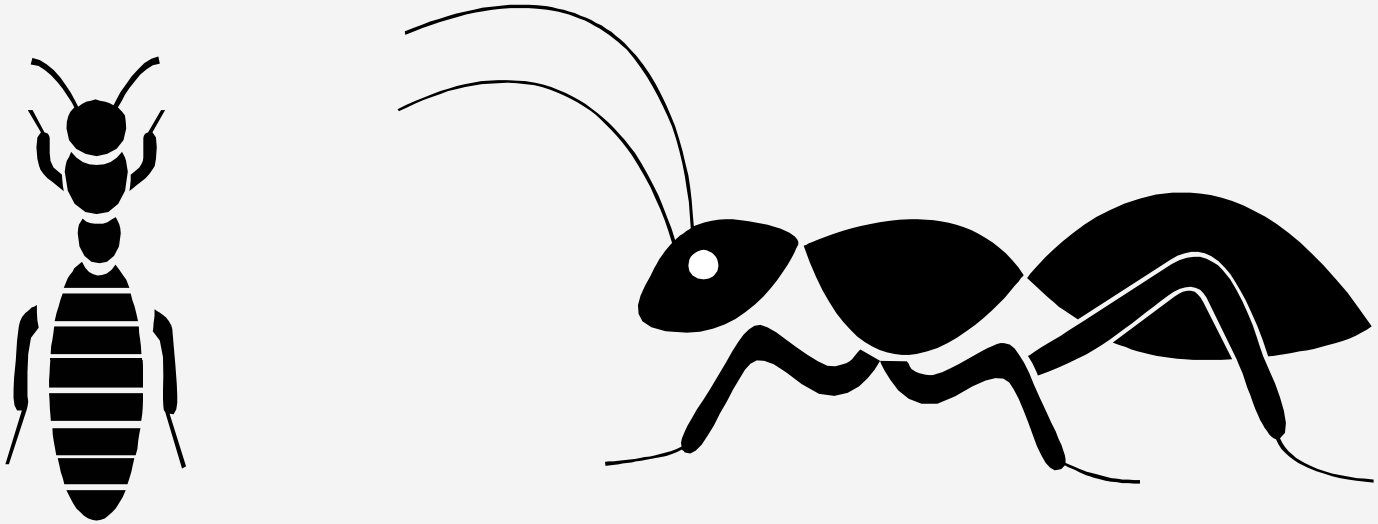
Global Risk: Outsourcing Services:

A new Aesop's Fable of the Ant and the Termite



Breakthrough Strategies

ISM Services Group Conference
Scottsdale December 3, 2004

PEGASUS

Globalization of the Services Supply Chain

India develops my software
Ireland manages my customer service
Taiwan does my testing
Mexico performs piece labor
Germany balances my finances
Israel does my clinical research

… my services supply sources are global.

I have the lowest over-all cost of services!

Macro Value of the Globalization Life Cycle

Processes become virtual and transparent
Low cost resources become employed
Technology become universal and seamless
Communications becomes cheap and real time
Immature capabilities are stabilized
Available capacity get utilized
Life cycles are accelerated
Learning curve has a multiplier effect
Capital becomes border free

Into the long term the entire global economy benefits where the global resources are optimized. The world's economy gets better.

Idle resources are re-trained and re-allocated.

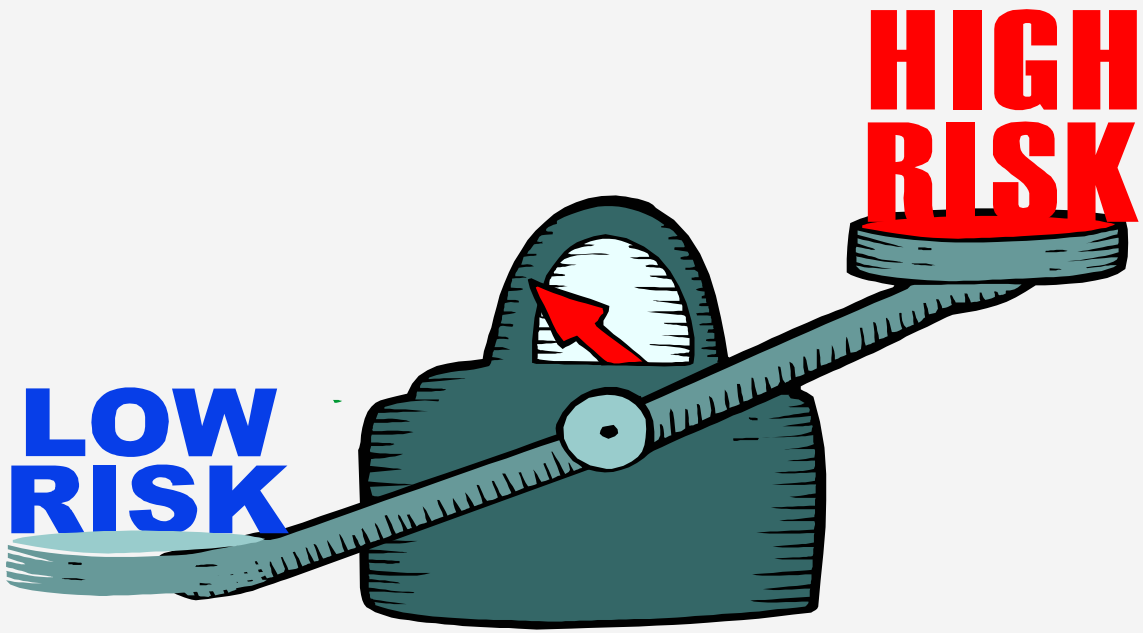
India owns my IT process and innovation
Ireland is between me and my customers
Taiwan controls my quality control
Mexico dominates my capacity curve
Germany leverages my finances
Israel has first views of my innovation

… but my services supply sources may be beyond my laws and conventions.

I have the highest level of risk to continued operations!

