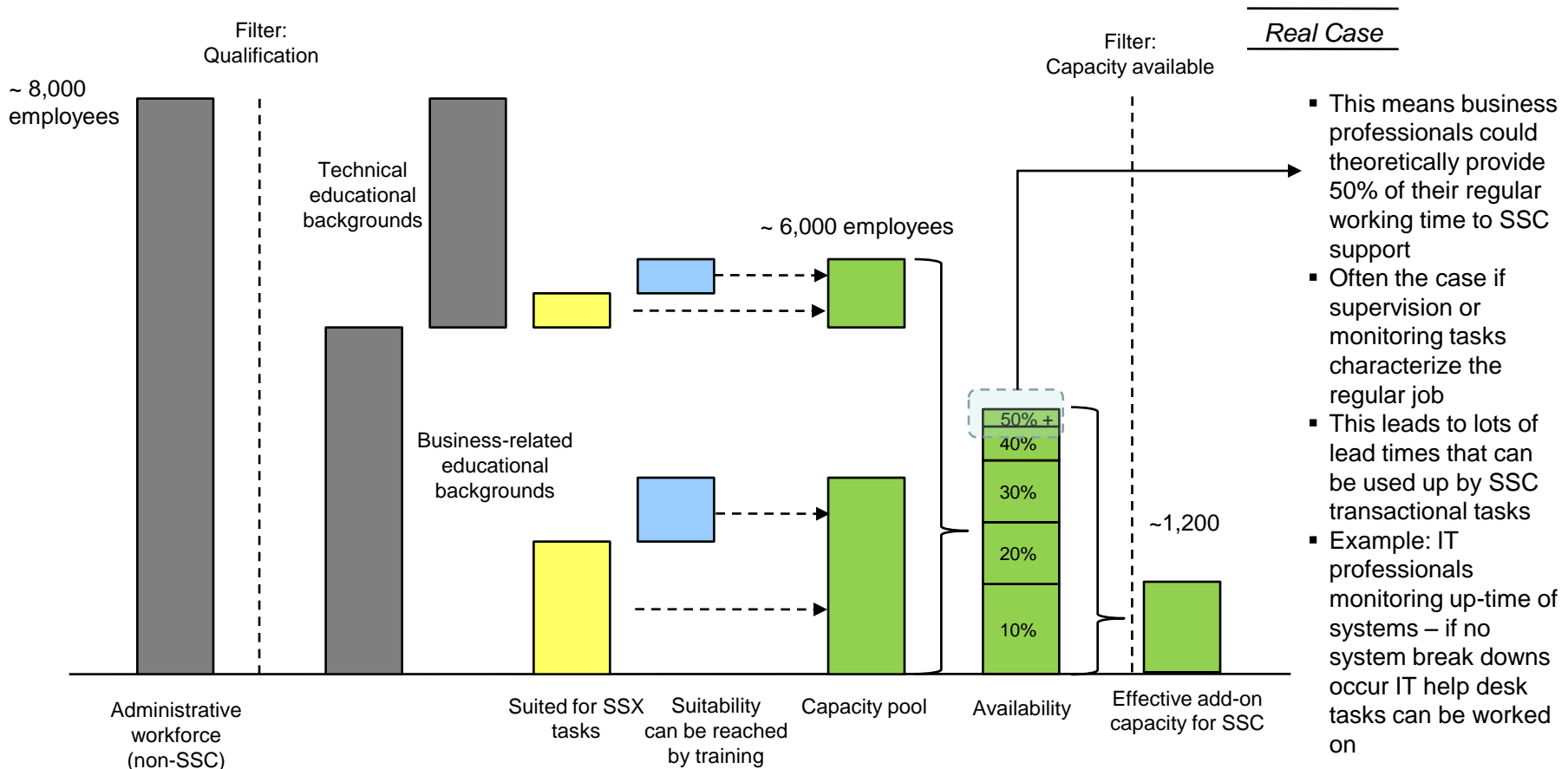
illustrative

- 1 Vertical smart sourcing within F&A Shared Service Center; different departments
- 2 Vertical smart sourcing within F & A function; from local organizations to Shared Service Center
- 3 Horizontal smart sourcing from other administrative functions (e.g. human resources or procurement functions); important skill sets and training

Managing capacity peaks

Flexibility through SSC and BPO

Large corporations can manage peak capacity through higher flexibility of its administrative workforce



Managing capacity peaks

Flexibility through SSC and BPO

Would it be possible to be as flexible as a BPO provider by just using spare capacity of the entire organization – yes, it would (theoretically...)

