DESTINATION excellence INC.

Gaining a Competitive Advantage

Offshore and Near-Shore Outsourcing

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EXECUTIVE SUMMARY

In its white paper, "Gaining a Competitive Advantage, Outsourcing v Insourcing," Destination Excellence looked at the critical factors that make outsourcing advantageous for some companies and not for others. This white paper is targeted to those companies who are either already outsourcing their contact center activities, and are considering the benefits of contracting with near-shore (Canada, Mexico) companies or offshore (India, Philippines, Panama) companies.

Outsourcing in itself is neither a good or bad decision, but is one that must be made to fit the particular circumstances and needs of a company. Likewise, outsourcing outside of the U.S. is not a "one-size-fits-all" solution. The benefits and pitfalls of outsourcing offshore or near-shore will be determined on the specific needs, applications and capabilities of the client in relation to those of the outsource company. The purpose of this white paper is to help companies that are currently outsourcing or planning to outsource determine if near-shore or offshore outsourcing is right for them. Key issues discussed include:

- **The Offshore and Near-Shore Outsourcing Market.** The Offshore and Near-Shore outsourcing market has recently become prominent in the industry with more than 10% of contact center outsourcing being conducted outside of the United States. This section will review the factors that will drive Offshore and Near-Shore outsourcing in the next two decades and what this means for companies looking to outsource.

- **Offshore and Near-Shore Applications.** Each geographical area outside of the U.S. has strengths and weaknesses that must be understood. Understanding the capabilities within the cultures of other countries will help companies align the needs of their programs with the appropriate skill sets. This section will look at various inbound and outbound applications and their fit with various geographical territories.

- **Selecting an Offshore or Near-Shore Partner.** Developing a long-term partnership with any outsource group, either in the U.S. or outside the U.S., must be done with great care. Excellent long-term partnerships can raise the quality of service and reduce the cost of business to companies. The wrong partnership can have the opposite effect. This section will review how to select the right Offshore and Near-Shore outsource partner.

- **The Future of the Offshore and Near-Shore Market.** Many companies are concerned that Offshore and Near-Shore outsourcing may be a fad with a short life cycle. This section will look at what will drive the Offshore and Near-Shore outsource market and how it will grow over the next two decades.

Destination Excellence offers our white papers to clients and prospects of the company without charge. We do this with the hopes that you will discover the value in partnering with Destination Excellence in your business. Clients of Destination Excellence have achieved significant cost savings and service improvements providing them with a competitive advantage in their respective industries. Additional white papers and newsletters are available by visiting our web site at **www.destex.com**.

If you have any questions regarding this white paper, or the services offered by Destination Excellence, please feel free to call us at **877-4DESTEX (877-433-7839)**, e-mail us at **info@destex.com**, or visit our web site at **www.destex.com**.

THE OFFSHORE AND NEAR-SHORE OUTSOURCING MARKET

In the early 1990s, outsourcing outside of the United States was unusual, and used to address specific and unique skill sets. The two primary applications included out-of-hours coverage and non-English language applications. Offshore (U.S. calls handled in Europe, Asia, Australia and South America) and near-shore (U.S. calls handled in Canada, Mexico and the Caribbean) outsourcing barely existed.

The primary impediment to outsourcing outside of the United States at the time was primarily telecommunications costs. Calls between the United States and Canada, where the most competitive telecommunications rates existed, cost as much as five times that of calls within the United States. Other countries required dedicated high-speed access lines to reduce telecommunication costs. However, the cost of these links was high. Countries that had a telecommunications infrastructure to support contact center quality requirements often had high wage and benefits costs. Countries with competitive wage and benefit costs did not have the telecommunications infrastructure necessary for contact center applications.

Significant changes, however, occurred in the latter part of the 1990s. First, telecommunications costs and tariffs plummeted. Artificial barriers created by high tariffs were removed as toll-free traffic costs and dedicated high-speed line costs fell. The telecommunications cost of transferring calls outside the U.S. became only marginally higher than the telecommunications costs of handling calls within the U.S.

Second, some countries built their telecommunications infrastructure to accommodate the requirements of the contact center market. In the early and mid-1990s, it was Ireland that boasted having U.S. network quality in order to attract U.S. and European business. Later, India and the Philippines became countries that made significant infrastructure investments to meet the market requirements. Other countries continue to follow suit to provide the telecommunications technological basis to support the contact center market.