Risks of an Open Environment

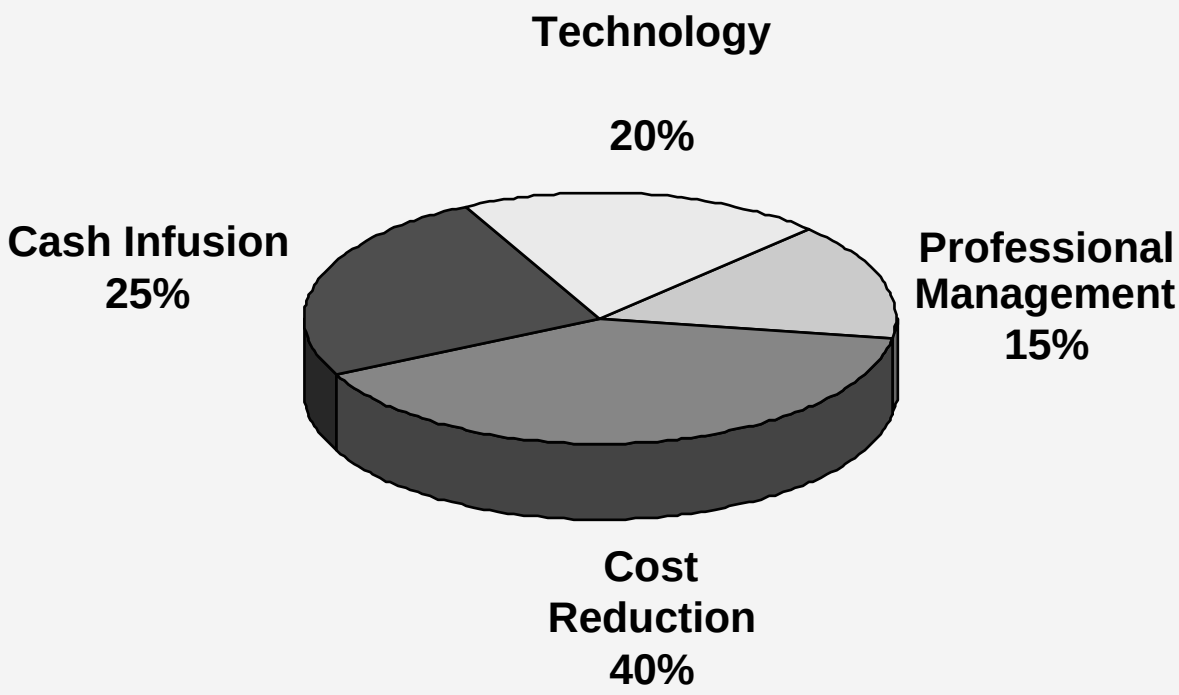
The world is increasingly at Risk and the Supply Chain is not exempt. The longer the Supply Chain the higher the Risk



Globalization is a Juggernaut that cannot be stop – the question is how do I develop options based on anticipatable Risks?

Primary Reasons for Outsourcing Services?

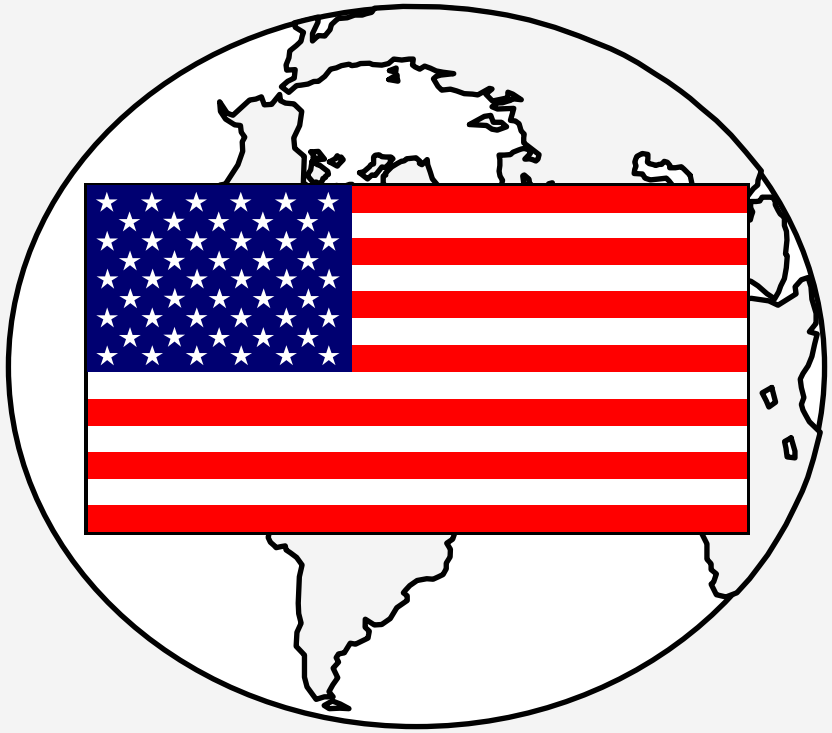
The decision making of outsourcing services is dominated by a desire to reduce cost.



The impact of Risk is rarely a significant factor.

Pax Americana is Declining

Is the US after fifty years of unparalleled growth and prosperity waning? Is Europe, 150% larger than the US, poised to take global economic leadership?



…or will the next fifty years belong to China? Today China is the recipient of technology and the largest manufacturer. How will China evolve from a low end supplier to a dominate competitor?

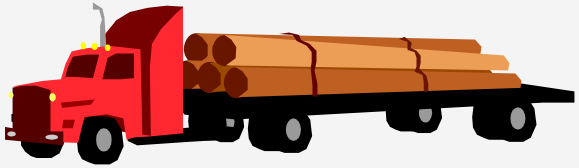
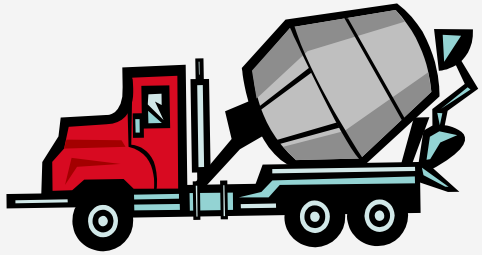
Educational System has Failed

The US ranks in the mid-twenties in most world-wide studies of Science and Math while ranking second in expenditures per student.

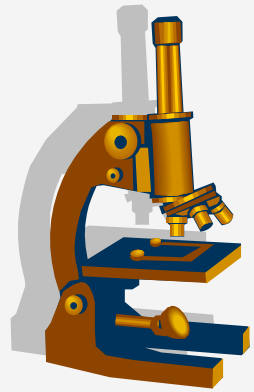
Where will your skilled Human Capital come from?

Geo-political Scarcity of Critical Resources

The growth of developing nations, particularly China, will create increased demand for limited world resources.

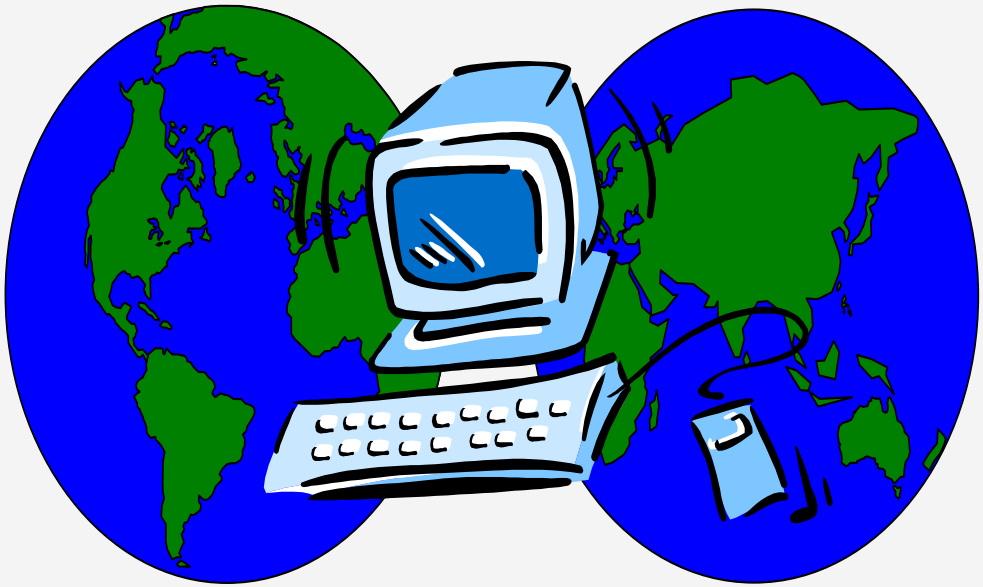





We are on the merge of a global Seller's market. What are your "A"; "B", and "C" services and the base materials that will impact services?

