



Impact of Global Crisis on Offshore BPO Market and Implications for South Africa



Business Trust

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Table of contents



Topic	Page no.
■ Section I: Executive Summary	3
■ Section II: Overview of the crisis and its likely impact on overall BPO growth	6
■ Section III: Likely demand impact across BPO segments	14
■ Section IV: Changing buyer needs and value drivers from offshoring	21
■ Section V: Implications for South Africa	28

Agenda



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- **Section I: Executive Summary**

- Section II: Overview of the crisis and its likely impact on overall BPO growth
- Section III: Likely demand impact across BPO segments
- Section IV: Changing buyer needs and value drivers from offshoring
- Section V: Implications for South Africa

Executive summary (page 1 of 2)



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- The current economic crisis has created significant pressures for organizations across the world
- While outsourcing activity witnessed only a slight dip in Q408, the decrease is likely to be more significant starting Q109. This view is further corroborated by the fact that suppliers have revised their growth plans for 2009 downwards
- We believe that offshore BPO growth is likely to be tempered (5-15% growth rate) in the short term (12-18 months), given the effect of countervailing forces impacting the growth of the industry
- However, the medium-long term outlook is likely to remain robust, with growth rate expected to pick up to 20-30%. Many companies are viewing offshoring as a key lever to respond to the crisis and there is significant untapped potential (~25 times current offshore market)
- In the short-term (12-18 months), while the overall offshore BPO market is likely to witness tempered growth (5-15% growth rate), the impact could vary across BPO segments
 - Functional view : While processes related to collections, fraud, legal/compliance could witness updrift in demand, processes related to customer origination (e.g., outbound calling) could see slower growth relative to market
 - Industry view: We have considered Financial Services (FS) and telecom, which are the key industries of interest to South Africa. In the short-term, growth is likely to be tempered across both FS and telecom
- Given the crisis, buyers' approach towards offshoring is likely to change significantly in the short-term
 - Strong focus towards aggressive pricing, smaller scope and quick results
 - Increasing spotlight on risk diversification accentuated by recent events in India (e.g., terrorist attacks, Satyam)
 - Re-evaluation of sourcing models (captive vs third-party), with the captive model likely to be under pressure



Implications for South Africa

- The crisis presents additional opportunities for South Africa, especially in FS BPO
 - Opportunities in specific BPO functions such as collections, fraud, legal, compliance
 - Window of opportunity to engage with investors on location risk diversification, given that it is an area of immediate interest to many global majors
- South Africa's intrinsic strengths and demonstrated BPO delivery capabilities position it well to capitalize on these opportunities. Specifically,
 - Strengths in terms of the advanced legal and regulatory framework in the domestic FS industry could become increasingly relevant, given FS majors focus' on risk and compliance in offshoring.
 - The fact that the domestic FS industry has been relatively less affected by the crisis further reinforces these strengths
 - Further, South Africa is one of the few countries beyond India/Philippines that can offer good English skills at scale and low cost, and is therefore an attractive risk diversification option
- However, while engaging with investors on these opportunities, South Africa needs to effectively consider and address investors' immediate priorities around costs and quick results

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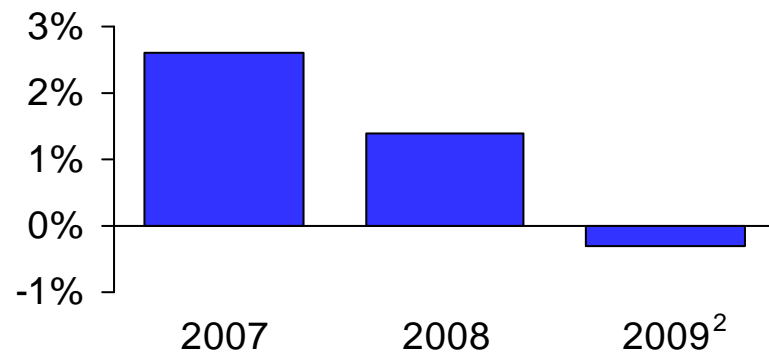
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The current economic crisis has created significant market pressures across the world, specially in developed countries

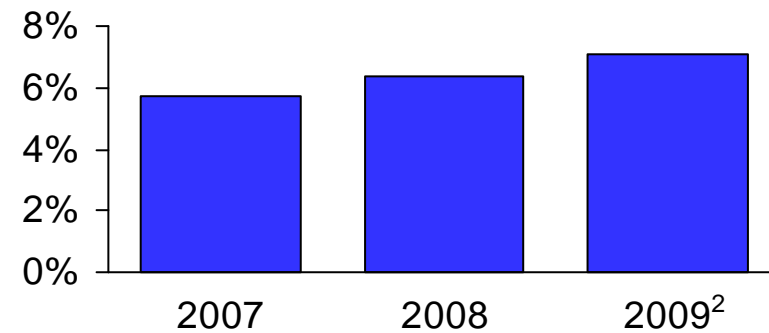


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Gross Domestic Product (GDP) growth rate in developed economies¹ and EU



Unemployment rate (%) in developed economies and EU



- Slowdown in all major economies – U.S., Europe and Japan
- Financial services, in particular, have been impacted severely:
 - Bankruptcies (Bear Stearns, Lehman)
 - Mergers and acquisitions (Bank of America – Merrill Lynch, Washington Mutual – JP Morgan Chase)
 - Increased government role due to bail-out (Fannie Mae, Freddie Mac, AIG)
 - Focus towards increased regulation/compliance and risk management

1 Developed economies include Canada, U.S., Australia, Gibraltar, Greenland Isle of Man, Japan, New Zealand, San Marino, St. Pierre & Miquelon, Andorra, Iceland, Liechtenstein, Monaco, Norway, Switzerland

2 Projections

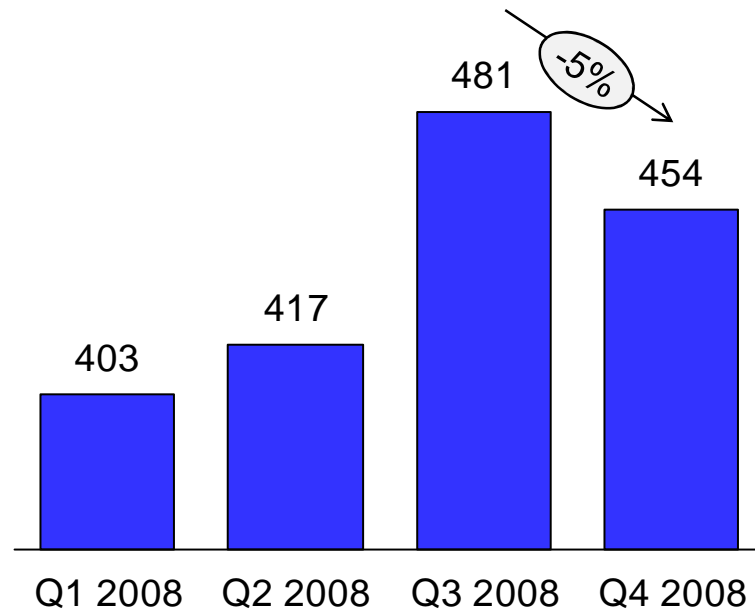
Source: ILO

While outsourcing activity witnessed only a slight decrease in Q4 2008; a prudent assessment of crisis impact can only be made by Q1-Q2 2009

