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A summary of the research conducted by- CORE, IDC, PRIMA

CORE recently released *The Outsourcing Monitor*, the result of a key partnership and the product of some weeks of research and analysis. The Outsourcing Monitor is a bi-yearly, research study that uses current data from IDC's outsourcing surveys and contract tracking, holds insightful discussions with CORE's members and taps into leading industry expertise on analysis. Some of you may already have a taste of this joint project when last June- IDC, CORE and Frank Hart from Prima- reported on the **impact of recession on Canadian outsourcing marketplace**. Last month's webcast covered an update on the subject with a deep dive into **offshoring**.

Our study assessed the market expectations and outsourcing intentions and compared these to that following the 2001 recession. Though unlike the post-2001 recession market activity, renewals and renegotiations were about 50 per cent of the deal mix in 2009, versus 30 per cent post 2001, similar increase in market demand for outsourcing services was noted. The total deal TCv more than doubled in 2009 from that of 2008. New deals were up 80+% vs. 2008, with 2009 renewals more than double 2008 renewals. The market outlook for 2010 was of continued growth at close to 4%.

Increased adoption of global sourcing by Canadian clients was the key finding of this research study. Indian firms are starting to win larger-scale Canadian ITO contracts, growing 6 times faster than traditional Tier 1 providers in ITO. However, it must be noted that their market share -only 9% of the Canadian global sourcing ITO market by 2013- is still small compared to the western based Tier 1 providers.

Increased adoption in the use of off-shore resources is expected to create permanent shifts in the market as clients grow more accustomed to the use of off-shore resources. Not surprisingly, those sectors of the economy generating the greatest interest in outsourcing are industries hardest hit by the recession, such as financial services, retail and manufacturing.

For the full report or the webcast recording, please visit our website- www.core-outsourcing.org

-----Charu Murti, Research Coordinator, CORE

Canadian News

Canadian outsourcing will grow in 2010

IDC Canada, CORE and Prima Management Consulting re-assess how the recession impacted outsourcing practices in Canada and forecast upcoming outsourcing trends for 2010

Outsourcing practices are expected to grow in 2010, according to a recent Web cast from IDC Canada, the Centre for Outsourcing Research and Education (CORE) and Prima Management Consulting on the impacts the recession has had on outsourcing in Canada.

According to IDC forecasts, the overall Canadian IT outsourcing market is expected to reach nearly \$15 billion in 2010, which represents a growth of about 3.8 per cent from 2009, said Sebastien Ruest, vice-president of service and technology research at IDC Canada.

“With the chipping away of the traditional outsourcing model, alternative outsourcing models such as remote infrastructure management, cloud and utility computing are forecast to grow by 5.4 per cent in 2010,” said Ruest.

IDC expects financial services firms will lead the way, market interest in business process outsourcing (BPO) to grow, further increases in global offshoring and challenging economic conditions ahead in 2010, he noted. The constraint of capital will continue to drive CIOs to conserve cash and avoid risk-taking by looking only one to two years down the road, he said.

Other 2010 trends highlighted by Ruest include cloud-delivered services increasingly being seen as a means to drive better value in IT and HST (harmonized sales tax) creating some hesitation in the outsourcing sector. BPO will see the largest gain and cut in spending this year, he said. Ruest also speculates high interest in outsourcing from the manufacturing industry.

The recession fuelled the need to reduce operating costs, which increased outsourcing demand, and recent outsourcing activity shows strong signs that companies are building agile, cost-effective platforms to improve their competitiveness, he said. “In summary, 2009 was a strong year for outsourcing in Canada, which is creating a positive market for 2010,” said Ruest.

Canada will expand its adoption of global outsourcing, but continue to lag behind the U.S., according to Frank Hart, president of Regina-based Prima Management Consulting. Hart also expects the number of RFIs and RFPs to increase in 2010 and sees BPO as “the next frontier” for global sourcing.

What's happening is a convergence of business models between traditional Tier 1 and India-based firms, said Hart. India-based firms are starting to win larger-scale Canadian ITO contracts and growing six times faster than traditional Tier 1 providers in ITO, he said.

Canadians are typically slow to adopt global outsourcing, Ruest pointed out. Canadian companies have comparatively less experience with global service delivery relative to U.S. business and seem more agnostic about global delivery location choices, he said.

But the Canadian preference for outsourcing to Western Tier 1 firms is expected to change and more Canadian businesses will begin to look at pure-play providers including India-based firms, said Ruest. Pure-play providers have tripled their share of the market to six per cent in the past four years, he noted.

The upcoming demand for new ICT employees, a result of retirements and industry growth, is driving the potential for global offshoring, according to Ron Babin, director and assistant professor at Ryerson University's Ted Rogers School of IT Management. Canada will see a shortfall of 162,000 positions in the next five years, which is why outsourcing is very important, said Babin.

Source: itbusiness.ca, ComputerWorld Canada, Network world, Jan 2010

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In The News

Outsourcing Industry turns in best performance in 6 quarters

Total contract value up 47 percent sequentially to \$24.7 billion, highest since 2Q08, according to 4Q09 Global TPI Index. Market bottomed in first half of 2009, turned in second half; positive outlook for 2010

TPI, recently released fourth-quarter and full-year 2009 data showing that the global outsourcing market had its best performance in six quarters and that a slow but steady recovery in the industry is underway as businesses commit to long-term strategies to reduce costs and streamline operations.

The 4Q09 Global TPI Index, which measured commercial outsourcing contracts valued at greater than \$25 million, showed the market's total contract value (TCV) reached \$24.7 billion, an increase of 47 percent sequentially and 8 percent year-over-year and the best quarterly performance since the second quarter of 2008. Driving the market were strong demand for IT

outsourcing (ITO), a regional surge in Europe, the Middle East and Africa (EMEA), and a continuation of the rebound in mega-deals and mega-relationships that began in the third quarter.

Full-year 2009 results could not overcome the market's weak showing during first two quarters. TCV for the year declined 13 percent to \$74.5 billion, its lowest point since 2001. However, as 2010 begins, industry pipelines are healthier and more stable than a year ago.

“As we anticipated, 2009 marked a low point in outsourcing because of the recession in the general economy and its impact on commercial buyers,” said Mark Mayo, Partner and President, Global Operations, TPI. “The global market bottomed in the first half of the year and turned in the second half. It now shows signs of recovering slowly and steadily, rather than bouncing back to pre-recession levels, but the outlook for building on its second-half momentum is positive.”

