

The Issue: How Western European Businesses are Addressing Globalisation's Opportunities and Challenges

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Recently completed EquaTerra market research finds a consensus among Western European business leaders that increased globalisation is inevitable and, in general, will benefit their organisations. Globalisation creates a broad range of opportunities and challenges Western European organisations must address or risk losing competitiveness. Funding challenges have certainly increased for most organisations over the course of 2008, especially during the fourth quarter, as the credit crisis fuelled a European and global markets economic downturn. Given the growth of competition, however, Western European firms cannot sit back and wait for better economic times before pursuing new business initiatives. Rather, new more creative and cost-effective ways to fund initiatives and enter new markets are required. Talent challenges, too, are a double-edged sword as globalisation and the growth of emerging market talent creates talent pools that Western European businesses can tap into and new competitive local market champions can also leverage for their own growth. Quickly and efficiently leveraging opportunities created by globalisation is the best means to avoid being overwhelmed by its associated challenges.

The Details

Challenges and Opportunities from Globalisation

Previously, EquaTerra research papers have reviewed some of the fundamental opportunities and challenges facing western businesses as a result of ongoing globalisation. These findings are based on EquaTerra client experiences as well as research conducted on EquaTerra's behalf by the Economist Intelligence Unit (EIU).

In April 2008, EquaTerra commissioned the EIU to conduct a market study assessing major business challenges facing western organisations today, as well as the opportunities and challenges created by globalisation (see Figure 1, follow this [link to the study's executive summary](#))

EquaTerra interpreted and extended these findings to assess the role alternative service delivery models (like shared services, captive offshore operations, and IT and business process outsourcing) can play in helping organisations take advantage of opportunities and respond to challenges from globalisation. These findings are presented in a Perspective paper titled "[The Role of Outsourcing in Responding to Opportunities and Challenges from Globalization](#)" that addresses how globalisation has enabled more outsourcing and how outsourcing has become a tool to respond to globalisation.

Study Profile

The Economist Intelligence Unit conducted this market study on EquaTerra's behalf and 1Q08 surveyed 217 global executives with the following profiles:

- 46 per cent North American
- 39 per cent Western Europe
- 15 per cent rest-of-world
- Western Europe respondent profile
 - 74 per cent “C-Suite”
 - All major industries
 - All major functional groups/ roles
 - 38 per cent \$3+ billion revenue

Figure 1

This paper reviews and interprets globalisation issues and opportunities specifically as they relate to the Western European market.

There are many dimensions to globalisation, including:

- The expansion and maturation of the global telecommunications infrastructure and Internet, enabling the creation of tightly linked global information and data service chains;
- Trade liberalisation, the growth of cross-border trade, and the expansion of the European Union;
- The migration of lower wage workers from the east to the west of Europe and the growth of Central and Eastern Europe (as viable markets from which to source business and IT services to the west);
- Growth of highly competitive non-European based businesses and increasingly interconnected global markets and economies;
- Political challenges related to population and labour migration, especially involving less skilled, and less easily assimilated populations;
- Pushback from trade and labour unions and others with vested interests against the increased use of migrant or “offshore” labour.

Clearly, globalisation creates as many opportunities for Western European businesses, markets and economies as it does threats. Whether something is a threat or an opportunity often depends on one's perspective. These developments have made it possible for Western European businesses to gain greater access to “emerging market” (old and new) resources and services. Some believe this has benefited emerging markets and business at the expense of local labour and labour pools. So the question of distribution of globalisation's benefits has become hotly debated. Hardly debatable, however, is the inevitability of globalisation's expansion, a reality that has driven leading Western European business interests for many hundreds of years.

As the global playing field for resources, talent and capital becomes more level, the emerging winners are the organisations (in Western Europe or elsewhere) that can make the most creative, efficient and effective use of these assets. Historically, the West has had an advantage derived from larger economies, more mature markets and business models, better educational systems and more educated workforces, and greater access to capital. More recently, emerging markets have benefited from cheap labour whose skill levels began to meet or exceed those of western workers. The next phase of globalisation will focus less on access to resources than on how to attract and competitively leverage these resources.

