



# Outsourcing: Croatian and world practice

## II. WIFI International Logistics Forum

**Roland Berger**  
Strategy Consultants

Zagreb, April 10, 2008

# Contents

# Page

<b>A. Outsourcing – Trends and challenges</b>	<b>3</b>
<b>B. Best-in-class outsourcing</b>	<b>14</b>
<b>C. Outsourcing in Croatia</b>	<b>21</b>

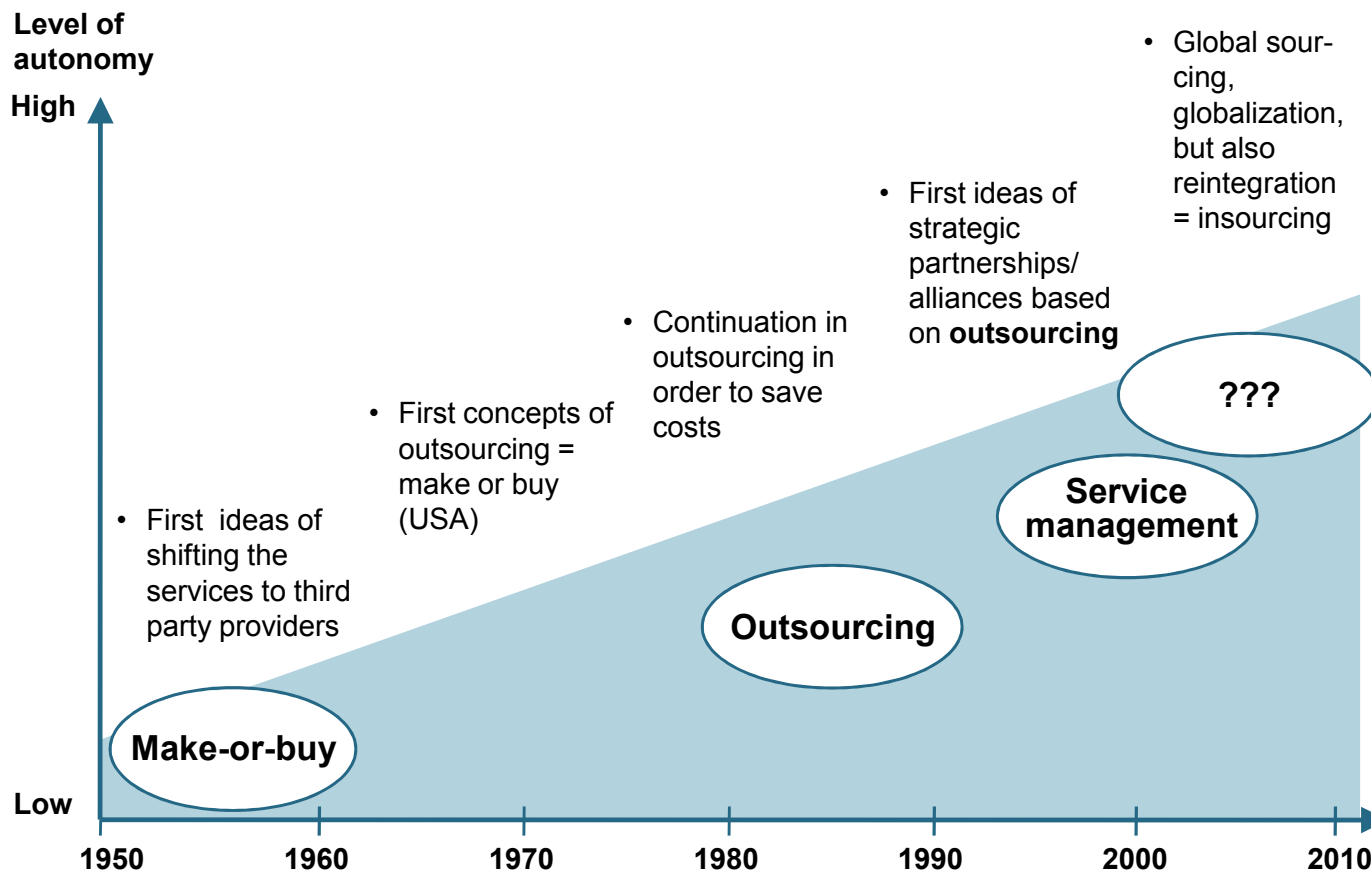


## A. Outsourcing – Trends and challenges

**Roland Berger**  
Strategy Consultants

# Concepts have experienced continuous development – From pure Make or Buy decision to Service management

## Development of outsourcing services

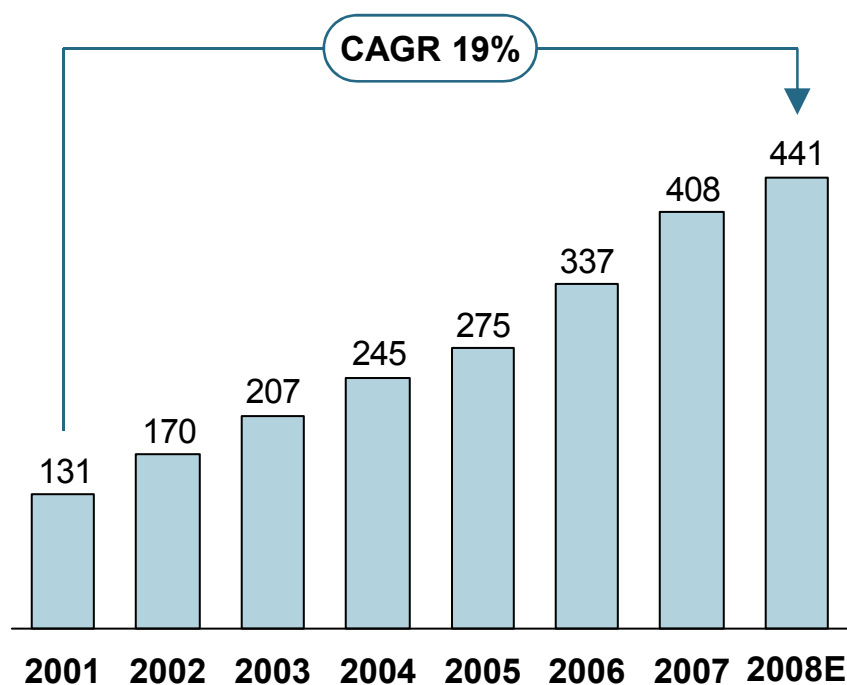


### KEY LEARNINGS

- Outsourcing = *Outside resources using*
- Benefits for the outsourcer
  - Focus on core business
  - Usage of external providers' favorable cost structures
  - Utilization of specialist know how
- Difficult to reverse due to its long-term strategic orientation

