TPI Market Education Series presents

Virtual Captives – The Future of Offshore?

Hosted By:

Peter Allen
TPI Partner and Managing Director, Market Development

Chaz Foster
TPI Partner, Financial Services Practice
Discussion Overview

► Offshore BPO – Key Trends
► Offshore Operating Model Questions and Lessons
► Virtual Captive – What is it?
► Q&A
Global Service Delivery (GSD) continues to grow

% of TPI–Advised Transactions with Scope Moving Offshore (Based on #)

<table>
<thead>
<tr>
<th>Year</th>
<th>% Scope with Offshore</th>
<th>% Scope with no Offshore</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>60.7%</td>
<td>39.3%</td>
</tr>
<tr>
<td>2004</td>
<td>59.7%</td>
<td>40.3%</td>
</tr>
<tr>
<td>2005</td>
<td>48.2%</td>
<td>51.8%</td>
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Contracts with Global Service Delivery (GSD) usually heat up the competition among service providers

2005 TPI-Advised Contracts: Scope of Contracts with GSD

- CRM: 1
- Procure.: 3
- F&A: 4
- HRO: 6
- Multi-Process: 13
- ADM: 2
- Infra.:
Growth in GSD is fueled by recognition of benefits beyond cost reduction

Global service delivery (GSD) can do more than just reduce costs – it addresses under-performing processes, scales operating models and adds variability to cost structures.

GSD Drivers

Cost Reduction
- Labor Arbitrage
- Reduced cost/unit

Cost Efficiency
- Move to more efficient, variable cost structures
- Improved scale at lower cost

Skills & Experience
- Access to qualified personnel / specialized skills
- Investment in specialized capabilities outside “core”
- Legacy migration to offshore operations – keep key resources focused on core business critical areas

Improve Quality
- Leverage supplier processes & best practices
- Improved testing
- Source to someone whose core business what is non-core to you

Competitive Changes
- New markets / growth strategy
- M&A activity
- New products & services
- New process/system Improvements
- Increased capacity
Organizations that are mature in offshoring are expanding their GSD

TPI has identified five stages of GSD maturity. From our 2005 study The State of Global Service Delivery**, we discovered that organizations at Stage 3 or 4 are expanding their GSD rapidly.

Service provider capabilities are converging

**MNCs**

- Knowledge of client’s business
- Better track record than anyone else
- Strong executive relationships
- Superior global delivery model
- Strong operational capabilities
- Looks real good when bringing “A” team to table

**Indian Providers**

- Very good at relationship building with client, working hard to bridge the cultural divide
- Presents capabilities in a way that makes their work look like the client’s process, not the service provider’s process
- Very flexible contractually (less rigorous around T&C)
- Very price competitive
- Excellent sales and delivery teams

**Convergence**

**Strengths:**

- Not as innovative or aggressive solution
  - Often focusing on selling their solution rather than the process and price
- Rigidness at negotiating table
  - Relatively expensive with a bias on additional services within proposed solution
  - High transition and termination costs can hurt client credibility in contract negotiation

**Weaknesses:**

- Still working to understand the contracting process
- Too deferential on some issues
- Newer, less experienced staff
- Possibility for slight over-commitments
Companies are using multiple service delivery models within their organizations.

Companies consider various models for optimal service delivery. Increasingly, they are using more than one alternative to drive their agendas for change.

**Services Delivery Framework**

- **Transform the Organization**
- **Set up a Shared Services Operation**
- **Establish a Captive Offshore Center**
- **Outsource**

**Service Delivery Model Objectives**

- Specify and source services at fixed prices
- Support business strategy
- Influence strategy by providing new capabilities (flexibility, cost variability etc.)
New service delivery models emerge as organizational requirements evolve

Best practice companies are adopting a range of delivery models—sourced from multiple vendors and designed to handle the full range of business functions, from simple to complex.

- **Out-Tasking**
- **Customized**
- **Traditional Captive**
- **Hybrid Models**
- **BPO / KPO**

**Zone of Customization**

- Discrete processes and functions
- Shared technologies, processes, accountability

**Where do ‘Virtual Captives’ fit?**

**Client Requirements**
- Customized
- Standard

**Accountability**
- Full accountability for business results:
  - People
  - Process
  - Technology
  - Facilities

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The Master Services Agreement (MSA) is being used to contractually support GSD.