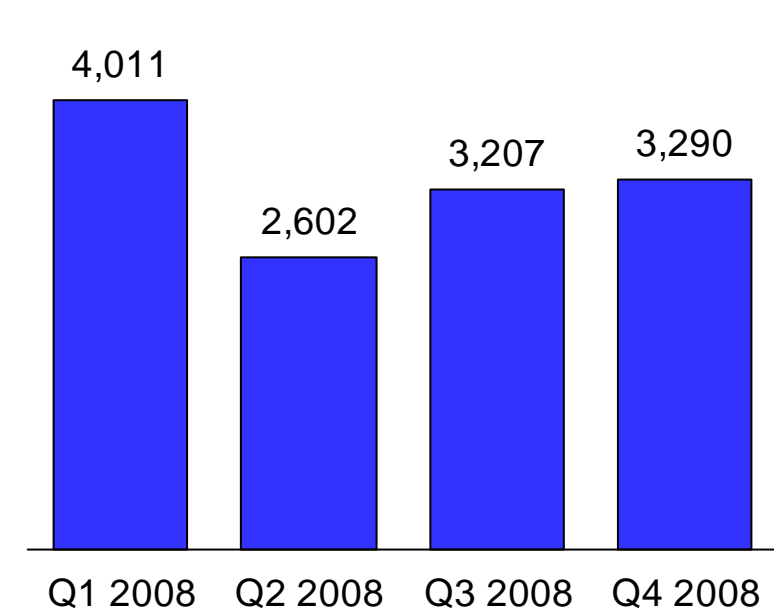


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Index of outsourcing transactions¹
Number



ACV² of outsourcing transactions signed
US\$ million



- The market witnessed ~5% decrease in transaction signings in Q4, relative to Q3
- However, activity in Q1-Q2 2009 would provide a clearer picture of crisis impact due to the typical time lag between onset of crisis and its fallout on outsourcing
- The transaction activity is expected to further decline in Q1-Q2 2009 compared to previous quarters

1 Includes only data that has been publicly disclosed and does not include the Citigroup-TCS deal due to the deal being a captive sell-off

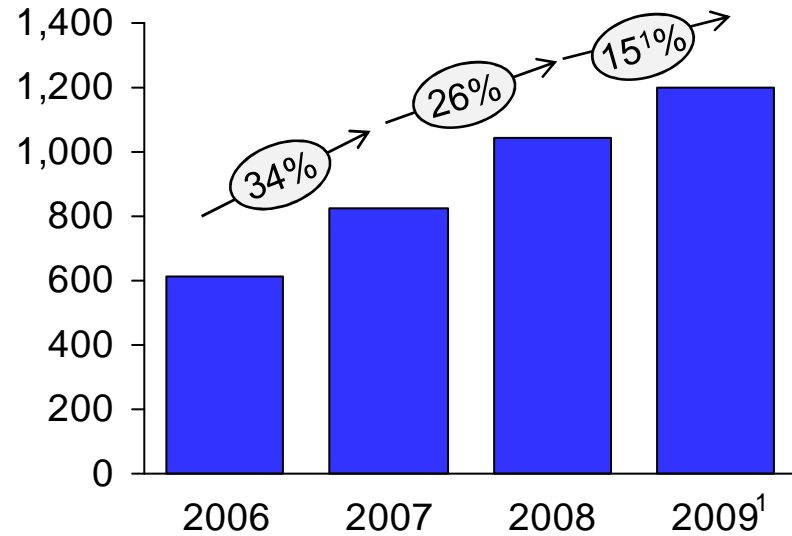
2 Annualized contract value

Source: Everest Research Institute Transaction Intelligence Database

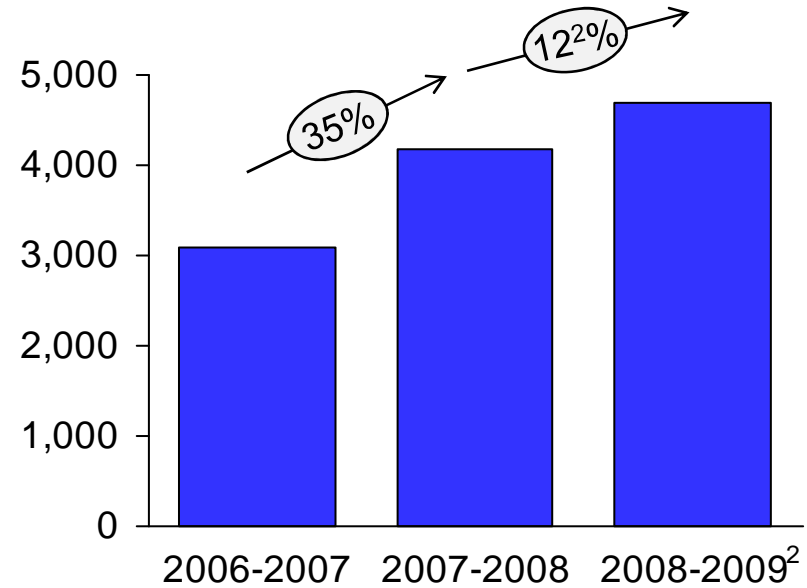
Most leading suppliers expect growth to slowdown in 2009



Revenue growth rates for GENPACT
US\$ million



Revenue growth rates for Infosys
US\$ million



- NASSCOM has revised India IT-BPO exports growth rate for FY 2009 (April 08-March 09) to 16% from earlier estimate of 25%
- Most IT-BPO suppliers estimate the annual growth rate to be 10-15% for 2009

