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Thank you for attending the Everest Research Institute Global Sourcing Webinar on June 27th. The following presentation contains a subset of the slides that were showcased and is part of a larger study included in the Global Sourcing program. To purchase the study or learn more about this and other offerings, please contact Peter Bowes at pbowes@everestgrp.com.



Global Sourcing Webinar – SAMPLE SLIDES

Topic: Sustainability of Labor Arbitrage

Presenters:

Phil Fersht, VP Research

Nikhil Rajpal, VP, Global Sourcing

Sheetal Bahl, Market Research Analyst

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Our overall approach to the labor arbitrage sustainability analysis



We have conducted the sustainability analysis using a three-step approach

- 1. In-depth illustration:** We analyzed the sustainability of labor arbitrage for offshoring of select processes from UK to India
- 2. Generic analyses:** We explored expected labor arbitrage sustainability among a comprehensive list of source-destination country pairs
Source countries: US, UK, France, Germany, Japan
Destination countries: Indian, China, Philippines, Czech Republic, Poland, Mexico
- 3. Sensitivity to variations in key factors:** We built an understanding of the expected variation in longevity of labor arbitrage due to variations in key underlying factors. Projections have been done for worst case scenarios

It is worth noting that labor arbitrage, while important, does not offer the sole value proposition for offshoring of services. The value proposition for offshoring is expanding beyond labor arbitrage to include factors such as productivity enhancements and quality improvements¹. Given this, the sustainability of offshoring is likely to be stronger than the sustainability of labor arbitrage. This report, however, analyzes sustainability of labor arbitrage solely from a wage differential standpoint

¹ Reference page 20 of Everest Research Institute's Global Sourcing Annual Report 2005 for more details

Our methodology takes into account that there are multiple factors affecting the longevity of labor arbitrage

Factor	Details	Effect on sustainability of labor arbitrage
Current wage differential	<ul style="list-style-type: none"> Specific to employee level, process being offshored, and source-destination pair 	<ul style="list-style-type: none"> Higher differential serves to sustain labor arbitrage longer
Compensation increase in source country	<ul style="list-style-type: none"> Governed by macroeconomic factors as well as demand-supply gap 	<ul style="list-style-type: none"> High growth rates in source destinations would elongate time required to bridge the wage gap
Compensation increase in destination country	<ul style="list-style-type: none"> Governed by macroeconomic factors as well as demand-supply gap 	<ul style="list-style-type: none"> High wage increases in destination country would erode arbitrage quickly
Exchange rate movements	<ul style="list-style-type: none"> Highly volatile and difficult to predict over a long-term horizon 	<ul style="list-style-type: none"> Strengthening of source country's currency has a positive impact on arbitrage
Wage differential hurdle rate	<ul style="list-style-type: none"> Maximum wage ratio of destination/source country which still allows for meaningful offshoring 	<ul style="list-style-type: none"> A higher hurdle rate increases sustainability of labor arbitrage