The Master Services Agreement (MSA) offers the following contractual advantages:

► Provides flexibility: limits upfront financial obligations while laying groundwork for future expansion
► Leverages individual service provider strengths and specialized skills
► Minimizes and diversifies risk through contracts with backup providers

Committed work – enables provider to invest in client-specific capacity

Service orders – for incremental work/processes
Example GSD Transactions from 2005

- Two global MSAs and associated operational schedules
  - Delivered by onshore & offshore resources
  - Fixed price application support services
  - Infosys/TCS were lower price than IBM & ACN

- Five identical framework agreements
  - No fixed ABN commitment to spend
  - Work to be contractually agreed under a work order
  - On-shore and off-shore mix TBD

- Overarching MSA and subsequent individual operational schedules
- Flexible approach to pricing
- Offered a “near shore solution at offshore rates” (Krakow, Poland), with offshoring to follow later
- Client has high level of visibility into provider’s costs and other economic drivers
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► “Virtual” Captive – What is it?
► Q&A
Late entrants to GSD can leapfrog the competition

There is an opportunity for late adopters to leapfrog competitors by leveraging early adopters’ experience and avoiding the mistakes they made:

► Better understanding of mix of control/trust needed to manage relationship
► Best practices are better established
► Key service levels are better understood

Ad Hoc Outsourcing
► Consists of staff supplementation and project-by-project outsourcing
► Focuses on management of vendors’ processes
► Measures effectiveness through “input-based” measurements (e.g., FTEs, cost per hour)

Relational Outsourcing
► Emphasizes longer-term relationship commitments and provider investment in infrastructure, knowledge transfer
► Reflects realization that “win/lose” economics do not work
► Manages to service levels and results

Strategic Outsourcing
► Promotes sourcing discipline that balances need to leverage corporate scale with responsiveness to business unit needs
► Organizes sourcing services centrally, with “flavors” of these services by business unit and geography
►Harnesses economies of scale that are implicit in business strategy

Global Service Delivery
► Aims for global operating capabilities that optimize costs and improve core processing for sustainable competitive advantage
► Blends in-sourcing and outsourcing with near- and offshore locations
► Sourcing is seen as a dimension of business planning: captive or third party sourcing in emerging markets supports marketing penetration push
Some questions to consider

What service delivery model will…

► Attract and retain top talent on a sustained basis?

► Align with the organization’s preparedness for offshoring?

► Manage organizational control needs?

► Address regulatory and risk issues?

► Provide transformational capabilities for the business?

► Ensure strong adoption across different business areas/units?
Start by taking an internal process view to determine the “fit” of service delivery models.

<table>
<thead>
<tr>
<th>Process Impact</th>
<th>Internal Competency Level</th>
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<tr>
<td></td>
<td>Weak</td>
</tr>
<tr>
<td>Strategic</td>
<td></td>
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<tr>
<td>Important</td>
<td></td>
</tr>
<tr>
<td>Commodity</td>
<td></td>
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- Outsource Partnership or Virtual Captive
- Retain – Shared Services or Captive -- Onshore, Offshore and Nearshore locations
- Should assess whether to reengineer, then outsource
- Predominantly Outsourced Offshore
- These are functions that are competitively differentiating
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What is a Virtual Captive?

The Range of Offshore Options

- Captive
- JV
- Virtual Captive
- BOT
- Outsourced

Characteristics

- Involves partnering with a best-of-breed global provider that offers complementary strengths and delivers operational excellence outside of offshoring
- Looks and feels like a captive: operations have the mindset of your organization across lines of business
- Shares risk and rewards: both parties have skin in the game

Examples

- **Service Provider** - Operational excellence, infrastructure, risk approach, people practices (attract, develop, retain top talent)
- **Client** - Domain knowledge, operations, people practices, regulatory areas
Virtual Captives combine the strengths of the Captive and Outsourced models

