

**booz&co.**

---

# Next-Generation Global Sourcing Opportunities In the Consumer Products Industry



---

---

Booz & Company is a leading global management consulting firm, helping the world's top businesses, governments, and organizations.

Our founder, Edwin Booz, defined the profession when he established the first management consulting firm in 1914.

Today, with more than 3,300 people in 58 offices around the world, we bring foresight and knowledge, deep functional expertise, and a practical approach to building capabilities and delivering real impact. We work closely with our clients to create and deliver essential advantage.

For our management magazine *strategy+business*, visit [www.strategy-business.com](http://www.strategy-business.com).

Visit [www.booz.com](http://www.booz.com) to learn more about Booz & Company.

---

## CONTACT INFORMATION

### Chicago

**Vinay Couto**

Partner  
312-578-4617  
[vinay.couto@booz.com](mailto:vinay.couto@booz.com)

**Ashok Divakaran**

Principal  
312-578-4751  
[ashok.divakaran@booz.com](mailto:ashok.divakaran@booz.com)

### New York

**Jeff Tucker**

Partner  
212-551-6653  
[jeffrey.tucker@booz.com](mailto:jeffrey.tucker@booz.com)

*The authors would like to acknowledge the contributions of Jack McGrath, Alex Kandybin, Tom Casey, Nikhil Bahadur, Amy Bernstein, and Namit Kapoor to this article.*

Originally published as:

*Next-Generation Global Sourcing Opportunities in the Consumer Products Industry*,  
by Vinay Couto, Ashok Divakaran, and Jeff Tucker, Booz Allen Hamilton, 2006.

# Next-Generation Global Sourcing Opportunities in the Consumer Products Industry

Consumer products companies today face a set of challenges that are different from any they have experienced before. On one hand, market saturation, retailer consolidation, and increasingly specialized consumer preferences have slowed growth and made it more important than ever before to be first to market with customer-relevant products. On the other hand, increasing retailer power, customer price sensitivity, and mounting supply-chain complexity are exacerbating cost pressures and distracting management from its core mission.

Against this backdrop, outsourcing continues to grow at explosive rates, and its potential to improve both cost efficiency and business effectiveness continues to increase. Yet, curiously, the consumer products industry has been slow to adopt it. Here, we examine the global sourcing opportunities for the industry, based on existing capabilities in the global market for services, as well as emerging trends.

## **The Case for Global Sourcing**

While just about every industry is facing cost pressures and revenue growth challenges, consumer packaged goods (CPG) companies face a unique set of issues. On the revenue side, companies are grappling with apparent market saturation in many

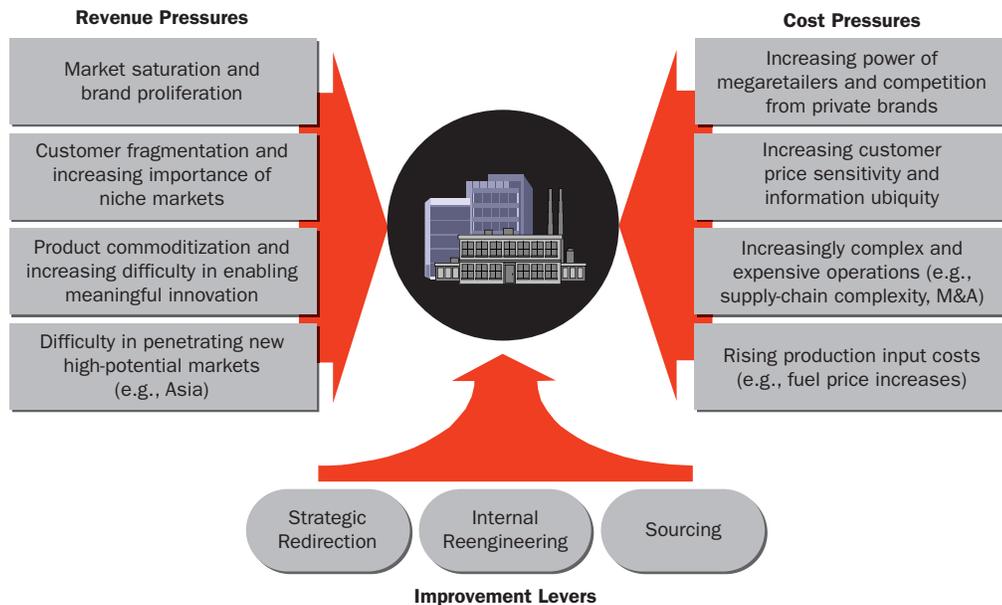
product categories, a proliferation of niche markets (and the increasing importance of being first to reach them), slower-than-expected penetration of promising new geographies such as India and China, and the difficulty of enabling continuous and meaningful product innovation. On the cost side, companies are contending with the proliferation of private labels, the expanding power of megaretailers, increasing consumer price sensitivity, and macroeconomic factors such as commodity price increases (see Exhibit 1, page 2).