MARKET OVERVIEW

During the fourth quarter of 2009, ITO activity continued to drive the broader market, as it has all year. TCV in this category increased 54 percent over the prior quarter and 32 percent over a year ago to \$19 billion, the highest quarterly total in six years. For the year, the market produced \$56 billion in TCV, flat with 2008. The Network Services and Application Development & Maintenance towers both experienced declines for the year, but Infrastructure, the largest tower within ITO, grew modestly.

Meanwhile, the market for business process outsourcing (BPO) continued to struggle in the fourth quarter. While TCV in this segment increased almost 29 percent sequentially, a third consecutive quarterly improvement, it remained 33 percent below the same period in 2008. For 2009, BPO TCV declined 38 percent to \$18.5 billion, its lowest level since 2001, and the Finance & Accounting, Financial Services Operations and Human Resources Outsourcing categories remained stalled at a fraction of totals reached in prior years.

REGIONS AND INDUSTRIES

Once again, the Global TPI Index showed vastly different results among the three major geographic regions of the world. In the Americas, TCV rose just over 4 percent over the prior quarter but remained off by 17 percent year-over-year. Despite growth in Latin America, full-year TCV in the region declined 6 percent to \$27 billion, the lowest level of the decade. The service provider landscape continued to shift in the region due to significant consolidation and gains by India-heritage firms, which now make up nearly one-third of the top players.

In EMEA, several large transactions boosted fourth-quarter TCV 135 percent sequentially and 60 percent year-over-year to \$15.4 billion, its best performance since the second quarter of 2008. However, full-year TCV in the region fell 21 percent to \$36.7 billion despite only a slight decline in the number of contracts, an indication that EMEA is experiencing the same shrinking transaction sizes that have slowed growth in the United States.

Asia Pacific fourth-quarter TCV fell 37 percent sequentially and 56 percent year-over-year to \$2.1 billion. But for the year, the region's \$10.5 billion in TCV represented stabilization with 2008 after several volatile years. While China and India have yet to reach their full potential as outsourcing markets, Australia continued its solid track record of late, doubling its share of the region's TCV.

Among industries, the three verticals with the largest footprint in the outsourcing market – Financial Services, Manufacturing and Telecom & Media – experienced significant increases in demand during the second half of 2009. Manufacturing, where softening consumer demand is necessitating investments in reducing operational costs, TCV rose 76 percent over the first two quarters of the year. In financial services, TCV was up 33 percent in the second half. And in Telecom & Media, a mature vertical that is nonetheless seeing contract renewals and renegotiations, TCV was up 24 percent. These three verticals will need to continue their positive momentum if the broader market is to maintain its gradual recovery.

OUTLOOK

Looking ahead, industry pipeline metrics monitored by TPI have strengthened over a year ago, as have anecdotal descriptions of the health of service provider pipelines. The rate of new transactions added to pipelines, which had slowed in 2009, has apparently stabilized, and the level of contracts coming up for renewal is up 29 percent.

Source: <http://www.tpi.net/knowledgecenter/tpiindex/>

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TCS, Infosys and Wipro hiring staff as US demand grows

The top three offshore companies are ramping up hiring and increasing pay as global corporations, mainly from the US, send more work offshore to cut costs as they emerge from the downturn.

Tata Consultancy Services, Infosys, and Wipro expanded their global workforces by an average of 5.1 per cent last quarter, together adding 16,701 employees, company documents show – an early sign that the Great Recession may ultimately benefit India as cost-conscious companies outsource more work, just as they did after the dot-com bust.

“Our expectations are for flat to marginally stronger IT budgets with a greater share of offshore spend,” Wipro chairman Azim Premji said. “Our customers remain focused on cost reduction.”

The employment revival in India's outsourcing sector, which counts on the US for about 60 per cent of global sales, comes as unemployment in the US stagnates around 10 per cent – near a 26-year high. Inflation-adjusted wages in the US last year fell 1.6 per cent, the biggest decline since 1990.

TCS, Infosys and Wipro, which do everything from call center management and claims processing to software development and consulting, all reported stronger than expected results for the December quarter. Revenues and volumes grew, signalling that the cost-cutting imperative of this last, lean year may be over for India's \$60 billion software services industry.

After about a year of hiring slowdowns, all three companies are sweetening compensation as the fight to hold on to talented employees in India heats up.

Infosys offered its employees an average 8 per cent pay hike in October, their first raise since April 2008, and executives said last week they are considering another raise to combat rising attrition.

“The market is heating up and we want to retain talent,” human resources director Mohandas Pai told reporters. Infosys last week raised its gross hiring target for the second time this fiscal year, to 24,000 people.

Wipro executives said they plan to offer staffers a raise in February. Tata Consultancy Services has paid out 150 per cent of performance-lined pay – which amount to 20 to 45 per cent of compensation – for the last two quarters, and executives say they will raise salaries next quarter, after a year-long wage freeze.

As demand for workers revives, employers have begun to worry about rising staff turnover. Employees who sat tight during the downturn have started to shop around for better jobs and better salaries.

Attrition at Wipro jumped to 13.4 per cent last quarter, up from an average of 8.9 per cent over the prior three quarters. Attrition at Infosys rose to 11.6 per cent last quarter from 10.9 percent the prior quarter. Attrition at TCS has been stable, at around 11.5 per cent, though executives say they expect that number to rise.

Indian firms say they are increasing global hiring, including in the US, as they pursue higher-end work like consulting. But US employees remain a fraction of total staff. TCS, for example, recently finished hiring 250 Americans for its Cincinnati campus, but US employees still account for less than 0.5 percent of the company's global workforce.

Source: January 2010, The Economic Times

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Obama wants to end tax breaks to Outsourcing Firms

US President Barack Obama said he will end tax breaks to American firms that ship out jobs abroad. "To encourage... Businesses to stay within our borders, it is time to finally slash the tax breaks for companies that ship our jobs overseas, and give those tax breaks to companies that create jobs right here in the United States of America," he said in his first State of Union address.

A report by IT consultancy firm Forrester Research estimates that 3.3 million American jobs will be lost to outsourcing in 15 years ending 2015. Already, half of the Indian IT-BPO industry's USD 71.7 billion revenue comes from the US. According to Gartner, Indian BPO vendors will command 10 per cent of the total global market share by this year end.

Obama said: "Now, the House has passed a jobs bill that includes some of these steps (to slash tax breaks). As the first order of business this year, I urge the Senate to do the same... People are out of work. They're hurting. They need our help. And I want a jobs bill on my desk without delay."

American companies primarily move jobs abroad to save costs, with no dent to services as countries like India boast of an English-educated workforce -- be it IT engineers or for jobs that have to be done over phone.

