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# **CEO Briefing**

## Corporate priorities for 2005



**A report from the Economist Intelligence Unit  
Sponsored by Dimension Data and Oracle Corporation**



## Preface

*CEO Briefing* is an annual Economist Intelligence Unit research programme designed to identify the most important management challenges facing the world's corporate leaders. Dimension Data and Oracle Corporation sponsor the *CEO Briefing*.

The Economist Intelligence Unit bears sole responsibility for the content of this report. The Economist Intelligence Unit's editorial team executed the online survey, conducted the interviews and wrote the report. The findings and views expressed do not necessarily reflect the views of the sponsors.

The research draws on three main initiatives:

- The Economist Intelligence Unit conducted a wide-ranging online survey of senior executives from around the world in December 2004. In total, 500 senior executives, including 219 chief executives, took part.
- To supplement the survey results, we also conducted more than 20 in-depth interviews with CEOs, CFOs, chairmen and other senior executives of major companies around the world. Their

insights shed additional light on the major trends, challenges and opportunities highlighted in this year's global survey.

- This year's *CEO Briefing* also includes a new strand of research that provides valuable insights into the future of offshoring. Our offshoring environment rankings reveal the relative strengths and attractiveness of 60 countries for offshoring projects.

Gareth Lofthouse is the author of the report. The following researchers conducted interviews with executives around the world: Jeanette Borzo, Mary Catherine Boyd, Margaret Dooley, Terry Ernest-Jones, Tom Fawthrop, Ben Gardner, Alison Rea and Simon Tilford. Laza Kekic created the offshoring ranking model, with additional contributions from Emily Fleckner and Simon Tilford.

Our thanks are due to everyone who shared their time and insights during our research.

January 2005



## Executive summary

The next twelve months promise to be an interesting time for business. The world's major economies have been expanding; earnings and share prices are up, and growth opportunities are plentiful at home and abroad. Executives have rediscovered their appetite for risk, with innovation and the globalisation of business operations returning as corporate priorities.

Yet executives enter 2005 aware that it will hold at least as many challenges as opportunities. Companies are accelerating their growth plans at a time when world economic growth is slowing. Cost-efficiency remains a top priority. Executives will also need to steer their companies through a range of risks and uncertainties in the global marketplace.

This year's *CEO Briefing* white paper draws on a major survey of 500 senior executives, as well as in-depth interviews with more than 20 global business leaders, to provide an insight into the trends and issues that will shape the corporate agenda over the next three years. The paper comes to a number of conclusions about the future:

- **Companies strive for growth in an uncertain environment.** Executives are becoming more ambitious in their plans for expansion, with 34% of executives surveyed predicting robust growth for their revenue and profit in 2005 (up from 26% last year). But achieving that growth may not be easy. Economies are slowing: the Economist Intelligence Unit forecasts that growth in the world economy will decelerate from a heady 5% in 2004 to 4.1% in 2005 and 4% in 2006. Executives are painfully aware of a number of threats—notably the sliding dollar, high levels of public- and private-sector debt, and the risk of a hard landing in China—which have the potential

to send the recovery into reverse. Developing a strategy in this uncertain environment becomes even more of a fine art than usual.

- **Competition for offshoring intensifies.** Fully 57% of executives see outsourcing and offshoring as critical forces that are reshaping the global marketplace, up from 51% last year. According to a new ranking model developed by the Economist Intelligence Unit (see the special feature on page 14), India is by far the most attractive offshoring location, owing to its English-speaking, low-cost labour force, and common law legal system. In second place, China is to manufacturing what India has become to the service economy. It lags behind, however, in its relative lack of English language skills, and some features of its business environment. As outsourcing moves up the value chain, Eastern Europe looks well-placed to attract more skills-intensive activity, with the Czech Republic, Poland and Hungary performing particularly strongly in the rankings.

- **China as opportunity, risk and competitive threat.** With another year of strong growth forecast for 2005, China is cited by 35% of executives as the country offering the greatest opportunities for business expansion. Those opportunities will only increase as the economy opens up further: 43% of executives believe WTO-related liberalisations, which should further reduce China's protective tariffs across a range of industries, will be an important development for business. However, executives know that any turbulence in China's economy could have major repercussions for the global business environment. In particular, concerns persist over



whether the Chinese authorities can successfully engineer a gradual slowdown for an overheating economy. In addition, some Western executives believe it is only a matter of time before Chinese companies come to compete “in their own backyards”.

● **Technology: disrupting industries, organising business.** Ambitious technology projects took a back seat after the dot-com crash. Now, and for the first time since the launch of the *CEO Briefing* programme, advances in technology are seen as the single most important driver of change. Fostering innovation is also a key strategic focus this year, and a stream of new ideas look set to fuel growth in industries ranging from biotechnology and energy to telecoms and information technology (IT). But IT will also be integral to the more mundane, but equally vital task of connecting and managing complex, globalised operations. As a result, mobile networks, business intelligence solutions, and supply-chain integration systems are seen as important technologies for the next three years.

● **Managing scarcity.** A total of 22% of executives surveyed cite rising commodity prices as a critical driver of change in the next three years. This is more than concern regarding oil, since increased demand for other raw materials, particularly in China, has also created upward pressure on commodity prices. Concerns over scarcity extend to people as well as to commodities: attracting skills is getting harder for many employers, with failure to attract talent cited as a major business risk by 36% of executives.

● **Governance goes global.** Forty-five percent of executives believe there will be a greater move towards a command-and-control style of management, whereas 18% predict a move in the opposite direction. Companies will continue to march

### CEO Briefing at a glance

Main conclusions drawn from this year’s survey for *CEO Briefing*.

**Top country for business growth:**  
China

**Country with greatest risk to business:** US

**Most critical force for change:**  
Advances in technology

**Most promising industries in next 3 years:** Healthcare and biotechnology; mining, oil and gas

**Strategic priorities:** Cost-efficiencies, customer satisfaction, process-optimisation, innovation

**Biggest threats:** Increased competition, inability to respond quickly to changing market conditions

**Key enterprise technologies:** Business intelligence software, mobile systems, supply-chain integration

towards their compliance deadlines, but there is also a greater emphasis on the broader aspects of governance. In this context, imposing financial discipline and standardised processes across operations in far-flung countries is seen as an important challenge. Another is to regulate supplier relationships, particularly now that a wider range of business functions and processes are being offshored.

● **Corporate agility as pre-requisite for survival.** Failure to keep pace with change is one of the top three risks facing businesses, according to 40% of executives in the survey. It is no surprise, then, to find that many executives in the survey emphasise the virtues of corporate agility. In this context, the shift from fixed cost-structures to the variable cost-structures associated with outsourcing is only likely to gather pace.

For the second year running, ambition contends with caution in the *CEO Briefing* survey. Can companies expand their product and service-lines, penetrate new markets and stay mean and lean? If so, 2005 will be a good year in which to prove it.



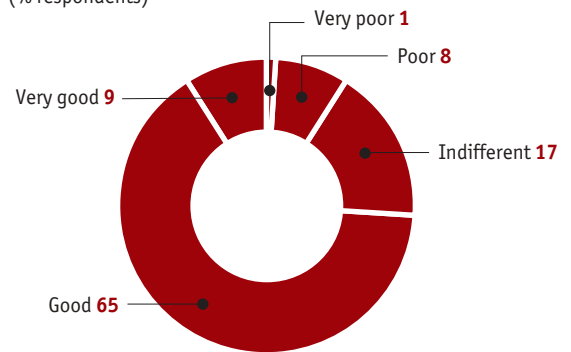
## Introduction

**2**004 was the year business swung back into growth mode. As the world economy grew at its fastest pace in recent memory, opportunities for expansion opened up at home and abroad. After several years of retrenchment, globalisation was back in business.

Does this mean business leaders are predicting another year of growth and opportunity in 2005? Yes and no, according to this year's *CEO Briefing*, an Economist Intelligence Unit survey and interview programme targeted at senior executives. The main findings from our survey denote an upbeat outlook among business leaders: 34% of those surveyed expect robust growth in their revenue and profit (up from 26% last year), while 53% expect at least modest growth. A total of 65% of executives in the survey believe that prospects for business in the global marketplace will be good over the next three years, compared with just 8% who say the outlook is poor.

Nevertheless, throughout the survey, as well as in many of the executive interviews we conducted for this

**How do you view the prospects for your business in the global marketplace over the coming three years?**  
(% respondents)

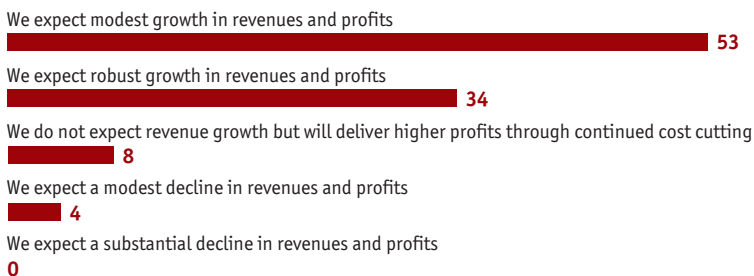


Source: Economist Intelligence Unit survey, 2005

report, there is a strong undercurrent of doubt and caution. A major reason for this is the fragility of the economic upswing. "How strong is the recovery? Will it continue to splutter?" asks one executive interviewed for this report. Adding to the uncertainty is a keen awareness of multiple risks—a sliding dollar, high oil prices and the impact of economic imbalances could all make for a bumpy ride in 2005.

Predicting the future in these uncertain times is even more difficult than usual, but there is little doubt that the next three years will test corporate leadership in a multitude of ways. In particular, corporate rivalry is only going to get tougher in the years ahead. Sixty-three percent of executives cite increased competition as a top-three risk to their business in this year's survey, up from 51% last year and 43% in 2003. Opportunities for growth abound in this fast-moving environment—but only the quick and agile are likely to thrive.

**How well do you expect your company to perform in the 2005 calendar year?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

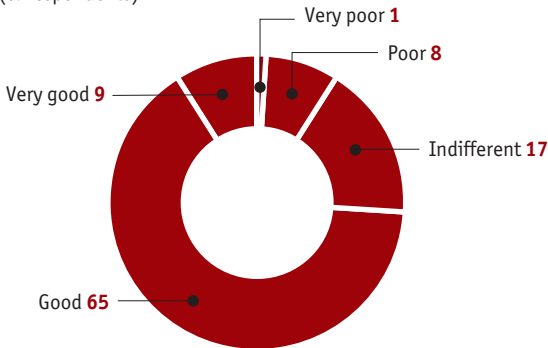


## Who took the survey?

Five-hundred executives from 75 countries around the world participated in this year's *CEO Briefing* survey. The US and the UK provided the largest number of respondents, but once again the survey reached an extremely diverse group of executives. Fully 44% of the participants were at CEO level, doubling last year's record. The rest of the participants were other senior executives, including 79 CFOs, 32 CIOs, and 39 other board members.

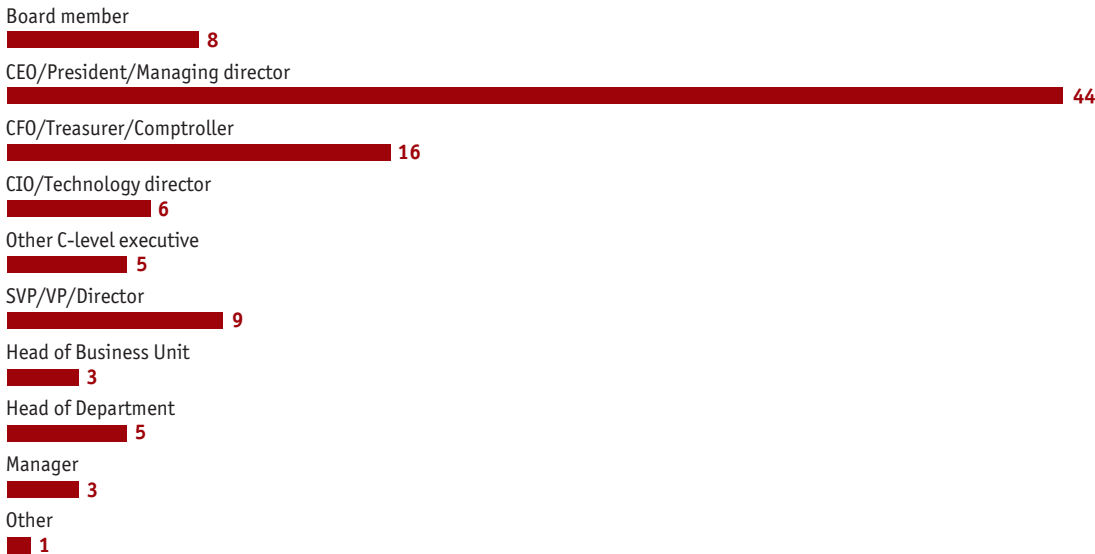
A range of industries was represented, with financial services, professional services, information technology and manufacturing contributing the most respondents to the survey. Participants also came from a range of company sizes, with 27% reporting annual revenue of more than US\$1bn.

**How do you view the prospects for your business in the global marketplace over the coming three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

**Which of the following best describes your title?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005



## The global marketplace

Last year saw the long-awaited economic recovery finally blossom—and what a spring it was for business. The world economy shook off its post-millennial gloom, growing at a rate that far outstripped all but the most optimistic predictions. By the year-end, global GDP growth was estimated to have reached 5%, the fastest rate of expansion in over two decades.

Better still, the boom reverberated across the world. China grew rapidly and the US economy outpaced expectations, while Japan’s economy also put in a robust performance. Many emerging-market

economies also surged ahead, including those in emerging Asia, Russia, Turkey and some Latin American countries. Even the euro zone’s major economies made something of a return to form after several years in the doldrums.