Third, the economics of outsourcing outside the U.S. changed. The U.S. labor market felt the wage pressure in contact centers with the average wage increasing 50% or more during the 1990s. And, while labor costs increased well above inflation, the quality of the agents was declining. Outside the U.S. in Canada, the Canadian dollar fell relative to the U.S. dollar, by approximately 35%. U.S. companies could now transfer calls to Canada at little additional cost and save significantly on labor costs while increasing the quality of labor. India, whose wages can be as little as 10% of the U.S. invested heavily in an already educated workforce to neutralize regional accents to be more compatible with the U.S. For Spanish calls, which normally demanded a premium in the U.S., Mexican companies were poised to provide U.S. quality support at significantly reduced prices.

The Contact Center Outsourcing Market

The future of the customer contact outsourcing market is detailed in Destination Excellence's "Gaining a Competitive Advantage" series white paper, "Insourcing v Outsourcing." The highlights of information from that white paper will be provided here. Readers may obtain a copy of the "Insourcing v Outsourcing" white paper by visiting Destination Excellence's web site at www.destex.com.

The customer contact market as a whole saw tremendous growth in the 1990s as businesses began to utilize contact centers more in an effort to reach their market and as a cost-effective strategy to replace most costly sales and service avenues. In addition, the economic growth during this period offered advantages to companies who could tap into the potential of their market by reaching prospective customers, often through the use of contact centers. The strong growth of the early and mid-1990s slowed significantly in the late 1990s and early 2000s primarily due to two influences.

First, the telecommunications market, the largest business segment utilizing customer contact operations, saw a dramatic decline in the late 1990s due to various financial issues in that industry. The unbridled addition of long distance and high-speed backbone capacity drove prices down significantly causing these companies to cut costs. In addition, the financial practices of companies, such as WorldCom and Global Crossing, suppressed the telecommunications market thereby reducing the need for customer contact applications. The result was significantly less customer contact projects and applications within the industry.

Second, the overall economy in the United States in the early 2000s softened significantly, led by a sharp decline in Internet and Internet-related companies. These Internet companies, who relied heavily on customer contact operations in lieu of field sales and service, dramatically cut back on customer contact costs. Other companies, as sales declined being impacted by the soft economy, also cut back.

While these two factors rapidly brought the customer contact industry to a point of maturity, technology will be the leading factor that will bring the market to a period of decline. While the overall transactions in the customer contact market will increase equal to or slightly above the growth in GDP, the mix of those transactions will change.

Contact center transactions remain heavily dependent on calls, which make up about 90% of transactions. The total number of transactions will increase slightly above the growth of consumers. However, technology and demographic changes are likely to significantly change this mix over the next decade. As the number of electronic (versus telephonic) transactions increase in number and proportion, the total revenue of the sector will decrease. This decrease will be driven by the initial lower cost of electronic transactions and the continuing decline of these costs as technology increases their efficiency.

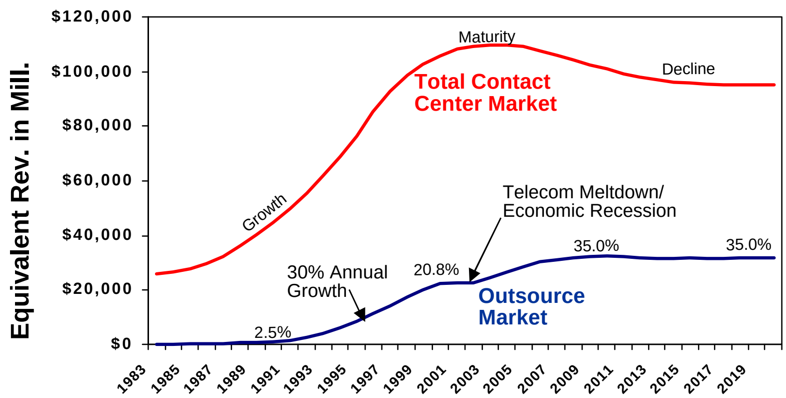
Consumer technology applications will provide consumers with more efficient, flexible and easy to use electronic message applications. Increased bandwidth, wireless communications and mobile devices will provide consumers with more options in electronic transactions. As younger, more technically savvy consumers mature, electronic messaging will increase in use.