# The outsourcing market has been growing constantly – The volume of a particular deal dependent upon industry

Development of the outsourcing market worldwide [USD bn]



Business Deals in IT Outsourcing

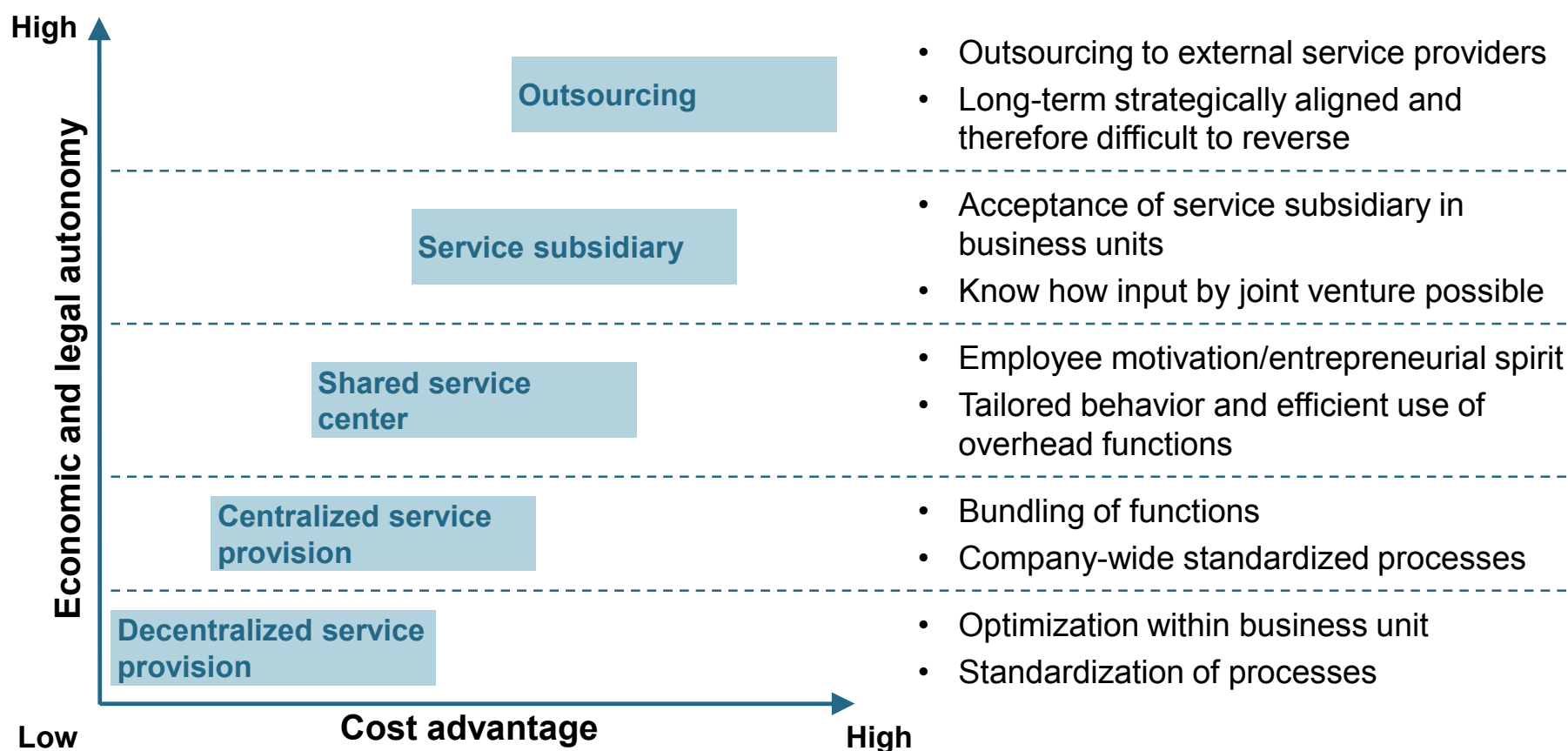
Customer	Volume [USD bn]	% of revenues	Out-sourcer	Year
General Motors	7.5	3.6	Multiple <sup>1)</sup>	2005
Navy	6.9	n.a.	EDS	2000
Fiat	6.0	11.6	IBM	2001
JP Morgan Chase	5.0	16.9	IBM	2002
Bank of America	4.5	12.8	EDS	2002
American Express	4.0	16.8	IBM	2002
Procter & Gamble	3.0	6.9	HP	2003
Deutsche Bank	2.8	12.1	IBM	2002
ABN Amro Bank	2.2	7.6	Multiple <sup>2)</sup>	2005

1) IBM, Accenture, Infosys, TCS

2) EDS (50%), IBM, France's Cap Gemini, HP, Compuware Covisint

# Expected benefits are heavily dependent on the chosen form of organization and level of autonomy

## Optimization levels



# Make or Buy decision generally has a strong impact on company's structure and organization

Outsourcing concepts in relation to the influencing factors

## Legal Form

- External outsourcing
- Internal outsourcing

## Location

- Nearshoring
- Offshoring

## Scope of activities

- Total outsourcing
- Partial/selective outsourcing
- Business process outsourcing