<table>
<thead>
<tr>
<th></th>
<th>Captive</th>
<th>Virtual Captive</th>
<th>Outsource</th>
</tr>
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<tbody>
<tr>
<td><strong>Service Delivery Risk</strong></td>
<td>► Client bears sole responsibility and costs for failures / inadequacies in service delivery</td>
<td>► Cooperative efforts at risk mitigation between Client and Service Provider</td>
<td>► Service provider typically looks to limit exposure, inhibiting service delivery ingenuity / results</td>
</tr>
<tr>
<td><strong>Pricing</strong></td>
<td>► No price; operations are managed as a cost</td>
<td>► Fully transparent pricing throughout the duration of the agreement</td>
<td>► Commercially negotiated -- limited transparency</td>
</tr>
<tr>
<td></td>
<td>► Separation of enterprise management fee from individual operational agreements</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operating Losses</strong></td>
<td>► Client absorbs all operating losses</td>
<td>► Client absorbs operating losses up to a historical average</td>
<td>► Negotiated limits between Client and Service Provider</td>
</tr>
<tr>
<td></td>
<td></td>
<td>► Service Provider absorbs additional losses up to a cap</td>
<td></td>
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</tbody>
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## Virtual Captives combine the strengths of the Captive and Outsourced models (cont’d)

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| **Attraction and Retention of Talent** | ► Client accepts fully responsibility and costs for initial talent recruitment and on-going attrition mitigation | ► Client leverages Service Provider’s in-country expertise: Service Provider hires, accepts costs, and lends brand  
► Client sets criteria, provides extensive insight  
► Service provider staff gain out-of-country exposure | ► Service Provider hires, accepts costs, hires, allocates staff  
► Client provides input into Service Provider key delivery personnel |
| **Termination**     | ► Client bears costs and risks of dismantling and re-transitioning operations | ► Costs and risks of termination shared between parties       | ► Costs and risks of termination shared between parties                      |
| **Performance Management** | ► Organizationally driven                                               | ► Organizationally and service level driven                  | ► Service level driven                                                     |
| **Transformational Capabilities** | ► Possible, but at a cost                                               | ► Contractually encouraged through gain sharing, where costs and benefits are split | ► Often promised during contracting but frequently not realized |
Building a Virtual Captive requires a range of competencies

<table>
<thead>
<tr>
<th>Strategy and Planning</th>
<th>Evaluation and Transaction</th>
<th>Transition/Commencement</th>
<th>Ongoing Delivery</th>
<th>Contract Expiration</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Understand outsourcing Market</td>
<td>▶ Develop methodology and best practices to be employed by organization</td>
<td>▶ Develop governance model</td>
<td>▶ Establish value tracking methodology</td>
<td>▶ Review value achieved</td>
</tr>
<tr>
<td>▶ Understand what other companies are doing</td>
<td>▶ Organize and educate sourcing teams</td>
<td>▶ Define roles and responsibilities</td>
<td>▶ Establish decision rights</td>
<td>▶ Review business strategy and determine sourcing needs</td>
</tr>
<tr>
<td>▶ Develop outsourcing strategy that links to overall business and market strategy</td>
<td>▶ Establish internal extended sourcing team</td>
<td>▶ Establish standards and protocols</td>
<td>▶ Monitor marketplace and peers</td>
<td>▶ Review options (renew, re-bid, cancel, transition back, consolidate)</td>
</tr>
<tr>
<td>▶ Develop plan</td>
<td></td>
<td>▶ Facilitate/ drive implementation</td>
<td></td>
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Initiate Services

- Track successes and failures
- Identify areas of organization where outsourcing should be evaluated
- Drive development of business case
- Drive RFI/RFP and selection processes
- Lead negotiation and deal team
- Launch transition, transformation and governance work streams

Manage Environment

- Establish retained organization
- Re-skill and re-tool
- Communicate
- Performance management
- Financial management
- Contract management
- Relationship management
- Evaluation of outsourcing efforts
- Execute expiration strategy
- Communication
- Manage transition-out and termination assistance services
- Recover assets
- Record management
Strong governance and execution are key to the success of the Virtual Captive model

- Develop **clear governance** and relationship model upfront
- Establish **joint strategic and operational oversight**
- **Operationalize** Virtual Captive approach
  - Both in spirit and letter of the law
- Build paths of **ongoing leadership support**, organizational change management
- Develop **accountability** in the lines of business - supported by central strategy and governance oversight
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Additional questions or follow up...

For more information, please contact:

Chaz Foster, Partner, TPI, Inc.
Tel: 609-430-1034
Email: charles.foster@tpi.net