Market Study on Globalisation

The following are the key findings from the EIU market study. Please refer to the executive summary referenced above for a complete overview of the study.

When asked to identify the biggest challenges overall to their organisation's success over the next three years, Western European respondents cited these as the top three:

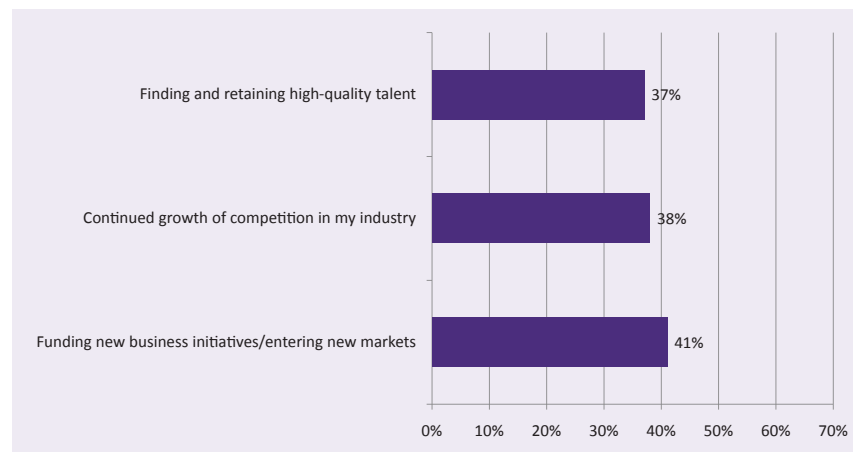


Figure 2

Overall, 90 per cent of Western European executives polled in the study indicated that globalisation was inevitable, and 81 per cent felt that its pace will accelerate. Seventy-three per cent saw globalisation having a positive impact overall on their organisation. Western European study respondents identified the following as the main opportunities globalisation will offer over the next three years:

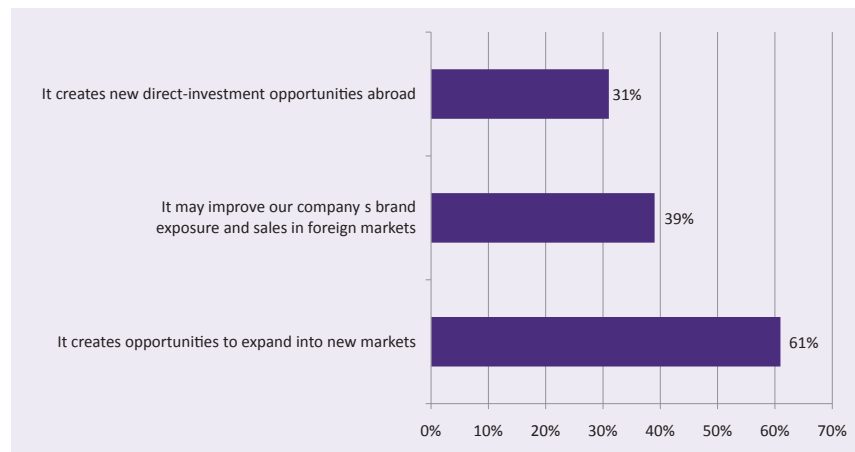


Figure 3

These responses show a strategic growth orientation relative to globalisation opportunities. The emphasis is much more on entering new markets to sell a firm's goods and services rather than just viewing those markets as sources of low-cost labour or raw materials. Given the expected escalating growth levels of emerging market economies over the next 20 years compared to Western markets, this is a wise perspective to take for any business with saleable offerings for these markets.