Methodology research on flexible utilization model

- The Corporate Flexible Utilization Model is currently investigated by a PhD study
- First results indicate that large-scale corporation do have lots of spare capacity that could be used by service functions
- However, practical application is still limited: mainly workers council issues (Monitoring of personnel work data)
- If model would work in reality – what does it mean to the BPO industry?



The reality as-of-today

- Quite unrealistic assumption that employees would indicate “spare” capacity → would fear bad impacts on corporate career, compensation and even job loss
- However, if SSC support is rewarded appropriately identification of capacity pockets might be possible
- Requires entire different mind-set, SSC-specific training and IT support so people can log-in from remote and work on a hourly basis for the SSC
- Again: different thinking required! (“I do have time and capacity, I help out for an hour, half a day or multiple days” → requires openness, trust and transparency)

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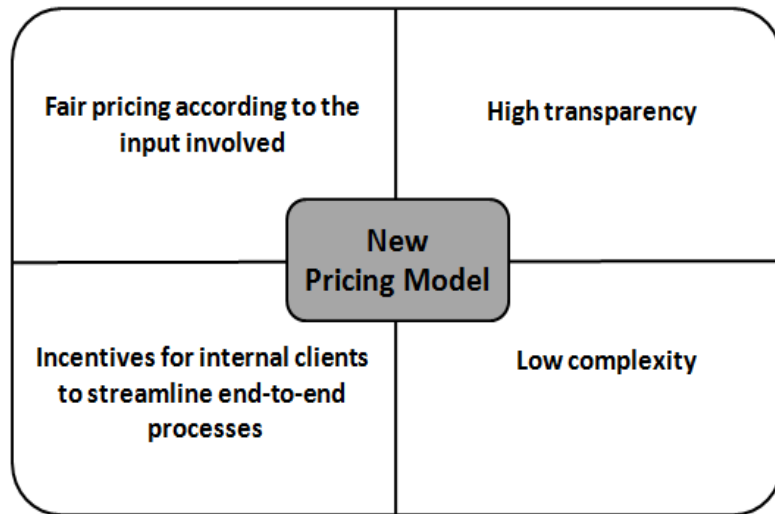
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BPO and SSC

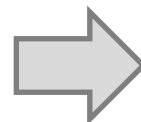
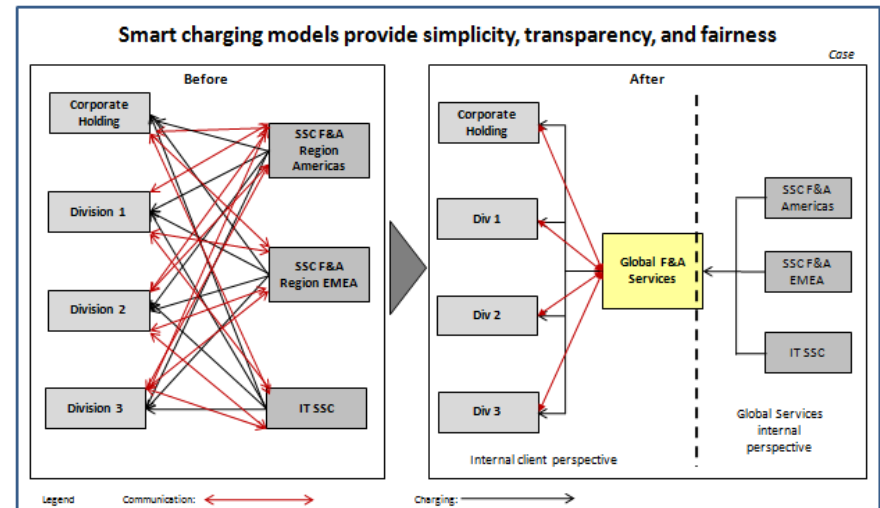
Flexibility through SSC and BPO