It may be tempting to focus on just one side of the equation, but we believe that doing so is a partial fix at best. The bottom line is that to remain financially viable in the long term, consumer products companies must not place higher priority on either revenue or cost at the expense of the other. They must build a sustainable capability to drive growth and transform themselves into agile and efficient market-focused entities. A compelling and efficient two-pronged strategy is called for—and fast.

The most effective approach seeks to optimize a company's core competencies—R&D and product innovation, marketing and sales, lean manufacturing, and the front end—while minimizing the amount of management needed on the back end. We believe outsourcing—and more broadly, global sourcing—represents a significant and untapped lever for generating value for the consumer industry in

## Exhibit 1

### Pressures Facing the Consumer Industry



Source: Booz Allen Hamilton

ways, increasingly, that transcend the obvious cost-reduction rationale. No longer is outsourcing just about doing things more cheaply; it's about doing them better and faster as well.

### The State of Outsourcing

Outsourcing has gone through a significant evolution in the last five years. Cost reduction has typically constituted the primary argument for most companies to outsource, and the benefits for CPG companies remain significant, particularly with the rise of offshoring (see Exhibit 2).

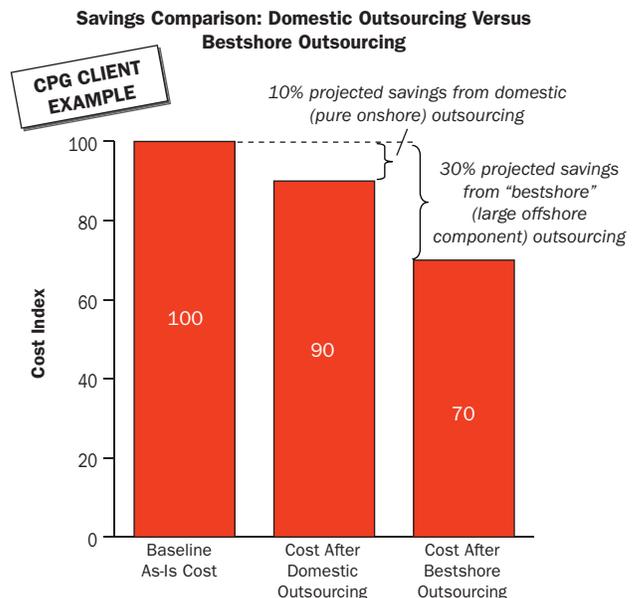
In addition to its traditional cost-reduction focus, historically, the outsourcing market has also been dominated by a few major players that have their roots in commodity IT services. But the outsourcing environment has seen significant changes on three fronts in the last several years.

▪ **Transformation of the Vendor Landscape:** More players are in the mix, and the characteristics of these players have changed. An explosion of offshore vendors has taken place in response to

market demand, previously U.S.-centric players have invested in building offshore capabilities,

## Exhibit 2

### Illustrative Savings Comparison for a Large CPG Company: Domestic Outsourcing versus Bestshore Outsourcing



Note: Process scope is transactional; finance and accounting and human resources  
Source: Booz Allen Hamilton

and the inevitable first cycle of consolidations has begun. The broader range of vendor options, combined with more selective deal structuring by customers, has driven down the major players' market share and caused a shift toward smaller offshore and specialist players.