## Fulfillment Flow

- Outsourcing
- Insourcing

## Multitude of outsourcers

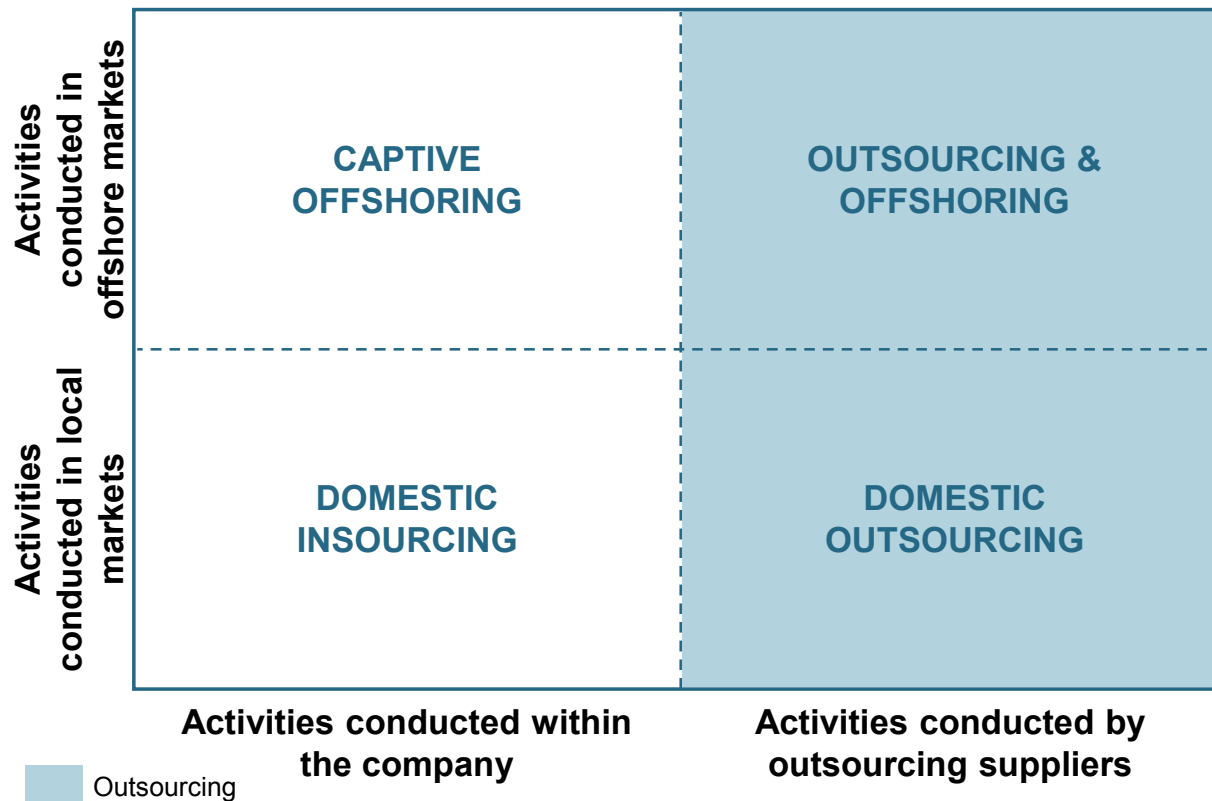
- Single sourcing
- Multi sourcing

- The term "outsourcing" is not clearly defined in general usage
- Some of the outsourcing concepts overlap with other organizational forms

Outsourcing is the organizational level with the highest economic and legal autonomy

# There is an overlap between outsourcing and offshoring – Clear borders to be defined

Relationship between outsourcing and offshoring



## KEY LEARNINGS

- Outsourcing = Giving service functions to external providers
- Offshoring = Shifting service functions to countries with low-cost structures
- Benefits of offshoring
  - Achievement of cost advantages (e.g. personnel costs)
  - High flexibility through different working hours (e.g. 24 - hours service)



# Make or Buy decision stems from both strategic and operational screenings

Key issues to be addressed in a Make or Buy decision

## Strategic Screening

**1** Is it core?

**2** Is it risky to outsource?

## Operational Screening

**3** Is it feasible internally?

**4** Is it cost effective internally?

MAKE

BUY

- Does the competency bring a competitive advantage?
- Could the supplier(s) develop a strong bargaining power?
- Are appropriate operational resources available?
- What is the current cost performance compared to supplier(s) offer?

## KEY LEARNINGS

- The Make or Buy analysis is strategic for a company as it enables to focus resources on core businesses
- The company decides to
  - Make – develop necessary competencies as well as ensure equipment ramp up and reliability
  - Buy – ensure technology transfers to suppliers and develop purchasing competencies

## Companies engage in outsourcing for a variety of good reasons – Fundamental risks and concerns to be considered

### Main advantages and disadvantages of outsourcing



- Focusing on core competencies
- Increasing the company's flexibility
- Raising efficiency
- Exploiting cost advantages



- Nonconforming provision of technological innovations
- Loss of technical know-how and efficiency
- Personal conflicts
- Financial losses due to depreciation of assets
- Complicated control mechanisms needed

# Outsourcing is a strategic step for companies as it enables to focus resources on core businesses

## Core and non-core businesses and functions

### Core business

---

- Management
- Research & Development
- Marketing
- Sales & Distribution
- Procurement
- Finance/Controlling

---

**MAKE**

### Non-core business

---

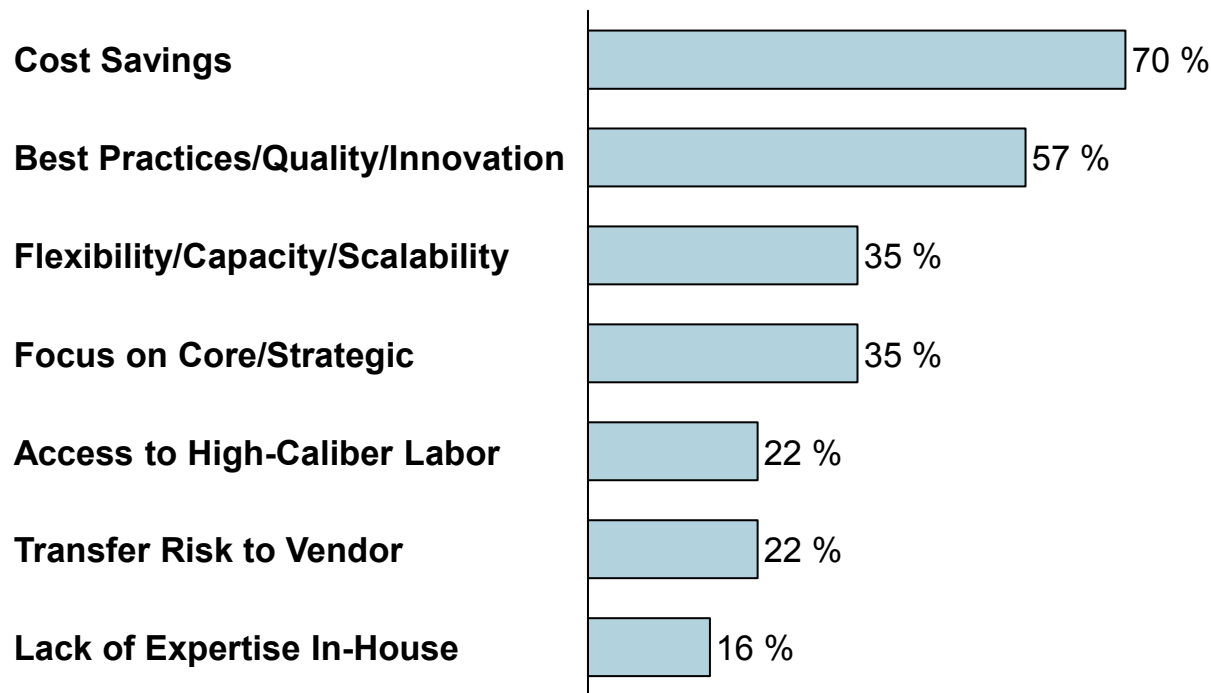
- IT
- Logistics, Transport, Fleet of vehicles
- Manufacturing
- Training, Education
- Purchasing
- Human Resources
- Call Center