Shared Services have become established organizational models – nowadays the internal customers are asking for fair and transparent pricing even more

Objectives of pricing in Shared Services



Impacts on the organization



Comprehensive and workload-based pricing models lead to better transparency and fairness

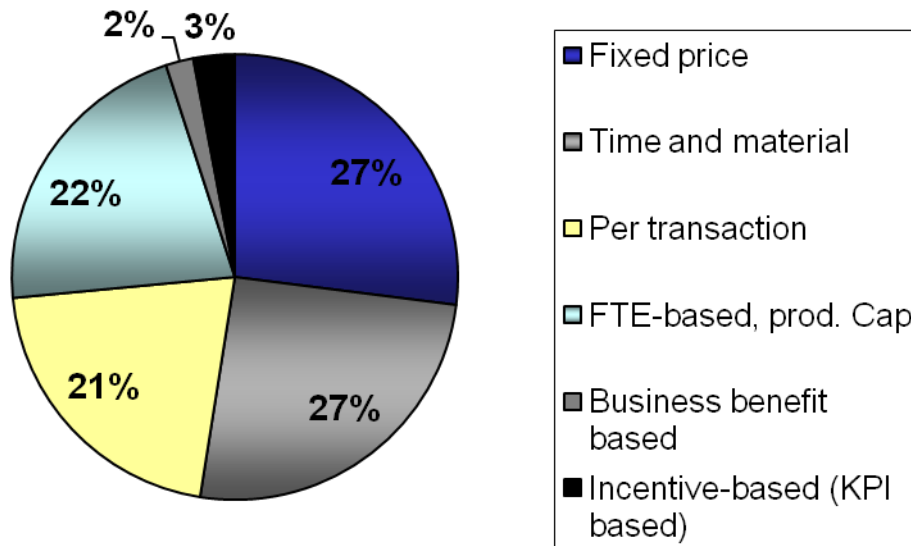
BPO AND SSC

RESULTS OF THE CHARGING STUDY 2008



Fixed Price and Time and Material are the most applied charging mechanisms among the services delivered in general

Charging Mechanisms usage frequency chart



| Comments |
|--|
| <ul style="list-style-type: none">• The graphic shows the preference for each charging mechanism among the companies interviewed• The percentages were obtained taking into account the total clients portfolio and how often the specific charging mechanism is applied among them |

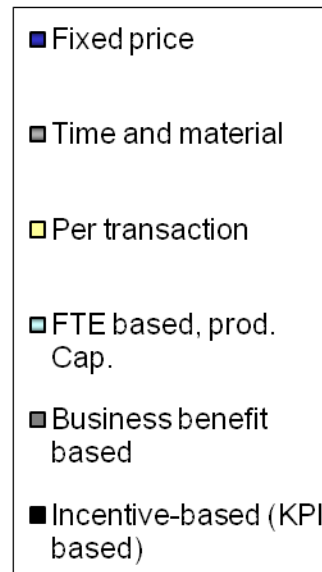
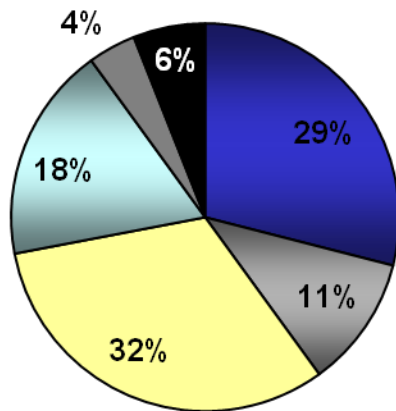
BPO AND SSC