While the overall customer contact market will decline, the outsource market will continue to increase, although more slowly than in the 1990s. The growth of the outsource market in the 1990s averaged 30% for the outsource market driven by the overall increase in the market and the increased penetration of outsourcing. The growth flattened from 2000-2003 due to the impact of the telecommunications sector and the general economic conditions in the U.S. as outlined previously.

Starting in late 2003, outsourcing will begin to increase its penetration in the customer contact market as companies look for ways to reduce costs. The outsourcing of customer contact applications by companies will be driven by the availability of qualified staff, the cost of labor, the cost of technology and the consistent ability of outsource operations to meet or exceed internal quality standards. The focus on cost reduction will provide a major impetus for offshore and near-shore outsourcing.

The following chart provides a graphical view of the growth of the customer contact market as a whole and the outsourcing market segment.

Customer Contact Market



Source: 2003 Destination Excellence estimates

The Growth of Offshore and Near-Shore Outsourcing

Offshore and near-shore outsourcing has experienced dramatic changes in recent years. Companies who, five years ago, did not even consider outsourcing outside of the U.S. an option are now sending 25% of their volume into other parts of the world.

While there are clear economic reasons to outsource outside of the U.S., cost savings alone will never be sufficient. Customer contact quality must meet or exceed the minimum requirements of the client in order for outsourcing to be considered. To the benefit of offshore and near-shore companies, this has been clearly understood with specific actions taken to meet the quality gatekeeper requirements.

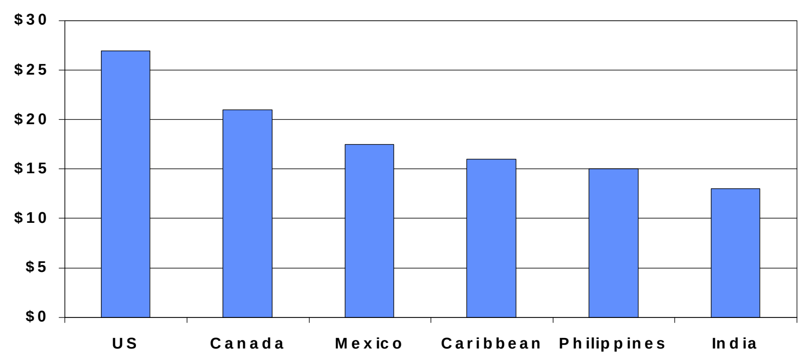
Outsourcers outside the U.S. understand that their operations must meet or exceed U.S. requirements in terms of training, technology and management. While labor is cheaper in the areas in which these companies operate, U.S. clients are accustomed to the convenience of CRM, ACDs, automated reports, monitoring and other technology that they expect in the outsource groups. In addition, U.S. clients clearly understand the benefits of enforcing a training regimen coupled with monitoring and other processes to ensure consistent and high quality.

Offshore and near-shore outsourcers will often benchmark themselves against U.S. based call centers to see that their technology, people and processes are complete and competitive. Many of these groups hire executives and managers from the U.S. (either citizens or expatriates who have worked in U.S. contact centers) to oversee the installation of facilities and management of the operations. The advantage here is that clients from the U.S. feel that the outsourcers has experience with and understands their requirements.

With this focus, outsource groups outside the U.S. have made some significant inroads. From 1990, when less than 1% of outsourcing was done outside the U.S., the penetration of outsource groups exceeded 12% by 2000. While cost and quality were the foundation of these gains, the same factors that worked to depress the overall outsource market in 2000-2003 worked in the offshore and near-shore outsourcers' favor. As clients became more pressed for profits, they became more willing to look at alternatives to outsourcing. The perspective of alternatives gave these outsourcers an entry into the bidding process that was previously unavailable to them. The result was that U.S. outsource groups saw a decline in volume during this period while offshore and near-shore outsourcers saw a significant increase in volume.

As the overall outsource market grows with the increased penetration of outsourcing, the greatest growth will be in the offshore and near-shore outsource market. After recovering from the 2000-2003 decline, U.S. based contact center outsourcers will again see a short period of volume increases. But this growth will be cut short by the increased penetration of the outsourcers outside of the U.S. As companies become more accustomed to outsourcing outside the U.S., the offshore and near-shore pricing will drive more business into these areas.