"I think the concerns we have is about indirect protectionism. I don't think tax break issue is... Important for us," Indian software services industry body NASSCOM Vice-President Ameet Nivsarker said.

"Because of the steps we took, there are about two million Americans working right now who would otherwise be unemployed," Obama said. He said job creation would be the country's number-one focus in 2010. The bill will provide for taking USD 30 billion of the money Wall Street banks repay and use it to help community banks give small businesses the credit they need.

"Now, the true engine of job creation in this country will always be America's businesses. But government can create the conditions necessary for businesses to expand and hire more workers," he said.

"The whole issue about taxing companies, which were shipping jobs overseas and taking away tax breaks actually does not relate to the work that is done out of India or other locations. That is really about US subsidiaries which have set up plants overseas," NASSCOM's Nivsarker said, adding that it will affect American companies more than Indian IT services industry.

Obama also announced that US would invest massively in skills and education of its people.

"Still, in this economy, a high school diploma no longer guarantees a good job...To make college more affordable, this bill will finally end the unwarranted taxpayer-subsidies that go to banks for student loans," he said. "Because in the United States of America, no one should go broke because they chose to go to college.

Source: Outlook.com, January 2010

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Public sector looks to outsourcing as costs slashed

Budget cuts will lead to offshoring surge, says NOA

The public sector will see a surge in outsourcing during 2010 as it attempts to deal with budget cuts, according to new research by the National Outsourcing Association (NOA). The spending deficit brought on by the UK government's banking bailout will force public sector IT bosses to

slash costs without impacting service delivery levels, and the NOA believes that they will turn to outsourcing as a result.

“The sector will need to explore more shared services and outsourcing options after the General Election than some currently believe. Efficiencies mooted in the Read OEP simply won’t be enough compared to the amount of government borrowing going on,” said NOA offshoring director, Mark Kobayashi-Hillary. “The sector will be forced to explore extensive changes and new operating models rather than just efficiency drives if they want to escape from this increasingly large black hole.”

Other 2010 predictions from the NOA include a revision of multisourcing or multivendor deals, driven by a desire from end users to simplify outsourcing deals; the rise up the agenda of environmental issues; an increase in SMEs looking at outsourcing as a way of reducing overheads; and an increase in the number of call centres in China as well as other outsourcing facilities in the Philippines, Brazil and Russia.

Business Process Outsourcing (BPO) is also tipped to make a big impression this year. It currently makes up around 3% of the outsourcing market but the NOA believes that it could grow to over 5% in 2010.

The NOA also claims that as traditionally-outsourced services such as CRM and storage and increasingly delivered via the cloud, the on-demand model will gain prominence in the outsource industry this year.

“2010 will be a game of two halves for outsourcing. On one hand we see optimism rising in the private sector with companies using outsourcing to seize growth opportunities and re-skill with minimal risk. And on the other we see what amounts to a ‘public sector recession’ wreaking havoc on those people and organizations in charge of public service delivery,” said NOA chairman Martyn Hart. “Outsourcing and offshoring can, and will be used positively, in both respects so we expect sizeable sector growth across the board.”

Source: NOA, January 2010

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Study Maps a Decade of Shrinking IT Innovation

Innovation’s Share of IT Budget Reduced by 50% Since 1999

A new study by global management consulting firm A.T. Kearney, Delivering Technology Innovations, finds that while industry leaders overwhelmingly acknowledge the value of IT as an important strategic differentiator, investment in IT innovation misses target levels more than 75% of the time. Moreover, although innovation accounted for 30% of the average IT budget in 1999, it has fallen to less than half of that – 14% – in the subsequent ten years.

“The central role IT innovation can play in a company’s overall performance and health is well-understood by corporate decision-makers,” said Christian Hagen, a principal at A.T. Kearney and one of the lead authors of the study. “And the healthier the company, the better the understanding. When they spoke with executives of companies who were seeing 3% to 5% annual sales growth, 68% said that IT innovation made a positive contribution. But when they looked at companies with greater than 10% annual growth, the number of those who had benefited from IT innovation reached nearly 90%.”

The study found that IT innovations were adding value in virtually every aspect of a business, from sales and marketing through R&D and product development, manufacturing and supply chain, and even mergers and acquisitions. Yet a successful IT program does not come easily, and the study identifies the greatest IT growth barriers as complexity, inconsistent data, and excessive time spent on daily activities. Further, it finds that the lack of effective enterprise integration and a limited incubator environment are the two most important reasons why IT innovation projects fail.

“What we discovered, though, was that IT innovation doesn’t need to fail, and it doesn’t need to be hugely expensive either,” said Bob Haas, leader of A.T. Kearney’s Strategic Information Technology Practice. “In fact, it is often the standard or mature technologies used in innovative, business-aligned approaches that create the greatest impact.”

But in order to leverage IT successfully, innovation has to be thoughtfully planned. Studying those companies that had the best results with IT innovation revealed six common themes, or as Haas puts it, the “Six Mandates for IT Innovation:”

1. *Ensure executive commitment to develop world-class IT delivery and innovation capabilities*
2. *Establish targets and execute dedicated and consistent investments in innovation*
3. *Create integrated IT leadership and business partnerships*
4. *Leverage technologies to integrate products and services with traditional back-office IT*
5. *Collaborate outside as well as within the organization (i.e., with customers and suppliers in addition to employees) to deliver IT innovation*
6. *Make sound business decisions on emerging technologies*

“A game-changing IT program is within reach of any company that wants to devote the talent, time, and commitment to develop a culture of innovation,” Haas said. “Most companies understand how important IT innovation is, but many aren’t doing anything about it or are not following best practices. Our study indicates that the ones that do will add value to their business and differentiate themselves from their competition.”

Delivering Technology Innovation, A.T. Kearney’s IT Innovation and Effectiveness Study, surveyed board members and senior-level executives from American and European companies with \$500 million or more in revenue. Companies were primarily from five industries: automotive, communications and high-tech, consumer products and retail, financial institutions, and process industries.

Source: AT Kearney, January 2010

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WEF Flags Risks of Fiscal Crisis, Bubbles and Chinese Economy

The risks of a sovereign-debt crisis, asset-price-bubble collapse and a hard landing for the Chinese economy was high on the agenda of global leaders recently convening in Davos, Switzerland, for the World Economic Forum.

Launching the forum's fifth global risks report, WEF Managing Director Robert Greenhill warned that the most pertinent risks weren't the ones that are unknown but those left unaddressed.

Great interconnectedness in all areas of society is largely taken for granted but a breakdown could cause chaos, he added, also highlighting the risks of chronic disease and underinvestment in infrastructure.