RESULTS OF THE CHARGING STUDY 2008

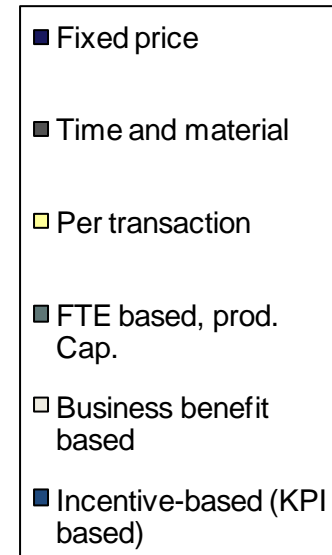
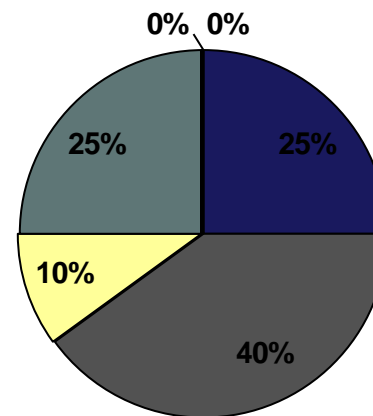


Nevertheless, individually BPO providers prefer the Per Transaction charging mechanism meanwhile captive centers prefer Time and Material pricing method

Charging mechanisms among BPO providers



Charging mechanisms among SSC



Note: Please refer to slide 5f for Charging mechanisms definitions

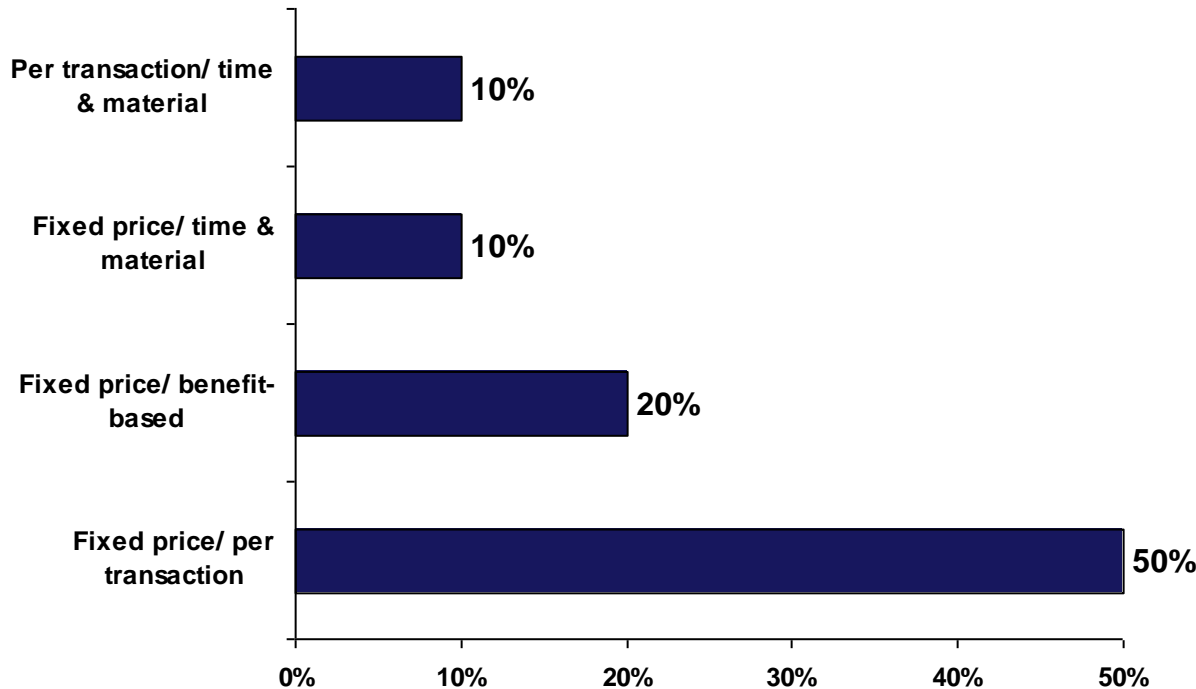
BPO AND SSC

RESULTS OF THE CHARGING STUDY 2008



Combination of fixed price and per transaction method is by far the most common charging mechanism overall

Types of combinations in use



| Comments |
|--|
| The graphic displays the percentage of companies, that mentioned a specific type of combination of different charging mechanisms |
| The most mentioned combination refers to a fixed base fee and additional fees per transaction to cover changes of the transaction volume |