---

**BUY**

# Cost savings represent the main incentive for outsourcing in the industry – Hidden costs often omitted

Major drivers in outsourcing decision making<sup>1)</sup>



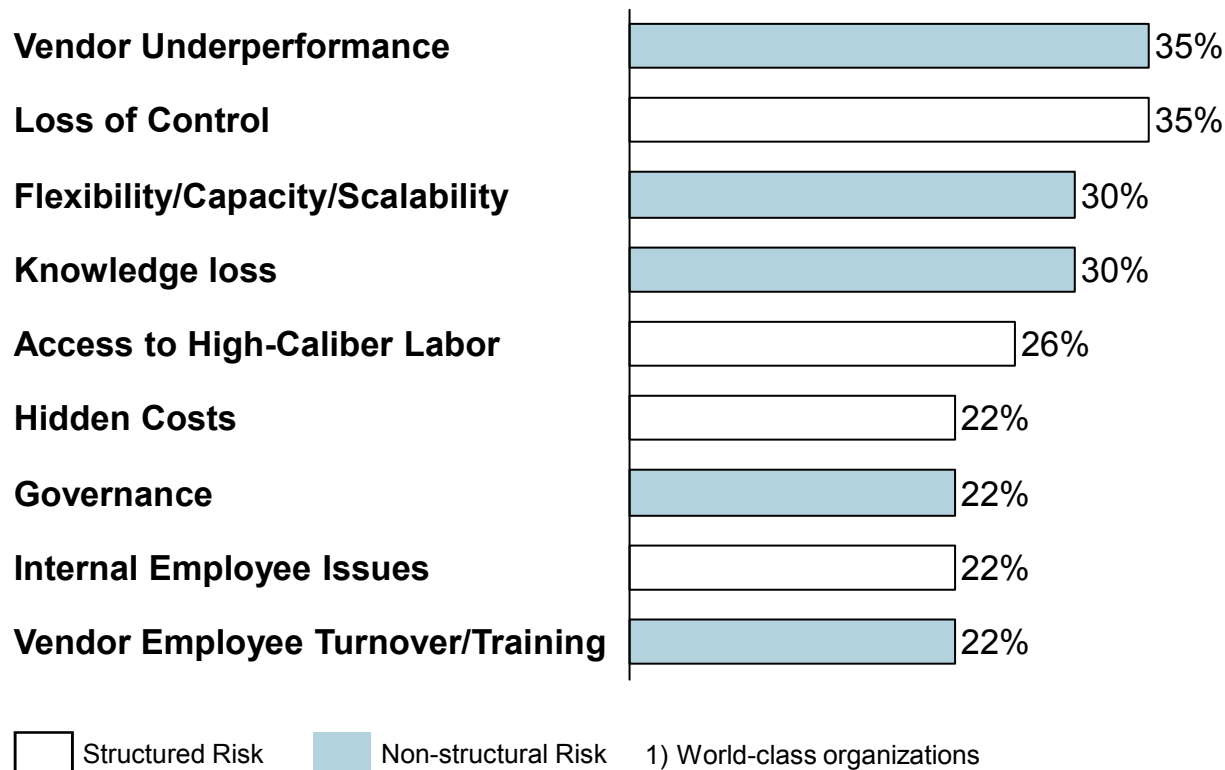
## KEY LEARNINGS

- Cost savings are the major driver in outsourcing decision making process
- But: Many companies don't consider additional/hidden costs for services they believe are included in their contracts
- Outsourcing leads to best practice adoption but vendors are often not forced to further develop it
- Expected flexibility is rather questionable as contracts are usually binding

1) World-class organizations

# Vendor underperformance and loss of control are perceived as the main threats in the outsourcing process

## Risks and concerns in outsourcing decision making



### KEY LEARNINGS

- Outsourcing without fully understanding the organization's processes and cost structure is extremely risky – What to demand and how much to pay?
- Many companies bring their functions back after realizing that they can do it better and/or at lower cost in-house



## B. Best-in-class outsourcing

**Roland Berger**  
Strategy Consultants

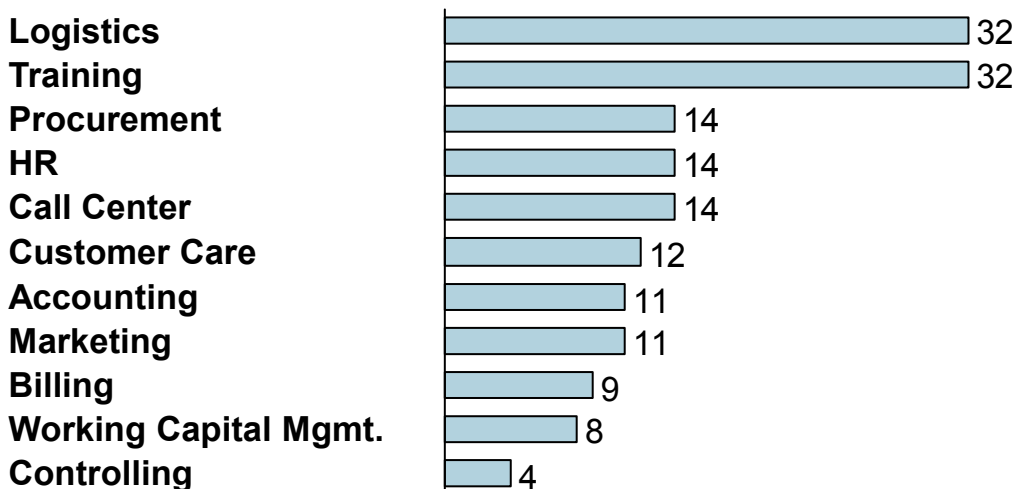
# IT industry shows by far the highest level of outsourcing, Logistics ranks first among functional sectors