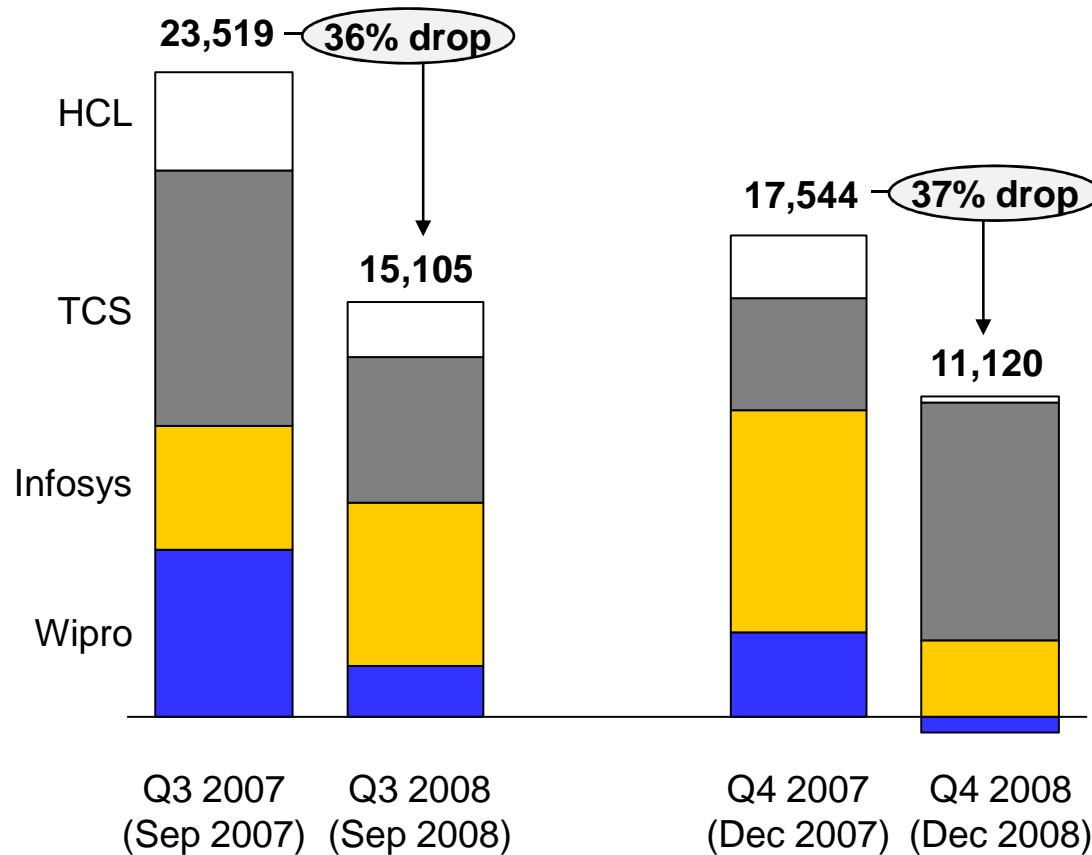
1 2009 projections
2 2008-09 projections

Sources: Company website; news releases

Consequently, suppliers have slowed down on new hiring



Net addition to employee base for major suppliers



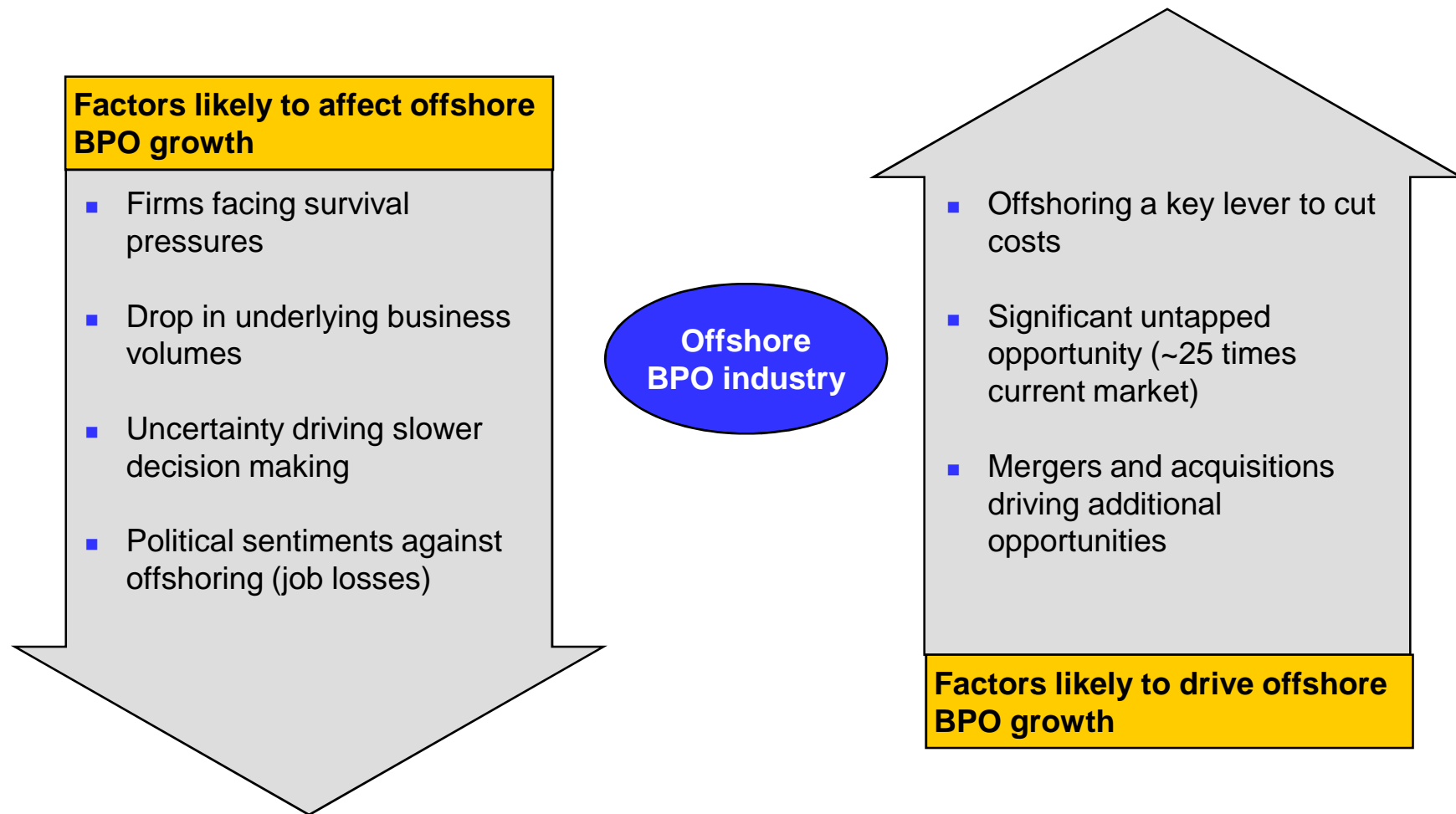
- Cautious approach towards new hiring
- Companies focusing more on:
 - Increasing utilization rate (slimmer bench)
 - On-demand recruitment compared to bulk hiring
 - Greater operational efficiencies in hiring
- On a positive side, the slow-down in hiring has also led to a drop in attrition rates by 2-3%

Sources: Company websites, Investor presentations

There are countervailing forces impacting growth of the offshore BPO industry in the current scenario



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Given these countervailing forces, we expect offshore BPO market growth to be tempered in the short-term (12-18 months)



FS EXAMPLE

Impact of financial crisis on FS majors' offshoring plans: Examples based on Everest experience

Leading investment bank

- "While we plan to increase offshoring as a % of our current spend, there is uncertainty around the current spend given the shrinking volumes."