Before anyone could celebrate a new era of boundless growth, however, old problems began to resurface. 2004 turned out to be a year of two halves: economies soared in the first six months, but there were signs of a slowdown in the second. Many economists now believe that 2004 may have been the highpoint for the economic recovery. With economic policy tightening in a number of major markets, and with significant debt levels constraining consumers, companies and governments, the Economist Intelligence Unit expects the global economy to slow to 4.1% in 2005 and 4% in 2006.

Despite the return to more subdued rates of growth, most companies in the survey believe that 2005 offers plenty of opportunities. Inevitably, however, some industries will be better placed to exploit these opportunities than others. Healthcare, pharmaceutical and biotech companies hold the best prospects according to 76% of executives, up from 62% last year—partly because new science is beginning to deliver on its promise. “In the next three to five years, life sciences will undergo a lot of changes, with genomics research increasing our understanding of diseases and changing the way new drugs are developed,” says Ned Barnholt, chairman, president and CEO of Agilent Technologies, a maker of test and measuring equipment for the life sciences, communications and electronics industries. Telecoms, software and computer companies benefit from a renewed enthusiasm in business for technology

### Which industries do you believe will enjoy the best growth prospects over the coming three years?

(year-on-year change in % of respondents picking each industry)

Mining, oil & gas	+16%
Healthcare, pharmaceuticals & biotechnology	+14%
Travel, tourism & transport	+11%
Telecommunications, software & computers	+10%
Leisure & entertainment	+8%
Engineering & machinery	+2%
Food, beverages & tobacco	+1%
Agriculture	+1%
Professional services	+/-0%
Retailing	+/-0%
Utilities	-1%
Construction & real estate	-2%
Chemicals & textiles	-2%
Aerospace & defence	-4%
Automotive	-5%
Consumer goods	-8%
Financial services	-9%
Electronic & electrical	-19%

Source: Economist Intelligence Unit survey, 2005



and communications. Travel and tourism is also expected to return to growth (the impact of the tsunami in south-east Asia is not expected to significantly alter this general trend).

High oil prices are perceived as an important risk for 7% of executives in the survey, but, of course, will prove to be good news for oil producers themselves. In the short term, this makes oil, gas and mining companies into an important growth sector in the eyes of the survey participants, despite longer-term concerns over the industry's success in replenishing reserves. Other industries are seen to be facing tough times: electronic and electrical, automotive and consumer goods fall into this category. Overall, however, the majority of executives in the survey believe their companies will deliver at least moderate rates of revenue or profit-growth in 2005.

## Dollars and deficits

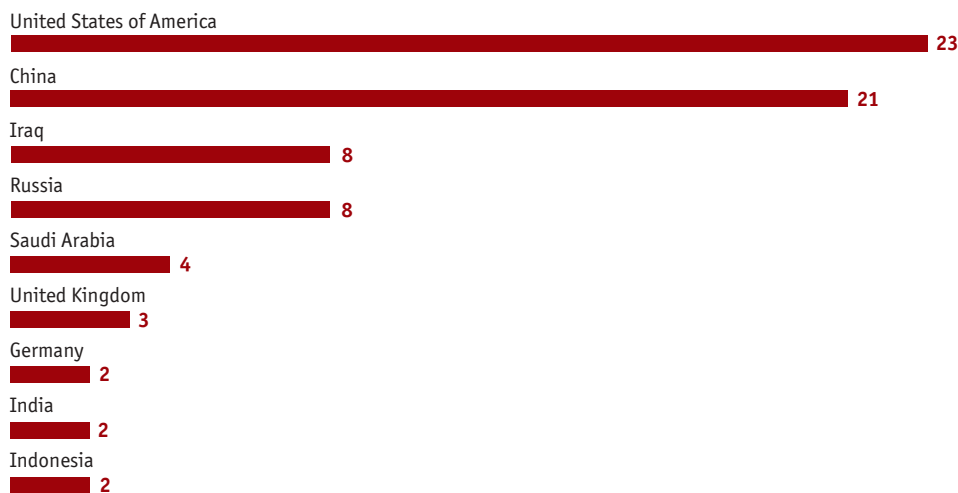
Those growth predictions are accompanied by some major qualifications, however. Executives' concerns over geopolitical and country risk have eased for the

time being, but in their place there is no shortage of other issues to keep them awake at night. Foremost among these are the economic prospects for the US, cited in the survey as the single country that entails the greatest risk to business over the next three years. "The US is such a big engine to the world economy that, if it has a hiccup, we all suffer," says Rob Ritchie, CEO of Canadian Pacific Railway, which earns some 30% of its revenues from carrying goods between the US and Canada.

Although the US delivered its fastest rate of economic growth since 1999 last year, growth is set to soften in 2005. High levels of consumer debt are likely to constrain consumer spending; long-term and short-term interest rates are expected to rise; and fiscal policy will tighten. High oil prices are also expected to continue to take a heavy toll on a country that is highly dependent on oil imports.

But it is the dollar's ongoing decline that is creating the greatest concern for executives in the survey. The sliding dollar is already hurting export firms outside the US, particularly in the euro zone. The Economist

**Which single country do you see as entailing the greatest risk to your business over the next three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005



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Intelligence Unit's central forecast is that this situation will persist over the first half of 2005, with the dollar continuing to slide gradually against the euro and the yen, but that it will then stabilise in the second half. However, a gloomier scenario cannot be ruled out. If the mounting capital losses being inflicted on European and Japanese investors in US assets ultimately lead to a flight from the US currency, this could result in an outright collapse in the dollar. US inflation and interest rates would surge, and there would probably be a sharp slowdown or recession in US domestic demand. There is no doubt that such a scenario, although less probable than a gradual decline in the dollar, would cast a pall over the business

**"Anything that promotes business and lowers trade barriers will have a net positive [effect] for business."**

Peter Lee, president & CEO of DataSynapse, which makes grid computing applications.

outlook for many companies represented in our survey. European executives interviewed for the report were united in depicting a tough three years ahead for the euro zone. Sluggish growth in Europe is a major problem for companies like Reuters, a financial information provider, which gets over 55% of its revenue from the region. "It's been the slowest-growing part of our business for the last three years...and we don't see a catalyst for changing that. What it means is that we have to look further afield for growth opportunities, particularly to the emerging colossuses in Asia," says Danny Grigson, CFO of Reuters.

Even in the first half of 2004, the euro zone's economic performance lagged behind both the US and Japan, but growth appeared to be dropping back further by the end of the year. In Germany and Italy, exports have performed well, but domestic demand has been held back by low consumer confidence. In contrast, France and the smaller European economies have seen improvements in both the trade and non-tradeables sectors, but now there are signs that these more dynamic economies are also slowing. As a consequence,

we expect that growth in western Europe will slow from an average of 1.9% in 2004 to 1.7% in 2005, with the UK likely to be the fastest-growing of the big four European countries over the next few years. By contrast, the business outlook for central and eastern Europe looks relatively rosy, with 34% of executives surveyed citing it as the top region for growth opportunities. Russia overtakes the UK as a major area for growth in this year's survey, but with this greater opportunity comes increased exposure to risk: 8% of executives cite Russia as the country creating the greatest risk to their businesses over the next three years, compared with just 3% last year.

## Dragon fire

Once again, it is Asia Pacific that stands out as the region that offers the greatest growth opportunities for businesses, with Asia's two emerging giants attracting most interest of all. India's allure continues to grow, with 8% of executives citing it as the single country offering the greatest growth opportunity, up from 6% last year. Nevertheless it remains in the shadow of China, cited by 35% of executives as the top market for growth opportunities. This is not surprising, given the pace of expansion in the Chinese economy: real GDP grew in China at a blistering rate of over 9% for the second year running in 2004.

A forecast slowdown to growth of 8% next year is unlikely to tarnish China's appeal going forward. Indeed, the country's importance to business will only increase as its economy opens up further. Forty-three percent of executives see WTO-related liberalisations in China as the most significant scheduled event of 2005 in terms of its impact on business (more important than general elections in Iraq, the UK and Italy). China's average tariffs have already fallen from 41% in 1992 to 6% after it joined the WTO in December 2001, giving it the lowest tariff-protection of any developing country, and further liberalisations in a



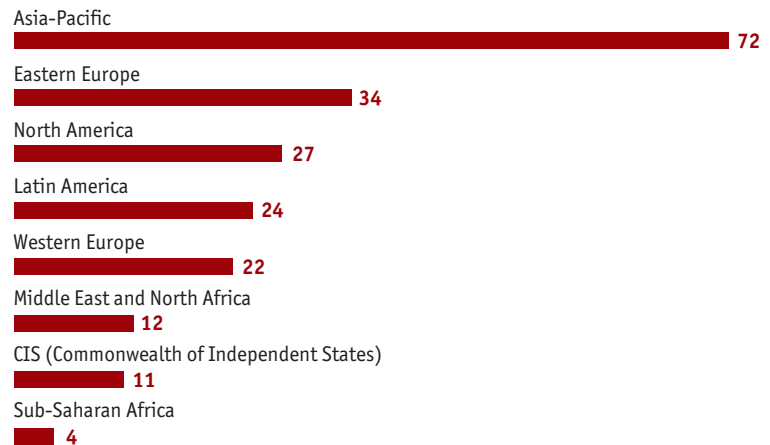
range of industries (such as banking, securities; telecommunications; and wholesale and retail) will take place over the next three years.

China's surging demand for imported raw materials has also been driving strong growth around the world. "We are just getting swamped by import-export containers through the port of Vancouver. The demand is all China or China induced. I think we have a busy decade ahead of us," says Mr Ritchie of Canadian Pacific Railway.

As China's importance as an engine of economic growth increases, however, the country becomes a source of greater risk as well as opportunity for business. In particular, there are persistent concerns over whether the Chinese authorities can gently deflate an investment bubble that has grown in some sectors, and deliver a "soft landing" for the economy. This will entail further tightening of economic policy; however there is a risk that policy action could go too far and cause economic growth to stall. This would be highly damaging, not just for businesses operating in China, but for companies with operations in the rest of Asia, as well as other regions around the world that have come to rely on Chinese demand as a source of revenue growth.

China's business expansion increasingly inspires fear as well as fascination, among western business leaders in particular. A number of executives interviewed for the report believe it is only a matter of time before Chinese companies compete directly in Europe and North America. Last year's purchase of IBM's PC business by Lenovo created a truly international, Chinese-owned corporation with the potential to take on multinationals like Dell and HP on the global stage. The deal, which had to be approved by the Chinese authorities, demonstrates China's determination to be more than a manufacturing hub for the rest of the world. Other Chinese companies are likely to expand into international markets in the

**Which region or regions do you see as offering the greatest growth opportunities for your business over the next three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

coming years—a prospect that causes unease in some quarters.

"One of the most dangerous developments...is the trend for Chinese companies to buy up Western branded companies, obviously to access their knowledge, expertise and their brands," says Martin McCourt, CEO of Dyson, a UK-based manufacturer of vacuum cleaners. "Already this is a terrific manufacturing nation, able to beat anybody on cost. In the future, we may see them coming in and competing with us in our own backyards." That day may be only 2-3 years away for sophisticated consumer products, according to Mr McCourt.

Such a development will only increase the challenges of operating in a business environment that is becoming ever more competitive and unpredictable. "Things are changing so rapidly everywhere, it's hard for businesses to keep up. We are all one economy, everything affects us all," says Vincent Lo, Chairman of Shui On Group, a construction and property-development group with interests in China and North America. With a shaky dollar, rising interest rates, pressure on commodity prices, and new sources of competition, managers will have to be more fleet of foot than ever in 2005.



## Critical forces

**W**ith so many uncertainties to ponder, which of the current crop of business issues cause greatest concern today? And what long-term forces for change does the survey reveal?

Some of the issues raised by executives are familiar from last year's *CEO Briefing*, but priorities have shifted. For the first time since *CEO Briefing* was launched, advances in technology are seen as the most critical issue shaping the global marketplace, with hi-tech advances in a number of industries promising to deliver new products for consumers and rich rewards for business.

Outsourcing and offshoring continue to redraw the business landscape, with 57% of respondents citing these as a critical force, compared with 50% last year (see also this year's special feature ranking of offshoring destinations on page 14). "This trend won't abate—jobs will find a home where they can be done best, at the least cost," says Garry Betty, president and CEO of Earthlink, an Internet Service Provider based in the US. Thomas Cook is a case in point. Having already outsourced HR, IT and finance functions mainly to Accenture, the UK-based travel giant now plans to

move such operations mainly to India. "Going offshore will reduce our cost base by something like another 25-35%," says Ian Ailles, managing director for special businesses and overseer of outsourcing initiatives.

Over half of executives also see customers continuing to call the shots with their demands for

innovative, better quality and cheaper products and services. This trend continues to inspire sweeping organisational changes: a number of executives interviewed for the report cite recent or ongoing initiatives to make their companies more customer-focused.

In addition to these enduring themes, the survey reveals some new preoccupations. The globalisation of supply chains comes to the fore at a time when securing access to cheap and reliable sources of materials and components is imperative. Governance remains an issue, but the focus is moving from meeting compliance deadlines to broader issues of performance-management and optimisation. The huge demographic changes wrought by population-ageing also create long-term issues with present-day ramifications for corporate leaders.