## Outsourcing of business sectors<sup>1)</sup> – Overview

### Outsourcing engagements in IT sectors [%]



### Outsourcing engagements in functional sectors [%]



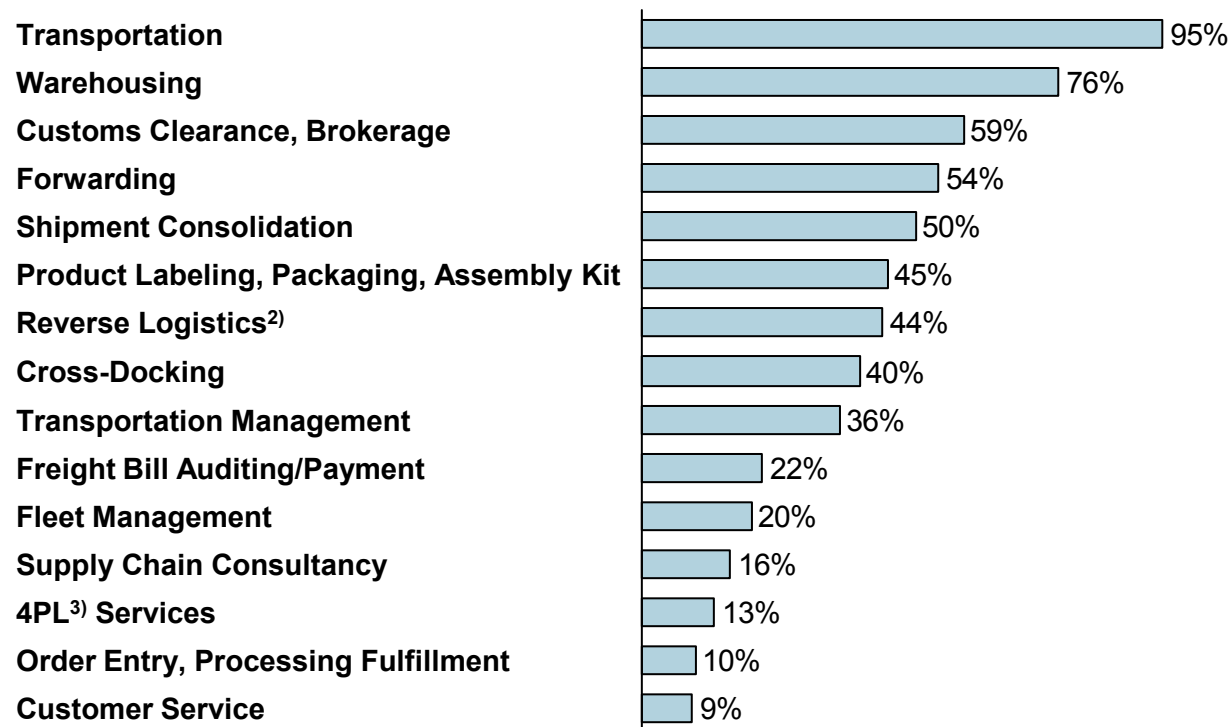
1) Germany, Austria, Switzerland

### KEY LEARNINGS

- In general, only non-core businesses are highly outsourced
- IT sector ranks first with regards to outsourcing
- All four IT sectors defined show a higher level of autonomy than the remaining sectors
- Logistics and Transportation together with Training and Education highly exceed other functional sectors

# Traditional logistics services such as transportation and warehousing belong to the most frequently outsourced

## Outsourced logistics services<sup>1)</sup> – Overview



1) Western Europe

2) Defective, Repair, Return

3) Fourth Party Logistics

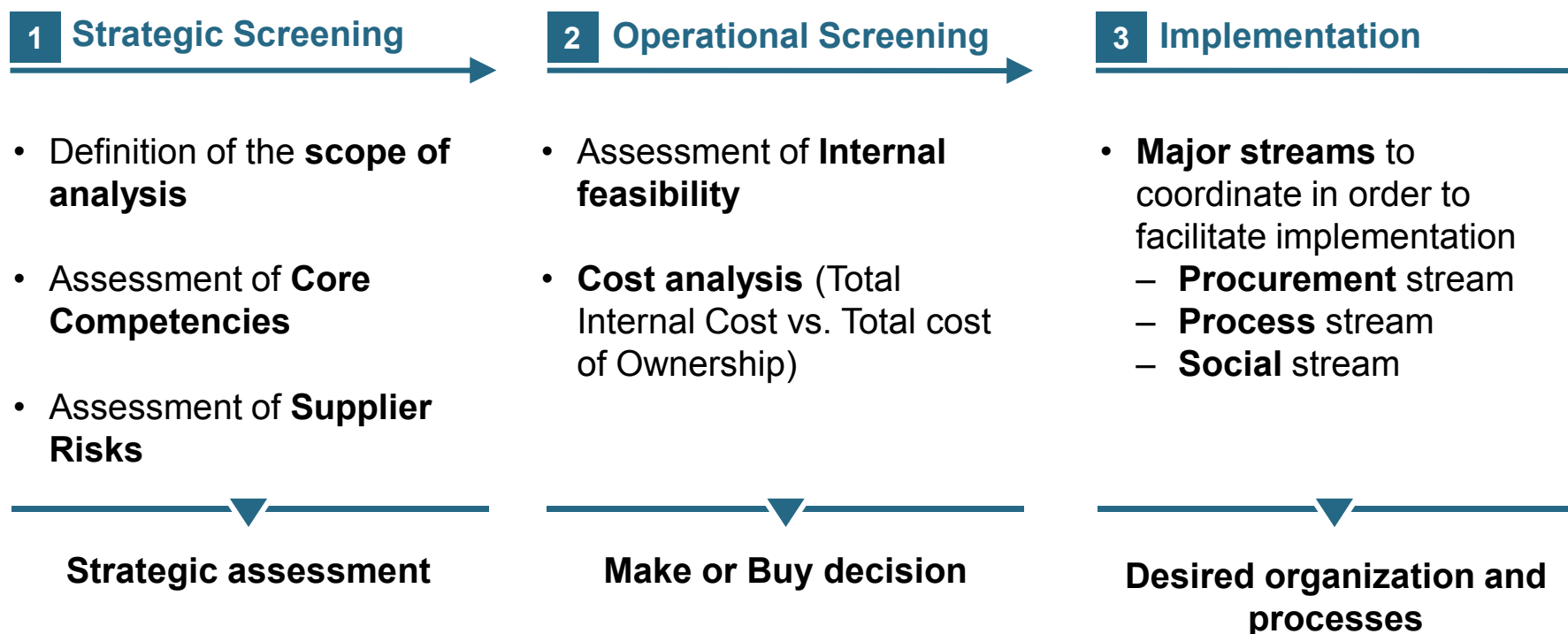
## KEY LEARNINGS

- Operational, transactional and repetitive logistics services, such as transportation and warehousing, are outsourced the most frequently
- The services outsourced less frequently tend to be customer-related, involve the use of IT, and are more strategic