Relative to the main ways globalisation will challenge organisations over the next three years, the following came out on top:

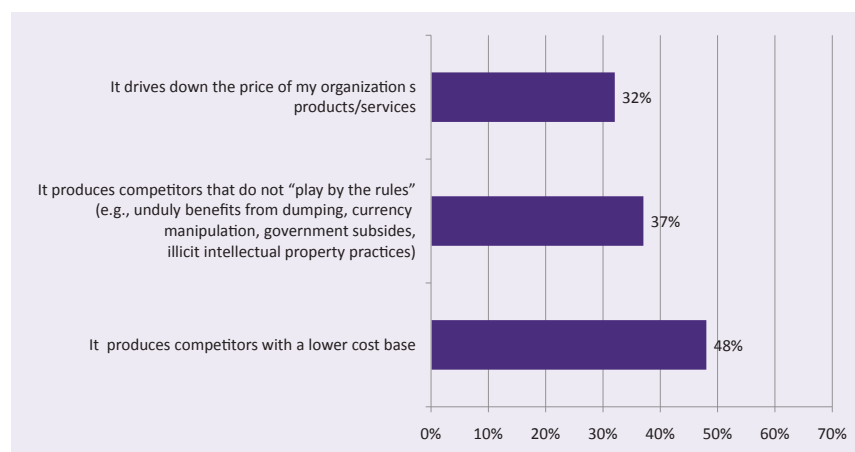


Figure 4

The second ranked challenge highlights the duality of globalisation. While it creates the opportunity to move into new markets, it also increases the pressure to do so to remain competitive. Entering these new markets, especially those more differentiated and exotic than just across the border in Europe, can prove very challenging given the growth of stronger local market competition.

While it is important to understand the perceived opportunities and challenges from globalisation, it is equally or more important to understand how to respond to them.

How are Buyers Responding?

Identifying the opportunities and challenges that globalisation creates is one thing. How to respond is another. The market study assessed which activities are most important to organisations with regard to globalisation. Western European respondents identified these as top priorities:

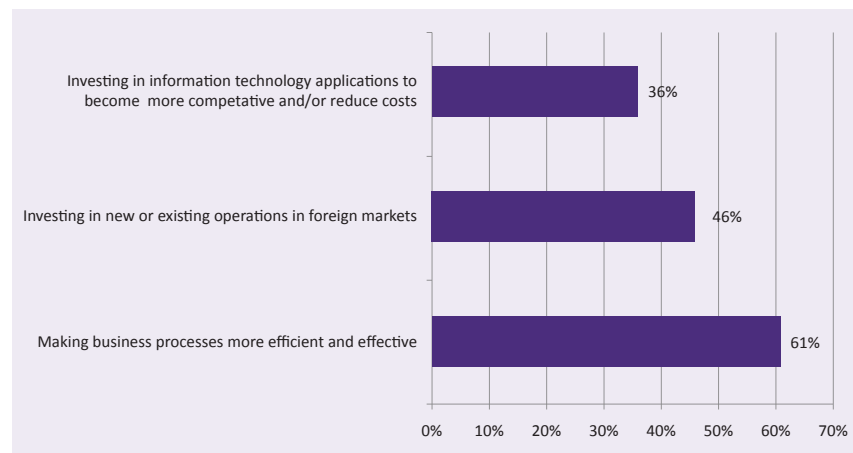


Figure 5

While these business change initiatives are not new for the most part, undertaking them successfully assumes a heightened sense of urgency for Western European organisations faced with global competition and the overall economic environment. Process redesign or “re-engineering” is an ongoing event in many organisations, as is the struggle to keep up with IT investment requirements and fully leverage the investments that have been made. These efforts are still required in most Western European businesses, but the key is how they will produce more cost-effective fruit than in the past and better support the critical need for investing in foreign markets.

In a related question, Western European respondents also were asked how their organisations were changing corporate strategy to respond to opportunities and threats created by globalisation. The top changes cited were:

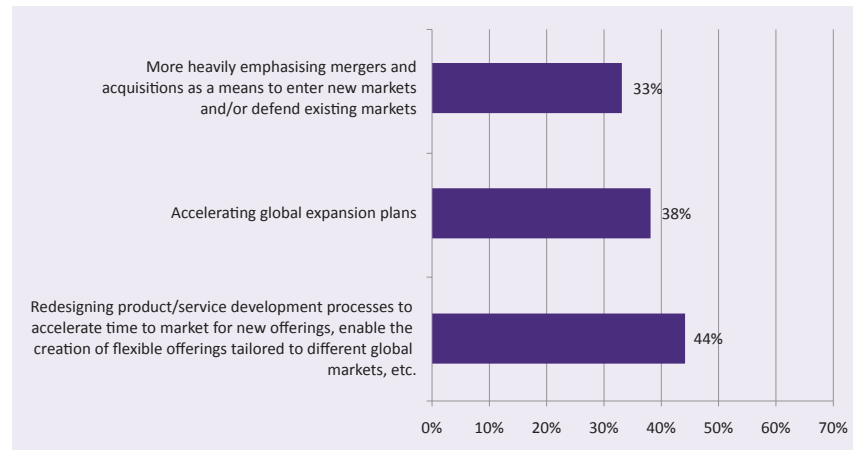


Figure 6

Here again the key to success is the ability to execute these change initiatives. Overall, the market study findings show that globalisation's expansion will continue to push forward and likely accelerate in Western Europe, even if it occurs in fits and starts in the short term given economic conditions driving populist and political backlash against globalisation. The challenges that globalisation creates for organisations are clearer today than ever. So too, however, is the imperative to take advantage of the opportunities created, particularly expansion into new and growing markets. There is much that Western European organisations can and must do to respond to globalisation.

How are Outsourcing Service Providers Responding?

Globalisation clearly has had a major impact on the global business and IT services marketplace. Leading Indian service providers have grown exponentially over the past decade, expanding their footprint from basic IT application work and staff augmentation to a full range of IT, business and vertical industry services. More recently they have expanded operations in Western Europe, both to take advantage of a growing European appetite for their services, as well as to make up for a slowdown in services growth in the North American market. Leading multinationals and regional European providers also have expanded their own operations in lower cost markets like Central and Eastern Europe, India, China, and numerous other countries and geographies.

The European service provider market is suffering from current economic market conditions, especially in banking, financial services, retail and in some segments of the manufacturing industry. This will impact the market in several ways, including driving buyers to cut back on services viewed as discretionary, having longer term ROIs or requiring major upfront investments. Buyers also will focus more on rationalising and paring down their service supplier base. This will further accelerate the service provider market consolidation already occurring in the European market.

The business and IT services market will continue to move from a point-to-point-solution model (e.g., outsource work from Europe to India) to a global sourcing model characterised by multi-provider, multi-function and multi-location service provisioning. Buyers and service providers today are creating complex global service chains, akin to global supply chains managed by multinational manufacturers. Often, however, the practices, policies, and procedures to manage these service chains are still emerging and immature. It is easier to set up the global services network than to successfully operate it. This is a challenge to emerging market and multinational service providers and their clients.

Both groups of service providers also face other challenges. Indian providers are still heavily weighted in application development work, face margin pressures from exchange rate trending, and have daunting challenges to maintain staffing growth levels, manage attrition, and invest in new and more complex service offerings and solutions. They also need to expand their models and operations into markets beyond India to address the above challenges and position themselves to deliver more high-touch services. Some Indian firms must also replace business lost from buyers impacted by the current market downturn, particularly in banking and financial services. Multinationals and regional European service providers still often need to improve their remote delivery capabilities, manage their own global expansion efforts, and improve the quality and efficiency of their service offerings. Each camp must also manage revenue growth and maintain profit levels during the ongoing economic downturn.

Indian Providers	Multinationals/Regional Europeans
<ul style="list-style-type: none"> • Heavy application development • Margin pressures from exchange rate trending • Maintenance of staffing growth levels • Manage attrition • Invest in new service offerings • Expand into markets beyond India • Position to deliver more high-touch services • Replace business from buyers lost do to market downturn • Manage revenue growth/maintain profit level during economic downturn 	<ul style="list-style-type: none"> • Need to improve remote delivery capabilities • Need to manage global expansion efforts • Need to improve quality and efficiency of service offerings. • Manage revenue growth/maintain profit level during economic downturn

Figure 7

Outsourcing and related alternative service delivery models are a key tool for buyers to use to address globalisation. Service providers, however, also need to become truly global so they are better positioned to help their clients.

The Advisor Perspective – Critical Points to Consider

EquaTerra advises Western European businesses to develop a concerted strategy and plan of action to address globalisation opportunities and challenges. Addressing globalisation is too critical and complex to adequately do in an ad-hoc fashion. While most large western organisations have some sort of global strategy, often it is not tied to a global sourcing strategy primarily because most buyers do not have a detailed strategy for sourcing or managing services globally. Even buyers with such a strategy should regularly review and reassess it, especially during challenging economic conditions.