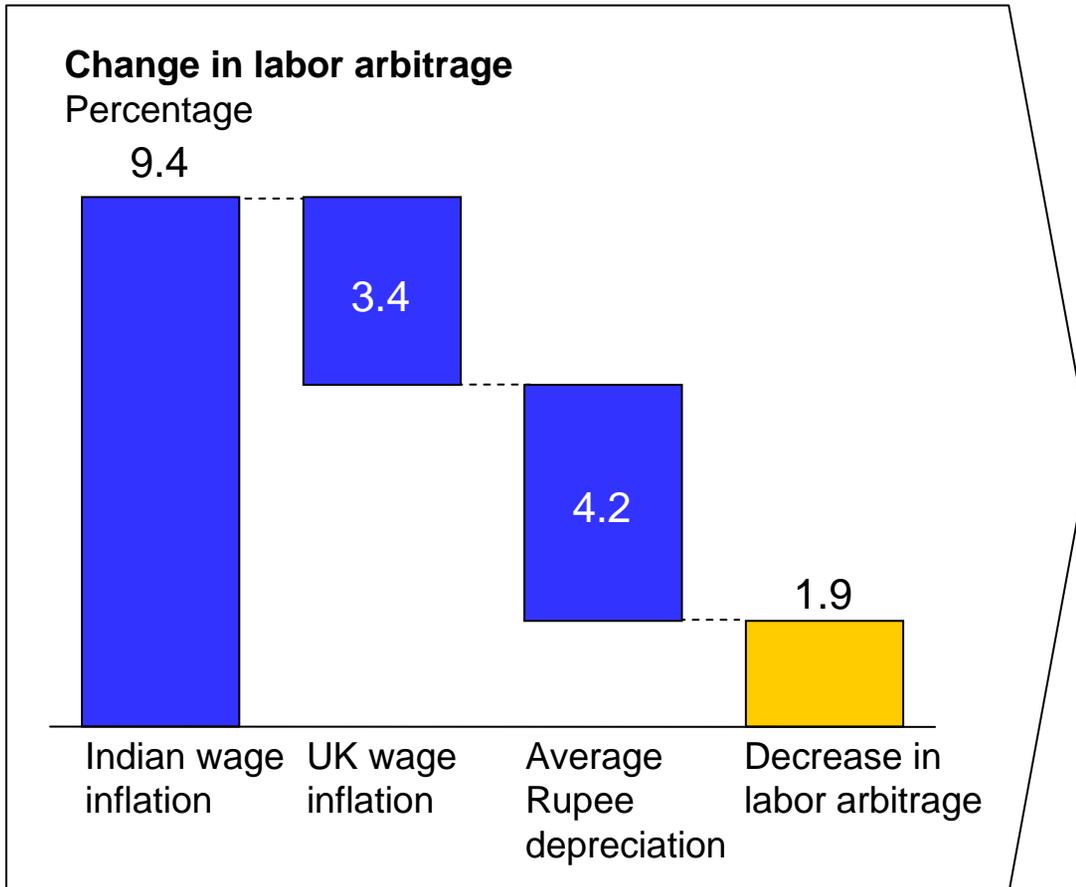
Source: Everest Research Institute

Conceptual illustration of our methodology



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ILLUSTRATIVE

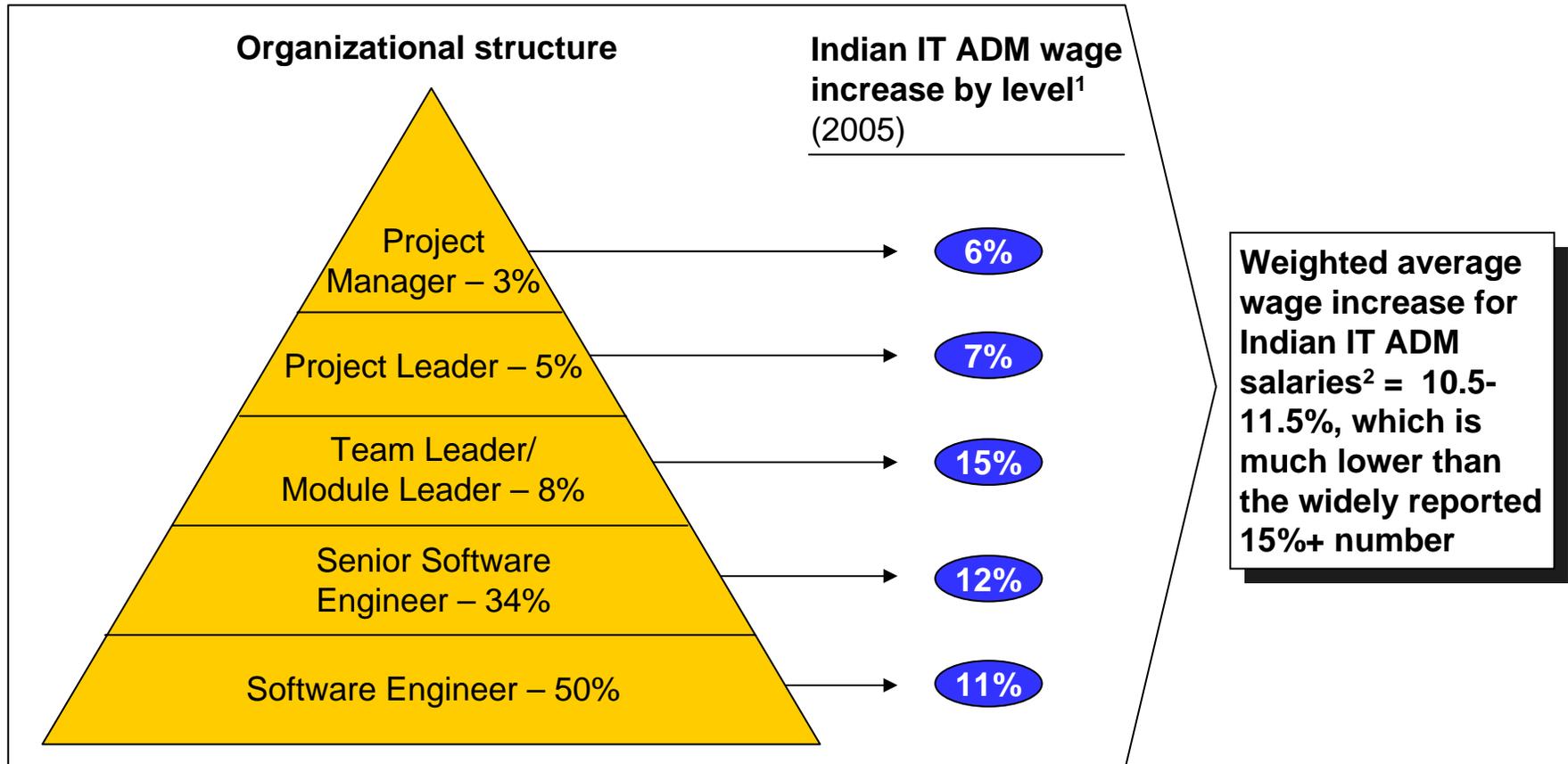


- Wage inflation in the destination country (e.g., India) often decreases the labor arbitrage
- This decrease gets countered to some extent by the wage inflation in the source country (e.g. UK)
- Finally, most often, exchange rates move to increase the labor arbitrage, and hence further negate the effect of the wage inflation in destination countries