# The overall Make or Buy decision process consists of three main steps

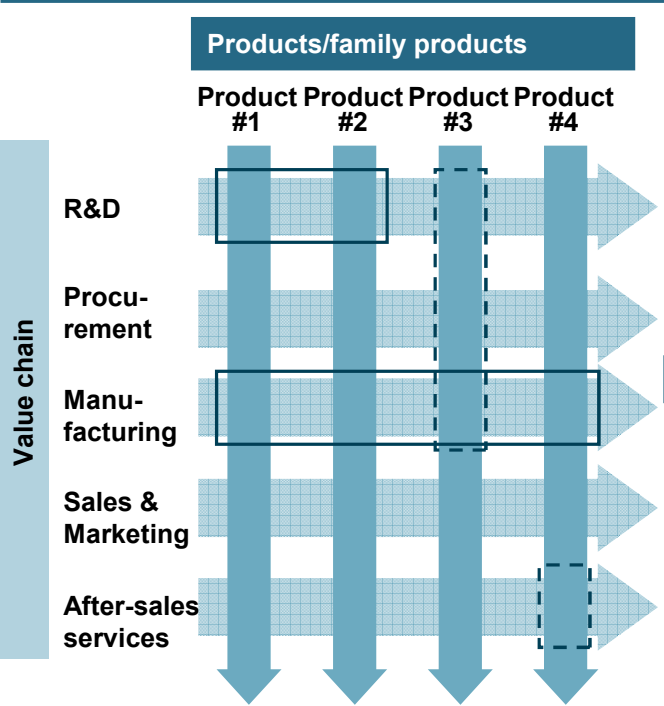
The outsourcing decision making process



# The Strategic screening is conducted according to "Corporate competency" and "Supplier risk" dimensions

## Strategic screening

### Definition of scope of analysis



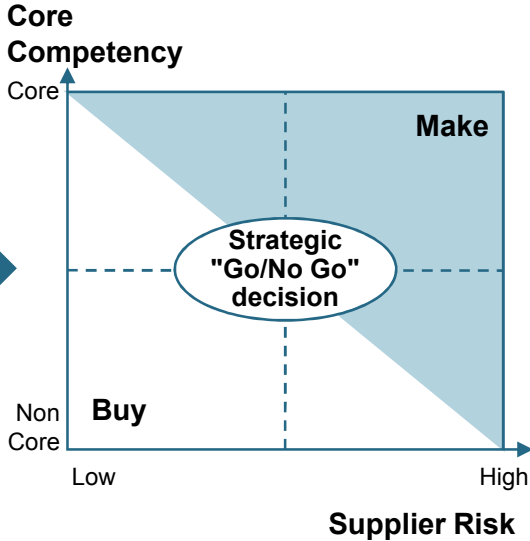
☐ Transversal scope    ☐ Vertical scope

### Assessment of core competencies

	Perfor- mance	Safety	Sustain- ability	Global assess- ment
Cand. 1	5	3	2	4
Cand. 2	5	5	3	5
...	...	...	...	...
Cand. n	2	2	3	1

### Assessment of supplier risks

	Comp. #1	Comp. #2	Comp. #n
Bargaining power sustainability	5	3	3
Risk of obsolescence	5	1	3
tbd	5	3	4
Global assessment	5	1	3



# The Operational screening is based on both "Internal feasibility" and "Cost effectiveness" dimensions

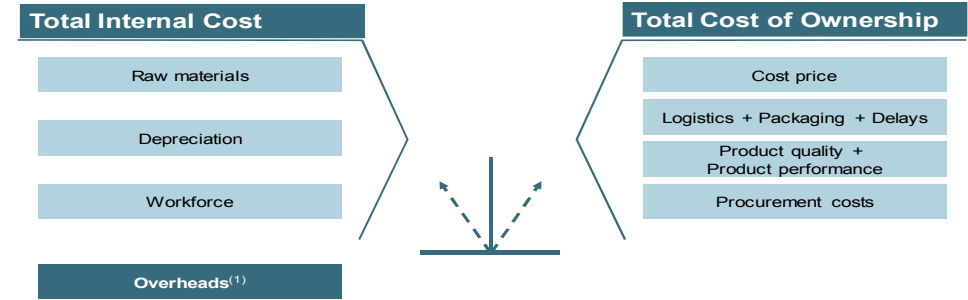
## Operational screening

### Assessment of internal feasibility

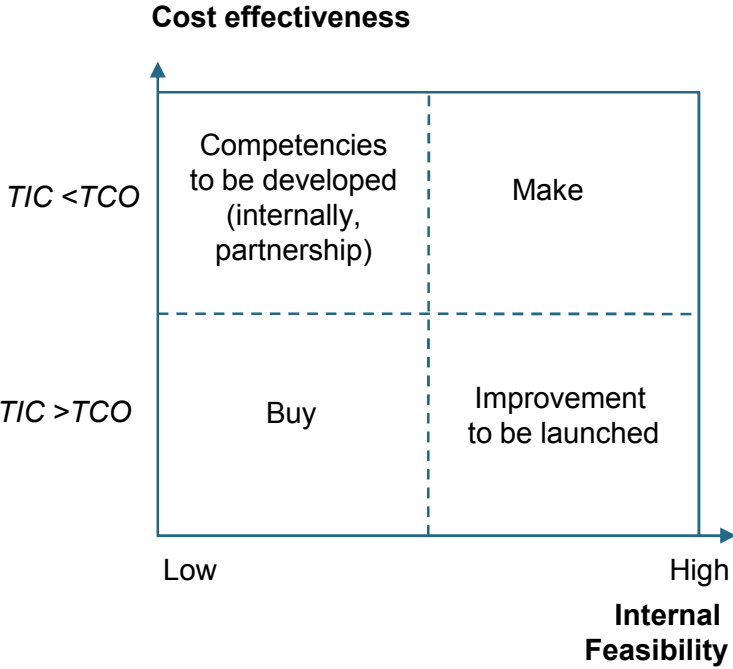
Criteria <sup>(1)</sup>	Comp. # 1	Comp. # 2	...	Comp. # n
• Criterion 1	5	3		3
• Criterion 2	5	2		3
• Criterion 3	5	1		3
• tbd	5	3		4
<b>Global assessment</b>	5	1		3

5 High 1 Low

### Analysis of cost effectiveness



(1) Overheads' impacts need to be carefully assessed: in case of outsourcing of certain product lines, contribution from the remaining product lines needs to be bigger as overheads remain unchanged

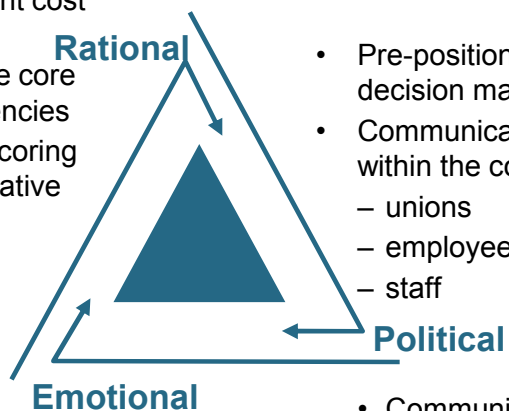


# As Make or Buy decision has strong impacts on organizations, implementation issues should not be underestimated

## Implementation

### "Make or buy" aspects to anticipate

- Significant cost savings
- Leverage core competencies
- Strong scoring on qualitative criteria



- Pre-positioning of key decision makers
- Communication strategy within the company's
  - unions
  - employees
  - staff
- Communication strategy with environment (regional, city hall, labor department...)