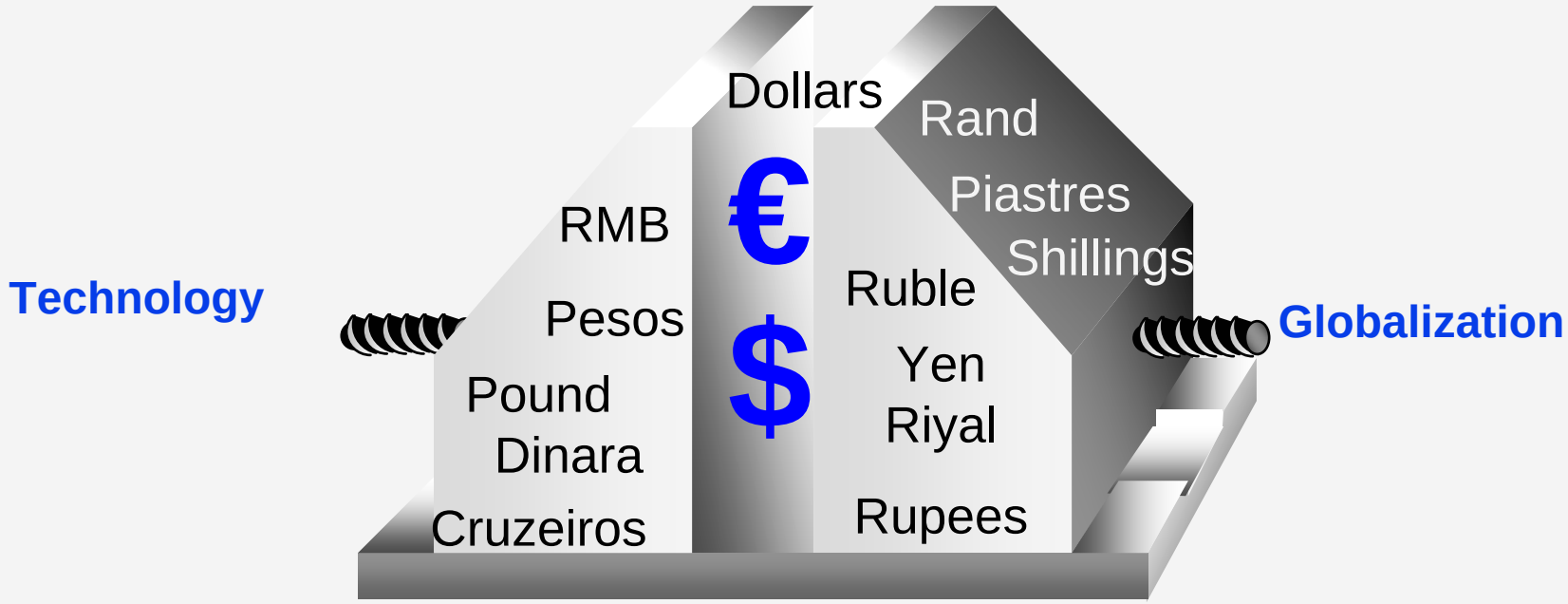
Technology has lowered the barriers to commerce.



eMarkets allow trading and sourcing the world.

Commerce, Technology, Labor are seamless and international; just like Capital.

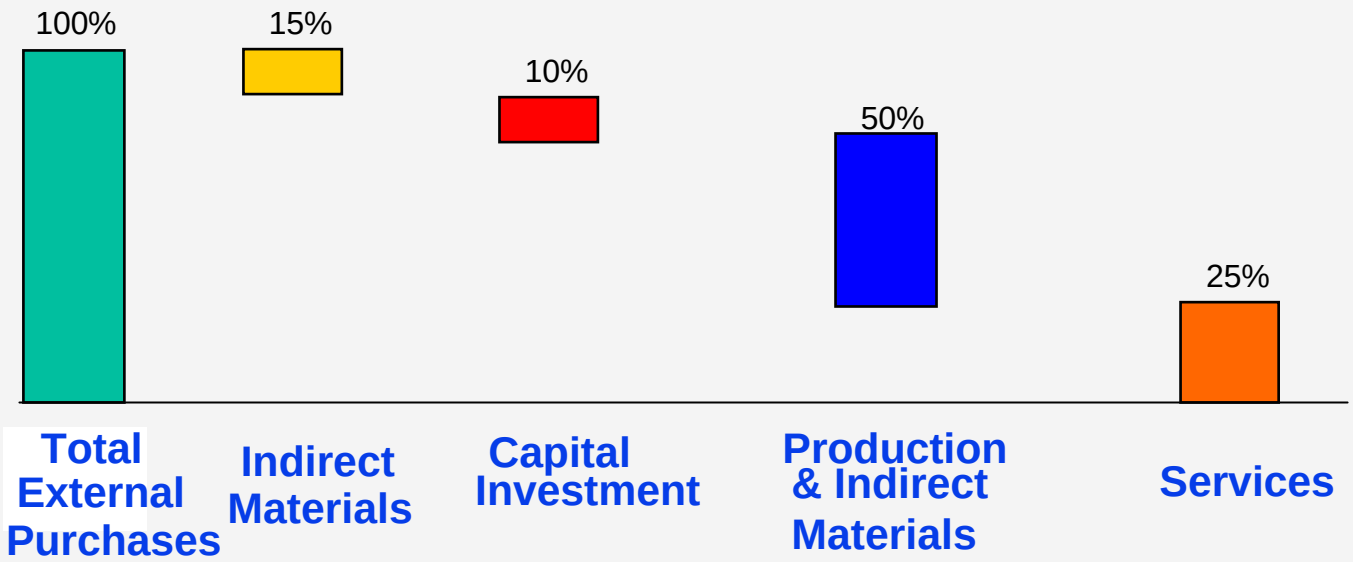
Now Services, formerly a localized supply source, has now gone global.



Technology and globalization has underwritten a mad dash to lower cost-based countries.