Outsourcing Cost-per-Hour



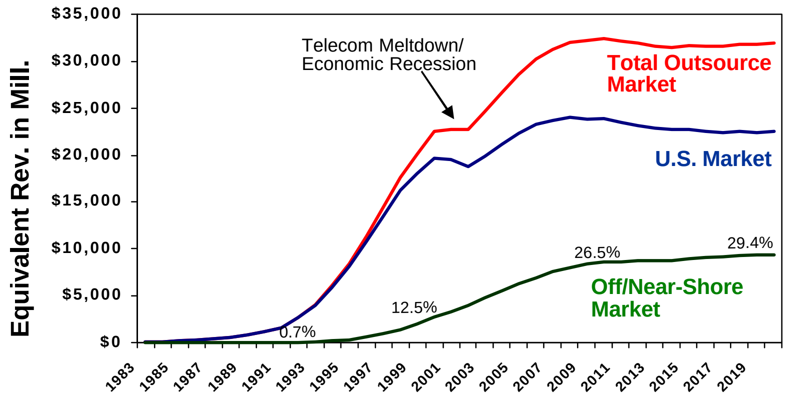
Source: 2002 Destination Excellence estimates

Two factors will limit the penetration of offshore and near-shore companies to roughly 30% of the outsource market. (Note that 30% is in terms of revenue. This amount represents approximately 45% of transactions.) The first factor is one of cost. While the production costs of outsourcers outside of the U.S. are lower, companies will factor in the cost of maintaining an overseas partnership into the total cost. Additional costs include the cost of travel as well as the cost of additional personnel that may be required due to a significant increase in travel time. (Clearly, these costs are less of a factor for near-shore outsourcers where such incremental costs are minimal.) While additional costs may not be a factor on large programs, where production savings are large, medium or small programs may see their total costs rise significantly.

The second factor is one of risk. Cultural differences, political stability, world conflict, anti-Americanism and lack of proximity may drive companies not to outsource offshore. While arguments can be made to minimize the likelihood of these risks, the fact remains that the impact of any of these events is huge. Some companies may not be willing to live with the consequences of those risks regardless of how much money can be saved.

The following provides a graphical illustration of the growth of the customer contact outsource market as well as the change in mix between U.S. outsourcing done within the U.S. and U.S. outsourcing that takes place outside of the U.S.

Outsource Customer Contact Market



Source: 2003 Destination Excellence estimates

IS OFFSHORE/NEAR-SHORE RIGHT FOR YOU?

Now that the trends and benefits of offshore and near-shore outsourcing have been reviewed, the key question for most companies is, "Is offshore and near-shore outsourcing right for me?" A white paper from the "Gaining a Competitive Advantage" series entitled "Insourcing v Outsourcing" reviews the question if outsourcing in general is right for a company. This section will review the issue of offshore and near-shore outsourcing after a company has decided to outsource some or all of their customer contact applications.

The following list of issues is included for companies to review before including offshore and near-shore groups in outsource plans. If companies are comfortable that they can achieve a positive position relative to the following issues, offshore or near-shore companies should be included in your outsource RFP:

- International comfort. The first question every company must ask is how comfortable are they in working with an overseas partner? Many U.S. based businesses continue to only do business in the U.S. and are unaware of cultural and business differences with other countries. Making contracts based on U.S. law and making payments in U.S. currency can reduce discomfort, and most vendors are more than willing to accommodate these requests. But the U.S. client must have a willingness to learn about the culture and business practices of an overseas partner to make the relationship work.
- Accent. Customers generally do not care about the location where their call is being answered. What they care about is the quality, friendliness and effectiveness of their interaction. While these same questions must be asked of a domestic outsource partner, offshore and near-shore companies carry the extra burden of accents. Most customers do not have an issue with a <u>slight</u> accent if the representative is <u>easily understood</u>. (Note that this is significantly different than twenty years ago when calls between the Northeastern U.S. and Southern U.S. could cause issues.) Make sure your customers have no issues with slight accents and that any vendor you select has trained its people on American English pronunciations. Heavy accents will likely be an issue on any program and will result in decreased customer satisfaction and hang-ups.
- Disaster recovery. While individual site disaster recovery is part of the vendor evaluation process, companies must be comfortable that they have a *country* disaster recovery plan. This would include cases where alternative sites are not available within a country due to a national disaster or issue. Companies must be able to re-route calls to other call centers on short notice so as not to impact their customers.
- Political Stability and Potential of War/Conflict. Particularly in these days, companies must be aware of regional issues that could impact their customers. Government overthrows, crackdowns, rebel insurgencies and aggressive neighbors can throw a country and its businesses into turmoil. While such issues are unthinkable in the U.S., companies must understand the political environment of potential partners and the likelihood of scenarios that may impact operations.
- Cost. Even with domestic outsource groups, costs should include travel and support expenses in order to manage the outsource partnership. Often these costs with domestic outsource companies are not significant. With offshore companies, this cost can be significantly higher and must be added into the cost equation. In general, programs over $1 million in annual operating costs will produce savings to amply cover incremental costs related to managing programs in offshore and near-shore vendors.