– *Head of Offshoring*

Leading UK insurance firm

- "We plan to hold back on additional offshoring in the next 6-9 months, till the situation is more stable."

– *Senior Executive, Offshoring Strategy*

Leading U.S. bank

- Planning to expand offshore scope
- Evaluating new offshore and nearshore locations

Leading U.S. insurer

- Planning to expand scope of current BPO contracts

Everest experience suggests mixed responses from players towards offshoring growth in the short-term

The Everest Research Institute expects the growth rate of the offshore BPO market to be between 5-15% over next 12-18 months, compared to 30+% growth over the past few years

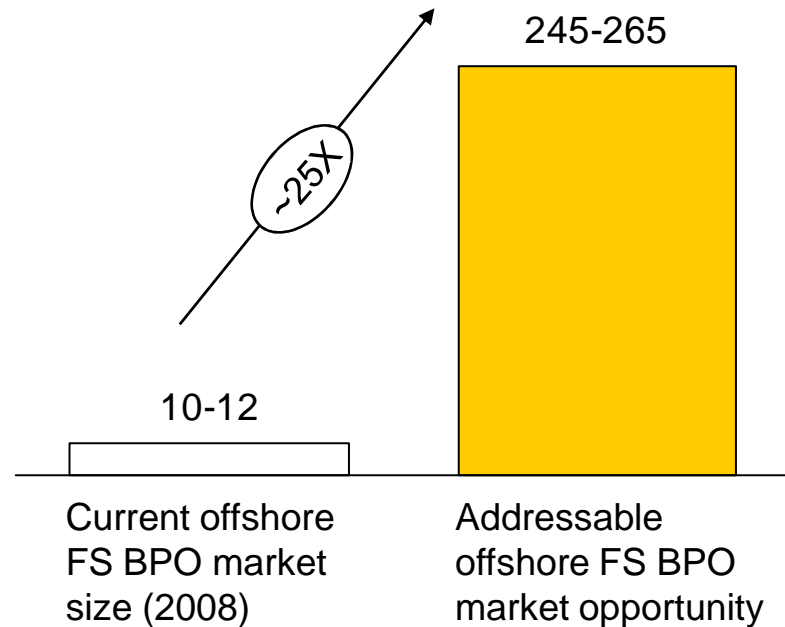
However, the medium-long term outlook is likely to remain robust



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FS EXAMPLE

Current and potential offshore FS BPO market US\$ billion



Theoretical opportunity to grow market 25 times to approximately US\$250 billion

Key drivers of medium-long term growth

- Offshoring likely to be a key lever for FS majors to reduce costs and survive competitive pressures
- Some FS majors have already indicated aggressive plans to grow their offshore footprint. For example, JP Morgan planning to grow offshoring by 25%
- Short-term forces affecting offshore growth likely to diminish (e.g., companies likely to have more stability in business volumes)

Growth is anticipated to pick up to 20-30% in the medium-long term (post 2011-2012)

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The report provides views on likely differential impact of the crisis across key BPO segments relevant to South Africa



1

Across types of functions

Impact of the crisis on offshore BPO demand growth across types of BPO functions

2

Across industry verticals

Impact of the crisis on offshore BPO demand growth across key industries of interest to South Africa, namely FS and Telecom

1 **While the overall BPO market is expected to grow between 5-15% in the short term, the impact could vary across types of BPO functions**

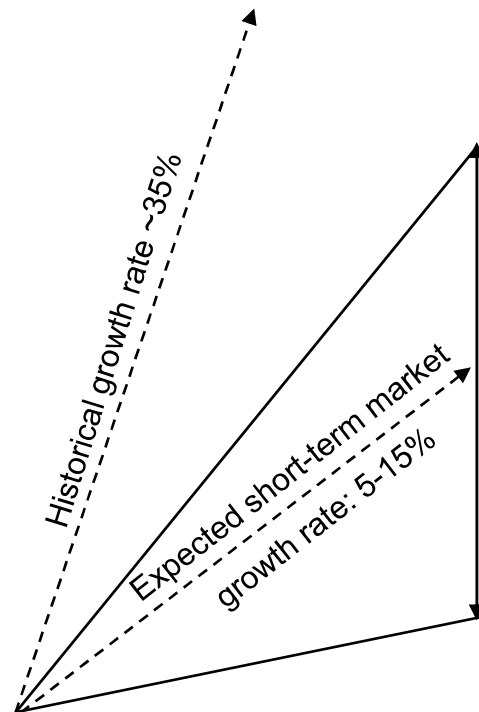


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SHORT TERM VIEW (12-18 MONTHS)

Growth rate	Process Description/Examples	Comments
Uprift	<ul style="list-style-type: none"> Compliance / Regulatory Loan recovery, collections Legal 	<ul style="list-style-type: none"> Key focus areas for companies in context of the current crisis
Moderate growth	<ul style="list-style-type: none"> Account servicing Transaction processing 	<ul style="list-style-type: none"> Some impact due to potentially lower underlying volumes (e.g., credit card transactions)
Slower growth	<ul style="list-style-type: none"> New business acquisition related processes Outbound calling 	<ul style="list-style-type: none"> Slowdown in new business volumes will consequently drive lesser growth in these functions