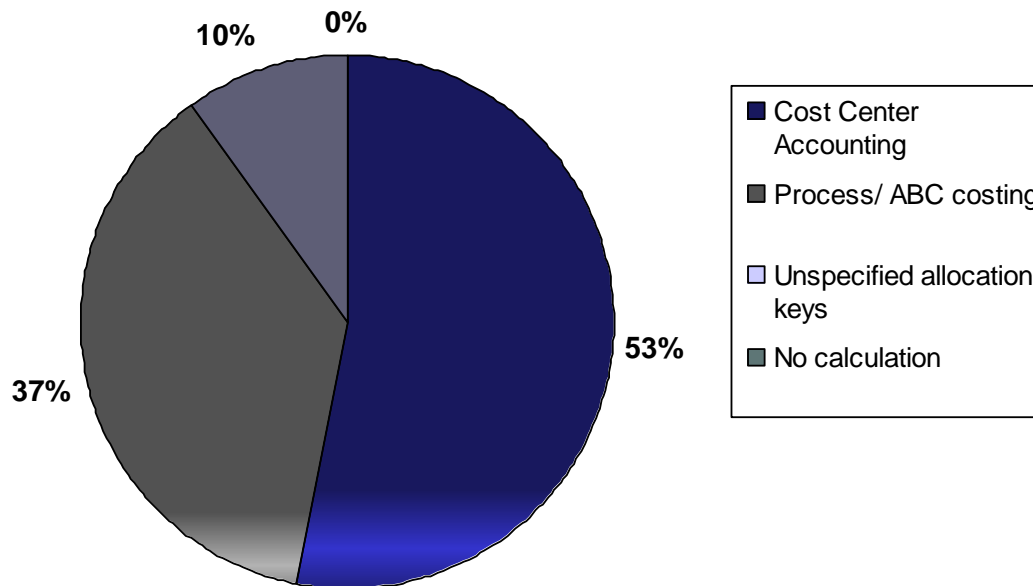
BPO AND SSC

RESULTS OF THE CHARGING STUDY 2008



Most companies track their cost for products and services to accomplish cost transparency among their projects

Cost calculation methods among services providers



| Comments |
|---|
| In order to assign the costs Cost Center accounting is the most common calculation method among the interviewees |
| The pie chart shows the way the services providers assign their cost to products and services delivered (which has no influence on the charging methods!) |

BPO AND SSC

PRICING



Simplified example of a transactional-based charging model

Baseline:

Same structure of invoices per LE

Legal Entities (LE)

| Transaction type | total volume | LE 1 | LE 2 | LE 3 | WF |
|----------------------------------|--------------|----------|-----------|-----------|-----|
| automatic invoices | 10 | 2 | 2 | 6 | 0,1 |
| manual transactional invoices | 10 | 2 | 4 | 4 | 1,0 |
| manual non-standardized invoices | 10 | 2 | 6 | 2 | 3,0 |
| Sum | 30 | 6 | 12 | 12 | |