Once the above issues have been determined to not be an issue, the company should determine if a specific geographic area is better suited to their application. Due to various cultural differences, some areas of the world are better suited to handle certain types of calls. This chart is meant to be a general guide for companies as specific outsourcers may have been able to overcome skill shortages in their area. The following table provides an overview of what geographic areas are well suited for certain applications.

	Near-Shore			Offshore	
	Canada	Mexico/ S/C America	Caribbean	Philippines	India
Tier 3 Technical Support	X				X
Tier 2 Technical Support	X				X
Executive Complaints	X	X			
Tier 1 Help Desk	X	X	X	X	X
Consumer Affairs	X	X	X	X	
Inbound Service/Soft Sales	X	X	X	X	X
Inbound Sales	X	X			X
Outbound Sales	X				
Media Response	X	X	X	X	X
Customer Service	X	X	X	X	X
Billing Inquiries	X	X	X	X	X
Third Party Verification	X	X	X	X	X
Product/Service Tracking	X	X	X	X	X
Dealer Locator	X	X	X	X	X
Spanish/Bilingual Support		X	[1]	X	

[1] Spanish support in Spanish-speaking Caribbean countries, such as Puerto Rico, may be used if the dialect is acceptable to the customer base.

Of particular note in the above matrix is the Spanish Language support outside of the U.S. Approximately 5% of the U.S. population prefers Spanish as their primary language. The number of Spanish-speakers in the U.S. is expected to climb considerably in the next decade. Most companies recognize the opportunity to speak to customers in their preferred language and have established Spanish language groups. Until recently, most of these groups have been based in the U.S. However, the cost of staffing these groups is higher than English language support as bilingual reps require a premium for their skills. Business in countries such as Mexico (over 75% of all Spanish speakers in the U.S. come from Mexico), have seized the opportunity to provide Spanish and bilingual services at a higher quality and lower cost than their counterparts in the U.S. Clients are increasingly seizing placing Spanish calls outside the U.S.

Destination Excellence recommends companies evaluate offshore and near-shore vendors on the same three specific criteria as they would a U.S. vendor. The scales or bandings of each criterion should not be altered to give special consideration to geography. The approach provided will produce the best overall vendor selection for the company. (Please review “Insourcing v Outsourcing” in the “Gaining a Competitive Advantage” series for more detail on the evaluation process and the tools used for evaluation.) The criteria include:

- Quality. Recommended to be the most highly weighted criteria (normally 50% or more), quality reflects the ability of a vendor to produce consistently high levels of performance. To judge quality, Destination Excellence utilizes its 100-Point Audit to evaluate vendors (see Optimizing Customer Care Operations – The 100 Point Audit for specifics). Vendors receive a score based on a one to two-day audit of their operation.
- Cost. Vendors' submissions are also evaluated in terms of cost. Costs include start-up costs, ongoing costs and termination costs. Costs should be determined over the proposed lifetime of the partnership agreement. Costs may be factored by year to take into account the greater certainty in costs in the early years.
- Strategic Fit. For longer-term partnership agreements, an evaluation of vendors is necessary to determine if the direction and investments vendors plan to make are consistent with the needs of the company. For example, investments in integrated marketing databases may be important and therefore should receive consideration. While the strategic fit assessment is rarely the final determinant of the selected vendor, in cases where the current quality and cost are essentially the same between two vendors, a strategic fit assessment can help select the best long-term vendor.

The scoring of the offshore and near-shore vendors using this methodology will determine if offshore or near-shore outsourcing is right for you.

YOUR OFFSHORE/NEAR-SHORE PARTERSHIP

If you have selected an offshore or near-shore partner based on the information provided in this white paper, you have completed the following processes:

1. You have determined that outsourcing is a viable option for you.
2. You have determined that an offshore or near-shore option is appropriate for your business.
3. You have completed an RFP process with both U.S. based vendors as well as non-U.S. based vendors.
4. You have selected an offshore or near-shore vendor that provides the best overall value for your business.