▪ **Growth of Business Process Outsourcing (BPO):**

Largely as a result of this maturation of the supply side, BPO has finally begun to live up to its initial promise, with several vendors having developed sophisticated end-to-end service offerings in HR, finance and accounting, and, increasingly, procurement. The U.S. BPO market, currently estimated at between \$125 billion and \$150 billion, is expected to grow by about 10 percent per year over the next few years and drive overall growth in demand for outsourcing services. Furthermore, with the rise of new areas of service such as knowledge process outsourcing (KPO) and R&D, the scope of services on offer has expanded.

▪ **Changes in Buyer Behavior:** Companies appear to be gradually shifting away from the megadeals, characterized by broad scope and long-term contracts, of years past. Several factors are causing this trend: More than a few well-publicized deal failures have been reported in the press, which resulted in a greater cautiousness about “turning over the keys” over the long term to external service providers; there has also been a push toward distributing contracts across a larger vendor base to manage risk and engage best-of-breed capabilities, particularly as the number of viable sourcing options has increased over the last couple of years.

Yet, at the same time, companies have offset this commercial and operational cautiousness with a greater strategic openness to outsourcing functions that were previously off-limits. This has mostly occurred in response to heavier revenue and cost pressures, but also as a result of more-

evolved vendor-management capabilities and increased confidence in operating in a networked world. A few industries, such as financial services, pharmaceuticals, and consumer electronics, are leading the charge by outsourcing areas such as R&D, advanced customer care, and clinical trials.

These evolutions have spurred a gradual but discernable change in the perceived and actual role of outsourcing as a lever to raise value. While hard savings will always constitute a powerful argument, outsourcing is increasingly being viewed not just as a cost-reduction tool that is fundamentally reactive, but as an improvement lever that can generate strategic advantage and revenue growth by tapping into a global talent pool with capabilities that match or surpass those of in-house talent. There is also a growing appreciation of the more intangible benefits that outsourcing can provide, such as freeing senior management to worry about strategy rather than execution.

In the midst of all of these developments, the consumer industry has been curiously slow to take advantage of the opportunities offered by outsourcing—particularly considering its history as an early adopter of contract manufacturing and its external sourcing of advertising and branding strategy. The process-manufacturing and retail sectors are jointly estimated to drive only about 15 percent of total outsourcing spend<sup>1</sup>, and outsourcing deals in the industry have been conservative, with the overwhelming focus being on the “safe bet” of IT. In part, this is understandable; with the exception of specific IT and staff administrative services, the outsourcing market is not yet mature and it is difficult for potential buyers to navigate. There is so much hype that it is hard to tell what's real and what's not, and there is an overall lack of transparency in the industry. Nonetheless, we believe there is a significant untapped opportunity for consumer and retail companies, based on our analysis of the market's current capabilities, as well

<sup>1</sup> Statistics from IDC

### Exhibit 3

#### P&G's Business Process Outsourcing Scope (Partial List)

		← Outsourced to Third-Party Providers* →				
		IT	HR	Finance	Customer Care	Facilities Management
Scope		<ul style="list-style-type: none"> <li>IT infrastructure</li> <li>Data center operations</li> <li>End-user support</li> <li>Network management</li> <li>Application development and maintenance</li> <li>Cross-functional IT process management</li> </ul>	<ul style="list-style-type: none"> <li>Payroll processing</li> <li>Benefits administration</li> <li>Compensation planning</li> <li>Expatriate and relocation services</li> <li>Travel and expense management</li> <li>HR data management</li> </ul>	<ul style="list-style-type: none"> <li>Accounts payables</li> <li>T&amp;E</li> <li><i>Additional processes are under consideration for outsourcing/offshoring</i></li> </ul>	<ul style="list-style-type: none"> <li>Customer service—voice and data inquiries</li> <li>Product information maintenance</li> <li>Coupons processing</li> <li>Early-stage collections</li> </ul>	<ul style="list-style-type: none"> <li>Corporate facilities management for ~14 million square feet of owned/leased real estate across 60+ countries</li> <li>Project management</li> </ul>
	Estimated Deal Size	\$3 Billion	\$400 Million	\$45 Billion	\$70 Million	\$700 Million

Source: Booz Allen Hamilton; public domain information

as our expectations of what could (or should) come next.