- Management committee leadership
- Careful involvement of various management players
- Top/down and bottom-up communications
- Anticipation of social issues

### Major streams to coordinate in order to facilitate implementation

Procurement stream	Process stream	Social stream
<p><b>Roles:</b></p> <ul style="list-style-type: none"> <li>• Ensures choice and long term relationship with reliable supplier</li> <li>• Works with R&amp;D</li> </ul> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>• Prepares information file to initiate negotiations with potential suppliers (partnership relation definition, technical/functional requirements, annual productivity savings expected...)</li> <li>• Initiates negotiations with at least 2 or 3 suppliers and selects one</li> <li>• Defines and monitor KPI</li> </ul>	<p><b>Roles:</b></p> <ul style="list-style-type: none"> <li>• Redesigns processes according to the new range of activities</li> <li>• Ensures additional productivity savings</li> </ul> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>• Reviews potential implications of buy solution on industrial process (square meters saved, opportunities to redesign more productive processes, requested investments...)</li> <li>• Finalizes the new design and implementation solution</li> <li>• Starts work and organizes transfer with no production interruption</li> </ul>	<p><b>Roles:</b></p> <ul style="list-style-type: none"> <li>• Takes care of all people issues</li> <li>• Manages communication within the company</li> <li>• Negotiates with staff and unions</li> </ul> <p><b>Activities:</b></p> <ul style="list-style-type: none"> <li>• Prepares social files to anticipate issues and remove barriers (social policy, conditions of staff transfer ...)</li> <li>• Selects a communication strategy</li> <li>• Appoints a lead for negotiations with unions who is fully entrusted by top management</li> <li>• Starts negotiations (includes social measures and budget to facilitate transfer...)</li> </ul>

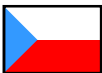







## C. Outsourcing in Croatia

**Roland Berger**  
Strategy Consultants

# In terms of offshoring, Croatia has to catch up with the rest of the CEE countries

## Comparison of CEE countries

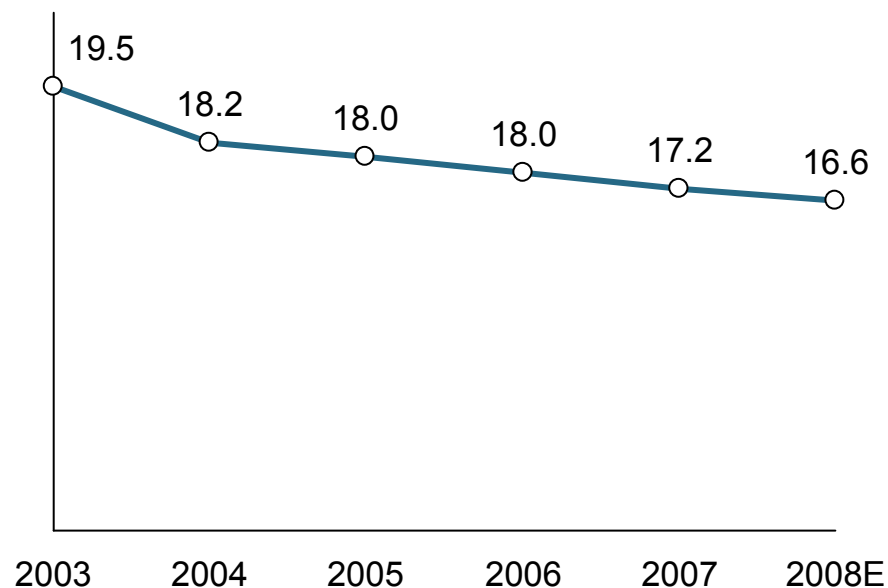
							
		Czech Republic	Hungary	Slovakia	Croatia	Poland	Romania
HR	Personnel cost	-	-	+	-	o	++
	Skills/availability	+	+	o	-	+	-
	Labor legislation	o	o	+	o	o	o
	Unionization	+	+	o	n.a.	++	--
Infra-structure	Proximity/accessibility	++	++	+	- <sup>1)</sup>	+	-
	Corporate taxation	o	++	++	+	++	++
	Bureaucracy	o	-	-	o	+	+
Stability	Political stability	+	++	+	-	o	-
	Macroeconomic stability	+	o	+	o	o	o
	Legal and regulatory stability	+	+	o	o	o	-
	Control of corruption	+	+	o	o	o	-

++ ... Advantageous    -- ... Not advantageous    o ... Neutral     ... Best within compared countries

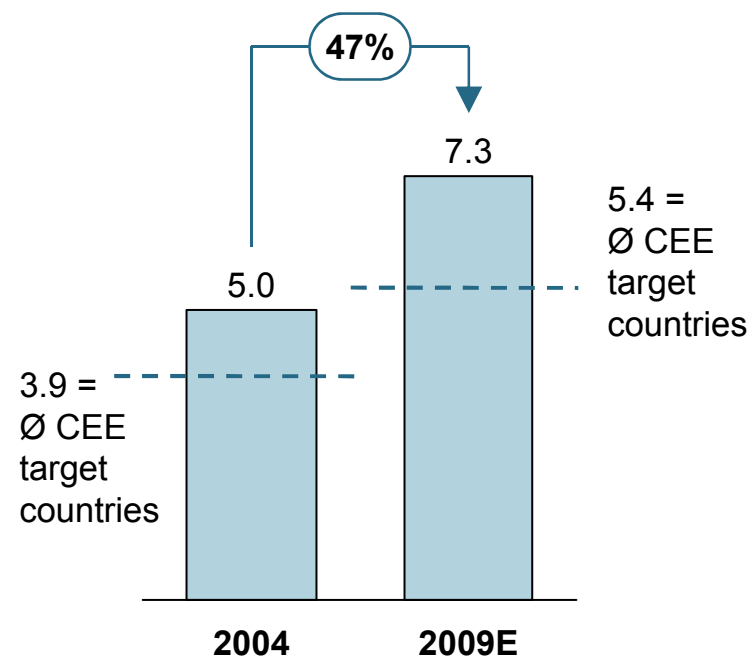
1) Roland Berger expert assessment – Croatia not covered in the respective report