### Technology, the great disruptor

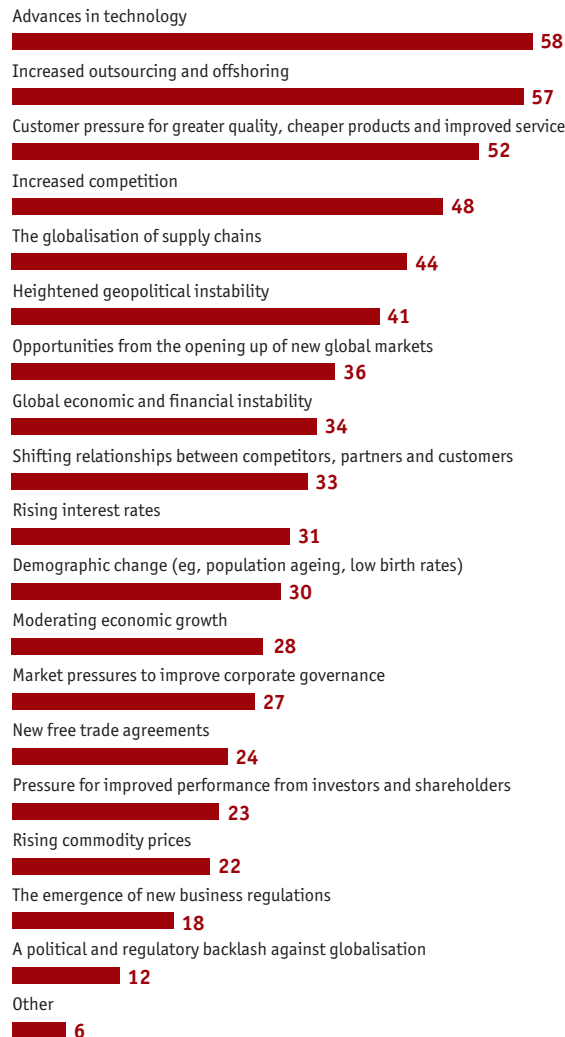
Business enthusiasm for technology took a dip after the disappointments of the dot-com era. Many an ambitious technology project did not survive the savage cost-cutting of recent years. Besides, companies have lately been more concerned with making their existing technology work to the benefit of the business, a trend which remains a focus for corporate IT. But now business enthusiasm for the transformational power of technology has been renewed; indeed, 58% of executives in this year's survey cite advances in technology as the most critical driver of change in the global marketplace, up from 37% only two years ago. As Dyson's Mr McCourt puts it: "If you have the breakthrough technology, you can buck the trend."

**"The opportunity to leverage technology investment to provide better service at a lower cost point is very big. The benefit comes both from streamlining back office operations and in servicing customers more efficiently online."**

Barbara Stymiest, chief operating officer at RBC Financial Group, Canada.



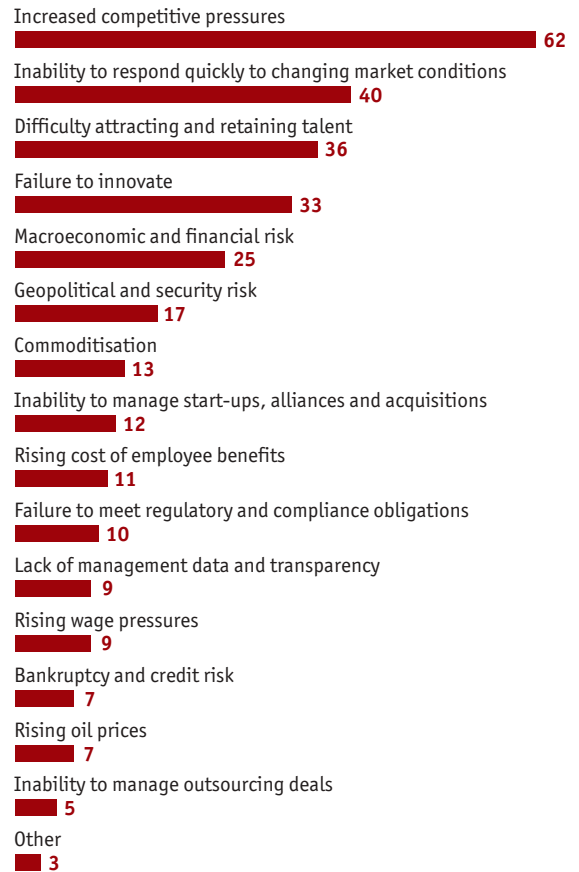
**What will be the critical forces changing the global marketplace over the coming three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

The list of potentially game-changing technologies includes new gene-therapy drugs and DNA vaccines in the healthcare and life sciences sector, and the increasingly pivotal role biotechnology plays in developing new drugs in general. In telecoms, convergence will bring together voice, data, video and other applications on unified Internet protocol (IP) networks, reducing cost and improving productivity in the process; while 3G, another long-heralded technology, is at last expected to make a big splash with consumers in 2005. The further penetration of

**What are the top three risks facing your company over the next three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

cheap, high-speed broadband should also enable a new generation of Internet, media and entertainment applications. Energy companies continue to invest in alternative fuel sources (with the consumption of liquefied natural gas set to grow 10% in 2005), and there will be a renewed focus on technologies to enhance oil discovery and extraction. Portable computers, and technology to help distribute knowledge and information through complex mobile networks, are also transforming the workplace.

Technology is an opportunity, but also has the power to disrupt industries and dislodge market-leaders. Failure to innovate is one of the top risks companies face, according to 32% of executives. Technology companies themselves are particular



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vulnerable. "I worry about technology innovation risk—the idea that comes out of left field," says Art Coviello, CEO of RSA Security, a computer-security firm based in Massachusetts.

### Securing scarce resources

Rising commodity prices are also placing an additional strain on companies, with 22% of executives citing this as a critical driver of change over the next three years. Demand for oil and natural gas will grow by nearly 3% in 2005, with China's insatiable demand for resources creating further pressure on prices. "China is playing a major role in increasing raw materials prices globally...We do not forecast oil prices to go back to the \$20 per barrel range," says Paolo Scaroni, CEO of Italian electricity company ENEL.

Other executives argue that high prices will extend beyond oil and gas to other commodities. "A critical force that is going to change the global marketplace

has to do with scarcity in certain raw materials. We know about oil and gas, but beyond that I think iron-ore and metals are becoming increasingly scarce," says Peter Lorange, president of IMD Business School. One company that has already had to respond to this trend is Arup, a global design and engineering company. Terry Hill, the company's CEO, says Arup has

had to become more intelligent about how to use scarce materials, and has found a way to re-use old building foundations in cities as the basis for new construction work. "I suppose it's bringing the example of car manufacture to buildings, in that a large part of material in a new car is recycled," he says.

These trends also have implications for sourcing strategies. Along with outsourcing, this year's survey brings another example of the global expansion of

business operations to the fore, with a total of 44% of executives citing the globalisation of supply chains as a key force for change. Supply chains are becoming more global as companies seek cheaper, more reliable sources of materials and components. Supply chain integration and automation technologies will be an important focus for 43% of companies in the next three years.

Scarcity of resources extends to people as well as materials—especially for industries that rely on highly-trained workers for their success.

Pharmaceuticals and IT companies are two industries where the competition to attract talented employees is intensifying. "We depend on scientists and medical people to guide us. We must make sure that we keep them and encourage them to remain enthusiastic," says David McGirr, CFO of Cubist Pharmaceuticals, a US maker of anti-infection drugs. In general, failure to attract talent is cited as a key business risk by 36% of executives. This is prompting companies to look further afield for key skills, and will once again pit business leaders against politicians on issues such as offshoring and immigration.

### Governance: moving up, and out

Regulatory issues remain a challenge, but some companies can see light at the end of the tunnel. Sue Powers, CIO at Worldspan, a travel-reservation system operator in Atlanta, now describes Sarbanes-Oxley as "one of the best things to happen to global corporations". She argues that regular auditing under Sarbanes helps employees to focus on a whole range of checks and balances that are necessary in a well-run company.

There is also some anecdotal evidence that companies are extracting wider benefits from compliance. RSA Security found that Sarbanes-Oxley was a catalyst for improving core business processes. "We had an arcane pricing system," explains Art

Chinese demand for key commodities will continue to grow. If India can begin to perform over the next few years like China, then the impact on oil and other commodity prices could be very significant."

Haw Kuang Lim, VP of corporate strategy at Shell.



Coviello, the company's CEO. "When we went to document it under Sarbanes-Oxley, we decided we could make it better." As a result of this rethink, distributors and resellers now find it much easier to work with the company. Governance watchers, including Mr Lorange, believe more and more companies will shift their focus from mechanical compliance to achieving cost-benefits through improved processes.

In addition to putting their internal processes in

order, executives are also obliged to manage a complex and increasingly fluid set of relationships with suppliers and business partners. In this environment, the systematic monitoring, management and optimisation of performance becomes more critical—and many times more difficult to achieve. As a result, there is a growing need to measure and manage the performance of partners and suppliers, and for tools that can deliver greater transparency across the global value chain.

## Business and demography: taking the long view

Global population-ageing is beginning to have a significant impact on business, with 30% of executives in this year's survey citing demographic change as one of the forces shaping the marketplace. Many businesses have already been hit hard by shortfalls in the company pension, partly because of an increase in life expectancy among employees. The shift from defined benefit pensions to defined contribution schemes will continue, but increased worker longevity will still make payouts difficult to sustain: in the US alone, pension funds will report a shortfall of US\$200bn in 2005.

Beyond ongoing worries over company pensions, population-ageing is giving rise to longer-term and more fundamental challenges for business. Consumers—particularly those in Europe—are likely to become increasingly cautious as they seek to save more in the face of rising pension and healthcare costs. "It's the relationship between government, the citizen and the employee...which is radically changing. That means [consumers in Europe] are postponing purchases that are not essential to their families," says Silvano Cassano, CEO of a European fashion house, Benetton.

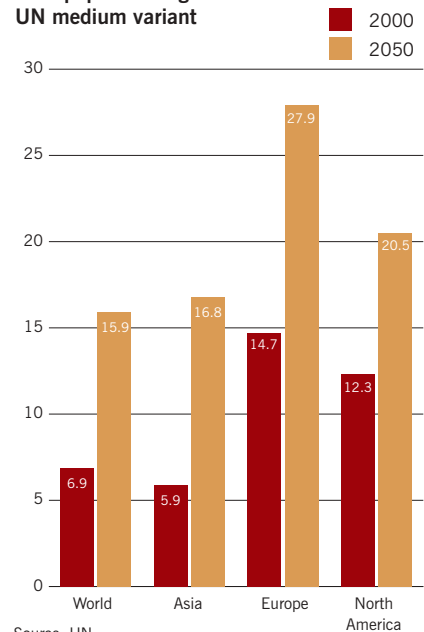
Skill shortages, already a concern for many companies represented in the survey, are likely to be exacerbated as the labour

pool shrinks. At a time when pension schemes, traditionally an important part of the benefits package for many employees, are becoming less generous, companies will need to develop new incentives to attract the best talent. They will also need to create pleasant and flexible working environments to attract women and older workers—groups that are currently under-represented, particularly in senior positions—into the workplace.

Population-ageing will bring its share of opportunities as well as challenges, however. Money is there to be made for companies than develop ways to target the "grey dollar". In developed markets, healthcare companies are already benefiting, as increased longevity keeps old folk consuming drugs and health services for longer. Treatments for chronic illness are also seen as an important growth area, while markets are opening up for new categories of leisure and entertainment products, targeted at the affluent old. "We have an ageing population, which implies greater demand for drugs," says Stefano Pessina, CEO of a European pharmaceuticals distributor, Alliance Unichem. "Similarly, people are becoming more educated and demanding better treatment. These trends will underpin growth in the pharmaceuticals market."

Financial services companies that can fine-tune their offerings to help ageing customers save more for their retirement should also benefit. "A demographic shift in Canada—the aging phenomenon—means people need lots of financial services," says Ms Stymiest, COO of RBC Financial Group.

% of population aged 65+  
UN medium variant



Source: UN



## Special feature: Future leaders in global offshoring

Introducing the Economist Intelligence Unit's 2005 ranking of global offshoring environments

Offshoring is one of the most significant forces shaping today's business environment. But which destinations are most attractive today, and which have the potential to become leading locations for offshoring in the future? The Economist Intelligence Unit, in co-operation with Dimension Data and Oracle Corporation, has developed a new model that ranks 60 of the world's key economies on the basis of their attractiveness as offshoring locations. It examines nine separate measures of attractiveness, covering proximity, political and security risk, macroeconomic stability, regulatory environment, tax regime, labour regulation, labour costs, labour skills, and infrastructure (for a fuller description of the methodology, see the appendix on page 34). While some highly ranked countries are already renowned as key offshoring destinations, the model points to considerable potential in some less obvious locations.

For the purposes of this report, offshoring is defined as the relocation of service activities abroad. It can entail moving service functions internally from a parent company to its foreign affiliates, or by outsourcing to a third party provider in another country.

### Asia's A-list

Asia dominates the offshoring environment ranking, occupying 6 of the top 10 places in the study. India takes the top position, owing mainly to the availability of large numbers of English-speaking graduates, its very low labour costs and a common law legal system. Traditionally, India has attracted US and UK investment in call centres, software development and other language-sensitive work. Now foreign

#### Offshoring Environment Rankings

	Score	Rank
<b>India</b>	<b>7.76</b>	<b>1</b>
China	7.34	2
Czech Republic	7.26	3
Singapore	7.25	4
Poland	7.24	5
Canada	7.23	6
Hong Kong	7.19	7
Hungary	7.17	8
Philippines	7.17	9
Thailand	7.16	10
Malaysia	7.13	11
Slovakia	7.12	12
Bulgaria	7.09	13
Romania	7.08	14
Chile	7.08	15
USA	6.91	20
UK	6.60	29

Source: The Economist Intelligence Unit, 2005

companies are carrying out higher-value activities in the country, such as electronic content provision and research and accounting services. However, India is primarily a centre for the offshoring of services; its attractiveness as location for manufacturing is much less pronounced, reflecting weak infrastructure and high tariff and non-tariff barriers to trade.

Very low labour costs and large numbers of skilled graduates also account for China's second place in the rankings. However, its scores lag behind India in other areas owing to lower language scores, cultural barriers, and a weak legal system. However, unlike India it is highly attractive as a manufacturing location



### Offshoring projects by country

UNCTAD offshoring projects include call centres, shared service facilities, IT services and regional headquarters.