Services Impact Base

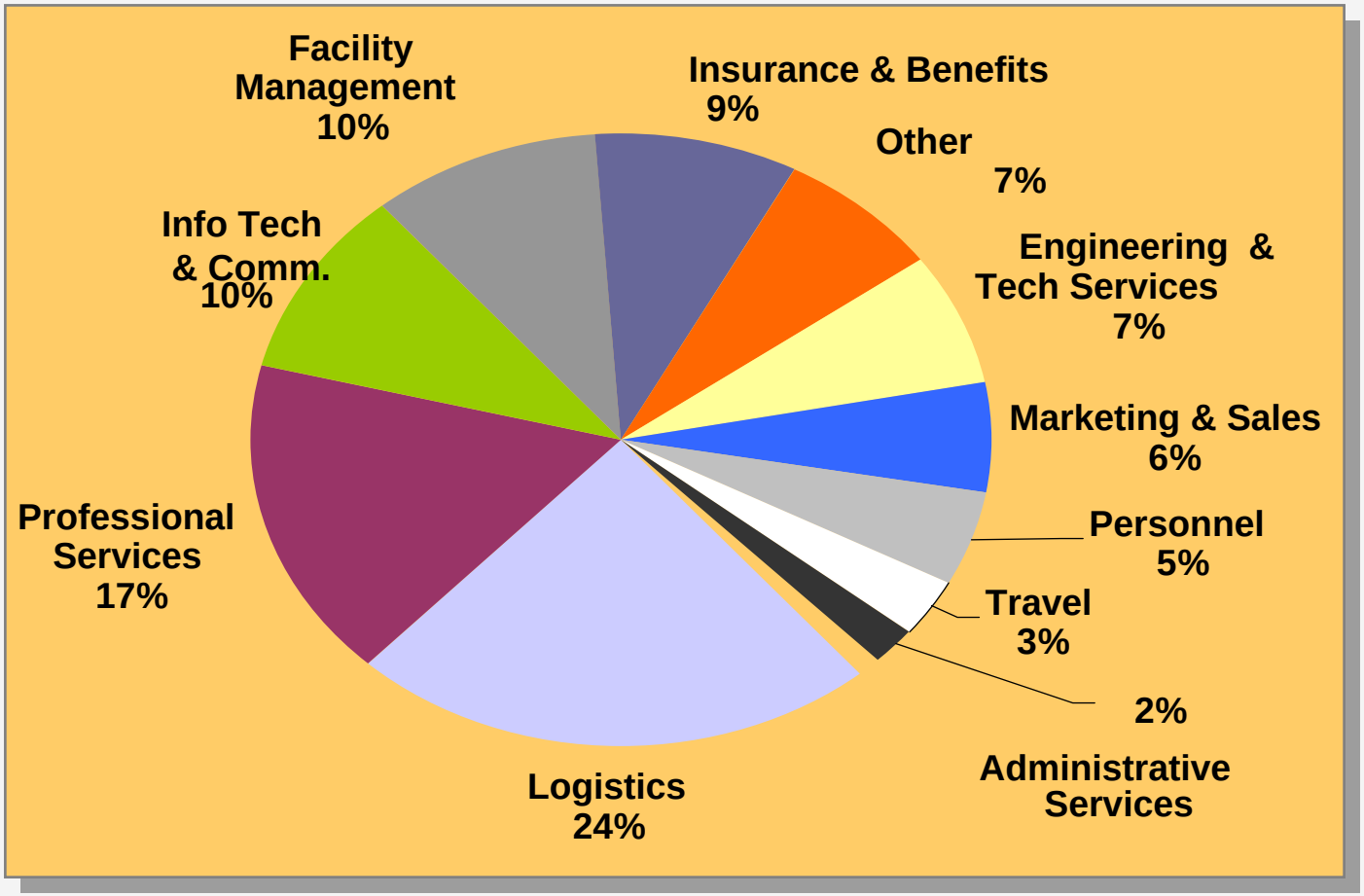
The approximate “pro-forma” breakdown in the major categories of purchase materials and services is below. The procurement of services is the fastest growing.



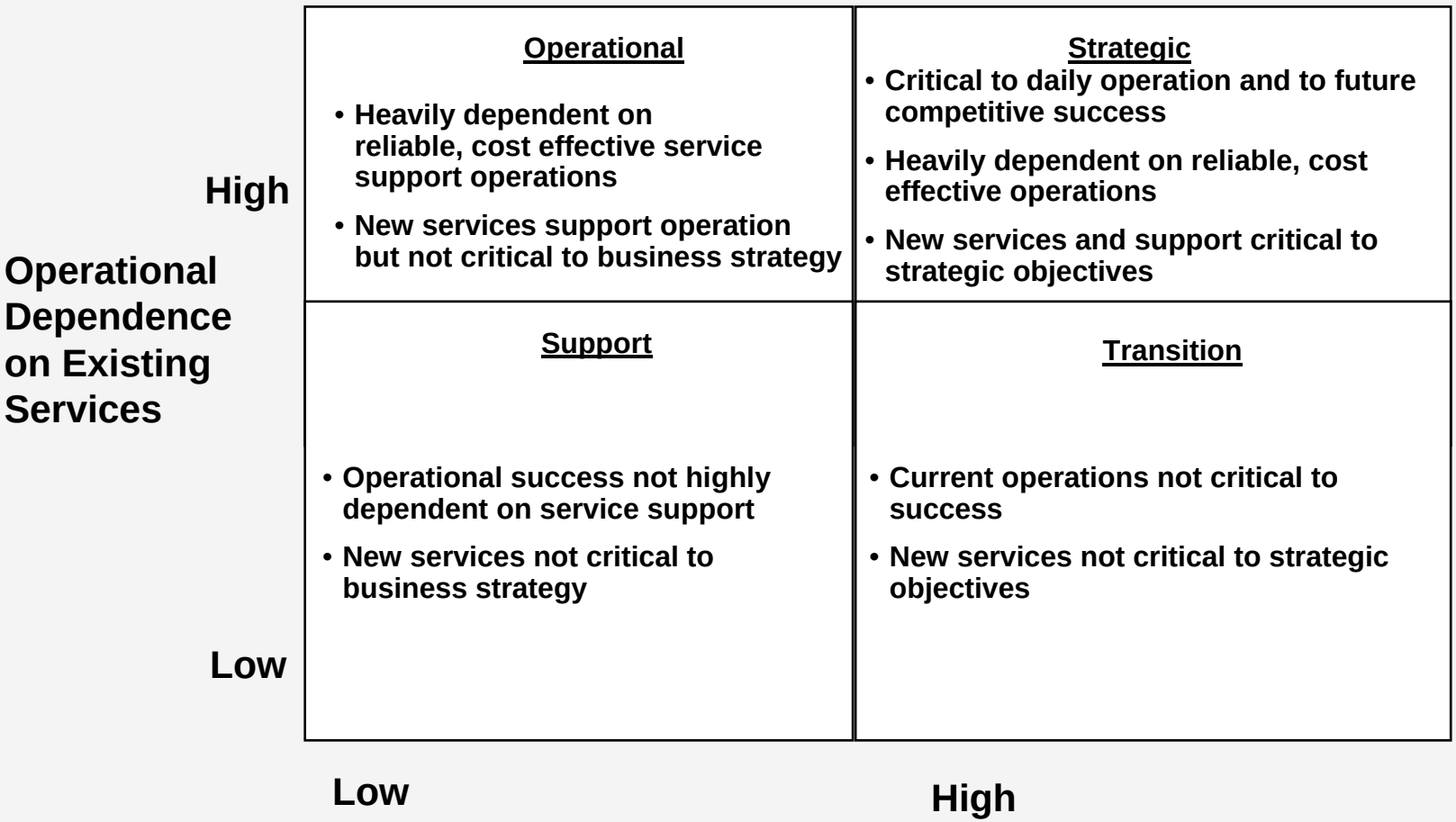
Below are the most commonly reported commodities coordinated and consolidated on an overall company wide basis by a non-Procurement function:

Services	Percent	1993	2003est
Insurance		90	74
Legal Services		88	77
Computer Hardware & Software		86	58
Telecommunications Equipment & Services		82	48
Professional Services (inc Consulting)		78	57
Advertising & Promotional		76	69

Most services are realistic and effective candidates for global outsourcing?