Weighting Factor of each invoice type

Workload 0,1 of transactional invoice

Workload 3x higher than transact. invoice

Total cost for all LE **100,00 €**

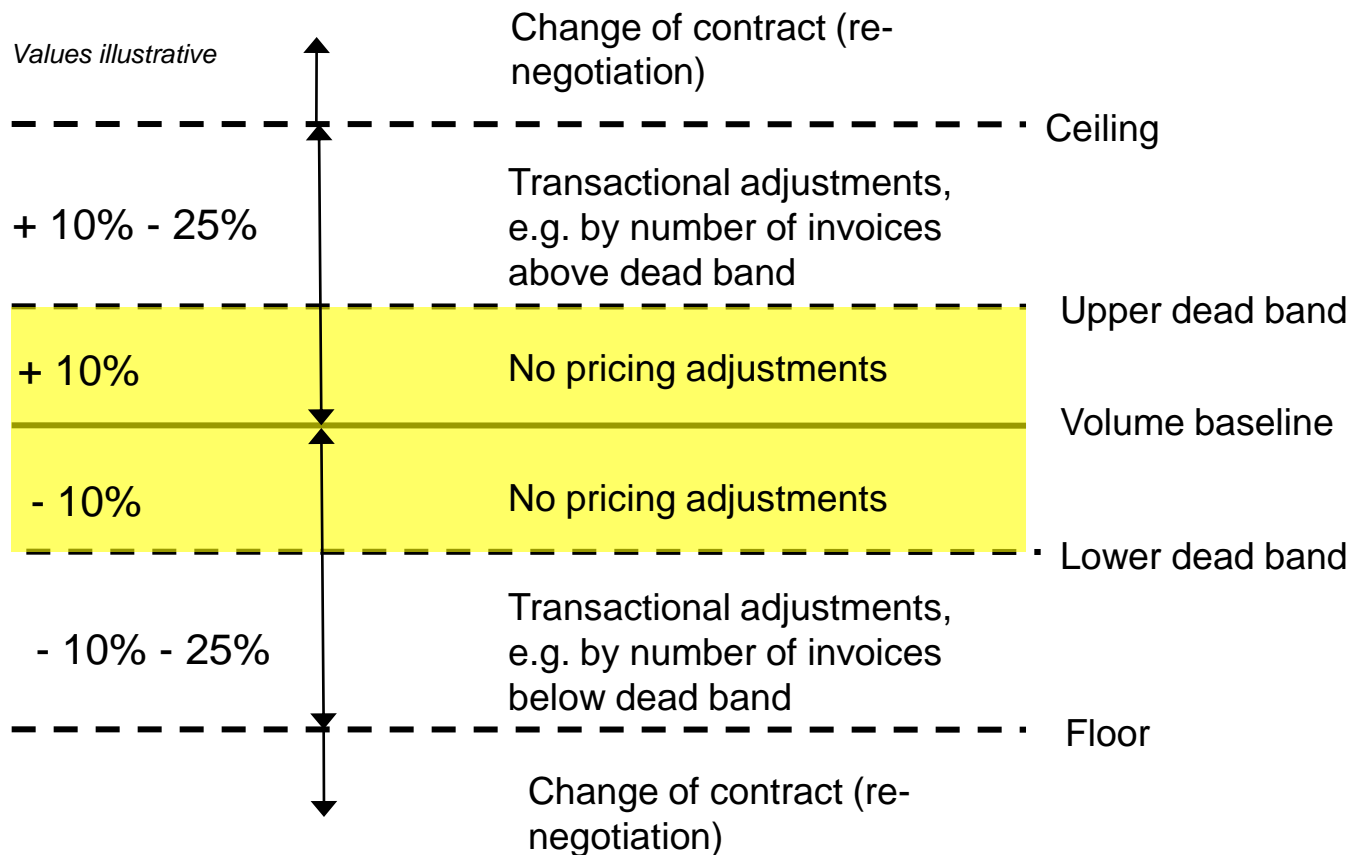
| Transaction type | adjusted volume | Price per invoice | Budget LE 1 | Budget LE 2 | Budget LE 3 |
|----------------------------------|-----------------------|-------------------------------|-----------------------------|------------------------------|-----------------------------|
| automatic invoices | 1 (10*0,1) | 0,24 € (100/41*0,1) | 0,49 € (0,24€*2) | 0,49 € (0,24€*2) | 1,46 € (0,24€*6) |
| manual transactional invoices | 10 (10*1,0) | 2,44 € (100/41*1,0) | 4,88 € (2,44€*2) | 9,76 € (2,44€*4) | 9,76 € (2,44€*4) |
| manual non-standardized invoices | 30 (10*3,0) | 7,32 € (100/41*3,0) | 14,63 € (7,32€*2) | 43,90 € (7,32€*46) | 14,63 € (7,32€*2) |
| Sum | 41 | | 20,00 € | 54,15 € | 25,85 € |