"The financial crisis and the ensuing recession have created a more vulnerable environment where unaddressed risks may become tomorrow's crisis," the WEF's Greenhill said. The report came a fortnight before more than 1,400 corporate and political leaders descended on the sleepy Swiss mountain town for a week of debate on how to rethink, redesign and rebuild in the wake of the devastation of the credit crisis and economic downturn.

The report found a collapse in asset prices to be the most severe and likely risk, amid concerns that the weak dollar and low global interest rates could fuel a liquidity-driven, rather than debt-driven, bubble.

It added that further shocks could emerge as refinancing needs arise. These are only expected to peak between 2011 and 2013.

"You see a lot of search for yield almost in disregard for or in denial of risks. It's as if the financial crisis of 2008/2009 had never happened," Daniel Hofmann, Group Chief Economist at Zurich Financial Services, told reporters at a briefing in London.

He also noted massive rises in house prices in Beijing and Shanghai in China over the past year and huge capital flows. "The only thing that's changed is the composition of the asset bubble," he said, adding that the ability to withstand another shock had been reduced by the damage done by the last one.

The global risks report also put a spotlight on events in Dubai as an illustration that debt loads remain high. Government-owned conglomerate Dubai World announced in November it was seeking a standstill on its \$22 billion of debt, shaking world markets.

Analysts have warned that such incidents could spur investors to steer clear more broadly of those nations with high debt burdens.

Greece has also come under intense scrutiny since it revealed late last year that its budget deficit would hit 12.7% of gross domestic product, four times the EU's 3% limit.

"In response to the financial crisis, many countries are at risk of overextending unsustainable levels of debt, which will exert strong upward pressures on real interest rates. In the final instance, unsustainable debt levels could lead to full-fledged sovereign debt crises," the report warned. "Dubai and Greece were early warnings, they should be heeded," Mr. Hofmann said.

The report also warns about the risk of a hard-landing of the Chinese economy, which could have serious implications, not only domestically but also for global capital and commodity markets and world economic growth.

"Much of the domestic impulses derive from high credit growth, which entails an increased risk of misallocation of capital and renewed bubbles in financial asset prices and real estate," the report said. "These can always carry the risk of a sharp and recessionary correction."

Mr. Hofmann said China was on a "very unbalanced growth trajectory," with fiscal stimulus of about 14% of GDP and monetary easing spurring a credit expansion of around 30% over the past year. "We're in an environment where policy mistakes can be made, and the risk, equally, of a hard-landing in China is probably heightened," he said.

Source: World Economic Forum, February 2010

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Articles in Depth

The looming deleveraging challenge

Several major economies are likely to face imminent deleveraging. If history is any guide, it will be a lengthy and painful process.

The spectre of deleveraging has been haunting the global economy since the credit crunch reached crisis proportions in 2008. The fear: an unwinding of unsustainable debt burdens will drag down growth rates for years to come. So far, reality has been more benign, with economic growth recovering sooner than expected in some countries, even though the financial sector is still cleaning up its balance sheets and consumer demand remains weak.

New research from the McKinsey Global Institute (MGI), though, suggests that the deleveraging process may just be getting under way and is likely to exert a significant drag on GDP growth.¹ The study of debt and leverage in ten mature and four emerging economies indicates that some sectors of the economies of five countries—Canada, South Korea, Spain, the United Kingdom, and the United States—will very probably experience deleveraging.

What's more, the analysis of deleveraging episodes since 1930 shows that virtually every major financial crisis after World War II was followed by a prolonged period in which the ratio of total

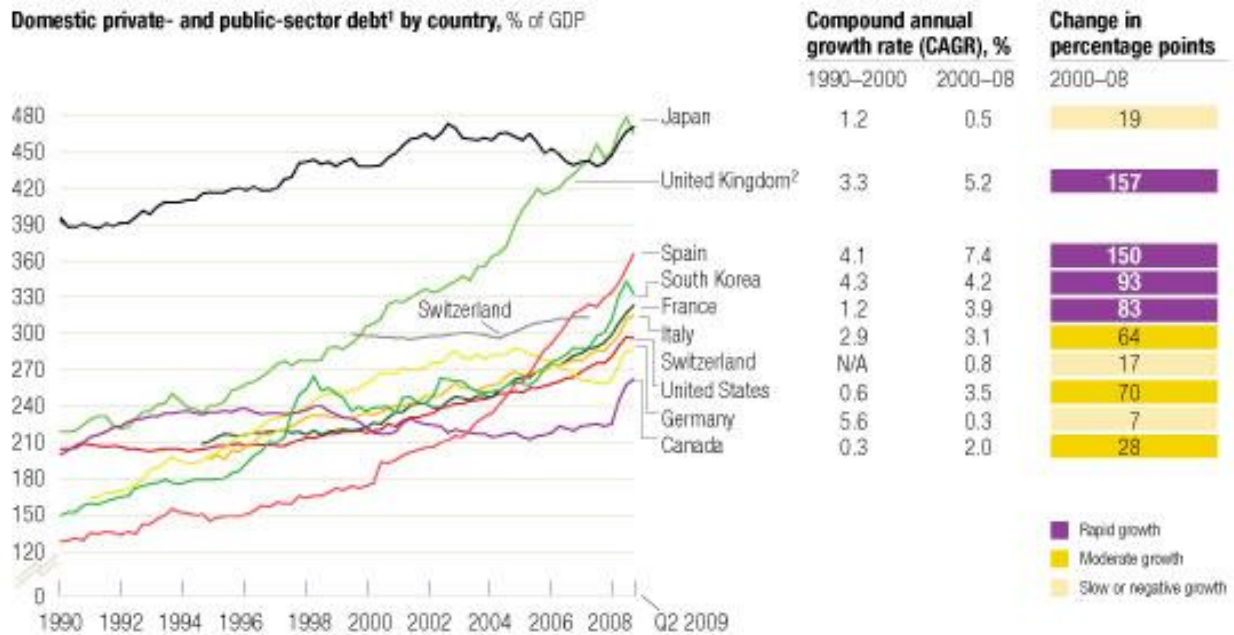
debt to GDP declined significantly. The one exception was Japan, whose bursting asset bubbles in the early 1990s touched off a financial crisis followed by many years when rising government debt offset deleveraging by the private sector. The “lost decade” of sluggish GDP growth that followed is a cautionary tale for policy makers hoping to somehow avoid the painful process of deleveraging.