Services Strategic Relevance and Impact



Strategic Outsourcing Screening Criteria

Outsourcing Presumptions

Operational Dependence on Existing Services

High

Operational

Presumption: YES, unless huge and well managed. Reasons to outsource:

- **Economies of scale**
- **Higher quality of service and reliability**
- **Management focus**
- **Technologies supporting international solutions**

Strategic

Presumption: NO, but may outsource to:

- **Rescue an out-of-control internal service support operation**
- **Tap source of cash**
- **Facilitate cost flexibility**
- **Facilitate management of divestiture**

Low

Support

Presumption: YES, Reasons to Outsource

- **Access to higher professionalism**
- **Possibility of laying off a low priority, problem-laden part of the firm**
- **Access to current technologies**
- **Reduces risk of inappropriate investment and infrastructure**

Transition

Presumption: NO, but may outsource to:

- **Obtain required technologies an internal unit lacks**
- **Obtain project management skills in an internal IT lacks**

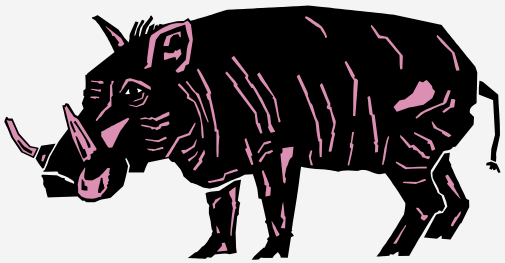
Low **High**

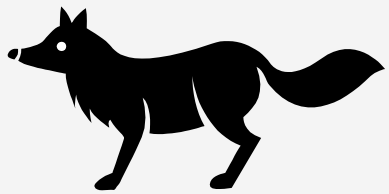
Importance of Sustained, Innovative Service

The Boar and the Fox

In your computations of total life-cycle costs to justify global service sources, what are your estimations of the costs of Risk ?

- To save one critical source of supply by establishing and supporting a viable and less risky (more costly) alternative?
- To replace a market share lost by exploitation of your intellectual properties?
- To train employees?
- To pay higher prices?
- To use alternative energy sources?
- To reconcile eCommerce incompatible formats?





…waiting until a Risk event happened lessens the options and increases the penalties.

Effective Service Sourcing Risk requires the identification of risk events, probability of occurrence, and the firm contingencies for alternative sources of supply before it is needed.

1. The specific supplier, materials, and services that are at Risk, especially those global sources of supply.
2. The compromise of intellectual properties from global sourcing.
3. The long-term limits to the continuity for skilled labor.
4. The alternatives to the politico-economic exclusions from global supply sources.
5. The contradictions of an open technology and the lack of seamless global commerce.

The Basic Responsibility of Procurement is to insure the uninterrupted continuance of supply.

Who are the specific suppliers, materials, and services that are at Risk, especially those global sources of supply?

In the current environment can we still have confidence that our global and extended sources of supply will continue as business-as-usual?

What is the impact of the compromise of intellectual properties from global sourcing of services?

The death spiral of lost technology, and subsequently lost markets, is directly related to the search for lowest over-all cost.

Plateau technology flows to lower labor cost providers. Subcontractors become suppliers, then partners, and, finally, competitors – all fostered by the transfer of technology for short-term cost advantage.

Is there an alternative to insular and protectionary regulations governing exchange of knowledge?

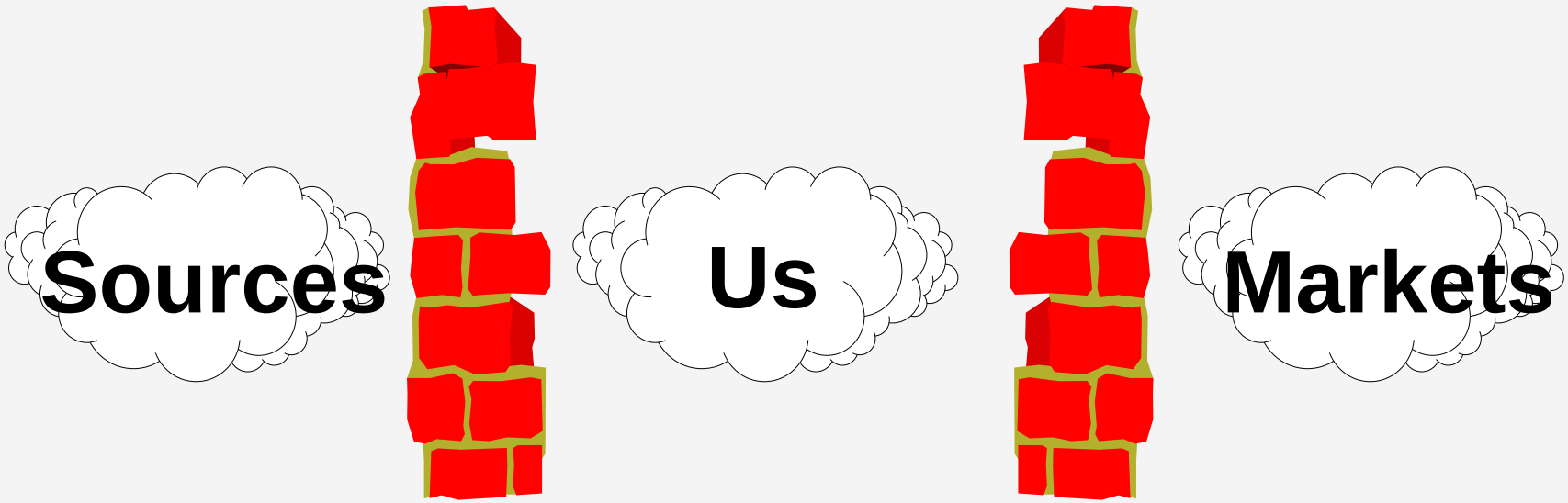
What are the long-term limits to the continuity for a skilled labor force if low ended jobs are outsourced ?

How long before the failure of our educational systems results in the cost of the only sustainable competitive advantage –a skilled labor force?

Will we become a nation of Lotus Eaters dependent on others for our survival?

Level playing field

What are the politico-economic exclusions from global supply sources? Emerging Economic Community agreements are regulatory and exclusionary.