While the services sourcing market is evolving from a point-to-point model toward a more global multi-source and multi-provider model, this transition typically occurs in an uncoordinated fashion within buyer organisations. Buyers may find, more by default than intent, that over several years they have established numerous global sourcing arrangements for IT and business services that were sourced and are now managed independently. This creates several problems, including general inefficiencies and redundancies in management efforts and lack of visibility across core business and IT functions or processes, components of which are supported by numerous third-party providers. Similar to problems that existed historically in organisations with siloed and fragmented processes, they are exacerbated by the involvement of external providers creating additional layers of processes and systems.

European organisations building global service delivery models typically need to apply more rigour and structure to this process. There are several components to doing this:

- Identifying the most critical aspects of the overall corporate globalisation strategy that alternative service delivery models can play a role in addressing;
- Building a process to determine which functions are suitable for delivery beyond local providers and boundaries, including assessing the viability of using third-party providers versus establishing captive operations;
- Defining the business case (including expected benefits) and how to measure achievements for a specific global sourcing scenario;
- Developing a risk profile to identify and assess the additional potential risks involved (e.g., financial, personnel, regulatory, compliance, data privacy, IP, negative PR) in undertaking a global sourcing effort;
- Defining processes to identify, vet, assess, and select candidate service providers, locations and geographies;
- Developing a retained organisation and outsourcing management and governance model and processes capable of supporting global sourcing efforts. This should include determining which specific functions, processes, and third-party relationships are aggregated and managed as a portfolio and which are still managed in a distributed fashion;

- Assessing or reassessing all of the above points in light of current economic conditions, the overall market slowdown expected to continue into 2009, and any changes these events introduce into a buyer organisation.

This collective strategy and set of processes is manifested in an organisation's Service Delivery Model (SDM, see the EquaTerra Perspective "[How to Design and Optimise Global Service Delivery Models](#)" for more details). An SDM becomes increasingly complicated as more and varied source markets for services are targeted.

EquaTerra expects that current negative economic conditions will ultimately make outsourcing an even more important tool to address business challenges. How it is being applied, however, from the standpoint of its business case, goals, timing and focus is changing. Efforts with short - term ROIs, limited upfront investments, straightforward business cases, and clear top or bottom line impact are being prioritised. European buyers need to ensure to the extent possible that their current outsourcing portfolio, particularly any new outsourcing efforts, reflects changes in the global economy and its impact on their business. Negative economic conditions will complicate and slow globalisation in some cases, but certainly will not stop its advance. Similarly, the focus and business case parameters for outsourcing are changing from what was the norm in the recent past. But outsourcing's usefulness as a tool to reduce cost, avoid or lower future investment costs, improve process performance and/or enable a shift in focus – all things required to respond to globalisation – will not diminish.

Conclusion

The trend toward ongoing globalisation of Western European economies and markets is being impacted by the current turbulent global economic conditions. While these conditions may slow globalisation in some respects, this will be more a respite than a reversal. As globalisation moves forward and European businesses either help push it along or are pulled along with it, they must have a clear strategy as to how to best respond to its challenges and take advantage of its opportunities. Economic and market uncertainty only increases the importance of this strategy. The key is a clear understanding of how alternative service delivery models, such as IT and business process outsourcing and the use of offshore captive operations, can help address globalisation. Globalisation is driving, enabling and requiring organisations to develop more global sourcing, governance models and service chains to remain competitive and tap into global talent, resource and capital pools. Given the complexity of developing and managing these global service chains, it will prove difficult for organisations to exploit their potential without a clear and viable strategy and plan of attack.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. Our advisors average more than 20 years of industry experience and have supported over 2000 transformation and outsourcing projects across more than 60 countries. Supporting clients throughout the Americas, Europe, and Asia Pacific, we have deep functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes. EquaTerra helps clients achieve significant cost savings and process improvement with internal transformation, shared services and outsourcing solutions.

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