### What to Outsource?

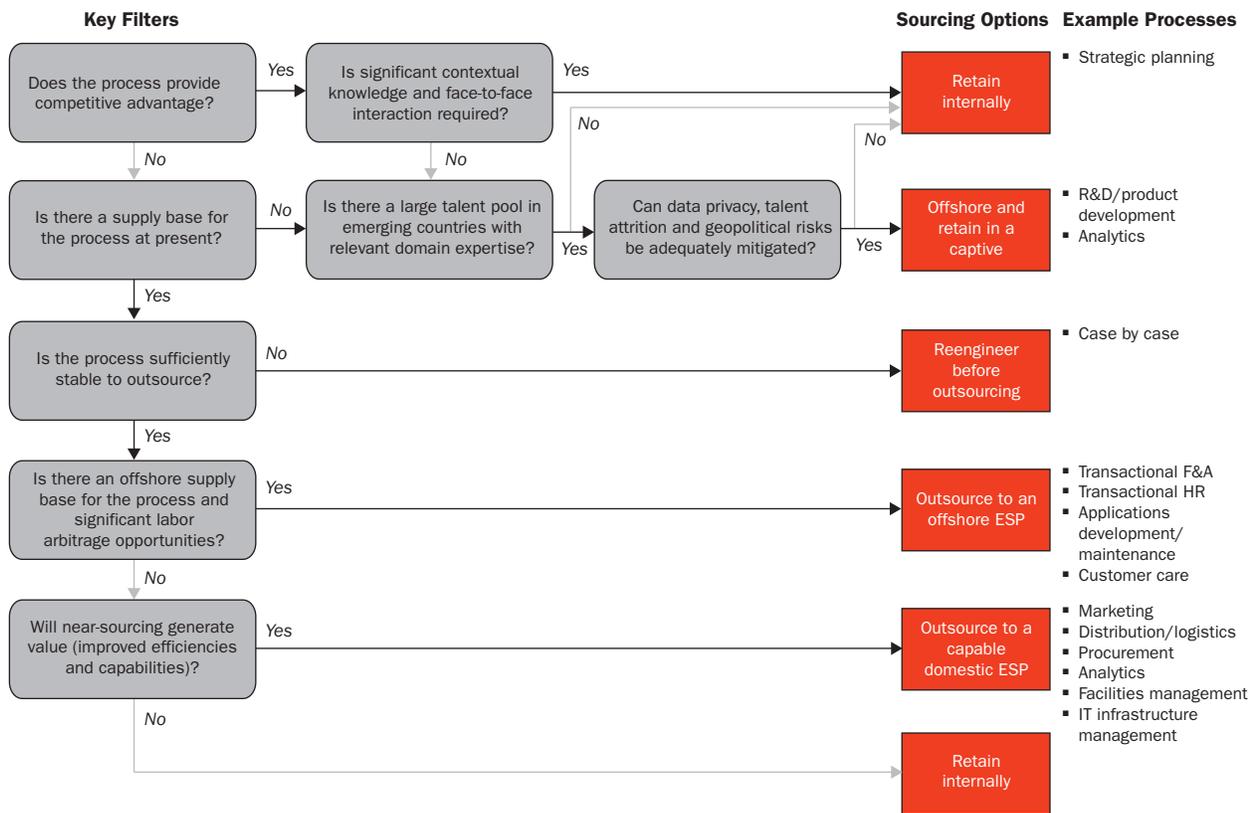
In deciding what to outsource, companies have historically relied on the dictate to outsource non-core activities and preserve core activities in-house. Non-core activities typically consisted of IT application development and maintenance, operations and support, help desk and low-risk customer care, and selected HR and finance transactional processes with a well-established vendor base and commoditized service offering, such as payroll and benefits administration.