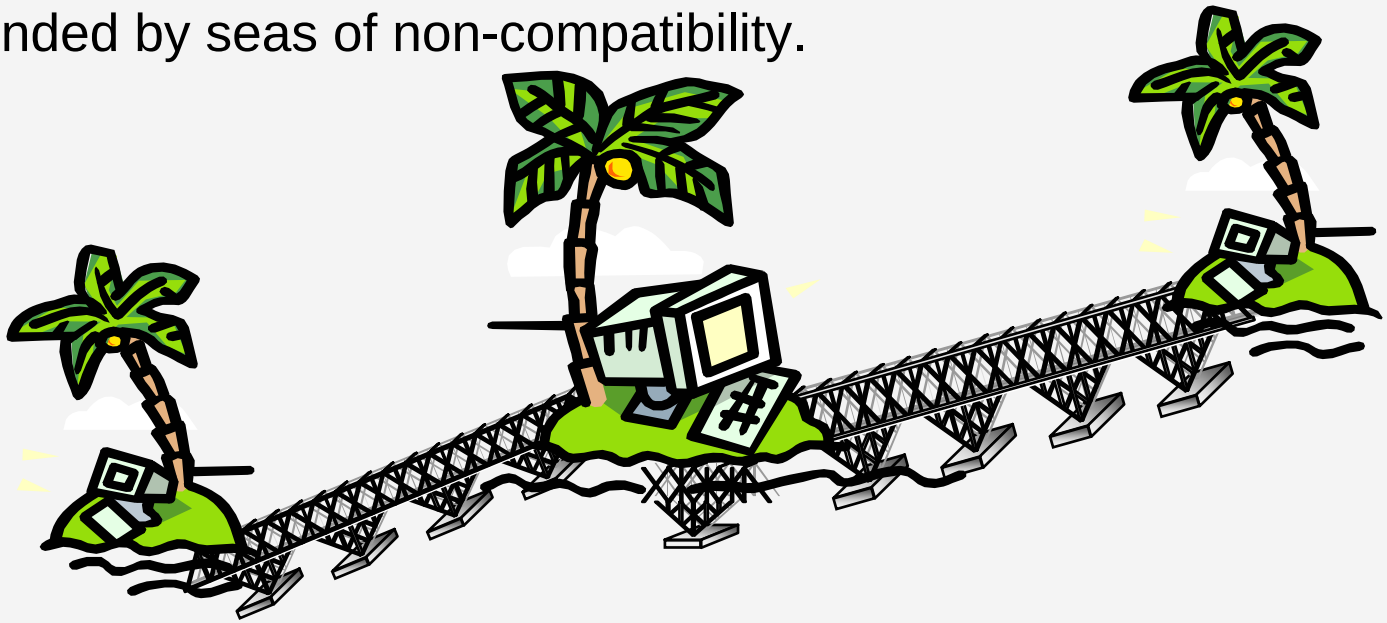


EC now has a consumption base of 150% of North America.

China is the leader in “blue collar” and India is the leader is “white collar”. Might (or should) political preferences give economic advantages to the home team… and how can a visiting team prosper?

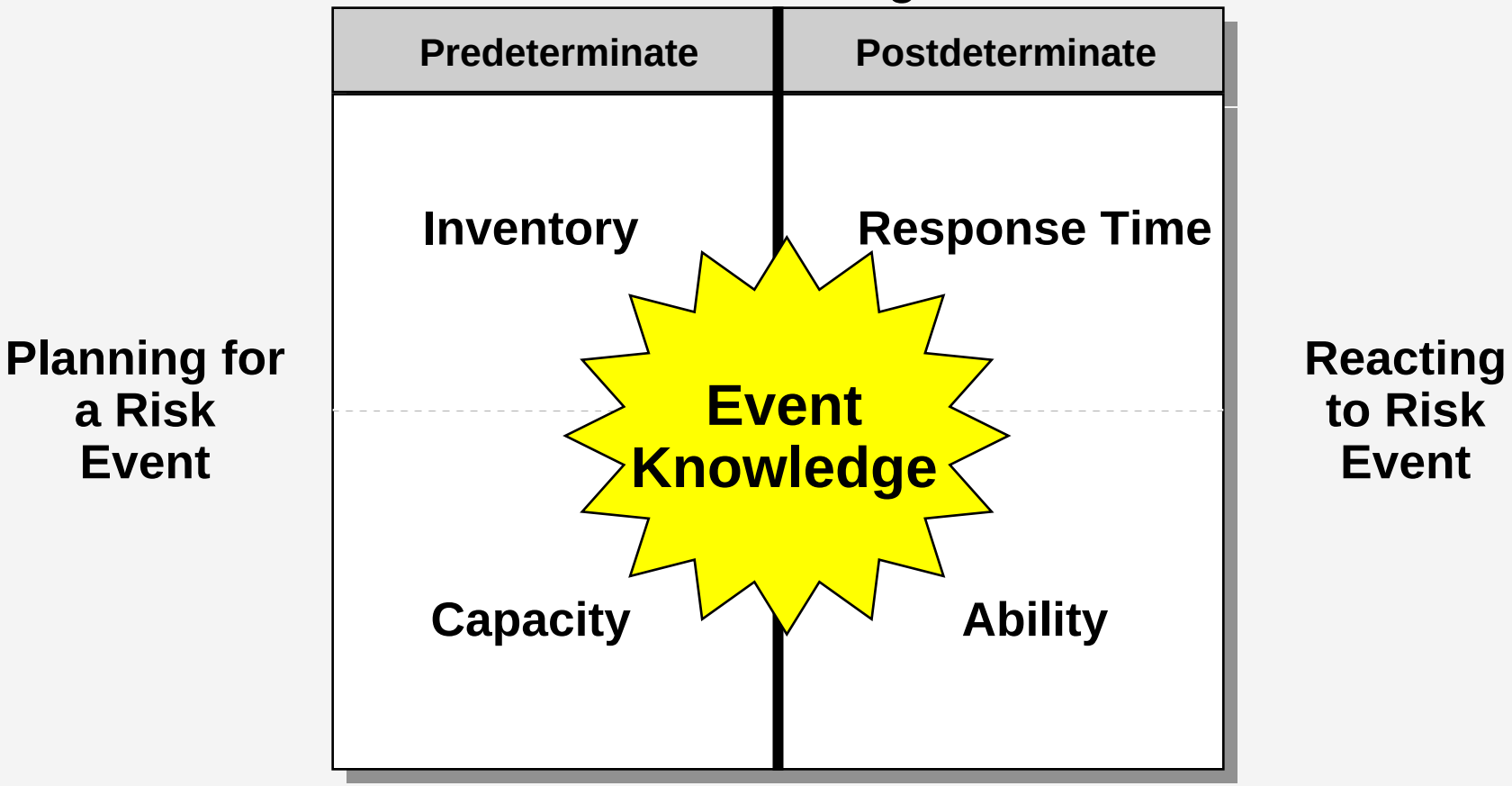
What are the contradictions of an open technology and the lack of seamless global eCommerce?

Current technology applications are island of digital standards surrounded by seas of non-compatibility.