Business executives too will face challenges: they may have to adapt to an environment in which credit is tighter and costlier and consumer spending could be slower than trend over the medium term in countries where household debt has built up. Our findings underscore the likelihood that growth will be stronger in emerging markets, which are far less leveraged, than in mature ones. To cope, companies should build the potential impact of “pockets” of deleveraging into their market outlooks.

Where deleveraging is likely today

Debt grew rapidly after 2000 in most mature economies. Although the United States is often assumed to be the most profligate borrower, by 2008 several countries—including France, South Korea, Spain, and the United Kingdom—had higher levels of debt as a percentage of GDP (Exhibit 1). Of course, such aggregate measures of leverage are not by themselves a reliable guide to the sustainability of debt. Swiss households, for example, have sustainably managed very high levels of leverage for a long time because they possess high levels of financial assets that can be drawn on to repay debt and because Swiss banks have conservative lending requirements.

Domestic private- and public-sector debt¹ by country, % of GDP



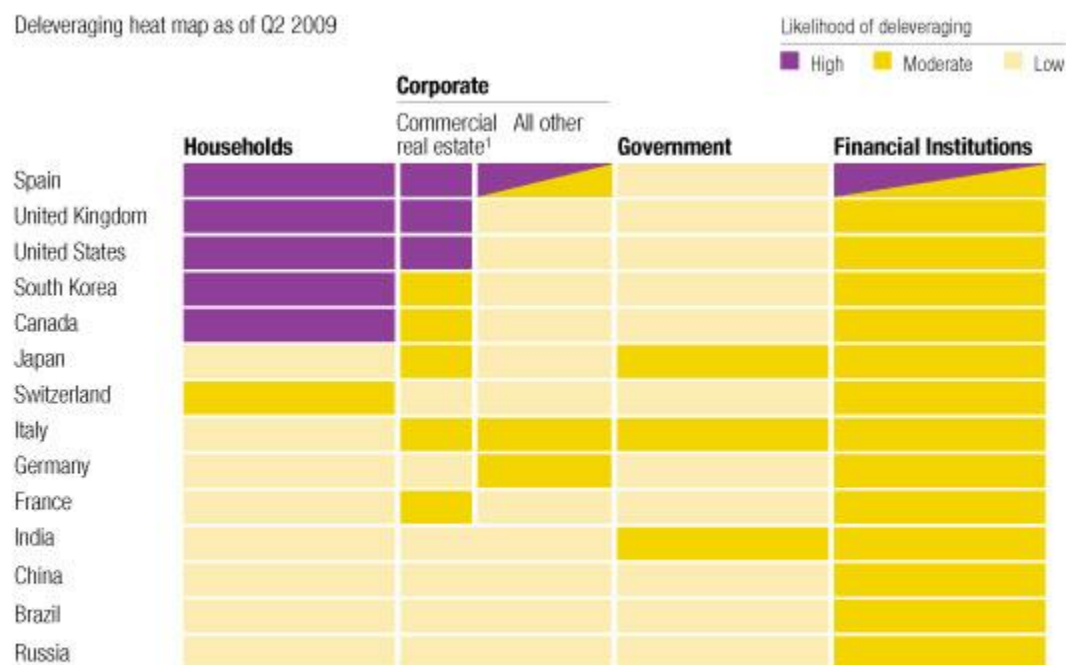
¹Defined as all credit-market borrowing including loans and fixed-income securities.

²Even after foreign lending by UK banks is removed, the United Kingdom's ratio of debt to GDP remains higher than every other country's except Japan.

Source: Central banks; Haver Analytics; McKinsey Global Institute analysis

So to gauge the likelihood of a deleveraging, MGI took a more granular view, studying how debt and leverage have grown over time in individual sectors of 14 major economies. They assessed the sustainability of debt by considering factors such as the level and recent growth of leverage and the borrowers' debt service capacity and vulnerability to income and interest rate shocks.

The analysis suggests that ten sectors have a high likelihood of deleveraging (Exhibit 2). In eight of the ten, very high levels of debt are linked to real-estate booms: the household sectors of Spain, the United States, and, to a lesser extent, of Canada and South Korea, as well as the commercial-real-estate sectors of Spain, the United Kingdom, and the United States. The remaining two are parts of Spain's financial and non-real-estate corporate sectors.



¹Includes public and private real-estate investment vehicles.

Source: McKinsey Global Institute analysis

Overall, the corporate sectors in most countries entered the crisis with lower levels of leverage than they had at the start of the decade, with the exceptions of the commercial-real-estate subsector and companies acquired through leveraged buyouts. Both of those pockets of leverage have over \$1 trillion of debt, which will need to be refinanced in coming years, suggesting difficulties ahead.

What history teaches about deleveraging

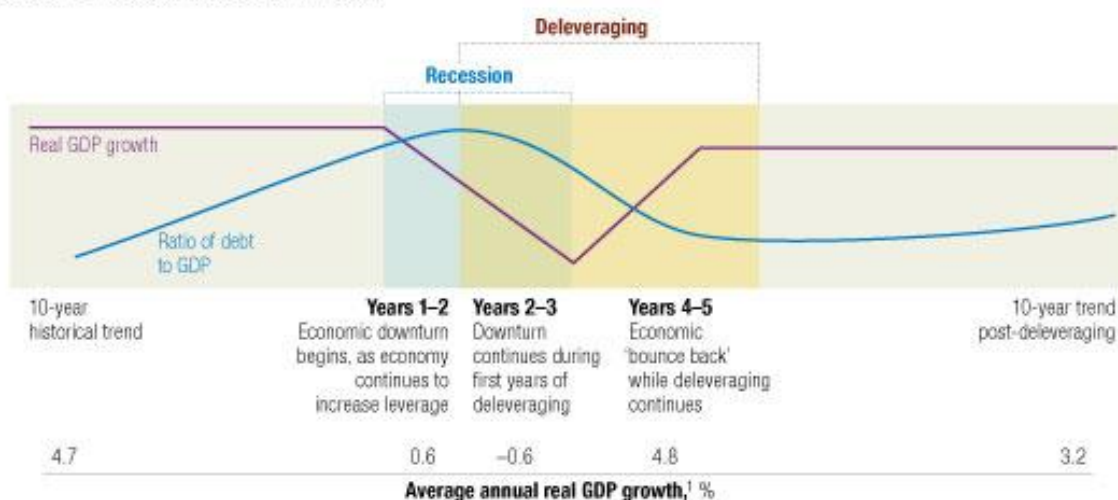
To understand what deleveraging might look like going forward, they analyzed 45 significant, historical deleveraging episodes: those in which the ratio of total debt to GDP declined for at least three consecutive years and fell by 10 percent or more. The deleveraging episodes ranged from the US Great Depression (1929–43) to Argentina's current troubles (2000–present).