Over the last couple of years, however, this question has become increasingly difficult to answer, and the reasons are simple: Cost reduction isn't the only benefit to be had from outsourcing, and the global talent pool is capable of a lot more than people once thought. A few enlightened companies have realized this—as well as the potential long-term consequences if they do not exploit what

the global market has to offer—and have pushed the envelope. Paradoxically, given the consumer industry's reluctance to embrace outsourcing, one of the leading lights is in this sector. Procter & Gamble, the consumer goods giant with 2005 sales of nearly \$60 billion, has aggressively outsourced across the entire value chain, and is widely considered a benchmark for external sourcing—regardless of industry (see Exhibit 3). More recently, Unilever has also signed a series of major global deals with a significant offshore component, including in finance and accounting, HR, and IT.

Other consumer companies can benefit from studying the P&G experience. The point is not to emulate it, since most companies do not have P&G's mature, global shared-services capabilities and its experience managing very large contracts with multiple vendors—both of which were critical to its outsourcing successes. Rather, the lesson is that large-scale transformational outsourcing is truly possible, can bring considerable rewards, and is a sustainable strategy.

**Exhibit 4**  
Global Sourcing of Services Framework for Consumer Products Industry



Source: Booz Allen Hamilton

We recommend that CPG companies considering outsourcing analyze the opportunity in a holistic and structured way, by considering the entirety of their value chain as well as the full range of service-model options available. Our experience has been that unless outsourcing opportunities are assessed and pursued in the context of a holistic strategy, savings are left on the table—or worse, the program never acquires critical mass and the attention of senior management and fails to take off or falters. It therefore pays to do the hard due diligence up front, based on solid economics, risk management, and change leadership approaches.

Exhibit 4 lays out a framework for holistically considering outsourcing potential across candidate process areas, and the potential basis for

a sourcing strategy based on current capabilities in the market.

Holistically addressing the full set of opportunities across the value chain is the foundation of a successful global sourcing strategy. However, in looking at the framework in Exhibit 4, one could argue that the CPG industry’s needs—and its available options—are not dramatically different from other industries. At a macro level, this is partly true. We believe, however, that the continued evolution of the global services market—and a resulting greater openness to outsource functions considered core—is starting to offer opportunities that shift the balance toward growth and away from simple cost reduction. Two areas will drive this: R&D and analytics.

### The Next Wave

P&G has been an innovator not only with respect to the global nature and scale of the outsourcing of its commodity functions; it is also exploring paths that few other companies have even considered. The most notable among these is its Connect and Develop Innovation Network—a decentralized, loose network of contributors that collectively advance P&G's innovation capability. P&G's chairman, A.G. Lafley, has gone so far as to say that he would like fully 50 percent of P&G's products to come from the outside by 2010. This represents nothing less than a paradigm shift in how companies approach innovation. What P&G has done is look ahead and realize that contemporary definitions of “core processes” are increasingly archaic; what is truly core—in today's and P&G's world—is branding and innovation management and commercialization.

One might wonder about the risks and doubt the upsides of farming out what most would consider the most core of core competencies for the consumer industry—product development. But we believe such thinking to be increasingly monolithic and obsolete. Consumer electronics companies, for example, have been quietly sourcing product designs from Asia for years. Perhaps more important, the realities of today's consumer products market—commoditized and undifferentiated products, finicky customers with low brand loyalty in increasingly niche markets, cutthroat competition, and increasing R&D costs combined with a low innovation hit rate—demand a new approach, focused on maximizing the throughput and customer relevance of innovation.