- Consequently, the net decrease in labor arbitrage is often significantly lower than the destination country wage inflation

Sources: Everest Research Institute; Nasscom-Hewitt Total Rewards Study; Robert Walters; www.oanda.com

The report contains deep dives into each factor affecting labor arbitrage

Weighted average wage increase for Indian IT ADM personnel



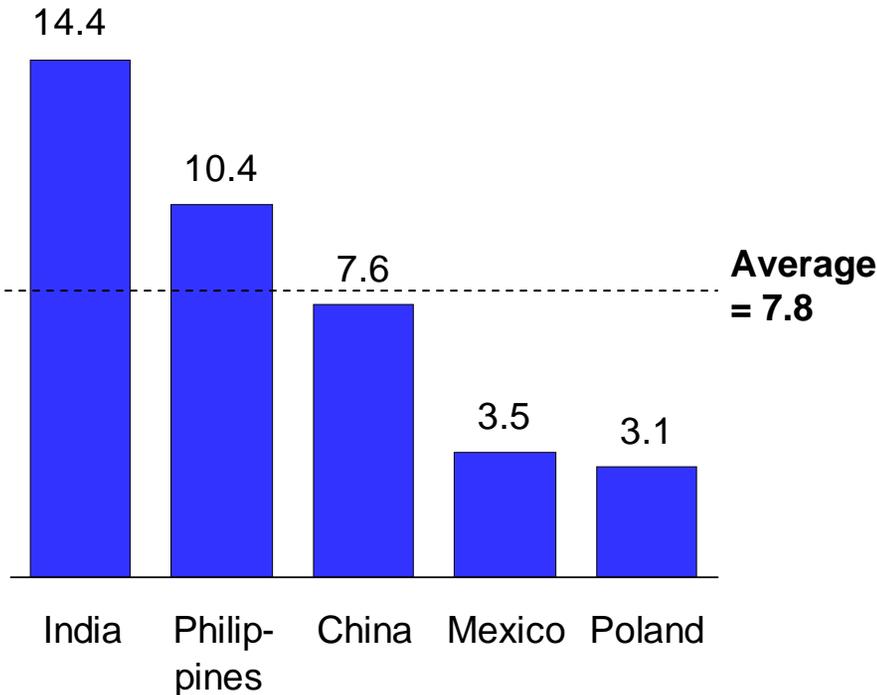
1 Designations vary by company. The chart plots the typical employee levels in order of decreasing seniority. Employees above Project Manager/Asst. Manager are less than 1% of the total workforce and have minimal impact on blended salary