In 32 of the episodes, the deleveraging process commenced after a financial crisis and followed one of four paths. Three typically occur under economic conditions that are not currently present,

so they are unlikely now: high inflation, which causes deleveraging by increasing nominal GDP growth; massive default, which typically follows currency crises; and rapid economic expansion fuelled by war or oil booms. The fourth—a prolonged period of austerity, or “belt tightening”—is not only the most common path, fitting 16 of the 32 deleveraging episodes that took place after a financial crisis, but also the one that seems most relevant today.

Deleveraging through belt tightening—exemplified by the US economy during the Depression years from 1934 to 1938 and by South Korea and Malaysia after the Asian financial crisis in 1997—is usually a long and difficult process that reduces the ratio of debt to GDP by about 25 percent. Credit growth in most cases slowed dramatically: in the mature economies in our sample, it averaged 17 percent annually in the ten years prior to the crisis but fell to just 4 percent during deleveraging. Real GDP typically declined in the first two to three years of deleveraging but then rebounded and grew strongly for the next four to five years while deleveraging continued (Exhibit 3).

Illustration of impact of deleveraging on GDP growth



¹For “belt tightening” scenario (historically, the most common path). This scenario involves a prolonged period of austerity when most countries experience some growth in credit, but at a pace far below pre-crisis rates of growth and slower than nominal GDP growth.

Source: International Monetary Fund (IMF); McKinsey Global Institute analysis

This time could be different

While the historical record is helpful, several elements of today’s environment suggest that deleveraging may start later and take longer. First, aging populations in much of the world are causing labor force participation rates to fall, which will make it more difficult than usual to jump-start and sustain GDP growth. Another complication is that the financial crisis of 2008 was global in scale, affecting the world’s biggest economies—not just one or a few, as in most previous crises. Therefore, it would be very difficult for all of today’s affected countries to boost net exports simultaneously, as many did in the past to support GDP expansion when credit growth was slowing and households were saving more.

Add to that problem the prospect of sharply increasing government debt relative to GDP in several major economies. According to Global Insight, US government debt will grow to 105 percent of GDP by 2012, from 60 percent in 2008; UK government debt to 91 percent, from 52

percent; and Spanish government debt to 74 percent, from 47 percent. This development could more than offset any deleveraging by the private sector. One implication is that Spain, the United Kingdom, and the United States might postpone deleveraging until after the crisis passes and growth in government debt has been reined in. It's also likely that debt-to-GDP ratios will decline more slowly and over a longer period than the historical average, creating severe headwinds on economic growth, though we do not forecast GDP.

How policy makers and business leaders can respond

Policy makers today face an acute challenge going forward. On the one hand, public policies that stimulate GDP growth will be invaluable for countries experiencing deleveraging, because such policies help an economy “grow into” its current level of debt rather than pay it off. Households and businesses can therefore save more without reducing consumption and investment as sharply as they would otherwise have to do. On the other hand, faced with rising public debt, policy makers must also carefully consider when to reduce government support of aggregate demand. Japan's experience in 1997 highlights the danger of winding down stimulus programs prematurely, potentially stifling a recovery. But it also illustrates the dangers of letting public debt grow unchecked. Getting the timing right will be critical.

Regulators are now discussing ways to improve the stability of the financial system. The analysis strongly suggests the need for monitoring leverage at a very granular level in the real economy, since overleveraged borrowers in a few sectors were at the heart of the crisis. The data, which could then inform the banks' risk models and regulatory policies on bank capital, should be compiled at an international level, given the growth in cross-border lending and the insights that can be gleaned from cross-country comparisons. Our analysis also provides support, in principle, for a more active approach to monitoring systemic risk in the financial system. Caution is suggested about moves to raise bank capital ratios too quickly and too high, however, given the risk of exacerbating the pressures facing major economies as they deleverage.

Corporate executives, meanwhile, must learn to manage under continuing uncertainty. Business models that rely on low-cost debt will not be economically feasible, but companies with capital will find ample opportunities to expand market share or make new acquisitions. Consumer-facing businesses have already seen a shift in spending toward value-oriented goods, and this new pattern may persist until households repair their balance sheets. Scenario planning will be of the essence. It is encouraged for business leaders to develop a range of scenarios that reflect different degrees and speeds of deleveraging rather than predicate strategies on a single view of what might unfold.

As of this writing, the deleveraging process has barely begun. Each week brings news of another country or company straining under the burden of too much debt. Deleveraging is likely to be a significant component of the post-crisis recovery, and this will dampen growth. Nevertheless, by learning lessons from past experiences of deleveraging, today's policy makers and business leaders may be better placed to steer a course through these challenging waters.

For the full report, see *Debt and deleveraging: The global credit bubble and its economic consequences*, McKinsey Global Institute, January 2010, available free of charge on mckinsey.com/mgi.

It may be noted that throughout this article, debt refers to the outstanding amount of debt, which was compared across countries by measuring it relative to GDP. Leverage, referring to debt relative to assets or income, is measured differently and often in sector-specific ways.

Also, many countries beyond the 14 large ones in the sample increased their borrowing in the years prior to the crisis, amassing large debts relative to GDP. For small economies—particularly those, such as Iceland and Ireland, that tried to build international financial hubs—the results were dramatic.

Source: McKinsey Global Institute, January 2010

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OECD Science, Technology & Industry Scorecard 2009

The OECD Science, Technology and Industry Scoreboard 2009 explores recent developments in matters relating to innovation, science, technology and globalisation. In this regard, it compares characteristics of OECD member and major non-member economies and provides information on the economic crisis and other global challenges.

Major findings include:

- Historical data show that research and development (R&D) and venture capital are among the first expenditures to be cut during recessions in OECD countries. Preliminary data confirm this finding for the first half of 2009.
- Foreign direct investment (FDI) inflows to G7 countries dropped by 15% in 2008 owing to the economic crisis, a trend that continued in 2009. As foreign affiliates provide access to new technologies and generate knowledge spillovers for domestic firms, lower inflows of FDI will reduce innovation capabilities in the host country.
- Patents in renewable energy and air pollution control are the most dynamic groups of environmental technologies. Over 1996-2006, they increased more rapidly than total patents filed under the Patent Co-operation Treaty (PCT).
- The United States accounted for over 42% of pharmaceutical patents in the mid-2000s; China and India together for nearly 5%. A decline in productivity of the pharmaceutical sector has been evident since the mid-1990s.
- A decrease in biotechnology patents has been observed in some countries in recent years in relation to the more stringent criteria on the patenting of genetic inventions.

