

Hybrid Captive Model



Addressing Global Business And IT Needs

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Collaborative Sourcing Overview

With IT globalization entering a new growth and acceptance phase in the early 1980's, companies began seriously considering alternative locations for many back office services and capabilities.

One such popular option continues to be offshore centers. This model has been the accepted and leading approach for the third evolutionary stage that began taking shape from 2015 onwards.

"A captive center is particularly well-suited to work dealing with sensitive information, intellectual property, and/or business critical or complex tasks," said H. Karthik, Partner and leader, Everest's global source research practice.

Since then, companies have considered and often used a blended mix of offshore centers and outsourcing arrangements with IT service providers in addressing their growing global IT and business process and operational needs.

These models have changed and evolved in different phases.

In a report by Everest research, technology and manufacturing, distribution and retail (MDR) firms are the greatest users of captive centers. Also, emerging technologies such as social, mobile, analytics, and cloud computing are leading to higher adoption of these in-house centers.

From 2003 onward, these centers are thriving, experiencing growth to the tune of \$11.1 billion in annual revenue, a 300+% increase.

This paper examines the current landscape of operating models, popular locations, and ongoing trends.

Operating Models Tour

With offshore centers, there is no 'one size fits all' for any industry or business sector. Even the models identified below are different in complexity, usage, and output.

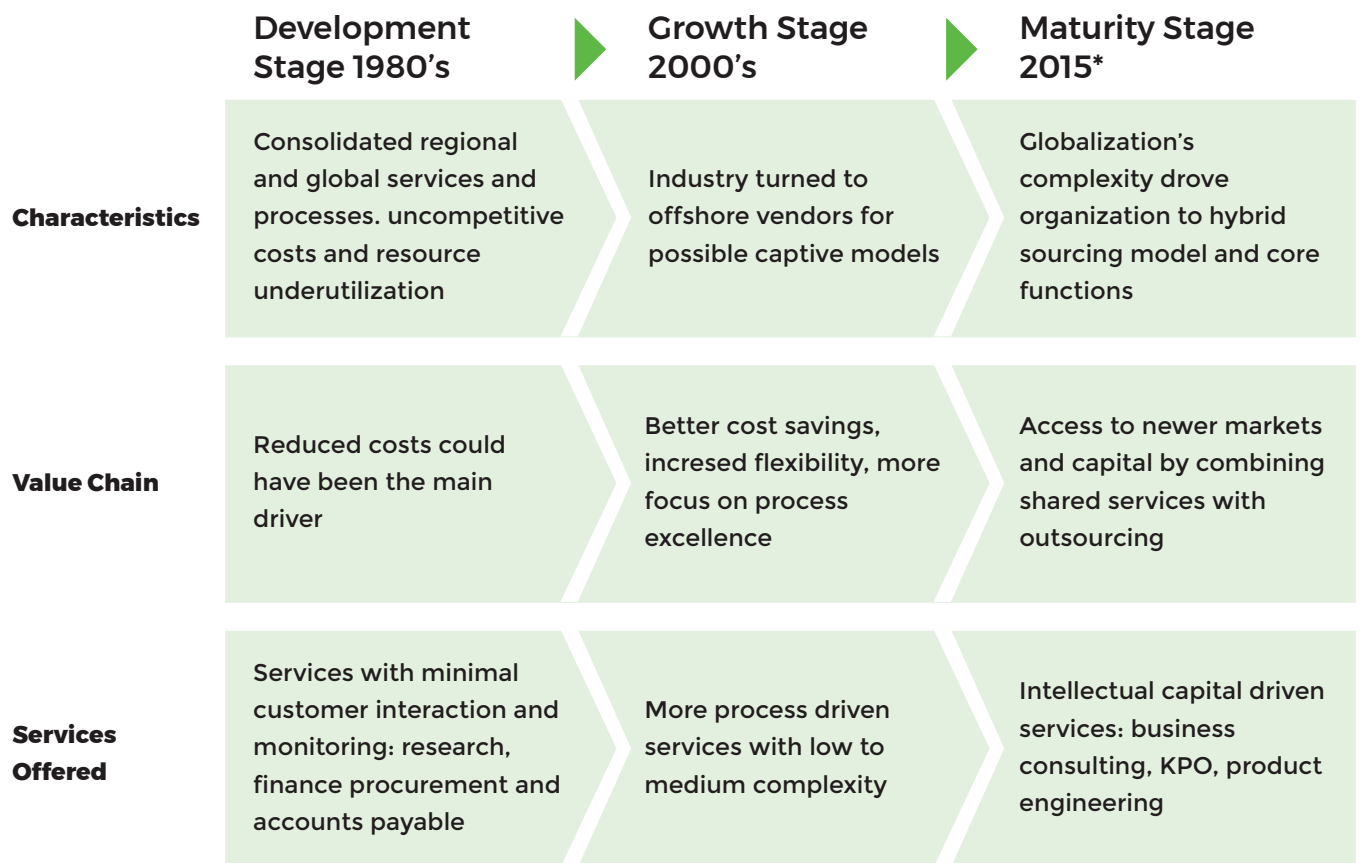
Choosing the right model—one allowing an organization to achieve global operating efficiencies while delivering services better, faster, and more cost effectively than its peers—can be a powerful competitive differentiator.