# Labor cost above CEE average and unfavorable development of unemployment are reasons against offshoring to Croatia

**Unemployment rate [%]**



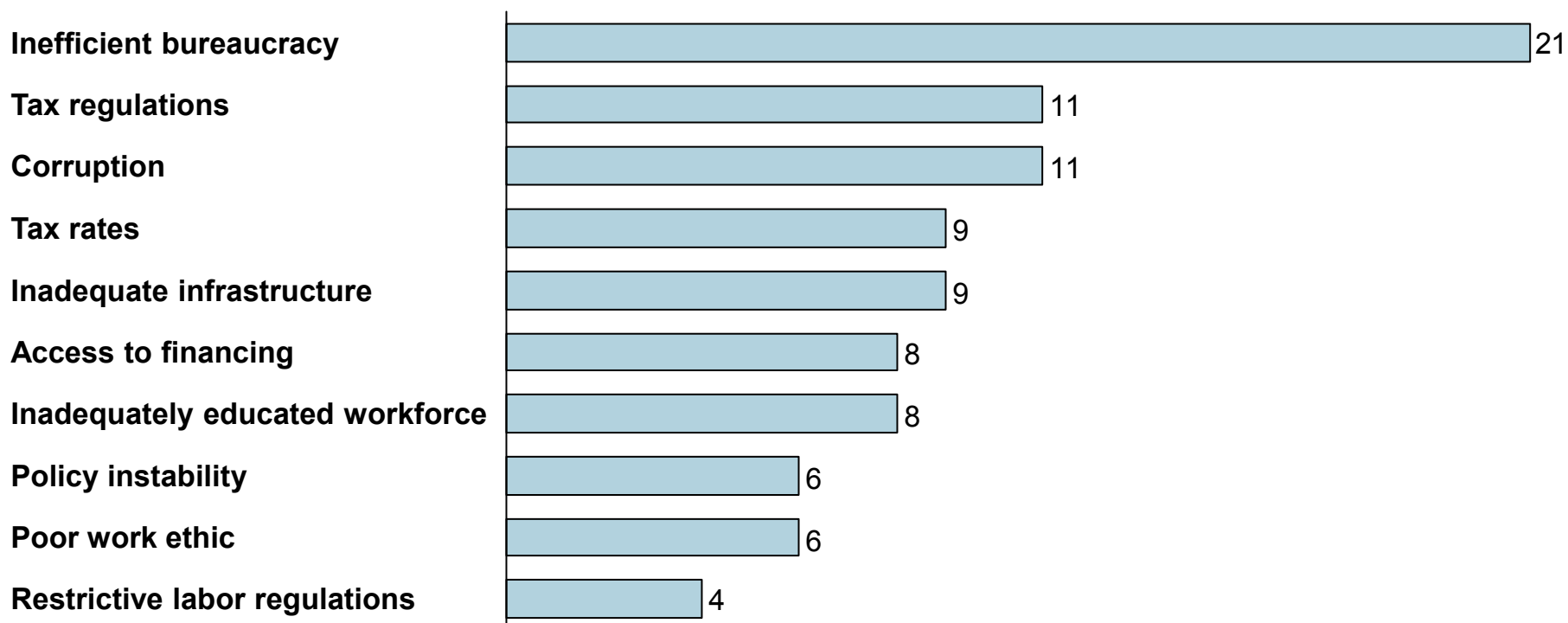
**Labor cost<sup>1)</sup> [EUR/h]**



1) Calculation based on total cost of labor (comprising gross wages to the employee, social security contribution, wage-related taxes)  
Assumption: 160 working hours per month

## High degree of government involvement and low degree of economic freedom don't support offshoring activities

Croatia – Most problematic factors for doing business<sup>1)</sup> [%]





1) From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their ranking



## The necessity for outsourcing services in Croatia is growing, but there are still many obstacles for market development

### Favors and obstacles for development of outsourcing market in Croatia

- 
- Traded companies are more aware of the need to externalize non core activities in order to decrease the costs and increase the profitability
  - Companies in Croatia do not have the best practice in non core activities
  - Banking sector has outsourced its IT activities and serves as positive example of focusing on core activities

- 
- Domestic market is not yet mature for individual outsourcing providers
  - Big international players specialized in certain fields are not yet interested in Croatia
  - Bureaucracy obstacles are preventing offshoring activities in Croatia
  - Workers unions can cause problems in outsourcing activities (especially offshoring)
  - Majority of contracts go over public tenders based on price as the main criteria, companies with dumping prices but not capabilities present the threat to professional outsourcing companies
  - There are problems in data protection especially in IT outsourcing activities

# Outsourcing activities in banking sector present positive trend that should be followed by other companies

<b>Bank</b>	<b>Outsourced activities</b>
<b>Zagrebačka banka</b>	<ul style="list-style-type: none"> <li>• IT services</li> <li>• Facility management and postal services</li> <li>• Protection of facilities and people</li> </ul>
<b>Privredna banka</b>	<ul style="list-style-type: none"> <li>• IT services</li> </ul>
<b>Erste banka</b>	<ul style="list-style-type: none"> <li>• IT services</li> <li>• Facility management</li> <li>• Technical management</li> </ul>
<b>Raiffeisen banka</b>	<ul style="list-style-type: none"> <li>• IT services</li> <li>• Document management</li> <li>• Softver development</li> </ul>
<b>Splitska banka</b>	<ul style="list-style-type: none"> <li>• Facility and people protection</li> <li>• Cleaning and courier service</li> <li>• Maintenance of banking IT equipment</li> </ul>
<b>Hypo Alpe Adria banka</b>	<ul style="list-style-type: none"> <li>• Cleaning and maintenance of retail stores</li> </ul>

**Banking sector is the leader in outsourcing, although less than in devel-oped countries**

## There is only a few specialized outsourcing providers in the country; majority of suppliers are small companies

There is a large number of small suppliers, only few large IT outsourcing providers

Small suppliers complicate supply process, management and coordination of outsourcing services, and quality control

Small local companies do not want to collaborate with each other when providing outsourcing service for the client (no clusters)

**There is a need for big international players, but market needs to be prepared for that**

## Supply side is, in fact, improving since the market is starting to offer specialized outsourcing providers

### Demand and supply of outsourcing activities

#### Demand

- Accounting services
- IT services
- Call centers
- Catering services
- Facility management
- Fleet management

#### Supply

- Few large IT outsourcing companies (HP, Siemens)
- Recruiting (head hunting) and employee trainings programs (Selectio)
- Call centers (Connect Contact Center)
- Cleaning services and maintenance (NIL)

**IT  
outsourcing  
has the best  
growth  
perspective**

## Companies have to carefully outsource their non core activities; the state has to offer cost effective solutions

### Recommendations for the Croatian outsourcing market

#### For companies (planning to outsource)

- Comprise outsourcing activities in detail
- Demand defined level of service
- Define inside workers to work with external providers (especially in IT)
- Keep planning and control in the company

#### For state (inviting to offshore)

- Increase the number of qualified workers and decrease labor cost → offer cost effective solutions
- Simplify legislative procedures
- Develop infrastructure
- Increase political stability in the country
- Offer tax advantages for companies offshoring in Croatia