2 The salary growth rate shown here is for the year 2005 only. The average salary growth rate for the last three years is shown on page 20

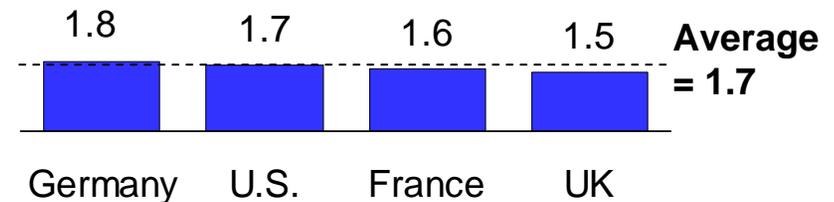
Sources: Everest Research Institute analysis; Nasscom-Hewitt Total Rewards Study 2005

We have also taken into account the effect of macroeconomic factors while forecasting the longevity of labor arbitrage (Illustrative example below)

Programmer salary/GDP per capita in destination countries
2004



Programmer salary/GDP per capita in source countries
2004



Given the attractiveness of IT/BPO salaries in destination countries, governments (and students) will move aggressively to increase the supply

Illustrative results: longevity of labor arbitrage between UK and India for IT ADM work

Number of years for Indian salaries to reach x% of UK salaries

	<i>Hurdle rate for labor arbitrage¹</i>	
	60%	70%
IT ADM (overall)	30+ years	30+ years
■ Junior Developer	■ 30+ years	■ 30+ years
■ Senior Developer	■ 12 years	■ 14 years
■ Project Manager	■ 14 years	■ 18 years

1 Maximum wage ratio of destination/source country which still allows for meaningful offshoring

2 For our detailed analysis, we take a conservative approach and assume that the hurdle rate is 60%

Source: Everest Research Institute analysis

Using the 'as-is' momentum parameters, Everest analysis shows that, in most cases, labor arbitrage will be sustained for over 30 years

Projected sustainability¹ of labor arbitrage for IT ADM

Number of years

 30+ years

Destination countries

		India	China	Philippines	Czech Republic	Poland	Mexico
Source countries	U.S.	18	25	24	3	6	
	UK				5	16	
	France				8	24	
	Germany				6-8	20	
	Japan	22			5	8-10	

These sustainability estimates are based on 'as-is' momentum. In reality, the rate of increase in salary levels, as well as exchange rate movements, are driven by a complex interplay of macro-economic factors and tend to be dynamic

¹ Assuming sustainability of labor arbitrage until destination country salaries are 60% of source country salaries for offshore pairs and 75% of the source country salary for near-shore players

Source: Everest Research Institute analysis

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Everest Research Institute has the resources, experience, and capabilities to provide companies with the strategic intelligence, analysis, and insight that are crucial to making the right decisions in today's outsourcing marketplace.

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Everest Research Institute

Two Galleria Tower
13455 Noel Road, Suite 2100
Dallas, TX 75240
+1-214-451-3000
www.everestresearchinstitute.com
info@everestresearchinstitute.com

Everest Group

150 E., 52nd Street, 16th Floor
New York, NY 10022
+1-646-805-4000

Everest Canada

5915 Airport Rd #400
Mississauga, ON L4V1T1
Canada
+1-905-405-5640

Everest UK

Gainsborough House
100 Pall Mall
St. James's
London, SW1Y 5HP
+44-20-7664-8920

Everest Australasia

Level 6, 90 Mount Street
North Sydney, NSW 2060
Australia
+61-3-9833-1018

Everest India

Ground Floor, Tower A
Unitech Business Park
South City - I, Gurgaon
New Delhi National Capital Region
India 122001
+91-124-304-1000