Evolutionary stages

From the early 1980's onward, the captive center model has been in play.

Since then, this model has evolved and changed into three primary phases leading to the hybrid model existing today. It continues to shift to align to new market demands.





Outsourcing

The outsourcing model is essentially a corporate campus based offshore. These captive organizations are overseas subsidiaries set up by global corporations to serve the parent company.

They offer an alternative to contracting out projects directly to an unrelated offshore provider.

Shared Captive

Shared services, or the captive model of sourcing, consolidates dispersed resources performing similar functions within one or more centers owned by the company. They serve multiple internal customers with similar needs. The shared services center (SSC) is

the internal service provider for the organization. This type of a model works for its parent company as well as external customers.

This is a potential revenue generator and a cost-sharing vehicle for the parent company.

Hybrid Captive

An engagement model where one continues to perform core business processes for its parent company, though where some or a significant portion of non-core work is outsourced. This is for companies who require the need to better streamline their offshore operation and to further customize its management.



Sourcing Model Comparison

| Differentiators | Outsourcing | Shared service | Hybrid |
|-----------------------------|--|--|---|
| Ownership | Does not own property | 100% owned property | Optional ownership |
| Capital investment | High capital investment, all ensured by client | Less initial capital investment, bigger flexibility throughout the process | Optional ownership |
| Risk level | Shared risks, outcomes under agreements (costs, SLAs) | All risks are undertaken by owner, no long-term commitment | No long-term commitment |
| Implementation speed | Quick implementation: 1-2 months | Long implementation time: 6-9 months | Quick implementation: 1-2 months |
| Management focus | Free focus on strategy and business issues | Operational and administrative activities | Enlarged strategy and business focus |
| Leverage factor | Multi-user environment, best practice process model, platforms and cooperation | Client environment | Pressing to reduce factor |
| Flexibility | Flexible pricing, ability to reduce operation size | Less flexibility | Quick adaption to changed business requirements |
| Cost management | High operational costs | Long time cost reduction | Transparent cost structure |
| Control | Very small control | Total operational control | Total operational control |

In recent years, however, some mature outsourcing companies have embraced hybrid models that theoretically deliver the best of both worlds.

Going forward, these new models could represent between 15% and 20% of the total work currently outsourced to offshore vendors. Companies with successful captive centers and strong relationships with offshore vendors will be most successful in using one of these hybrid approaches, while companies with no captive center should consider establishing a small satellite office in locations where their vendors have an offshore development center (ODC).



Hybrid Captive

A hybrid captive model is an evolution in software engineering and process management outsourcing. Its unique structure gives the client visibility into all operational aspects.

Popular Locations

There a range of potential global outsourcing locations ranging from emerging to mature. These locations can support a wide range of client objectives – balancing cost, time zone alignment, and physical proximity to client offices.