- Inventive activities in nanotechnology have risen substantially since the end of the 1990s but the share of nanotechnology in total patenting remains just above 1% on average. Singapore is the country most specialised in nanotechnology.
- Business is an important source of funding for R&D performed in the higher education and government sectors, with an OECD-area average of 5.3% in 2006.
- High-technology goods have been among the most dynamic components of international trade over the last decade. In 2007 high- and medium-high-technology manufactures accounted for 23% and 39%, respectively, of total manufacturing trade.
- Information and communication technology (ICT) goods and services have been among the most dynamic components of international trade over the last decade. But the share of OECD countries in total world ICT trade decreased from 75% in 1997 to 52% in 2007 with the rapid rise in trade from non-OECD Asian economies.
- Patent data show a significant degree of internationalisation of research activities. On average, over 15% of the patents filed by an OECD country in 2004-06 under the Patent Co-operation Treaty concerned inventions made abroad.
- International co-authorship has also been growing fast. In 2007, 21.9% of scientific articles involved international co-authorship, a figure three times higher than in 1985.
- The number of foreign students within the OECD area has tripled since 1980, and doubled between 2000 and 2006. The United States hosted the largest foreign doctoral population, with more than 92 000 students from abroad, followed by the United Kingdom (38 000) and France (28 000).
- Emerging countries are expanding their first-stage university system. Graduation rates in Russia (45%) are significantly above the EU average. In China the number of graduates has almost tripled since 2000, although the graduation rate (12%) is still low compared to the OECD average.
- Between 1998 and 2007, employment of tertiary-level graduates rose on average almost three times faster than total employment. Overall, 35% of persons employed in the OECD area had a tertiary-level degree in 2007.

Source: www.oecd.org, December 2009

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What CIOs Get Wrong About Emerging Technology

Harvard Business Professor, Clayton Christensen discusses how groundbreaking innovations such as cloud computing, Google's Android operating system and mobile telecom are disrupting the information technology sector today and forever changing the role of the CIO

What about the CIO role do you think is changing?

I don't think we've seen significant enough change. But in the next five years, it will be very dramatic. Interesting disruptions loom, such as cloud computing, Google's Android operating system and mobile telecom.

Cloud computing—any computing over the Internet—just isn't as good as enterprise computing. It's not as secure, not as fast, not as reliable as your internal network.

But like all disruptions, it's getting bigger and better. As it does, it pulls applications, one by one, out of the corporate network into its world. CIOs have to manage that.

In the past, the CIO's role has been deciding what services and what software he is going to make available to the users of his network. As users source more of what they use from the Internet, they will use applications more on an as-needed basis.

The CIO's role must be to help people find what they need on the Internet and create security systems to be sure the corporation is not compromised.

Can't CIOs just block these applications?

Not really. Look at e-mail. E-mail is increasingly done on BlackBerrys rather than on laptops and in airports rather than at the office.

That's just the first manifestation of individuals choosing to use one platform versus another and it's very hard to stop. Others are deciding to use Google Docs, not Microsoft Word.

Should we still be talking about business-IT alignment?

Unfortunately, we're not beyond it yet, but it's a problem with all management, not just CIOs. Executives conceive of their markets incorrectly.

Most companies developing a new product know they can't make something that does everything for everyone. So they develop a product to target a segment of the market. Forty-five-to 65-year-old males with college degrees. Middle-income females with kids.

CIOs try to define the average need of all the customers—the users—in a particular department. But the average customer doesn't exist.

What should they be doing?

The customer is actually the wrong unit of analysis. It's the job that the customer is trying to accomplish that's the correct unit.

Understanding the job connects your development efforts with what causes the consumer to purchase and the user to adopt. The job is like true north for CIOs.

When you nail a job with your system, competitors have a very hard time copying you.

Every CEO wants to make money for his company. They want to be smart and maybe cool. They want to be Steve Jobs. What do CIOs want to be?

Deep down in my heart, I know CIOs want to make people happy. They want to make their customers as effective in doing their jobs as they possibly can. When you see them offering technology for technology's sake, or see their customers having to do workarounds because the data doesn't come at them in a way that helps, it's because the CIOs have thought of their world by product category. "We need to upgrade the ERP system." Not "We need to find a new way to coordinate this information to help this person do his job."

I'm surprised to hear CIOs still talking about how they can get a seat at the table. Do they have an inferiority complex?

When CIOs are not pulled by fellow C-level executives to the table, it's because CIOs have framed their mission by product or customer category. Not by this idea of doing jobs well.

Source: CIO.com, February 2010

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Interview on Trends in Outsourcing Contracts

Morrison & Foerster's Global Sourcing Group (over 60 outsourcing lawyers located in the U.S., Europe, and Asia) annually publishes a report on the state of the worldwide outsourcing market and the forces likely to shape outsourcing for the coming 12 months. The 2010 edition of Morrison & Foerster's **Global Sourcing Trends** includes predictions about several contractual aspects of outsourcing. An interview with Julian S. Millstein, Senior Counsellor at M&F, New York, for further insights about several of those predictions:

Your firm's Global Sourcing Trends report predicts shorter deal cycles and companies trying to close deals quickly during 2010. Doesn't this often lead to contracts that are not as comprehensive and precise as necessary, which eventually have to be renegotiated?

JSM: Shorter deal cycles increase risk of failure to reach agreement on key issues. But lengthening the cycle does not necessarily yield incremental gains worth waiting for. Determining the amount of information to put into an outsourcing contract is both an art and a science.

On the one hand, it is extremely important to define an accurate "baseline" of scope, cost, and performance so that, among other things, the benefits of the outsourcing relationship can be measured and understood. On the other hand, it is virtually impossible to capture a totally accurate baseline at any given time - usually because information is not available or the business

is in flux. So usually the parties must come to grips with a certain amount of missing data and must contractually agree on how to address resulting problems. And the truth is, no matter how well the baseline is captured, it is always changing for many reasons other than the process of outsourcing.

What are some risk mitigation strategies when developing a contract quickly?

JSM: If the circumstances are such that the parties wish to get the ball rolling before amassing a critical amount of accurate data, the contract should be structured so that a party has the flexibility, after trying to resolve issues in a specifically defined mutual process, to terminate within a relatively short period if facts develop that make the deal unfeasible for it. In effect, this documents that the parties recognize further work needs to be done, and they have expressly provided a process to address the uncertainty.