BPO and SSC

Pricing



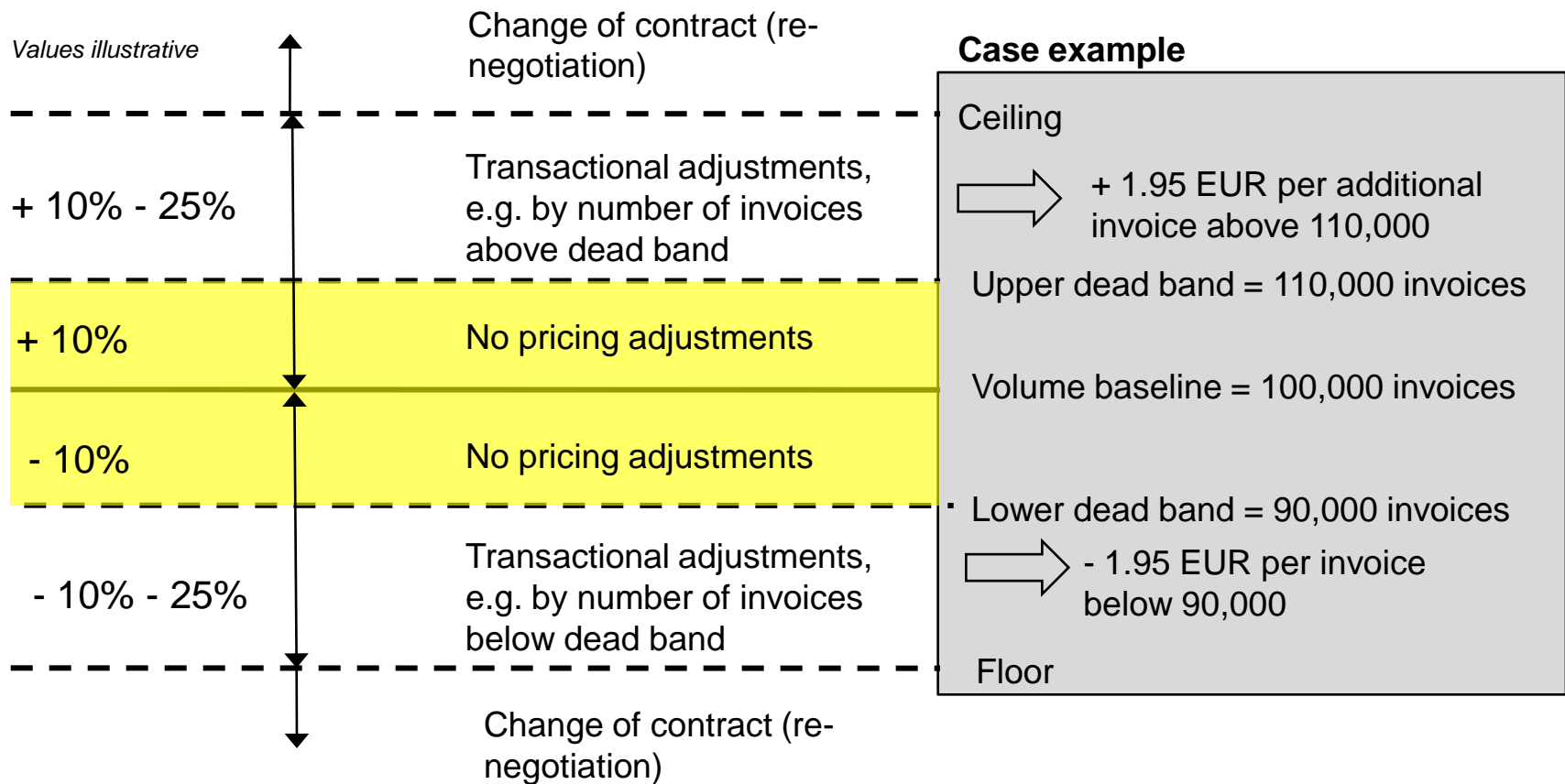
Transactional flexible pricing models contain usually pre-determined dead bands and variable charges above/below certain thresholds



BPO and SSC

Pricing

Transactional flexible pricing models contain usually pre-determined dead bands and variable charges above/below certain thresholds



BPO and SSC

Pricing

In order to simplify charging, adjustments are required only in cases the intervals (dead bands) are left

Case example

Ceiling

➔ + 1.95 EUR per additional invoice above 110,000

Upper dead band = 110,000 invoices

Volume baseline = 100,000 invoices

Lower dead band = 90,000 invoices

➔ - 1.95 EUR per invoice below 90,000

Floor

Base contract data:

- 100,000 invoices in period (volume baseline)
- Base charge 180,000 EUR (1.80 per invoice)