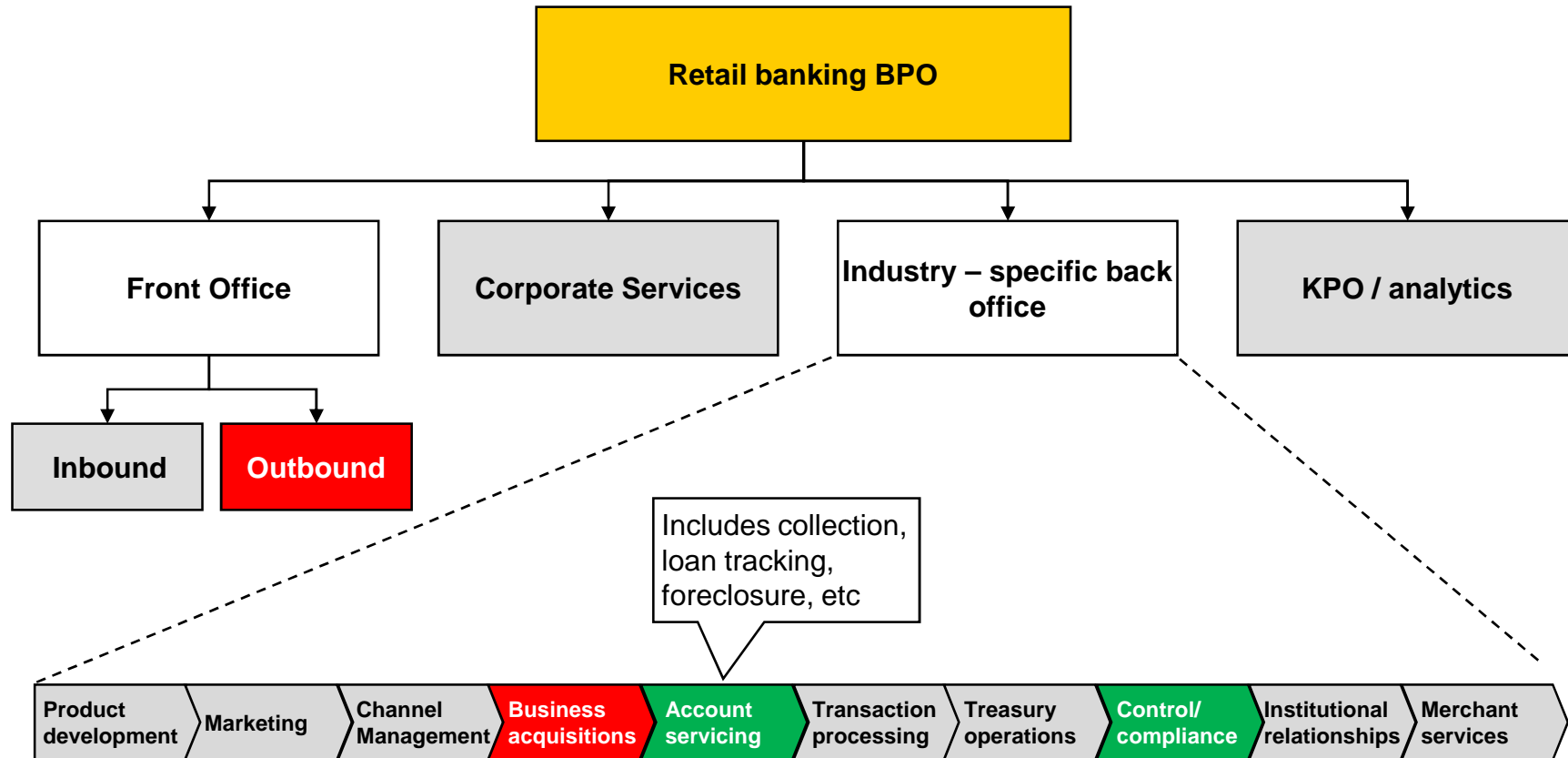


1 Illustration of differential impact of crisis across BPO functions: Retail banking example



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■ Updrift
 ■ Moderate growth
 ■ Slower growth



1 Legal Process Outsourcing (LPO) is likely to emerge as an opportunity area given the current crisis



Key drivers of LPO growth

- Additional litigation work due to increasing volumes from recoveries, foreclosures, bankruptcies
- Cost pressures forcing corporate legal departments to offshore more
- Law firms under pressure to reduce pricing and are consequently offshoring

Early signs of growth are emerging

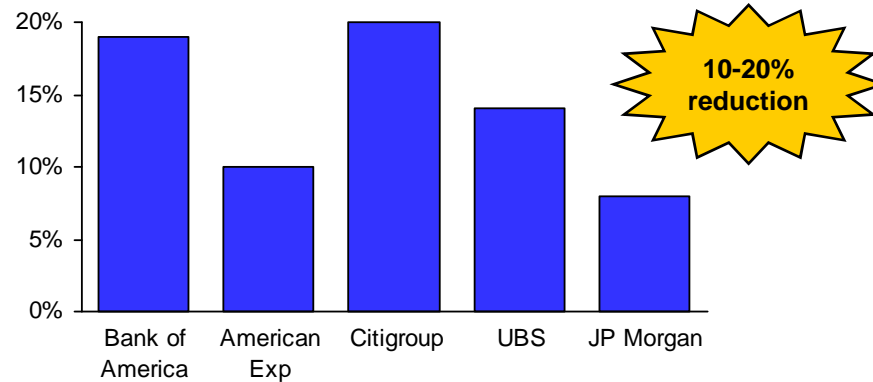
- "We have seen an increase of over 100 per cent in our volumes in the last six months. We need to make substantial additions to our workforce"
– CEO, leading LPO supplier
- "Law firms recognize times are getting tougher and clients are demanding more creativity when it comes to billing"
– VP Business Development, LPO supplier
- "Assistance in document reviews are arising as a result of crisis-related litigations. Assistance in internal and regulatory investigations are arising..."
– COO, LPO major

Opportunity for South Africa given the evolved legal and regulatory framework in the FS sector