Rank	Country	No offshoring projects	Rank	No of offshoring projects relative to population	No of projects per million population
1	India	228	1	Singapore	22.6
2	UK	187	2	Ireland	19.7
3	China	132	3	Netherlands	11.6
4	US	123	4	Hong Kong	7.6
5	Canada	98	5	Denmark	5.1
6	Singapore	95	6	Sweden	4.8
7	Germany	77	7	Australia	3.7
8	Ireland	77	8	Switzerland	3.6
9	Australia	72	9	UK	3.1
10	Netherlands	52	10	Canada	3.1
			35	India	0.2
			37	China	0.1

Source: UNCTAD, Trade Investment Report, 2004

thanks to a combination of plentiful labour supply, fast improving infrastructure, relatively light bureaucratic burden and close proximity to Taiwan, Hong Kong, Japan and South Korea.

It is interesting to compare the rankings with historical data on the global distribution of offshoring projects. The most recent data from UNCTAD (the United Nations Conference on Trade and Development) shows that India is currently home to the largest number of offshoring projects, followed by the UK and China. The Economist Intelligence Unit would expect to see the UK and US's share of offshoring projects dropping in the future, given their diminished attractiveness in the ranking. By contrast, India and China have considerable scope for further growth, given that India receives just 0.2 offshoring projects per million people and China just 0.1 per million people.

Asia's other top performers are Singapore and Hong Kong (ranked 4th and 7th respectively), demonstrating that success in attracting offshoring projects is not just a question of very low labour costs.

Both have long been popular locations for international corporate headquarters. Indeed, relative to its population size, Singapore is currently the most successful location for offshoring in the world, boasting 22.6 projects per million people. Even in absolute terms, its total of 95 offshoring projects puts it in 6th place globally. In particular, Singapore's very high quality telecommunications infrastructure makes it a logical location for data centres that demand world-class telecommunications, while its well-educated workforce makes it suitable for high-tech activities and the offshoring of financial services.

### Offshoring in the near East

Eastern Europe also emerges as a region with strong attractions for offshoring, with all eight of its countries clustered towards the top of the ranking. The Czech Republic leads the pack, taking third place in the ranking behind India and China. The Czech Republic's potential stems from a combination of relatively low labour costs, an attractive regulatory environment, and



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close proximity to western Europe, with which it also shares close cultural and historical ties. The country's relatively well-educated workforce broadens its attractiveness as an offshoring location beyond those of regional competitors such as Poland and Slovakia.

Like the Czech Republic, all of the Eastern European countries achieve relatively strong scores across a wide range of indicators. Importantly, the region's economic, historical and geographic ties with Western Europe make it attractive for smaller companies looking for a culturally similar labour force. Western European companies can also leverage Eastern Europe's linguistic skills. For example, 4m Romanians speak French, and 2m speak German. Although Eastern Europe currently accounts for a small number of existing offshoring projects, with only Hungary exceeding more than 2 projects per million people, the ranking model points to very strong potential.

### Canada makes the cut

Of the OECD members, Canada is easily the highest ranked country, in 6th place. This is partly the result of relatively low labour costs for a developed country, but also reflects a very strong performance across all the remaining indicators. Canada's close proximity to the US and its highly skilled workforce have also made it an attractive destination for US companies. This is illustrated by the historical data from UNCTAD, showing that Canada is home to 98 service sector offshoring projects, the 5th highest total in the world. The US is the second highest-scoring OECD member, ranked 20th. US labour costs are high, but the country's workforce is huge, and its business environment highly attractive.

The top ranked Western European countries are Ireland and the UK, in 27th and 29th places respectively. Labour costs are high in both countries, but this is partially offset by attractive labour markets, favourable business environments and English

language skills. Although the UK is a major offshorer of IT and manufacturing jobs itself, it attracts corporate headquarters as well as investment in sophisticated services such as advertising and recruitment, software development and pharmaceuticals.

When correlated to population size, data from UNCTAD suggests that Ireland is currently the 2nd most successful offshoring destination in the world and the UK the 7th. As noted, however, strong competition from the emerging markets is likely to see the UK and Ireland's share of offshoring projects falling. Even so, they look set to perform far better than the rest of Western Europe, where high labour costs combined with dense labour regulation undercut the attractiveness of major western European countries such as France, Germany and Italy. Turkey, where labour costs are very low, ranks just 31st, let down by political and macroeconomic instability and a weak business environment.

Most Latin American countries are placed in or around the middle-third of the ranking, suggesting that they will struggle to improve upon their current poor performance in attracting offshoring. Chile outshines its neighbours, luring investment with educated workers and strong IT skills. According to UNCTAD's data, Chile is currently the strongest performing Latin American country, with 0.9 projects per million people, and it is the only Latin American country to make it into the top 15 countries in the rankings model. Mexico, ranked 18th, should profit from its proximity to the US and from the growing number of Spanish-speakers in the US.

### Competition for offshoring is set to intensify

The Economist Intelligence Unit's offshoring rankings model suggests that India, China and several Eastern European countries will provide increasingly tough



competition to established destinations for offshoring such as the UK, Ireland and the US. However, in order to fully exploit their potential and to prevent their attractiveness waning as their labour costs rise, both India and China will have to address weaknesses in their infrastructure and business environments, and in China's case improve the availability of English language skills. The model suggests that Eastern Europe will emerge as an

offshoring hub. Currently, the numbers of offshoring projects in these countries is low, but they offer a very good mix of advantages, not least close proximity to high-cost Western Europe. Finally, the high ranking of Canada, Singapore and Hong Kong demonstrates that it is possible for relatively high cost locations to remain attractive for offshoring, assuming they have the right skills and infrastructure and attractive regulatory environments.



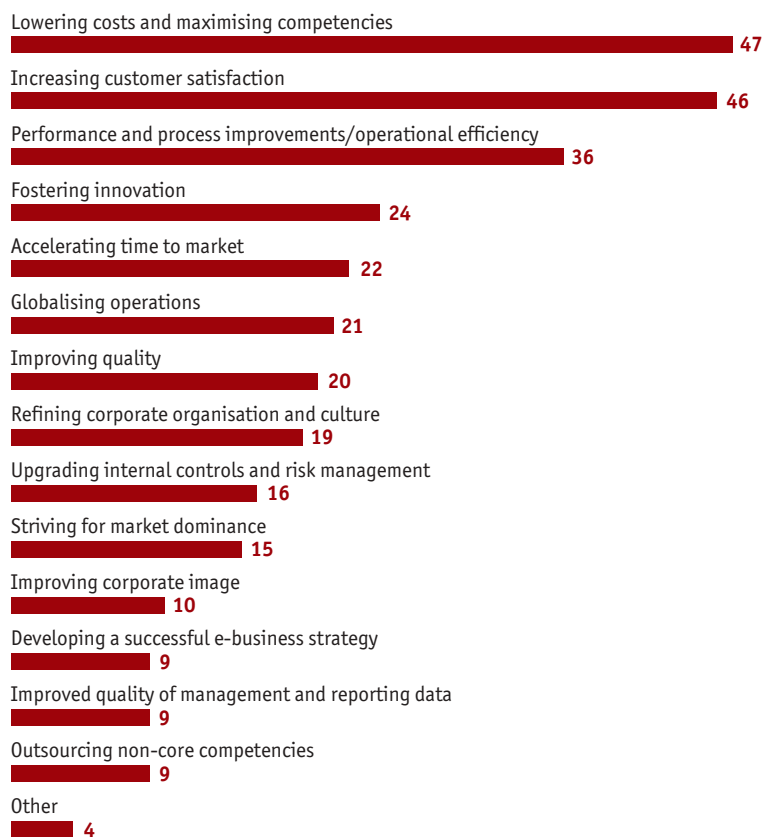
## Corporate strategies

**T**he next three years will see companies striving to restore balance to their businesses. Managers continue to preach the gospel of cost-efficiency, almost half those surveyed citing lowering costs and maximising competencies as strategic priorities. But as the major economies have strengthened, business horizons have expanded. There is a renewed determination to pursue growth,

with 87% of executives targeting higher revenue and profit levels for 2005. Companies are again looking overseas for new opportunities, with many citing international expansion and globalisation of their business operations as a strategic priority.

How do companies reconcile a continued focus on cost savings with the need to create value in their businesses? The answer may lie in the third-most commonly cited strategic priority in this year's survey: 36% of executives surveyed see performance and process improvements as being a key source of value in the years ahead. This is prompting executives to pursue two distinct agendas—firstly, to make global processes more transparent and standardised, and secondly, to make them more responsive to changing market needs.

### What are your company's top three strategic priorities over the next three years? (% respondents)



Source: Economist Intelligence Unit survey, 2005

### More discipline...

With Enron, Parmalat and several other failures still fresh in their minds, business leaders are much more hawkish in this year's survey on issues of performance and control. A total of 45% of executives in this year's survey say there will be a move towards greater command and control, compared with 18% who believe there will be a move in the opposite direction. "We've got the balance of power right now; in our business, we have to be heavy on the control side when it comes to operational standards," remarks Tony Tyler, chief operating officer at Cathay Pacific Airways. Many other executives in the survey stress the need for control as their operations become more disparate and complex.

This does not necessarily augur a return to centralised management—only 25% see this as a focus



for organisational change—but there is a greater emphasis on discipline and more robust performance-management across global operations. To achieve this, companies will impose standardised, proven processes across the business. “We need to make sure that we’re driving procedures on a global basis...to instil financial discipline and the trait of operational excellence,” says James Schiro, CEO of Zurich Financial Services.

Sarbanes Oxley, Basel II and other compliance initiatives have already prompted companies to improve their financial reporting systems and processes. But performance will need to be measured in other ways. In particular, companies are seeking greater transparency and accountability in supplier relationships, and non-financial metrics—for example, customer-satisfaction and service quality—will become increasingly important performance measures.

## Versus greater flexibility

Discipline is all very well, but companies also need to be able to respond to change. Having faced a range of unpredictable events such as “war (Iraq), disease (Sars), and recession”, the challenge for companies like Cathay Pacific Airways, according to Mr Tyler, is implementing a clear strategy, while maintaining flexibility. In this unpredictable environment, inability to respond quickly to changing market conditions emerges as the second most-cited business risk (up from fourth last year). “All companies have to become agile to address changing market needs because of broader uncertainty and change in the marketplace,” says Brian Keane, CEO and president of Keane Inc, a US\$1bn outsourcing firm based in Boston.

One way to achieve this agility will be by implementing “sense and respond” strategies, through which companies improve their ability to detect and act on new trends in the marketplace. Companies will need to systematically capture customer requirements from front line staff in sales,

marketing and customer services and use them to help drive strategy. Coach Inc, a thriving US designer of accessories and handbags, is a strong proponent of this approach. Last year the company used the findings from interviews with over 15,000 consumers to guide its product development. “We are innovative and consumer centric. Our overarching strategy is to stay fresh and relevant to the consumer,” says Lew Frankfort, the company’s CEO.

Companies will also achieve greater flexibility by focusing on alliance strategies and by moving away from big, fixed-cost structures, according to Mr Keane: “It means focusing on core strengths and outsourcing—not so much as a way to cut costs, as it was five years ago, but as a way to remain flexible.” Sue Powers, CIO at Worldspan, also sees outsourcing as a great enabler of business flexibility, particularly through on-demand services “which can help companies to be more scaleable and agile in response to market forces”.

## IT as glue for the enterprise

Companies face a tough challenge when it comes to co-ordinating an expanding web of business operations against coherent goals. Collaboration, whether it is with customers, partners or between different business silos, is an important concept for many executives in the survey. For most, the focus for organisational change needs to be on sharing information more quickly and widely across the enterprise—cited by 77% of executives surveyed this year, compared with only 58% last year. Fortunately, a crop of diverse information technology (IT) tools—in particular, the Internet, mobile data systems, and business intelligence solutions—are helping companies to achieve this.

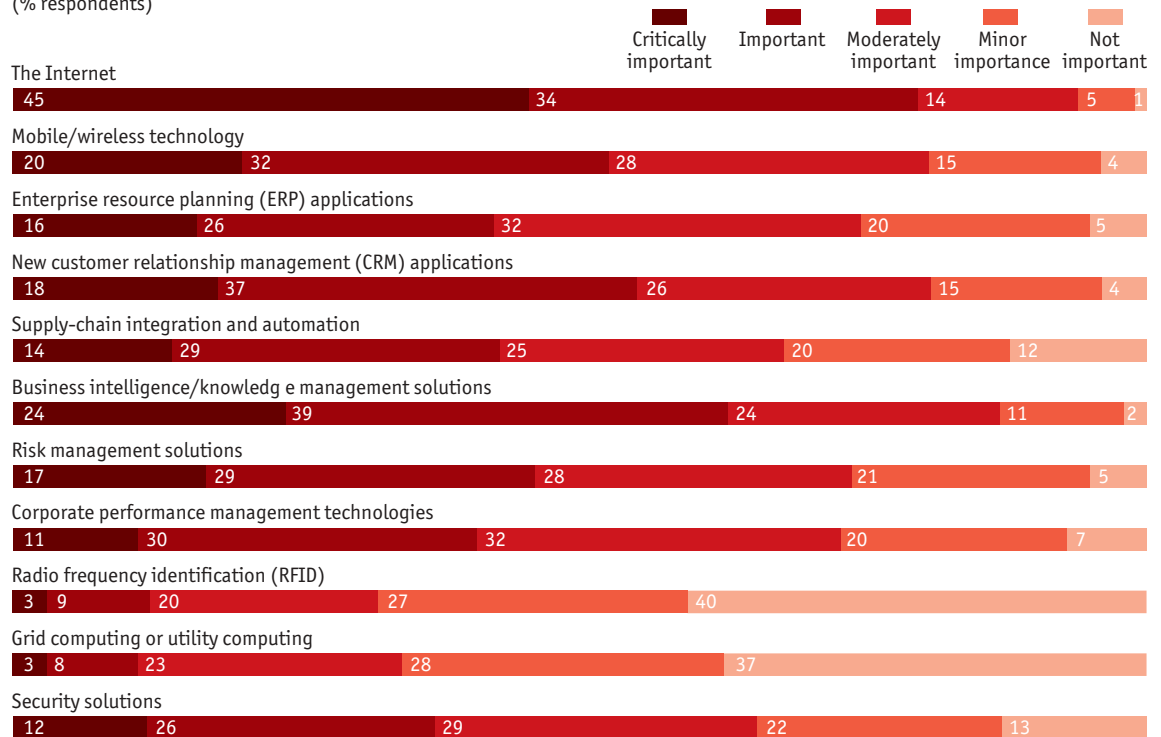
These collaborative technologies tend to fall into two buckets. The first is communication infrastructure: The Internet is ubiquitous and critical for 45% of



## CEO Briefing

### Corporate priorities for 2005

How important are the following technologies in achieving your company's strategic goals over the next three years?  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

companies represented in the survey, but mobile and wireless technology has also become crucial for 20% of executives, as flexible working trends such as remote working become more commonplace. Other research conducted by the Economist Intelligence Unit suggests that Voice over IP, a technology which enables data and voice to be transmitted over Internet-based networks, will also help companies rationalise their communication infrastructures over the next three years.