Situation A

- 125,000 invoices
- Calculation:
- Base charge: 180,000 EUR
- 15,000 invoices above baseline
- $15,000 * 1.95 = 29,250$
- Charge for period overall $180,000 + 29,250 = 209,250$

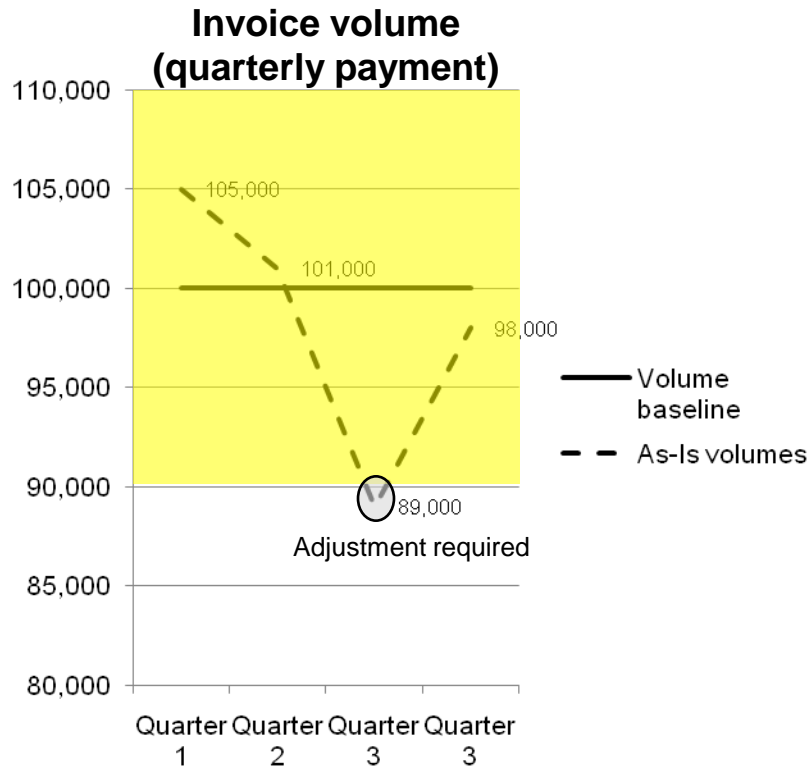
Situation B

- 75,000 invoices
- Calculation:
- Base charge: 180,000 EUR
- 15,000 invoices below baseline
- $15,000 * 1.95 = 29,250$
- Charge for period overall $180,000 - 29,250 = 150,750$

BPO and SSC

Pricing

The intervals need to be defined according to the realistically planned volumes



Calculation of yearly charges

- Quarter 1 : 180,000 (Base)
 - Quarter 2: 180,000 (Base)
 - Quarter 3: 180,000 (Base)
- 1,000 * 1.95
= 178,050
 - Quarter 4: 180,000 (Base)
 - **Overall: 718,050**
- ⇒ **Low effort charging model through dead bands**
- ⇒ **Continuous higher/lower volumes require adjustments on a yearly basis**

BPO and SSC

Summary



SSC will remain mainly a question of scale – getting a consistent pricing model in place is the most important homework

- ⇒ The crisis has created a sense of urgency – however, companies will **not hurry in not well-thought BPO projects**
- ⇒ Severance will remain a key challenge to for companies to implement BPO solutions – **captive models** will be the first choice of those with **sufficient scale**
- ⇒ With the right scale **smart staffing models** will help large-scale players to optimize capacity utilization with own resources
- ⇒ SSC and BPO models require **proper pricing/ charging methods** – key foundation for a **functioning partnership model**

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A business card for the Offshoring Institute. The card has a blue header and footer. The main body is white with a faint world map background. It includes the Offshoring Institute logo in the top right corner. The text on the card reads: "Prof. Dr. Soeren Dressler", "Director", "Offshoring Institute", "Treskowallee 26", "10318 Berlin • Germany", "Telephone: +49 30 5001 226-12", "Mobile: +49 175 254 7787", "✉ soeren.dressler@offshoring-institute.org", and "www.offshoring-institute.org". There is a small image of a globe on the right side of the card.

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Director

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