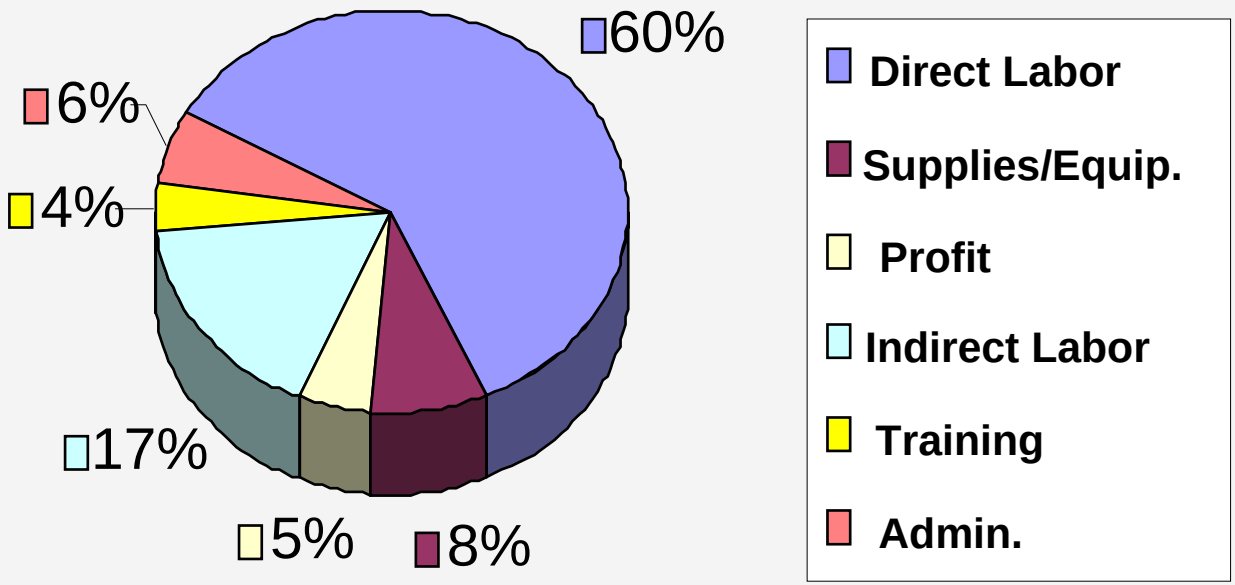


If technology and communication becomes truly global and seamless, how will you sustain technology innovations and advantages?

Risk is both Planning for an unknown but anticipated Risk Event and Reacting when that Risk Event occurs – a dual Challenge.

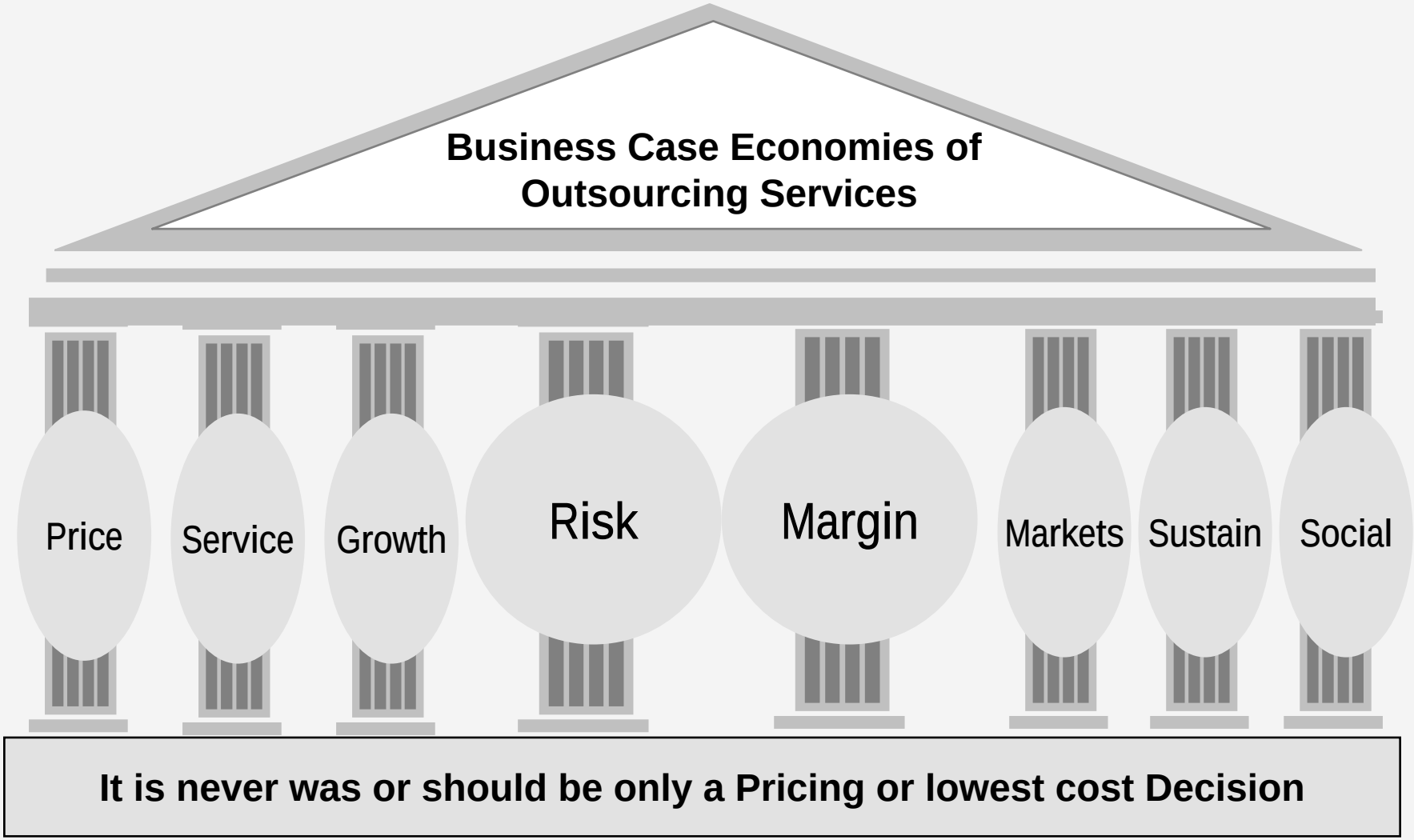


Outsourcing Decision: Services Should Cost Breakdown



Where is the cost of Risk? How much higher should the cost of Risk be if the source is Detroit or Dublin or Dubai? Can the cost of Risk Be the same for all locations?