Another distinct trend, however, is the growing importance of technologies that help make information more relevant and useful to managers. Business intelligence solutions have assumed greater importance, with 24% of executives describing it as a critical technology versus 18% who say the same of CRM. Technologies that aid performance management are also important or critical for 41% of executives. "I see technology...as a glue for corporate governance," says Sergey Kravchenko, Boeing's president for Russia

and the Confederation of Independent States. "Technology allows us to work towards compliance more effectively."

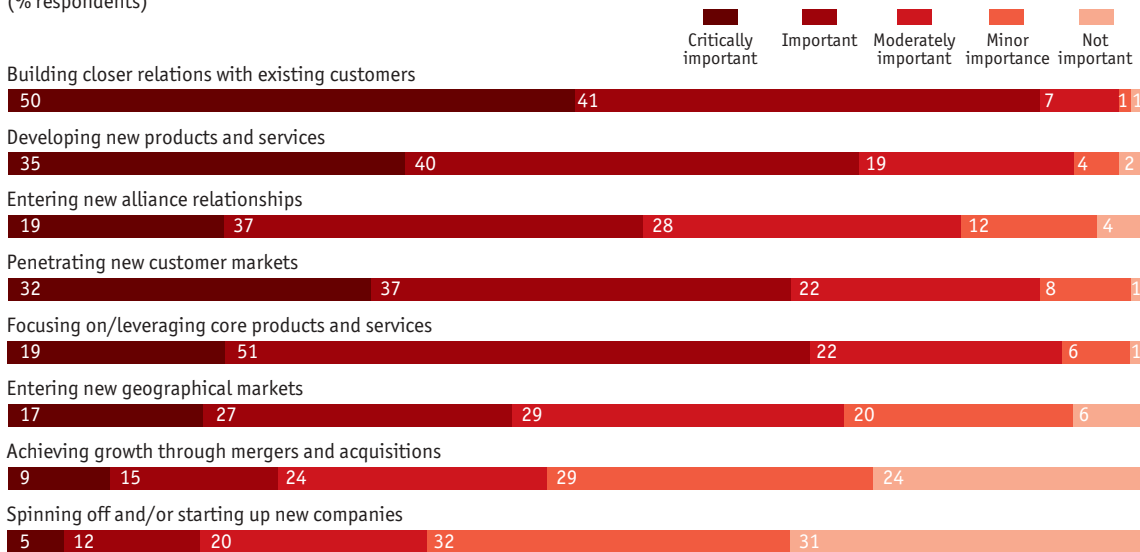
These trends will drive modest investments in IT, but the emphasis remains on connecting and improving existing systems. Medium and large companies spent a lot of money on IT around the year 2000, notes Shanghai-based Trevor Williams, a principal with Gramercy Venture Advisors, a boutique investment bank and corporate advisory firm with offices in London, San Francisco, Sydney, Melbourne, and Singapore. Mr Williams says the overriding attitude today is, "We've spent this money, now let's get it working properly."

### Marrying innovation with customer satisfaction

Efficiency drives can only go so far and, for many companies represented in the survey, fostering innovation will be the key to growth in 2005. "Cutting



**How important are the following strategies in driving global growth in your company over the next three years?**  
(% respondents)



Source: Economist Intelligence Unit survey, 2005

cost is important, but if you do a really good job managing innovation then you can increase your revenue. Innovation gives you an order of magnitude of revenue-increase over cost savings," says Joel Lemke, CEO of Enovia Corp, a division of the French industrial conglomerate, Dassault Systèmes. Customer pressure for new and better products is also an important factor. Seventy-five percent of executives see the development of new products and services as their major growth strategy, second only to strengthening customer relationships.

Innovation is back at the heart of the corporate agenda, but companies now tend to eschew theoretical research and development (R&D) in favour of less ambitious projects focused on product-line enhancement. Innovation is a resource-hungry activity, and the vast majority of companies interviewed for this report embark on R&D projects with a clear-eyed focus on commercial viability. Profitable innovation requires companies to become adept at weeding out flawed ideas early, so that resources can be invested in projects with the greatest likelihood of success. This is where recent efforts to make companies more customer-focused overlaps with

a new-style of market-led R&D. For hi-technology companies like Samsung, "marketing is becoming a pivotal function" in product innovation, according to Yun Jong-Yong, vice-chairman and CEO at Samsung. Mr Yun contends that companies must be able to sense market requirements and incorporate these needs into the company's product planning.

A customer-driven approach to R&D has obvious advantages (not least that people are more likely to buy your innovations when they finally come to market), but once again requires a more collaborative approach, this time between marketing and sales and corporate laboratories.

Unfortunately, even with the most joined-up approach to R&D, staying at the cutting edge of innovation is never easy—particularly when your rivals are pursuing the same goal with equal vigour. "There are short periods when we've come up with a stunning, efficient, modern design...and commoditisation poses little threat," observes Terry Hill of Arup, a global design and engineering company. "The question is, how long can we keep the lead?"

**"Innovation gives you an order of magnitude of revenue-increase over cost savings."**

Joel Lemke, CEO of Enovia Corp



## Conclusion

**P**ity the CEOs of today's global businesses. While keeping ahead in fast-moving markets has never been easy, it becomes doubly challenging in a climate of uncertainty. More executives see opportunities for robust growth in this year's *CEO Briefing* than last year, but there is a strong sense that the business environment could take a sudden turn for the worse. The risk of a collapse of the dollar, rising interest rates, and persistent turbulence caused by economic imbalances in the world's major economies leave executives preparing for trouble, even as they lay their strategies for growth.

Fortunately, most executives will not allow an unpredictable business environment to paralyse the strategic agenda. Instead, they are tightening governance of their global empires, and improving

processes across their expanded operations. Offshoring and the globalisation of supply chains offer lower costs and increased flexibility, but bring new layers of complexity to the job of management. In response, companies are once again turning to technology to connect and streamline their operations, improve knowledge-sharing, and increase management's ability to sense and respond to market-change.

The next few years will test executives' leadership skills to the utmost. Competition from traditional sources, as well as the emergence of new international challengers from China and India, will only raise the bar higher. With a to-do list ranging from cost-savings to value-creation, from strategy-setting to flawless implementation, who would envy the CEO's task in 2005?

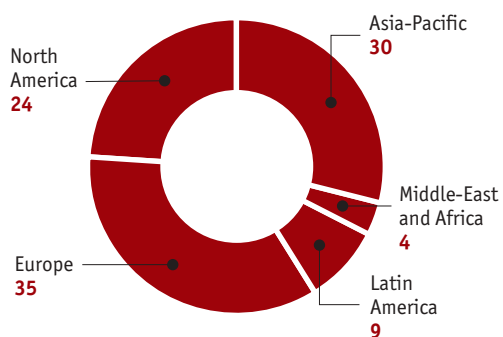
# Appendix 1: Survey results



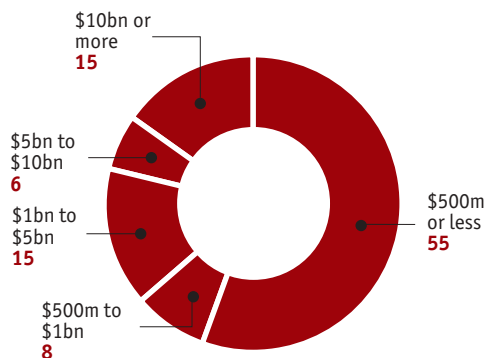
500 respondents from a total of 75 countries participated in the survey, which was administered online in December 2004. Our sincere thanks go to everyone who took part in the survey.

Please note that not all answers add up to 100%, because of rounding, because respondents were able to give multiple answers to one question, or because a selection of top answers is given.

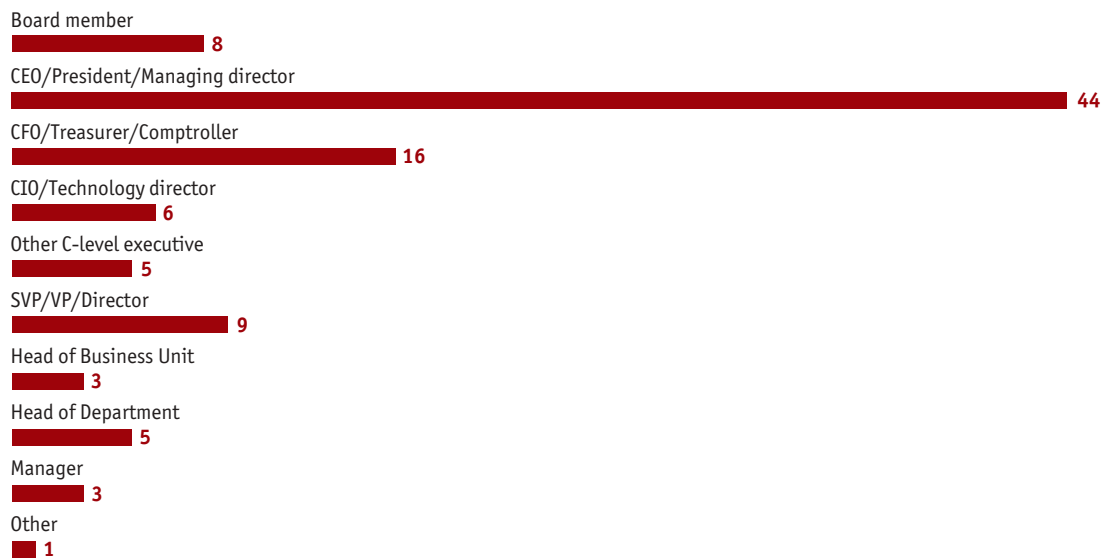
**In which region are you personally based?**  
(% respondents)



**What are your organisation's global annual revenues?**  
(US dollars)



**Which of the following best describes your title?**  
(% respondents)

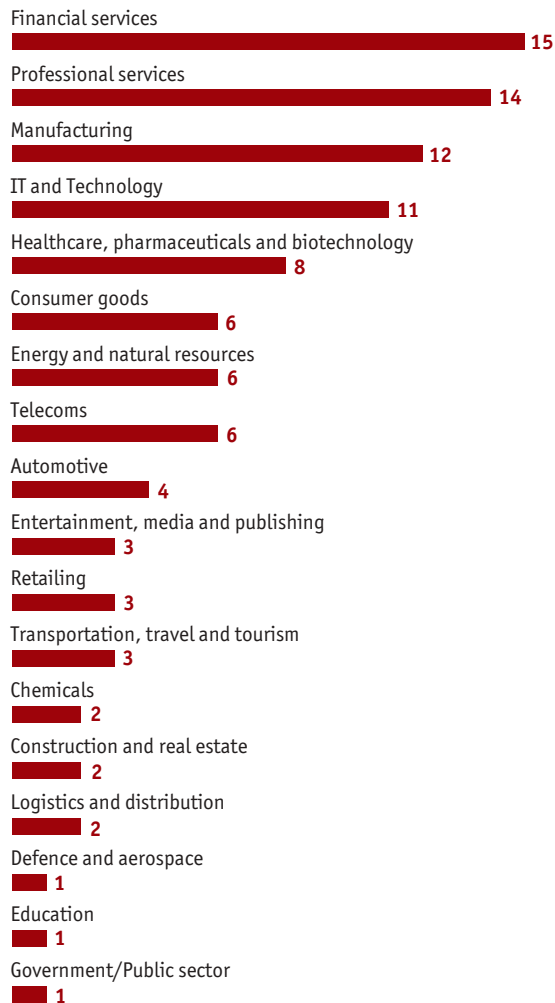


**Appendix 1: Survey results**  
 CEO Briefing  
 Corporate priorities for 2005

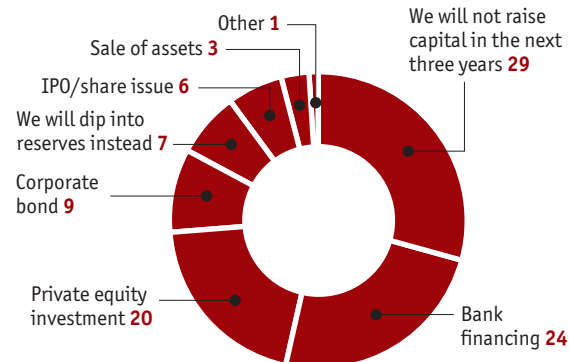
**What are your main functional roles?**  
 Please choose no more than 3 functions.  
 (% respondents)



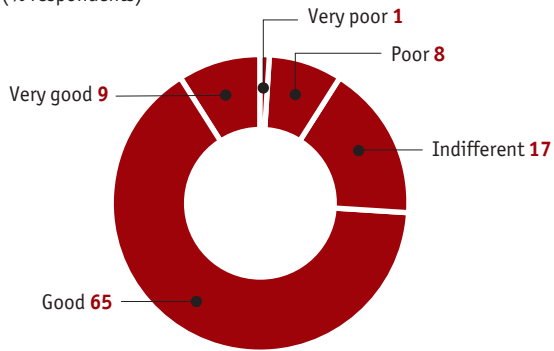
**What is your primary industry?**  
 (% respondents)