Accompanying these new pressures is the sobering fact that Japan, Europe, and China are producing more Ph.D.'s in science and engineering than the United States. We believe these forces will conspire to transform global, outsourced innovation from an idea that is viewed as an exotic option by most business executives to an absolute necessity for

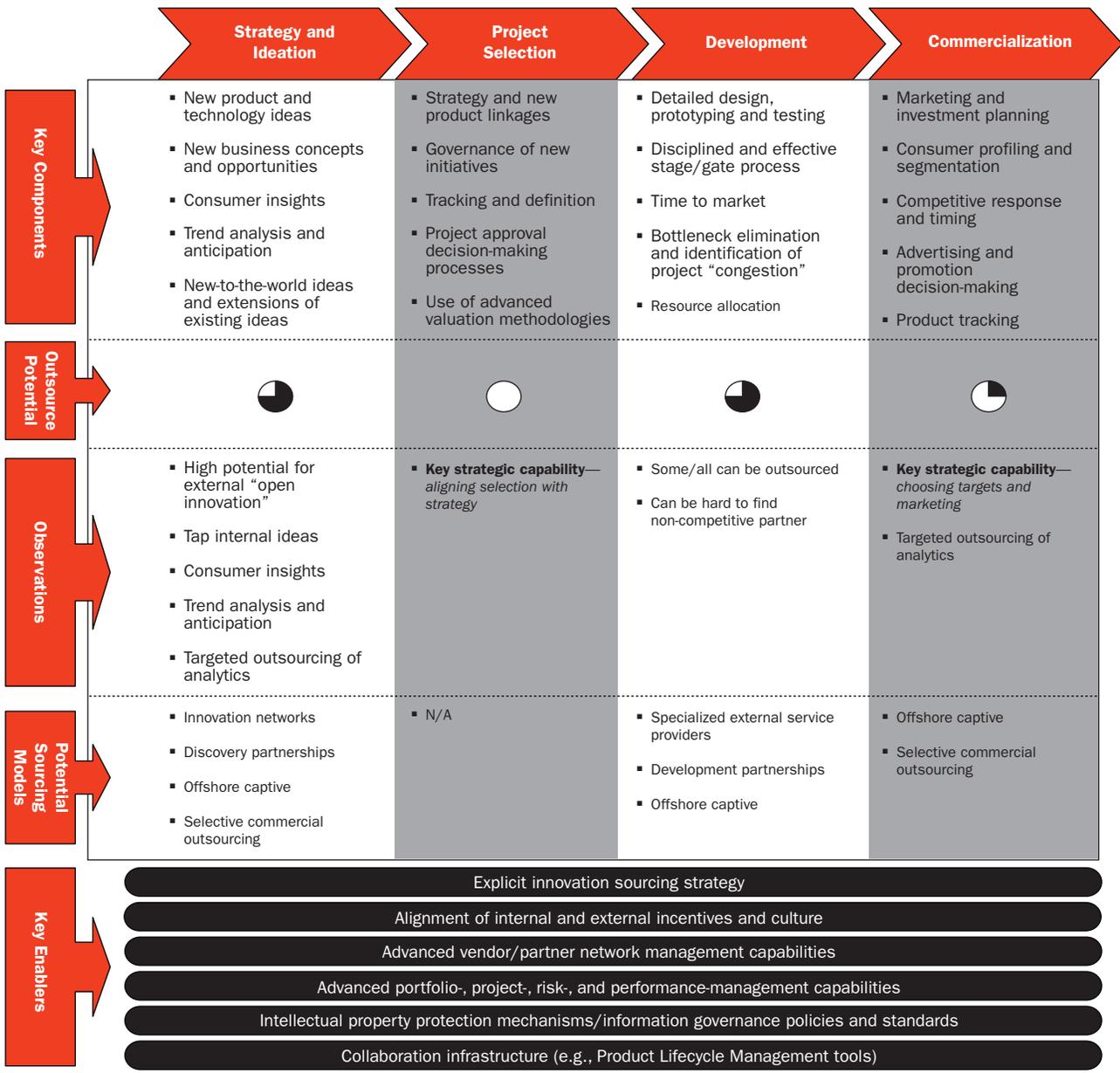
survival—particularly for large companies with complex product lines and global markets.