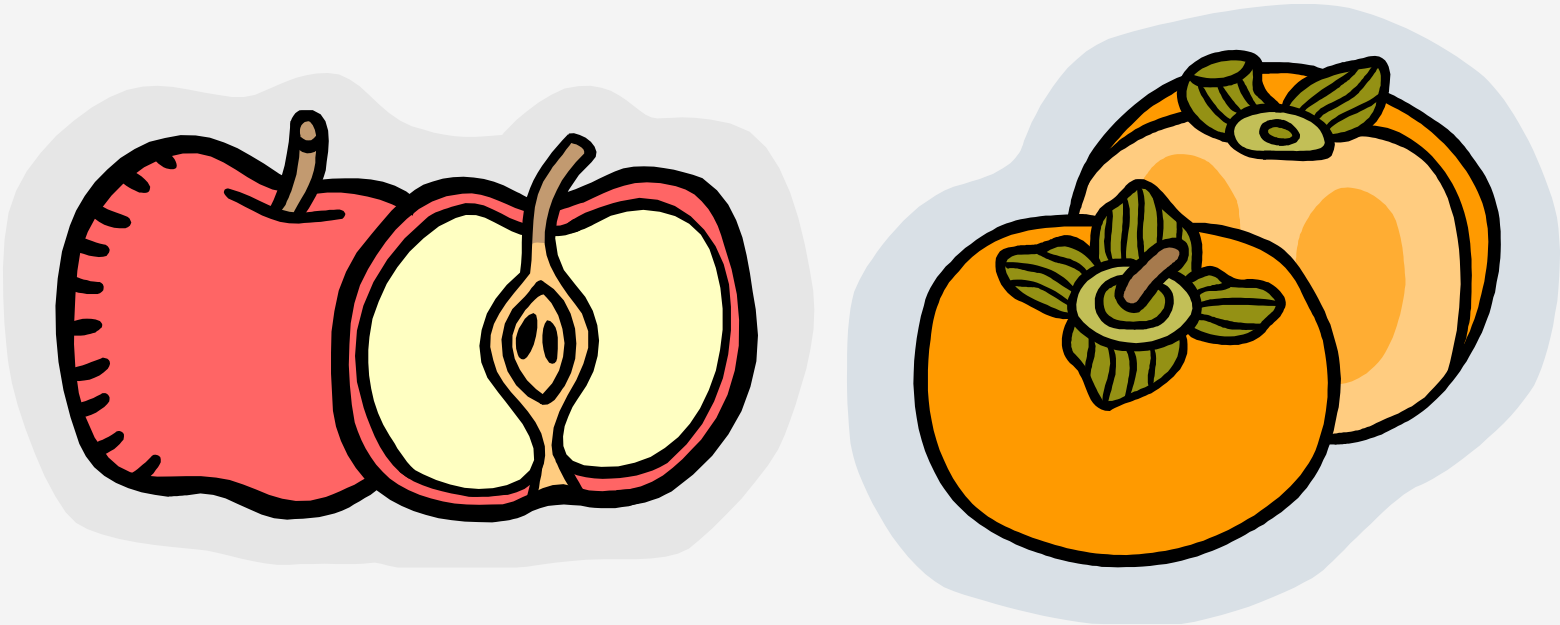
Rationale – Business Case



It is never was or should be only a Pricing or lowest cost Decision

Total Cost of Outsourcing

Outsourcing of Service is a viable and necessary aspect of effective Procurement. It is no longer optional but mandatory.



The challenge is identifying and quantifying the accurate and realistic total life cycle cost. Otherwise comparative decision-making is very Risky.

The focus of Global Service Management and Procurement has changed dramatically and will change again, exponentially.

	Yesterday	Today	Tomorrow
Markets	Local	National	Global
Leverage	Seller's	Buyer's	Market
Technology	Afterthought	Innovative	Seamless
Measurements	Cost	Savings	Value
Leadership	Functional	Technical	Executive
Sources	Shortages	Abundance	Shortages
Key Advantage	Volume	Information	Talent

Your investment in human capital is…

…your only sustainable competitive advantage and the New Wealth of Nations

PERSPECTIVES

Supply chain risk in an uncertain global supply chain environment

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Keywords *Risk analysis, Risk management, Supply chain management*

Abstract *The breadth and scope of supply chain risks have broadened significantly in recent years. Even prior to the 2001 terrorist attacks, the creep of risks and uncertainties were widening with increased globalization, widening political reach by leading countries, and the rise of market producing and consuming economies. This article raises some essential supply chain questions as well as some that have impact on the field from outside of it.*

The world is at risk and the supply chain is not exempt

Supply risk used to be defined as the potential for strikes by transport workers, fires at a key supplier's plant, or missed deliveries. That simple vision no longer applies.

For the last 50 years, the global economies have benefited from the stability afforded by Pax Group of Seven – the longest period of uninterrupted economic advance. The compromise of communism, the introduction of market drivers in China and Russia, the break-up of colonialism in Africa, the growth of economic communities in Europe, South East Asia, Africa, the Americas, and the acceleration from technology applications have all been encouraged by the openness in this era of peace. Internet technology now flows as freely in Dubai as it does in Detroit. The ability to arbitrage knowledge is slowing. The self-proclaimed world's policeman and sole remaining world power, the USA, has provided the "loan guarantee" for that openness and stability. The US economic and military prowess is now discounted by diplomatic isolation and diluting of resources in multiple presences.

History tells us that the role of world policeman is costly and short term. Therefore, in this continued drive to outsource and source globally, what quantifiable value do we assign to risk. The scope of supply chain sources and the markets are global; so is the risk. Globalization often results in the lowest overall cost of goods sold! However, what economic cost factors should now be assigned to the higher level of risk associated with a global supply chain. Supply sources and customers may be beyond the reach of the buyer's laws and conventions.

An enterprise may have lowest over-all costs in a stable world environment, but may also have the highest level of risk – if any one of the multiple gating factors kink up an elongated global supply chain!

The difference between contingency planning, insurance, and paranoia is very thin. However, the lack of any of the three in your risk assessment processes is insane.

The shock of 9/11 was to be a wake-up call to the uncertainty of a global environment. It was instead a snooze button. The world is restored to comfort and complacencies, at least in the short run.

Effective supply risk requires the identification and monetization of risk events, probability of occurrence, and the firm contingencies for alternative sources of supply:

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- Who are the specific suppliers, materials, and services that are at risk, especially those global sources of supply? In the post-9/11 environment can we still have confidence that our global and extended sources of supply will continue as business-as-usual?
- What is the impact of the compromise of intellectual properties from global sourcing? The death spiral of lost technology, and subsequently lost markets, is directly related to the supply search for lowest overall cost. Plateau technology flows to lower labor cost providers. Subcontractors become suppliers, then partners, and, finally, competitors – all fostered by the transfer of technology for short-term cost advantage. Is there an alternative to insular and protectionary regulations governing exchange of knowledge?
- What are the long-term limits to the continuity for skilled labor? How long before the failure of our educational systems results in the cost of the only sustainable competitive advantage -a skilled labor force?
- What are the alternatives to $15 a gallon for fuel? The big gray elephant in everyone's office is known oil reserves. OPEC nations control over 80 percent of known reserves yet produce less than a third of production. Non-OPEC nations control less than 20 percent of known reserves but delete those reserves twice as fast as OPEC nations. Are we waiting for a technology breakthrough of bathtub levels of cold fusion?
- What are the politico-economic exclusions from global supply sources? Emerging Economic Community (EC) agreements are regulatory and exclusionary. The EC now has a consumption base of 150 percent of North America. China is becoming the world's largest manufacturer. Might (or should) political preferences give economic advantages to the home team . . . and how can a visiting team prosper?
- What are the contradictions of an open technology and the lack of seamless global e-commerce? Current technology applications are island of digital standards surrounded by seas of non-compatibility. Each island can be probed and exploited by intrusive agents, but cannot communicate with the other islands. How long can the supply chain afford the buffers of excesses required by just-in-case technology?

Aesop's fable of the wild boar and the fox is most applicable. Now is the time to sharpen your weapons – not when you may need them. The US Office of Management and Budgets (OMB) estimates the cost to save one life by auto steering column standards is $200, while the cost to save one life by landfill restrictions is $100,000. In your computations of total life-cycle costs to justify global sources, what are your estimations of the costs of risk, for example:

- To save one critical source of supply by establishing and supporting a viable and less risky (yet often more costly) alternative?
- To replace a market share lost by exploitation of your intellectual properties?
- To train warehouse workers to read numbers?
- To use alternative energy sources?
- To pay higher tariffs?
- To reconcile e-commerce incompatible formats?

The point is simple: risk is broader than ever before. A risk and uncertainty lens is the newest and perhaps one of the most important capabilities and contributions that can be made to a firm's competitiveness and viability.

About the author

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Prior to his consulting experience, he served as the Worldwide Director of Materials Distribution, and Director of Physical Distribution and Transportation for GTE Corporation.

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