Time Zone Challenges

A key challenge in executing an outsourcing model is ensuring effective time zone alignment and appropriate management and knowledge transition coverage. Many companies are surprised when realizing the out-of-business commitments needed to successfully operate a non-time zone project. There no single solution, it is important to consider time zone friction to lessen overall project costs. For global US based corporations with domestic and international operations in either the Philippines and/or India, this provides their customers with 24/7 coverage..

Trends

Build-Operate-Transfer (BOT)

The essence of the BOT is a client partners with a provider who builds the service center, runs it for specified number of years, and then transfers ownership back to the client. This model utilizes offshore staff who are legally employed and fully supported by the provider. However, the client has 100% operational control. Many major companies initially have this approach and have converted to full ownership – more so after the model has been proven.

Virtual Captive

Another popular hybrid solution is the virtual captive model. This incorporates the benefits of captive offshoring and outsourcing models. Client owned, they provide overall management and control. The service provider is responsible for most day-to-day operations. The term came from the cooperation of Wachovia and Genpact that was signed for seven years in 2005.



Hybrid Model Trends Comparison

| Differentiators | Build-Operate-Transfer (BOT) | Virtual-Captive Center |
|-------------------|--|---|
| Service delivery | Providers own the risk under-performance | The risk of service-providing are treated in a more cooperative way |
| Pricing | Related to outsourcing market-like pricing | Continuous management of several special cost elements |
| Image | Own image | Usually under the client's name |
| Human capital | Provider is responsible for staff recruitment, training, and retention | Client has voice in the HR management |
| Governance | More simpler and linear governance structure | Less governance than captive center; larger than in outsourcing |
| Termination | In case of profound agreement there is clear pricing | Client bears costs |
| Operational risks | Provider's own risks | Above agreed upon level, shared risks and operational loss |

Service Provider Expectations

Your organization has decided to move ahead. Now comes the part where you have to decide what your company and personnel will manage and be responsible for, and more importantly what your vendor will do—when, under what conditions, and what will be the physical outputs.

Breaking these into categories focuses the decision tree. Having both parties agree up front on the large and more so small operation details will in the end be the factor in determining if this model works best for your organization.

Financial Transparency

- TSeparate accounts book
- Detailed financial reports
- Transparency on annual budgets, variance, and financial documents

Regulatory And Administrative Formalities

- TSpecial economic zone registrations, permits, and zoning are handled by the service provider

Digital And Physical Security

- Isolated networks protected with firewalls and access controls
- Password policies and encrypted communications
- Audits and logs
- Comprehensive backup and business disaster recovery plans (BDR)



Blueprint For Action

Whether your company does business or sources globally, taking advantage of local resources for your operations will result in greater efficiency and cost-effective competitive and business results. ThoughtFocus advocates looking at your cross-organizational processes for uncovering areas for improvement, while keeping the strategic vision in mind.

Below are the benefits and resultant advantages we recommend you consider when aligning a hybrid sourcing model with your organization's vision and overall strategy:

- **Talent pool flexibility:** Hybrid captives make way for improved resourcing, skills, and talent. Your and the provider's employees equally and immensely gain and benefit from best-in-class training; making the handling of escalations much more efficient.
- **Reduces fixed costs -** A hybrid captive's cost reduction = 17% to 23% over traditional offshore contracts and improve control without taking on the risk of a pure captive operation. With multi-industry experience, diverse business and technical experience providers help address non-standard client needs, expectations, and requirements.
- **Increased revenue and profitability -** This model allows and permits the provider to gain a deeper understanding of you and your business; leading to more tangible profitable business. A way to navigate increasingly complex domestic and international regulatory requirements and scrutiny of offshore outsourcing relationships. Provides complete transparency to operational and financial metrics.
- **Hybrid captive preserves existing relationships and channels of communication.** Provides for an integrated control over operations and for greater operational flexibility.
- **Fosters control retention.** Simultaneously extends your processes and corporate culture to the offshore center.
- **Reduces conflicting business interests between you and the provider.** A truly collaborative relationship with aligned business objectives.

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