Your trends report predicts an increase in 2010 in the trend of do-it-yourself (DIY) sourcing by internal teams rather than using consultant/advisory firms in implementing an outsourcing arrangement. Are there significant risks in following this trend?

JSM: DIY outsourcing by inexperienced customers has many risks. The top five are:

- Failure to understand the complexity of the outsourcing relationship
- Failure to pay attention to capturing an accurate baseline
- Thinking that short-term cost reduction alone will yield satisfactory results
- Counting on the provider to fix everything that's broken
- Lack of recognition of continued need to be involved with and manage the outsourced function with people who are qualified to do so

And there is no quick fix for this. If buyers do not have experienced advisors, they'd better study their Outsourcing Journals and the other sources of available knowledge - and hope they are "quick studies" at that.

Of course, governance is always critical to successful outsourcing. But the report states that governance will be a crucial issue in 2010 because of multisourcing. Is it best to include the multisourcing aspects within the overall outsourcing agreement, or should there be a separate agreement regarding these aspects?

JSM: Multisourcing has various guises. There are certain "multisourcing" clauses that belong inside every contract simply because the customer may choose to multisource in the future and needs to have the provider's cooperation if and when that happens.

More formal multisourcing processes, with joint steering committees and other formal reporting and process mechanisms, may best be structured outside of any individual provider's agreement. This is dependent primarily on how the relationships are to be managed.

The key is not so much the documentation of the process, as the selection, staffing, and executive buy-in to the process by all parties. If the process is set forth in an agreement that all providers sign on to, then the details of each provider's specific agreements should be captured separately.

The report predicts that many of the 2009/10 deals will run into problems because of their short-term, cost-savings approach rather than a longer-term approach. I assume the biggest problem arising from this approach would be that the service provider will not focus on adding any value

beyond cost savings and thus also will not be flexible to new needs that arise. Are there other, bigger problems from a short-term approach?

JSM: Those are the two biggest problems. Also, it is usually not as easy as parties think to extract themselves from short-term arrangements, especially when in the haste to contract they may have not focused on obtaining the best protections during wind-down of the deal.

What do you recommend as a strategy to avoid these problems?

JSM: For every deal, whether short or long term, there is no substitute for active evaluation of the delivery of value, including taking periodic surveys to assure the deal is meeting the customer's changing needs.

Source: Outsourcing-Center.com, February 2010

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Events

Shared Services & Outsourcing Summit

Feb 8-10th

London, UK

NASSCOM's India Leadership Forum

Feb 9-11th

Mumbai, India

The International Outsourcing Forum

Feb 11-14th

London, UK

SIG Global Sourcing Summit

March 30 - April 1, 2010

Savannah, Georgia, USA

Cloud Computing- an IT Paradigm Shift Conference

co-located with- IT360° conference and Asterisk & Open Telephony conference

April 7, 2010

MTCC, Toronto

Gartner's Outsourcing & vendor management Summit 2010

September 14-16, 2010

Marriot World Center, Orlando, Florida

October 17 – 21, 2010

Orlando, Florida

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Books and Reports

Accelerating Out of the Great Recession: How to Win in a Slow-Growth Economy

-----Published February 2010

Many of the business leaders who gathered for the annual World Economic Forum in Davos need to build stronger links with politicians and state officials as governments strive to reassert power and influence over the corporate world, according to a study by The Boston Consulting Group (BCG).

The authors of a new book, which identifies the strategies companies should deploy to accelerate out of the "Great Recession," warn that chief executives "ignore politics at their peril." Chief executives have "little choice" but to get closer to governments amid a slowdown in the 30-year trend toward economic deregulation, privatization, and trade liberalization.

David Rhodes and Daniel Stelter, senior partners at The Boston Consulting Group, argue that a deep understanding of politics will become an essential feature of a new managerial mindset for the post-recession era. Business leaders will need to influence government policy even more than they do today, anticipate (and thereby benefit from) government spending plans aimed at revitalizing struggling economies, and help shape government views on regulation. But many businesses have not yet engaged sufficiently with governments.

In a survey of major companies for their book, the authors found that business executives expect the rising tide of government intervention to act as a brake on growth and the global economy.

Executives at more than 400 companies with revenues greater than \$1 billion were surveyed, with the following findings:

- 81 percent expect an increase in government regulation
- 81 percent believe that regulation will be a restraint on growth
- 75 percent expect an increase in trade and financial protectionism
- 71 percent expect an increase in labor protectionist measures

-- 64 percent believe that growth will be more difficult

The BCG partners contend that the relationship between businesses and governments will be critical to agreeing on policy solutions that stimulate sustainable economic growth.

According to Rhodes, "In the future, a chief executive's decisions will not just be based on business criteria. They will have to take into account what government wants -- or, in some cases, demands. Clearly, executives should focus on what they know best: growing their businesses in difficult circumstances. But they ignore politics at their peril. Company leaders need to learn politics well and lobby hard."

"In a world in which long-term fiscal and monetary stimulus policies become the norm, businesses will have to become even closer to government -- either through lobbying or by anticipating where the government plans to spend money," added Stelter. "This is not good for the long-term health of business or the economy. But business has little choice."

Source: Boston Consulting Group, January 2010

The China Strategy: harnessing the power of world's fastest growing economy- Edward Tse

Here, for the first time, Booz China Managing Director Edward Tse parses the Chinese landscape, walking the reader through the Chinese business environment, the effects of Chinese economic power on worldwide business, and how the two mesh and interact. The China Strategy is the only book you'll need to do business in China, with China, or in competition against China.

About the Author

Edward Tse is Booz & Company's Managing Director for Greater China, with more than twenty years of management consulting and senior corporate management experience. He has also worked with the World Bank, the Asian Development Bank, and the Chinese government. He lives in Hong Kong and Shanghai.

Global Risk Report 2010- World Economic Forum

Published January 2010. The result of extensive input throughout the previous year by experts from business, academia, and the public sector, Global Risks 2010 highlights a number of slow-moving risks exacerbated by the financial crisis and global economic downturn, and stresses the continued need to further enhance global resilience to risks. Global governance gaps, an issue already to the fore in Global Risks 2009, continues to be at the nexus of global risks and the need for coordinated global action is increasingly urgent.

Fiscal crises and unemployment, underinvestment in infrastructure and chronic disease are identified as the pivotal areas of risk over the next years. At the same time, the Report warns that there are also a number of risks to keep on the radar, including the economic and social costs of transnational crime and corruption, biodiversity losses and risks to critical systems from cyber vulnerability.

<http://www.weforum.org/pdf/globalrisk/globalrisks2010.pdf>

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