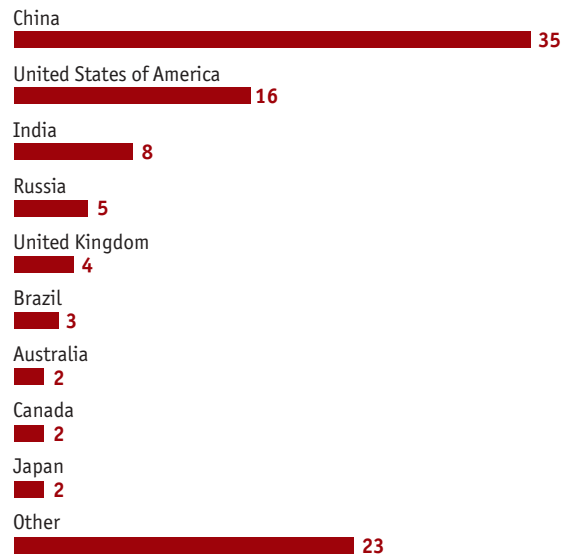
**Should your company need to raise capital in the coming three years, which route are you most likely to use?**  
 (% respondents)



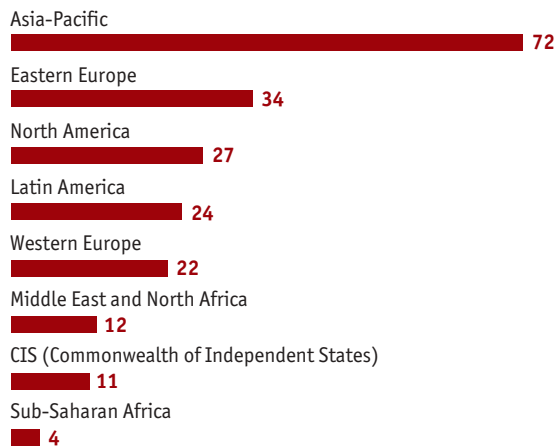
**How do you view the prospects for your business in the global marketplace over the coming three years?**  
 (% respondents)



**Which single country do you see as offering the greatest growth opportunity for your business over the next three years?**  
 (% respondents)

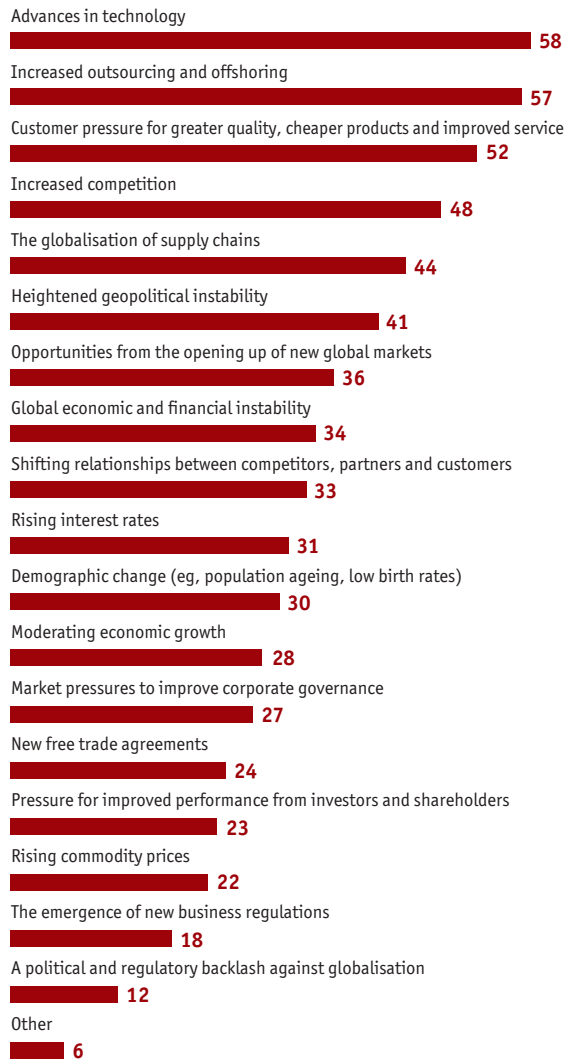


**Which region or regions do you see as offering the greatest growth opportunities for your business over the next three years?**  
 (% respondents)

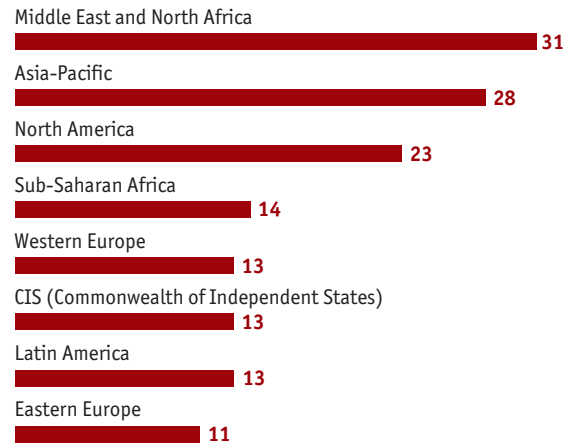


**Appendix 1: Survey results**  
 CEO Briefing  
 Corporate priorities for 2005

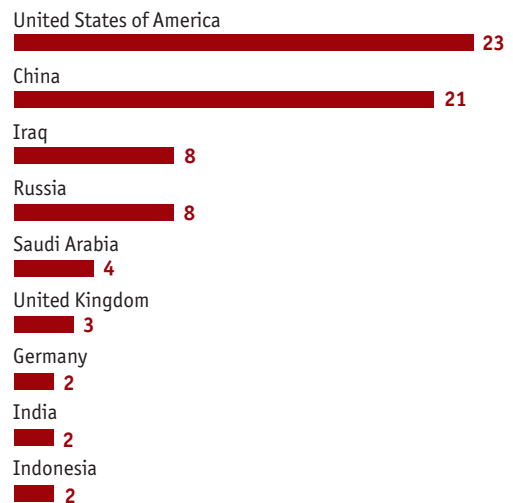
**What will be the critical forces changing the global marketplace over the coming three years?**  
 (% respondents)



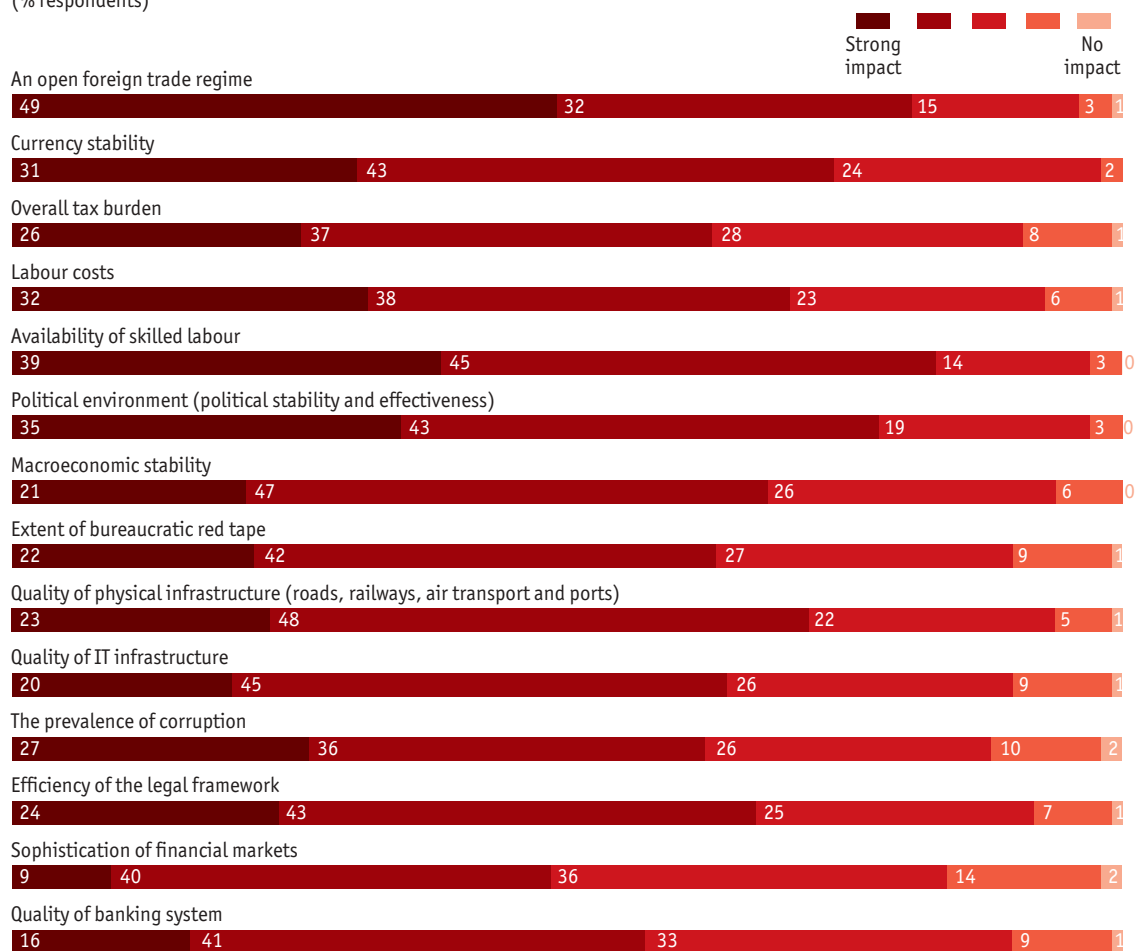
**Which region or regions do you think entail the greatest risks for your business over the next three years?**  
 (% respondents)



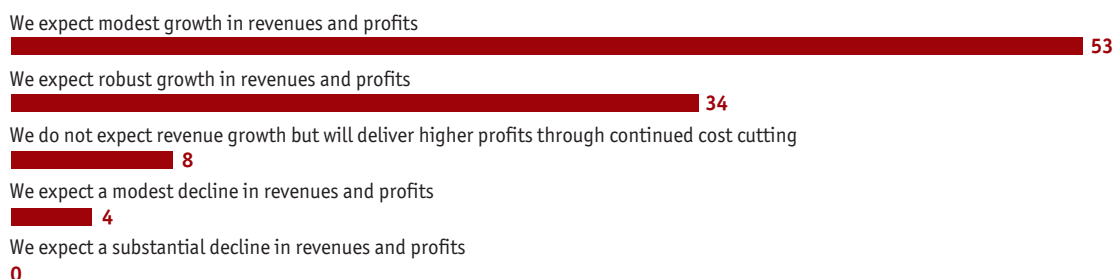
**Which single country do you see as entailing the greatest risk to your business over the next three years?**  
 (% respondents)



**Which of the following do you believe have the greatest influence on a country's competitiveness?**  
(% respondents)

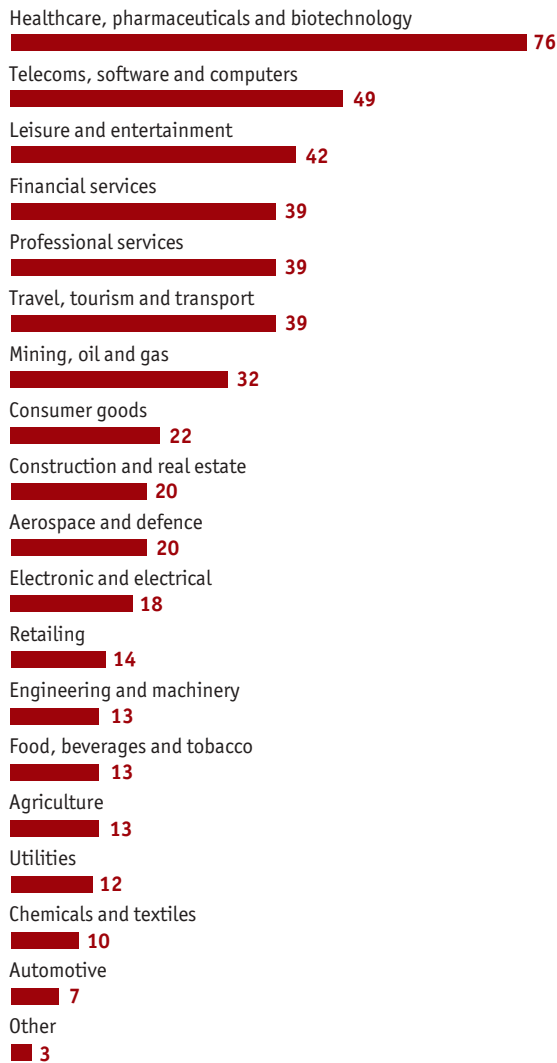


**How well do you expect your company to perform in the 2005 calendar year?**  
(% respondents)

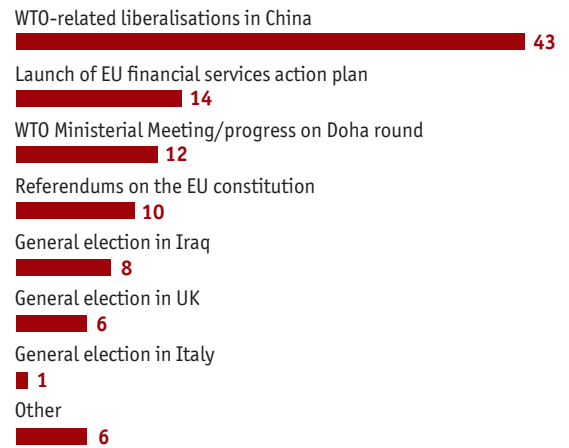


**Appendix 1: Survey results**  
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 Corporate priorities for 2005

**Which industries do you believe enjoy the best growth prospects over the coming three years?**  
 (% respondents)



**Which of the following scheduled events in 2005 is likely to have the biggest impact on your business?**  
 (% respondents)