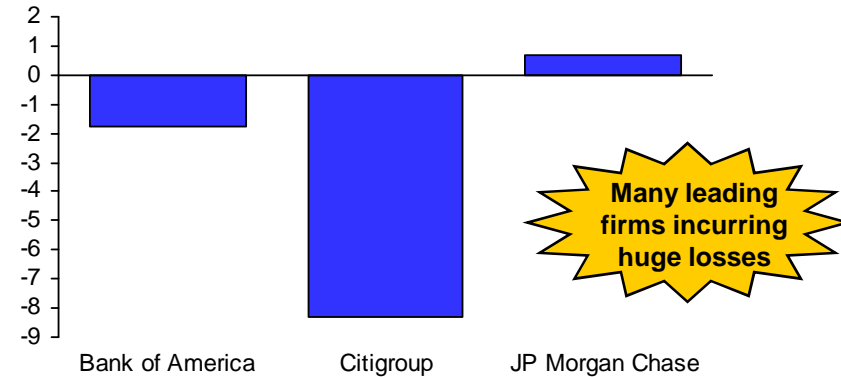
Source: News articles

2 While the crisis has affected the telecom service provider industry, the impact is less severe compared to FS

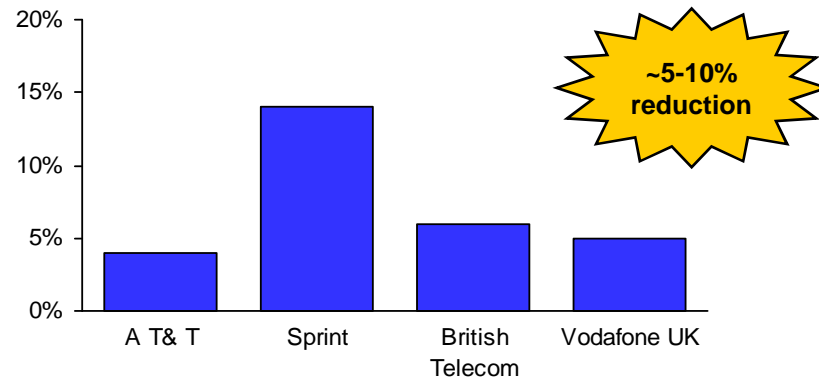
Headcount reduction in Financial Services
Percentage of workforce



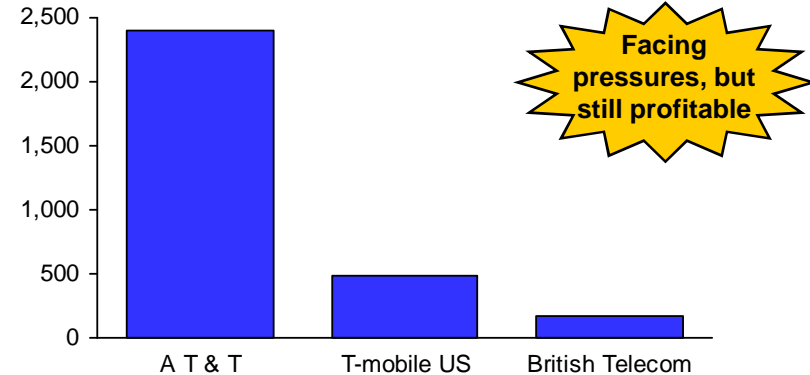
Q4 08 Net Income of Financial Services majors
US\$ billion



Headcount reduction in Telecom
Percentage of workforce



Q4 08 Net Income of Telecom majors
US\$ million



Sources: ILO; Company websites, News reports

2 **However, given strong resistance to lay-offs due to unions, offshore BPO market growth in telecom is likely to be tempered in the short-term**

Key factors affecting short term BPO growth	Financial Services		Telecom	Comments
	Low impact	High impact	Low impact	
Drop in business volumes / financial pressures	High impact	Low impact	Low impact	Impact on Telecom less severe than FS
Sentiments / resistance to lay-offs	Low impact	High impact	High impact	<ul style="list-style-type: none"> Political sentiments likely to affect both the industries However, Telecom is strongly unionized (e.g., UK unions 'Connect' and 'Communication Workers Union' together represent more than 120,000 telecom industry workers across 20 companies)

“We expect growth to slow down in both FS and Telecom over next 12-18 months. Resistance to lay-offs due to unionization in telecom likely to aggravate in the current conditions. However, the mid to long term growth remains robust in both the industries”

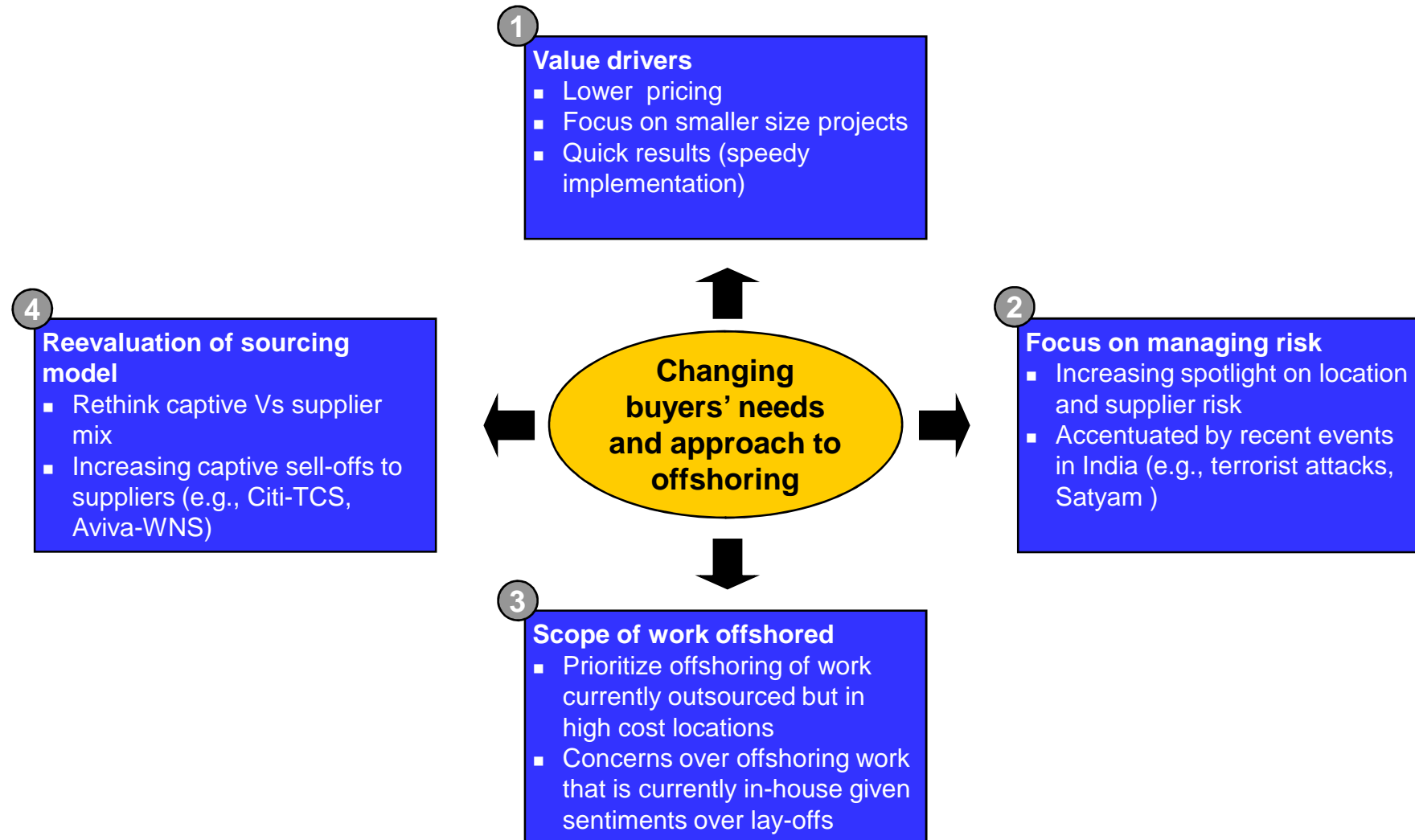
– *Leading BPO supplier*

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The current crisis has significantly impacted buyers' needs and consequently their approach to offshoring