Now that you have partner outside of the U.S., what should you do next? The real answer is nothing different than if they were here in the U.S. Destination Excellence recommends the following steps should be followed in managing your outsource partnership:

- **Make your expectations clear.** Everyone wants to perform well, but by what measure? As the client, you must set clear and quantitative expectations for the vendor, including operational metrics, specific timeframes and any potential penalties associated with non-performance.
- **Invest time, particularly in the beginning.** As a partnership, both companies are interested in mutual success. From implementation to start-up, the client company must be willing to invest significant time on-site to infuse their operating knowledge, wisdom and insights into the vendor. The vendor desires to provide the best possible operating results, but needs the client company to help it quickly climb the learning curve.
- **Maintain a constant stream of communications.** What location is to real estate, communication is to contact programs. Communication stops little problems from becoming big and allows market insight to be passed readily to where it will have the most benefit.
- **Watch the results.** Monitoring results on a daily, weekly and monthly basis is critical to optimizing results. The more quickly issues can be highlighted; the more quickly they can be resolved.
- **Remember to say thank you.** One thank you can go a long way. From the representative to the supervisor to the executive, a thank you is appreciated and reinforces the type of results and behavior you desire.
- **Leverage your outsource partnership.** Look beyond the current program and configuration for areas of opportunity. The vendor has access to technology, processes and ideas that will be helpful to your company. Actively seeking these opportunities will open up new avenues for success.

In reality, a good outsource partner is valuable to any company. If selected properly, the only difference between an off/near-shore partner and a U.S. partner is one of distance. Utilize your partnership effectively and it can become on of the most valuable business relationships you may have.

DESTINATION EXCELLENCE - YOUR COMPETITIVE ADVANTAGE

Excellence is more than a word – it's a destination.

During this period of rapid and often chaotic change, internal resources can be stretched beyond capacity. Many companies use industry professionals, to augment resources. Destination Excellence brings practical understanding with a history of success from both the utilities and telecommunications deregulatory environments. Our experienced professionals can assist you in achieving excellence by developing custom programs to maximize sales, improve customer service, decrease costs and ultimately, increase your profitability.

- **OUTSOURCING** – Destination Excellence understands that not all businesses require, or desire, to maintain their own call centers. Successful businesses focus on their own core competencies. Strategic partnerships with excellent outsourcing centers provide a company with professional customer contact, while freeing up valuable internal resources. Destination Excellence has helped companies place outsourced call center and e-center business, as both a partner and intermediary. Utilizing a proprietary 100-point call center audit, Destination Excellence has successfully placed over $10 million in call center business, and helped to create excellent, metric-driven long-term partnerships.

- **PROFIT/PROGRAM MANAGEMENT** - Whether your call center is internal or outsourced, the cost of doing business is interconnected with each area of your company. Destination Excellence has developed strategic business modeling for companies in a number of vertical markets: wireless, utilities, travel, financial and e-commerce to name a few. We will also assist you in minimizing your overall costs while increasing your service levels. The key is to correctly determine the factors that drive your business and optimize those performance factors.

- **OPERATIONS/TECHNOLOGY EVALUATION** – Destination Excellence has hands-on experience in call centers and with call center systems. Telecommunications services, ACDs, Manpower Planning Systems, and CRM systems are included in the array of call center technology experience found at Destination Excellence. Destination Excellence provides a three-dimensional analysis of not only the cost of new technologies, but also the return on investment to the call center. Our services also include user specification development, contract negotiation, vendor management and post-installation quality checks.

- **FORECASTING AND STAFFING** – Destination Excellence utilizes a proprietary set of call volume forecasts, customized to fit your individual needs. Based on specific call volume drivers that are unique to you, our call volume forecasts have been accurate to within 5% on a daily basis.

- **HIRING AND TRAINING** – Hiring the right person is a great beginning. The next step is to train them to achieve their best for themselves and the company in order to create an environment of excellence. Destination Excellence will help your company accomplish the following:
  - Identify the best tools to predict the success of people *before* you hire them.
  - Develop a comprehensive hiring program to maximize the potential success of everyone you hire.
  - Implement a new-hire training program to equip people to perform at their maximum potential.
  - Design ongoing training and communications systems to maintain the enthusiasm of your people throughout their career.

Contact Destination Excellence toll-free on 877-433-7839, or e-mail us at info@destex.com. You will be glad that you did.