**To run a successful global company, what should senior management's single greatest priority be over the next three years?**  
 (% respondents)



**What are your company's top three strategic priorities over the next three years?**

(% respondents)



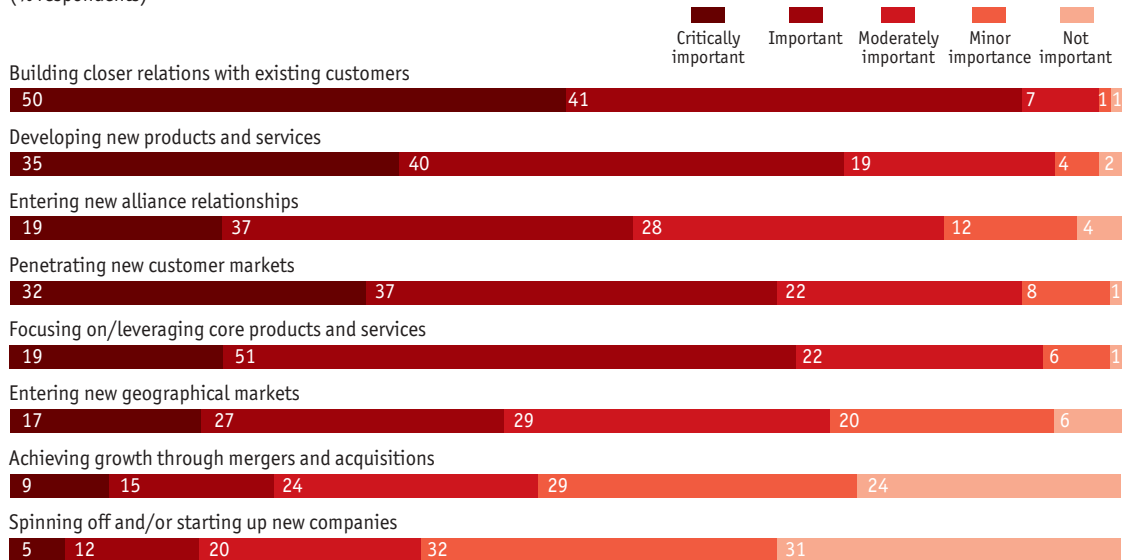
**What are the top three risks facing your company over the next three years?**

(% respondents)

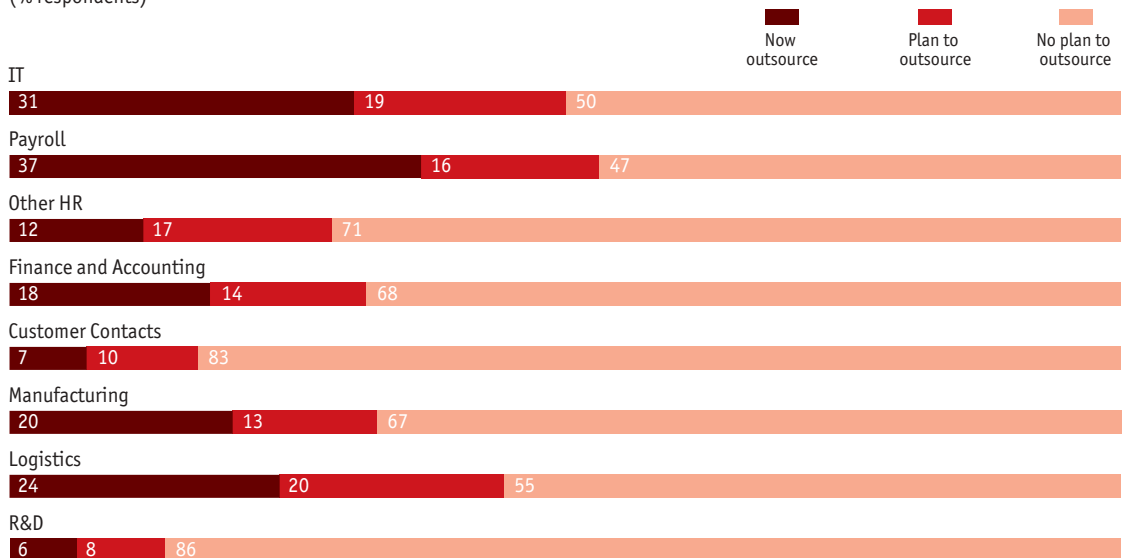


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 CEO Briefing  
 Corporate priorities for 2005

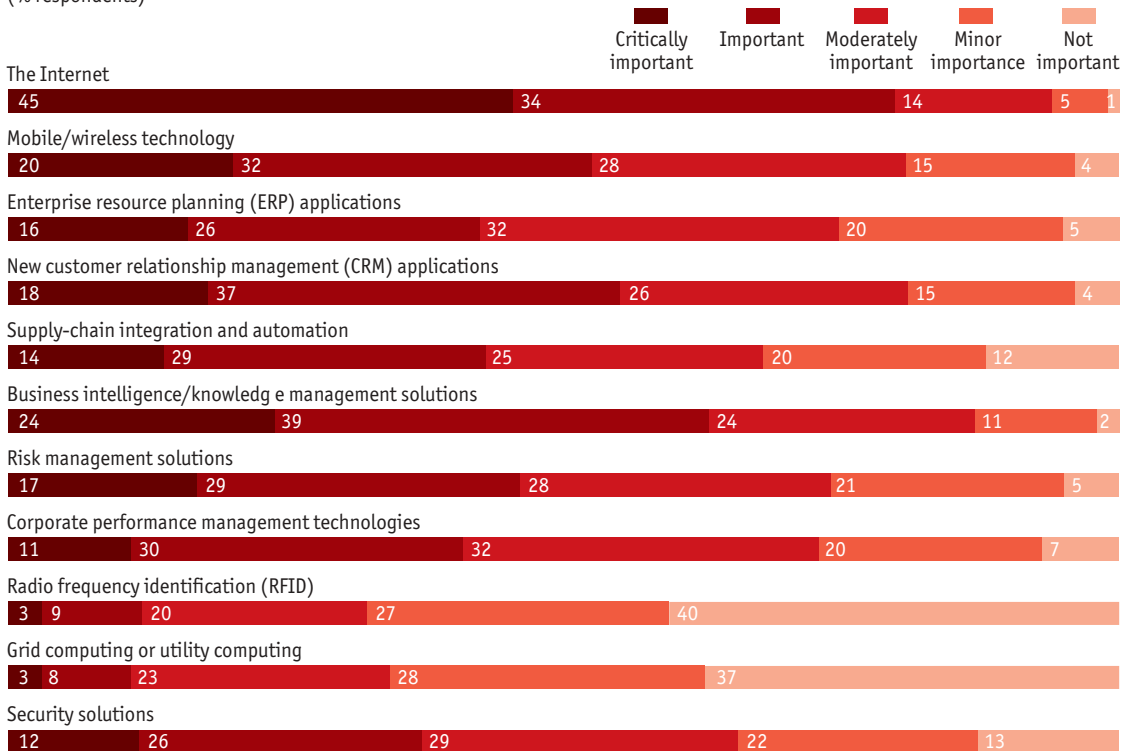
**How important are the following strategies in driving global growth in your company over the next three years?**  
 (% respondents)



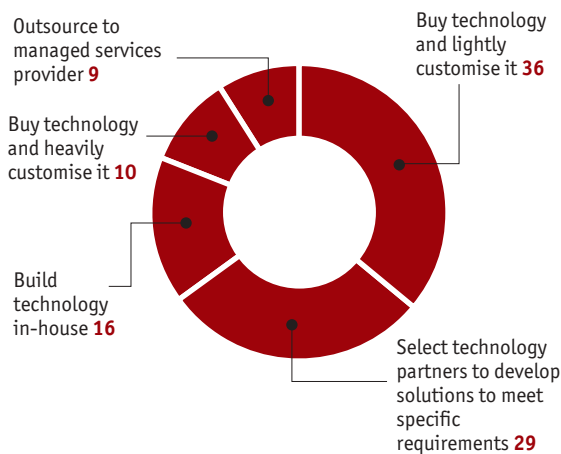
**Which functions, if any, does your company outsource now and which do you plan to outsource within the next three years?**  
 (% respondents)



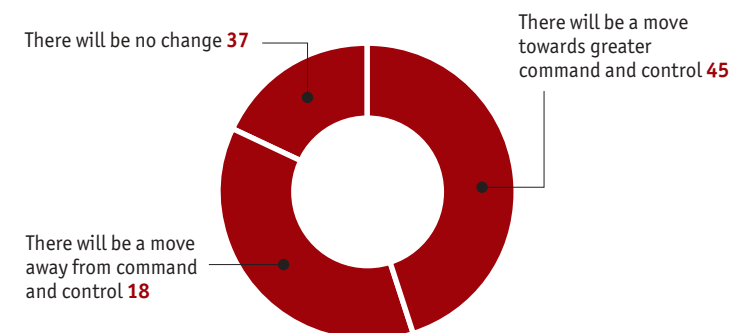
**How important are the following technologies in achieving your company's strategic goals over the next three years?**  
 (% respondents)



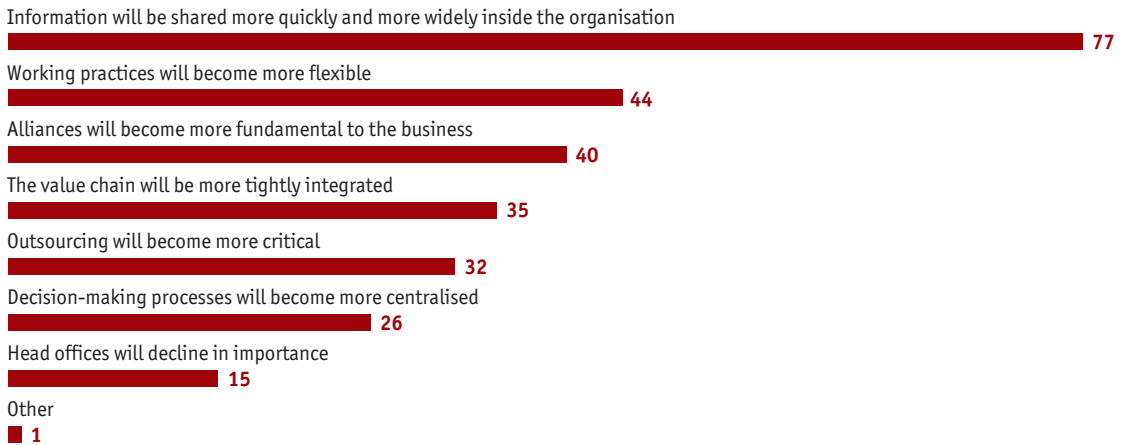
**What is your company's preferred method for developing technology-based business solutions?**  
 (% respondents)



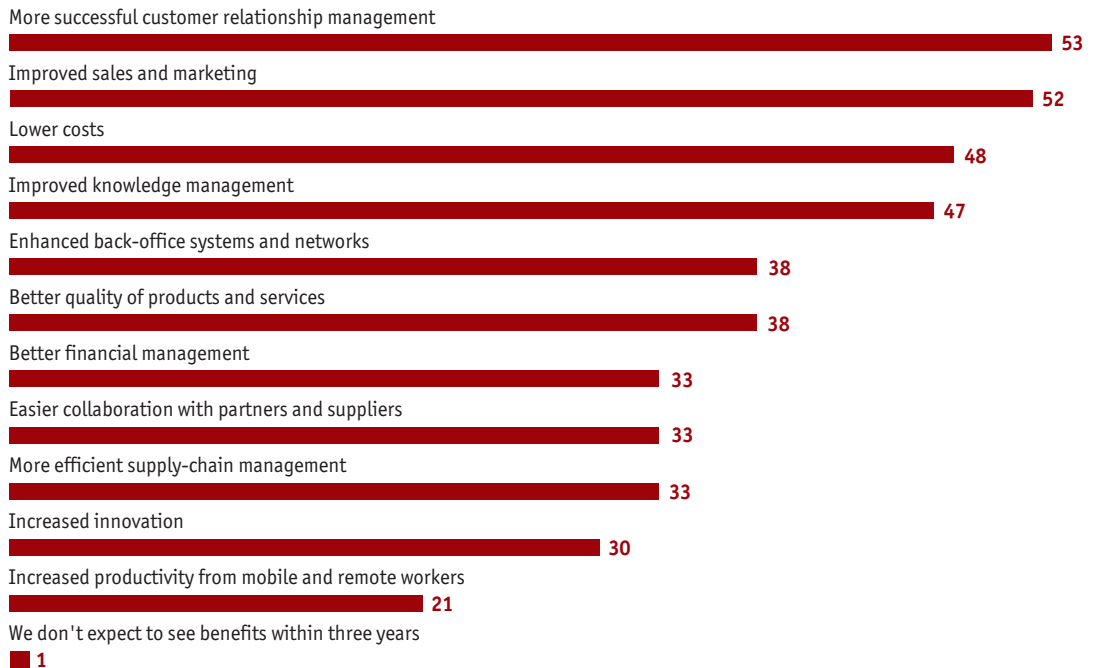
**In the current environment, company structures are pressured by two conflicting trends: the technology-enabled push towards greater flexibility and networking, and the need for greater control and tighter corporate governance. How will your corporate organisation respond over the next three years?**  
 (% respondents)



**Over the next three years, how do you expect your company's organisational structure to change?**  
 (% respondents)



**In which areas of your business do you expect to see the greatest benefits from investment in technology over the next three years?**  
 (% respondents)



## Appendix 2: Offshoring environment rankings methodology



The Economist Intelligence Unit's Offshoring Environment Rankings model measures the attractiveness of 60 countries as locations for offshoring. It is designed to reflect the main criteria used by companies when deciding where to locate their offshoring activities. The model examines nine separate measures of attractiveness, covering proximity, political and security risk, macroeconomic stability, regulatory environment, tax regime, labour regulation, labour costs, labour skills, and infrastructure. Each of these categories contains a varying number of indicators, of which there are 37 in total.