1 Buyers are pushing aggressively on price reductions and are looking at smaller deals

Pricing pressures

- Buyers putting pressure on suppliers to offer aggressive price concessions, even on renewal of existing contracts
- Looking at alternative pricing models: output Vs input based pricing
- “In general we have received a price reduction varying between 4 and 15%” – *CEO, leading Indian IT player*

Smaller size projects

- Buyers seeking smaller deals (e.g., <50 people), that involve lower upfront investment
- Focus towards achieving savings quickly, even if the extent of savings could be small
- Demanding speedy transition from suppliers
- “We are focusing on mid and small size projects that come alive quickly rather than large ones which could get delayed” – *CEO, Global IT-BPO player*

- Large suppliers are taking more risk (e.g., in deal structuring) and are being more flexible about the types of opportunities to pursue (e.g., also targeting smaller deals)
- Implication: South African service providers likely to witness more competition in the market

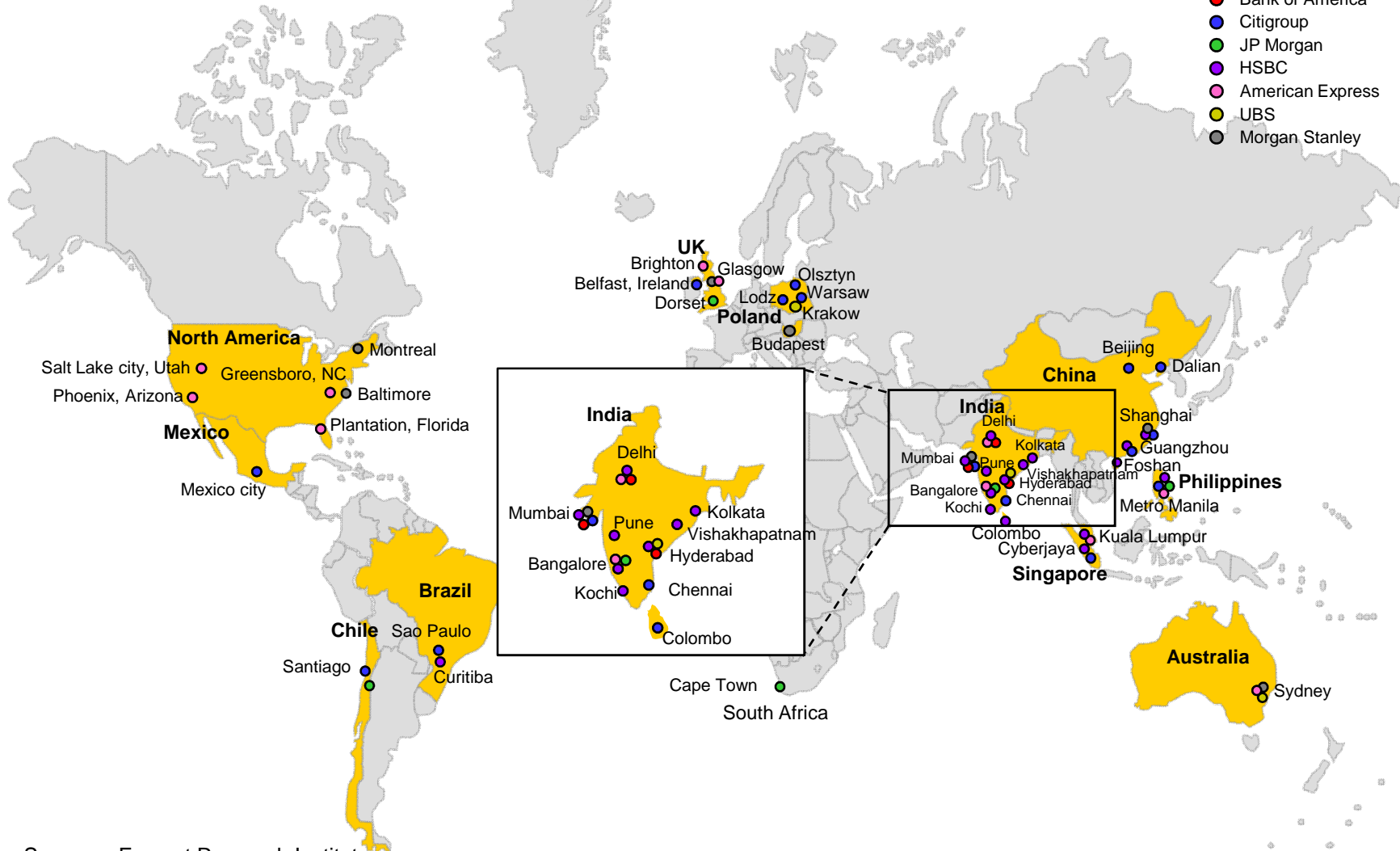
2 As leading companies grow their offshoring footprint, they are building global networks and are looking beyond the leading destinations (India, Philippines)



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EXAMPLES

Delivery locations of global banking majors



Source: Everest Research Institute

2 The need to diversify beyond India/Philippines is driven by multiple factors with concentration risk becoming an area of increasing concern



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Concentration Risk

- Significant exposure in India/Philippines (>80% of offshore workforce)
- Managing supplier concentration risk also an area of focus

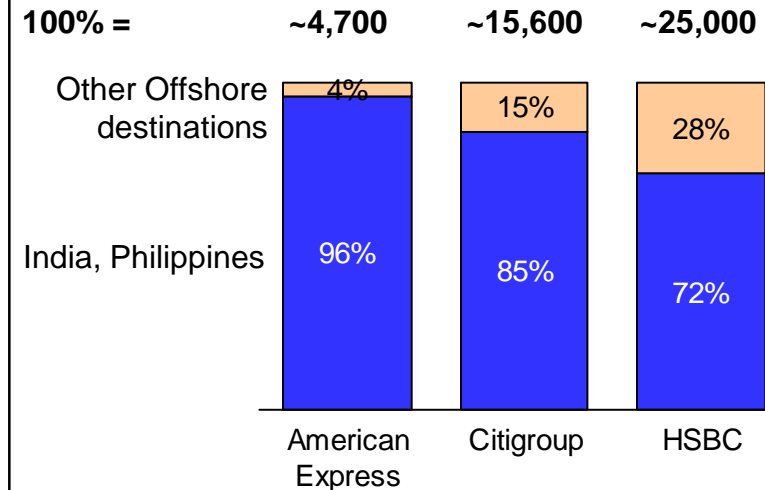
Access to talent

- Increase catchment areas
- Access specific talents (e.g., languages, certified professionals) at desired scale and costs