Clearly, however, the entire R&D process cannot be handed over to external parties, nor should it. Where, then, do the specific opportunities lie? The trick is to dissect the R&D process and identify specific subprocesses that present controllable risks, and determine where a global talent pool exists or is emerging. In a nutshell, we believe that only activities focused on market strategy, portfolio decision-making, and truly differentiated intellectual capital must remain largely in-house; the majority of development activity can be externally sourced through a variety of models (see Exhibit 5, page 7).

To be sure, there are risks involved in the global sourcing of innovation, including both factors within companies' control—such as the thoroughness and strictness of contract terms that govern vendor behavior—and factors outside of it, such as countries' intellectual property laws. However, if companies develop an explicit innovation sourcing strategy that recognizes these limitations, and put a key set of innovation enablers and capabilities in place, global innovation has the potential to put companies back in the driver's seat—taking action to harness the power of external sourcing for step-change revenue generation and long-term brand equity creation, rather than simply reacting to the need for cost reduction.

But if global innovation allows companies to generate more product leads, it also prompts the question of whether those are the right leads. This is increasingly the case with the splintering of many consumer goods markets into low-cost, undifferentiated segments and niche microsegments, where rapidly identifying customer needs and preferences and being first to market with a finely tuned set of products is of paramount importance. Like R&D, analytics has historically

**Exhibit 5**  
The Innovation Value Chain—What Does a Company Have to Do for Itself?



Source: Booz Allen Hamilton

been treated as one of the crown jewels of a company—a truly strategic core competency. But the increasing realization that anything that doesn't require physical interaction can be outsourced is causing companies to now consider whether they can leverage global talent to effectively operate

like a giant human grid computer. And it's not just basic demand forecasting that will eventually be outsourced: The full analytical cycle, from demand analysis through channel planning and logistics scheduling analysis, can be performed remotely—at a lower cost—using advanced statistical techniques.

Analytics is still an emerging global capability, with vendors' lack of deep industry and domain knowledge as the primary obstacle. However, we believe it is only a matter of time before it becomes one arrow amongst others in the global sourcing quiver.

**Conclusion**

The global sourcing of services is here to stay; the economic case is compelling, and both the demand and the need for these alternative models are growing. The quality and variety of services available will continue to get better as vendors' experience grows and technology improves; innovation is leading to

enhanced offerings and more-sophisticated business models, and much value can be extracted. For something that offers such opportunity, outsourcing has been curiously underleveraged by the CPG industry. But we believe that this is about to change as consumer products companies come under increasing cost and revenue pressure and exhaust other options—and as they realize that outsourcing isn't just a reactive cost-reduction play but a more transformational and strategic-improvement lever that can also boost the top line and drive long-term value creation.



---

## BOOZ & COMPANY WORLDWIDE OFFICES

### Asia

Beijing  
Hong Kong  
Mumbai  
Seoul  
Shanghai  
Taipei  
Tokyo

### Australia, New Zealand, and Southeast Asia

Adelaide  
Auckland  
Bangkok  
Brisbane  
Canberra  
Jakarta  
Kuala Lumpur  
Melbourne  
Sydney

### Europe

Amsterdam  
Berlin  
Copenhagen  
Dublin  
Düsseldorf  
Frankfurt  
Helsinki  
London  
Madrid  
Milan  
Moscow  
Munich  
Oslo  
Paris  
Rome  
Stockholm  
Stuttgart  
Vienna  
Warsaw  
Zurich

### Middle East

Abu Dhabi  
Beirut  
Cairo  
Dubai  
Riyadh

### North America

Atlanta  
Chicago  
Cleveland  
Dallas  
Detroit  
Florham Park  
Houston  
Los Angeles  
McLean  
Mexico City  
New York City  
Parsippany  
San Francisco

### South America

Buenos Aires  
Rio de Janeiro  
Santiago  
São Paulo