The methodology used to construct the Offshoring Environment Rankings draws on that of our well-established Business Environment Rankings, which measure the attractiveness of countries for foreign direct investment. Just over a third of indicators are quantitative, and are drawn from national and international statistical sources and the Economist Intelligence Unit's forecasts. The other indicators are qualitative in nature (for example, the regulatory environment), and draw on a range of sources as well as our deep pool of in-house country expertise and our extensive global network.

### Calculating the rankings

The nine main categories for scoring offshoring attractiveness have been weighted to reflect the importance that companies place on labour costs and skills when deciding where to offshore. These two categories account for 0.3 of the index respectively, and the labour regulation category accounts for 0.1. The relative weights have been derived on the basis of interviews and survey data. The remaining six categories all account for 0.05 of the index. The use of equal weights for these categories reflects the theoretical uncertainty of some of the determinants of outsourcing.

The measure of labour costs is average monthly wages in US\$, unadjusted for differences in productivity as companies generally hope to achieve comparable productivity levels in their offshoring activities. The measure of English language skills reflects a combination of Toefl scores (Toefl is a test of English as a foreign language) and qualitative assessment of the availability of English, related to population size. For example, average English ability is relatively low in India but because of the size of the country's population it still offers a massive pool of English-speakers. The education indicators are drawn from the World Economic Forum's Global Competitiveness Report 2003-04, and the Economist Intelligence Unit's e-readiness model. The proximity variable refers to the distance between a country's capital and the nearest major source area of investment, whether that is the US, EU or Japan.

### Weightings for the offshoring rankings

Labour costs	0.3
Labour skills	0.3
Labour regulation	0.1
Proximity	0.05
Political and security risk	0.05
Macroeconomic stability	0.05
Regulatory environment	0.05
Tax regime	0.05
Infrastructure	0.05

When offshoring, companies are not primarily concerned with serving the markets of the country in which they have outsourced activities, but rather their existing markets. As a result, we have attached relatively little weight to the macroeconomic stability category.

The rankings are calculated in several stages. With the exception of the proximity variable (which is scored on a scale from 1 to 10, with 10 being closest to the region's major source area of investment) and the labour costs variable, each of the indicators is scored on a scale from 1 (negative for offshoring) to 5 (positive for offshoring). The aggregate category scores are derived on the basis of simple or weighted averages of the indicators' scores within each category. These are then adjusted, on the basis of a linear transformation, to produce indexes valued on a 1-10 scale. An average of the nine categories is then calculated according to the weights attached to each category to yield the aggregate outsourcing score for each country, again on a 1-10 scale.

### Sources for the ranking

The main sources used include Economist Intelligence Unit, *Country Risk Service*; Economist Intelligence Unit, *Country Forecast*; Economist Intelligence Unit, *e-readiness ranking*; IMF, *Annual Report on Foreign Exchange Restrictions*; International Labour Organisation, *International Labour Statistics Yearbook*; UN, *Monthly Bulletin of Statistics*; UN, *World Development Report and World Development Indicators*; World Economic Forum, *Global Competitiveness Report, 2003-04*; Educational Testing Service, *Test of English as a Foreign Language*.

**Appendix 2: Offshore rankings methodology**  
 CEO Briefing  
 Corporate priorities for 2005

**The Economist Intelligence Unit's Offshoring Rankings**

	Proximity	Political environment & security	Macro-economic stability	Regulatory environment	Tax regime	Labour costs	Labour skills & availability	Labour regulation	Infra-structure	Total score	Rank
India	4.37	7.20	8.40	6.00	6.50	9.69	7.78	7.33	4.60	<b>7.76</b>	<b>1</b>
China	8.07	6.00	9.20	5.25	5.50	9.70	6.46	5.33	5.20	<b>7.34</b>	<b>2</b>
Czech Rep	9.46	8.40	8.40	8.00	6.00	8.50	5.62	6.00	6.20	<b>7.26</b>	<b>3</b>
Singapore	5.90	8.40	8.80	9.50	8.50	6.23	6.92	8.00	7.40	<b>7.25</b>	<b>4</b>
Poland	9.03	7.60	8.00	7.25	7.00	8.81	5.69	6.00	5.60	<b>7.24</b>	<b>5</b>
Canada	9.61	8.00	9.20	9.00	8.00	5.08	7.60	7.33	8.40	<b>7.23</b>	<b>6</b>
Hong Kong	7.24	6.80	9.60	8.50	8.50	7.33	5.65	8.67	8.20	<b>7.19</b>	<b>7</b>
Hungary	9.00	7.60	6.80	8.00	7.00	8.46	5.58	6.67	6.20	<b>7.17</b>	<b>8</b>
Philippines	7.17	6.00	8.40	5.75	7.50	9.80	5.18	8.00	5.00	<b>7.17</b>	<b>9</b>
Thailand	5.59	7.60	9.60	6.25	7.50	9.65	4.87	7.33	6.00	<b>7.16</b>	<b>10</b>
Malaysia	5.92	7.60	9.20	7.00	8.00	8.52	5.65	7.33	5.40	<b>7.13</b>	<b>11</b>
Slovakia	9.14	8.00	9.20	7.00	6.50	8.98	5.07	6.00	5.20	<b>7.12</b>	<b>12</b>
Bulgaria	8.41	7.20	7.60	5.75	6.00	9.61	4.96	7.33	6.40	<b>7.09</b>	<b>13</b>
Romania	8.35	7.20	7.20	5.75	6.50	9.49	5.55	6.00	4.60	<b>7.08</b>	<b>14</b>
Chile	1.97	7.60	9.60	8.75	8.50	9.14	4.64	7.33	6.40	<b>7.08</b>	<b>15</b>
Taiwan	8.04	7.60	9.60	8.25	8.00	6.80	5.79	8.00	7.80	<b>7.05</b>	<b>16</b>
Russia	7.95	5.20	9.60	4.50	5.00	9.51	6.05	6.67	4.20	<b>7.05</b>	<b>17</b>
Mexico	6.83	7.60	8.80	6.00	6.00	9.45	4.79	7.33	5.40	<b>6.97</b>	<b>18</b>
Israel	6.89	5.60	8.40	8.75	8.00	6.80	6.10	8.00	7.20	<b>6.95</b>	<b>19</b>
USA	10.00	7.20	6.80	9.25	7.50	3.59	8.40	8.67	7.60	<b>6.91</b>	<b>20</b>
Brazil	2.56	7.20	8.40	6.25	5.00	9.52	5.34	7.33	4.80	<b>6.85</b>	<b>21</b>
Australia	2.46	9.20	9.20	9.50	7.50	5.20	7.41	6.00	7.00	<b>6.80</b>	<b>22</b>
Ukraine	8.33	5.60	9.20	3.75	4.50	9.79	5.28	6.00	4.20	<b>6.79</b>	<b>23</b>
Portugal	8.41	8.80	8.40	8.25	6.00	7.45	4.72	7.33	6.40	<b>6.74</b>	<b>24</b>
S. Korea	9.01	7.60	9.60	7.75	7.00	5.58	6.09	7.33	8.00	<b>6.70</b>	<b>25</b>
Sri Lanka	3.39	6.00	6.80	6.75	6.50	9.65	4.85	7.33	3.40	<b>6.70</b>	<b>26</b>
Ireland	9.35	9.20	9.60	9.25	9.50	3.80	6.37	8.00	7.40	<b>6.63</b>	<b>27</b>
Argentina	1.70	6.40	8.40	6.50	5.00	9.38	5.01	6.67	5.00	<b>6.63</b>	<b>28</b>
UK	9.82	8.00	8.80	9.50	8.50	3.28	7.03	8.67	7.40	<b>6.60</b>	<b>29</b>
Vietnam	6.51	5.60	6.40	5.00	6.00	9.75	4.74	7.33	3.00	<b>6.59</b>	<b>30</b>
Turkey	7.66	5.60	5.60	6.25	6.00	9.02	4.69	6.00	5.80	<b>6.57</b>	<b>31</b>
Indonesia	4.43	4.00	8.80	4.50	5.50	9.91	4.89	6.00	4.20	<b>6.54</b>	<b>32</b>
Colombia	6.17	4.80	7.60	6.25	4.50	9.17	4.81	6.67	4.60	<b>6.54</b>	<b>33</b>
S. Africa	1.34	4.80	8.40	7.75	6.50	8.19	5.59	4.67	6.40	<b>6.51</b>	<b>34</b>
Spain	8.74	8.00	8.40	8.50	6.00	5.21	6.02	7.33	7.40	<b>6.51</b>	<b>35</b>
Egypt	6.94	5.20	6.40	5.50	6.00	9.31	4.70	6.00	4.00	<b>6.48</b>	<b>36</b>
Nigeria	5.12	4.00	6.80	3.75	7.00	10.00	4.63	7.33	4.00	<b>6.47</b>	<b>37</b>
Pakistan	4.28	2.80	8.00	5.25	5.50	9.84	4.87	6.00	3.80	<b>6.45</b>	<b>38</b>
N. Zealand	1.00	9.20	9.20	9.25	8.00	5.52	5.63	8.00	7.60	<b>6.42</b>	<b>39</b>

	Proximity	Political environment & security	Macro-economic stability	Regulatory environment	Tax regime	Labour costs	labour skills & availability	Labour regulation	Infra-structure	Total score	Rank
Greece	8.04	8.00	6.40	7.25	7.00	7.47	4.26	7.33	6.40	6.40	40
Venezuela	6.66	5.60	8.00	5.00	5.00	9.60	4.01	5.33	5.20	6.37	41
Netherlands	10.00	9.20	9.20	9.50	8.00	2.94	6.14	8.00	8.00	6.29	42
Finland	8.52	10.00	10.00	9.50	8.00	3.20	5.87	8.00	7.80	6.29	43
Ecuador	5.63	5.20	9.60	5.25	5.50	9.82	3.09	6.00	4.80	6.23	44
Iran	6.10	5.20	7.20	3.75	5.50	9.65	4.18	6.00	4.20	6.23	45
Austria	9.31	9.20	8.40	9.25	7.50	3.79	5.52	8.00	7.80	6.23	46
Germany	9.90	8.80	8.80	9.25	7.00	3.00	6.61	6.67	7.20	6.23	47
Peru	4.29	5.60	9.60	5.25	5.00	8.79	3.88	7.33	5.80	6.21	48
Italy	8.89	7.60	8.00	7.50	5.50	4.56	6.07	6.00	7.40	6.11	49
Algeria	8.49	4.80	9.20	5.00	5.00	9.46	3.06	6.00	3.00	6.08	50
S. Arabia	5.51	5.20	7.60	5.50	7.00	8.88	3.53	5.33	5.40	6.07	51
Sweden	8.96	10.00	9.60	9.50	6.50	2.23	6.36	6.00	7.80	5.97	52
Switzerland	9.55	10.00	9.20	9.50	8.00	2.17	5.83	8.00	7.40	5.96	53
Azerbaijan	6.57	6.00	8.40	3.50	5.50	9.75	2.81	6.00	3.60	5.92	54
France	9.70	8.00	8.80	9.25	6.00	1.99	6.73	7.33	6.40	5.85	55
Kazakhstan	4.92	6.00	9.60	4.00	3.50	9.55	2.63	6.00	3.20	5.72	56
Belgium	9.95	8.40	8.40	9.00	7.00	1.95	5.81	7.33	8.40	5.70	57
Japan	10.00	9.20	6.80	8.25	5.00	2.12	6.38	7.33	7.00	5.64	58
Denmark	9.38	9.20	10.00	9.50	8.50	1.27	5.14	9.33	7.80	5.59	59
Norway	9.15	9.60	10.00	9.25	7.50	1.00	5.05	6.00	7.40	5.22	60

## Indicators in the offshoring rankings model

### Proximity

- 1\* Distance between a country's capital and the nearest major source area of investment

### Political and security risk

- 1 Social unrest  
2 Change of government  
3 Terror threat  
4 Crime  
5 Risk of international tensions or conflicts

### Macroeconomic stability

- 1\* Consumer price inflation  
2\* Exchange rate policy  
3\* Budget balance (% of GDP)

- 4\* External debt (% of GDP)  
5\* Current-account balance (% of GDP)

### Regulatory environment

- 1 Protection of private property  
2 Protection of intellectual property  
3 Expropriation risk  
4 Share of world merchandise trade  
5 Government regulation  
6 Policies towards foreign direct investment  
7 Red tape/bureaucracy  
8 Legal system  
9 Corruption

### Tax regime

- 1\* The corporate tax burden  
2\* Compulsory social insurance contributions  
3\* Fiscal incentives for investment  
4\* Fairness of the tax system

### Labour regulation

- 1 Restrictiveness of labour laws on hiring and firing  
2 Extent of wage regulation  
3 Minimum wage laws

### Labour costs

- 1\* Average months wages (\$), unadjusted for productivity

### Labour skills

- 1 Quality of maths and science education  
2\*\* English language skills  
3 Technical skills of the workforce  
4\* Labour force

### Infrastructure

- 1\* Telephone density  
2\* Broadband penetration  
3\* Stock of personal computers  
4\* Costs of office space  
5 Laws covering the internet

Note. A single asterisk (\*) denotes a purely quantitative indicator. Indicators with a double asterisk (\*\*) are partly based on data. All other indicators are qualitative in nature.

Whilst every effort has been taken to verify the accuracy of this information, neither The Economist Intelligence Unit Ltd. nor the sponsors of this report can accept any responsibility or liability for reliance by any person on this white paper or any of the information, opinions or conclusions set out in the white paper.

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