Service quality

- Certain service quality considerations such as time-to-market, language proficiency, etc. have led companies to explore newer destinations

Geographical break-up of captive FTEs of leading FS majors

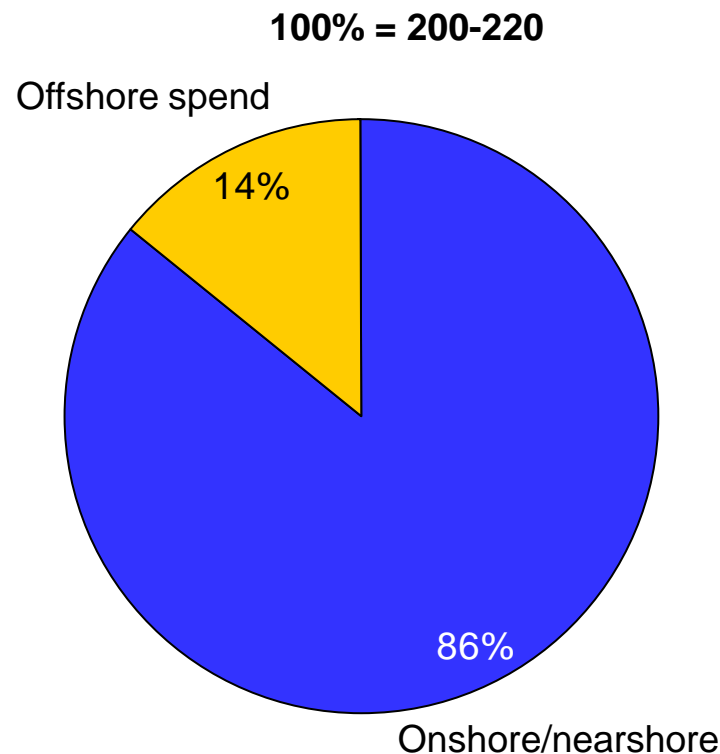


Source: Everest Research Institute

- Recent events in India (Mumbai terror attacks, Satyam fiasco) have accentuated the need to manage risk
- Many companies are now reassessing their global delivery network
- Implication: Likely opportunity for South Africa

3 Firms are likely to prioritize offshoring of work that has already been outsourced but currently in onshore (high cost) locations

Split of global BPO spend by location of work
2008; US \$ billion



- Concerns over offshoring work that is currently inhouse
 - Involves more effort/complexity
 - Sentiments against layoffs
- Preference to offshore work that has already been outsourced but in onshore locations
 - Constitutes >85% of BPO spend
 - Relatively easier to offshore given existing comfort with outsourcing
- Example: A leading investment bank planning to move 2000 FTEs from its onshore outsourced centers to offshore locations

Sources: NASSCOM Everest BPO Study, Bernstein research

4 Companies are reevaluating their sourcing models and the captive model is likely to be under pressure



Recent captive divestiture activities

Aviva

Divested its BPO operations, Aviva Global Services with assets in India and Sri Lanka, to WNS for US\$228 million

Citigroup

- TCS acquired Citigroup Global Services, (India-based back-office operations) for US\$505 million
- Wipro acquired Citi Technology Services, Citigroup's IT subsidiary for US\$127 million

Fidelity

Reports indicate plans to divest 2,000-member captive units in Bangalore and Chennai

AXA

In the process of transferring ~500 employees from its India captive to Capita

Key drivers of captive sell-offs

- Cash generation
- Increase operational efficiencies
- Free management bandwidth

Sources: Everest Transaction Intelligence database, news articles

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South Africa has multiple strengths that position it as an attractive destination for FS BPO



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- Evolved products, legal and regulatory framework
- Strength further evidenced by the fact that SA banks have weathered the crisis and remained profitable

Sizeable FS experienced talent pool with service delivery and domain skills

English language skills

- Large entry-level talent pool (~470,000 annually)
- Strengths in language proficiency and cultural affinity, especially with UK

Strengths in FS BPO

Sizeable pool of specialized FS skills

- Meaningful scale in relevant skills (e.g., actuaries, certified financial analysts)

Narrowing cost differences with mature offshoring destinations

- Current arbitrage potential significant (50-60% on operating cost basis relative to US,UK)
- Lower inflation levels relative to mature offshore destinations (e.g., India, Philippines)

Given its intrinsic strengths, South Africa could have different roles to play in the global sourcing delivery network



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Rationale / Key drivers

Offshore destination for high-quality English language front-office

- Large talent pool with good quality English skills
- Accent and cultural affinity with international geographies
- Savings gap with leading offshore destinations narrowing

Offshore destination for complex FS back-office work

- Large FS experienced talent pool
- Advantages in certain niche skills
- Costs for certain types of complex work on par with leading offshore destinations, savings gap narrowing for other types

Near-shore scalable destination for sub-Saharan Africa

- Opportunities to serve sub-Saharan operations of domestic FS companies
- SA offers larger talent pool, more evolved BPO industry and better infrastructure compared to rest of sub-Saharan Africa

Risk diversification option for India / Philippines

- Investors looking to diversify beyond India/Philippines
- SA is one of the few alternatives that can provide good quality English language skills at low-cost

While these are still quite relevant in the current environment, the crisis presents additional opportunities and challenges for South Africa



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Implications for South Africa

Opportunities

- Could have an increasing role to play as a complementary destination to India and Philippines, as FS majors look to diversify
- Well positioned to support FS majors' regulatory/risk requirements, given experienced talent pool and evolved domestic FS environment
- Service providers have demonstrated credibility in service delivery for collections and fraud, which are likely to see increasing demand
- Given FS majors' focus on customer retention to sustain revenues, SA's strengths in customer service make it an attractive option
- Given advanced legal/regulatory environment, SA could capitalize on new legal process outsourcing opportunities that are likely to emerge

Challenges

- Need to address buyers' immediate priorities on "least costs/price" and quick results
- Nascent offshore FS BPO market can be a challenge for buyers looking to adopt the "follower" approach
- South African suppliers likely to face increasing competition