Companies that outsource outperform peers

Business

Bangalore, 28 June 2005 – A study launched today by LogicaCMG reveals that outsourcing is one means by which UK companies can increase corporate value*. The report, conducted by the Centre for Economic and Business Research (cebr), shows that companies that outsource outperform peers and could create an equivalent ? 20 billion of additional shareholder value**.

However, companies may be falling short in communicating to investors the long-term dividends created by outsourcing, resulting in an under-representation in share valuations, says LogicaCMG. The LogicaCMG study, " Outsourcing for Corporate Value", analyses historical stock market data of companies that have announced outsourcing deals against companies in the same sector that have not announced deals. The report further explores the total potential value outsourcing can release for UK industry, including the public sector. The first part of the study investigates the correlation between the announcement of an outsourcing deal and a company's market valuation one month after the announcement. The findings show that companies that have announced an outsourcing deal perform on average 1. 7 per cent higher in the stock markets benchmarked against others in their sector that have not announced outsourcing deals.

In five out of seven sectors, companies that outsource outperform peers. In certain sectors, companies are realising upwards of an 11 per cent increase in share value. LogicaCMG states that despite this increase, the numbers under-represent the opportunities outsourcing creates to maximise long-term corporate value. It notes that shares are priced based upon expectations of the Free Cash Flow a business is expected to generate and the effect outsourcing (and related initiatives e. g.

refocusing for growth) can have on Free Cash Flow generation. Given this, intuitively, outsourcing should positively affect company valuations. However, this can only be achieved if companies communicate to investors what they plan to do with the cost-savings and opportunities for re-investment that outsourcing creates. The second part of the study uses analysis to forecast the economic impact on corporate value from outsourcing. The analysis calculates that if UK companies increased outsourcing by 52 per cent by 2010, over ? 9.

9 billion in additional stock market value would be created. Guy Warren, chief executive, UK, LogicaCMG, said: “ Outsourcing enables organisations to reap benefits in addition to cost-reduction, such as releasing capital and human efficiencies and using savings for reinvestment. We have proved that successful companies do outsource and that more outsourcing would create greater corporate value across the UK economy. However, despite this, UK industry and financial markets could be under-estimating the long-term economic benefits unleashed from outsourcing initiatives.” This economic forecast shows that outsourcing has the potential to be worth ? 370 billion by 2010 – up 52 per cent on 2004.

If companies increased outsourcing at this level, the following would be achieved: – An increase in UK GDP by more than ? 40 billion by 2010 alone.- A boost to company investment over the period 2004 to 2010 to ? 25 billion.- An additional average boost in gross corporate profits over the period from

2005 to 2010 of ? 698 million per annum or ? 4. 2 billion in total over the 5-year period.- The increase in profits equates to an equivalent ? 9. 9 billion of additional stock market value that could be created for UK companies.

– It’s also equivalent boost of ? 184 million per annum on Economic Value Add (EVA) (boost to profits minus cost of capital) and ? 1 billion on Market Value Add (MVA). Mark Pragnell, managing director at cebr, said: “ Outsourcing has been proven not only to reduce costs and increase profitability, but also to enable organisations to improve their utilisation of investors’ capital, thereby improving free cash flow in the medium to long term. Our findings indicate that those businesses that outsource outperform peers, significantly adding to the value of their owners’ investment. Our forecasts show that if UK companies were to take advantage of the opportunities made available from outsourcing, the economy would be boosted, making the UK more competitive.” About the cebr studyThe study was conducted by the cebr between April and June 2005 and comprised research in two areas: 1. Stock Market AnalysisShare price movements are used in this analysis to assess the impact that outsourcing may have on shareholder value In terms of market capitalisation, the overall sample accounts for almost 50 per cent of the companies listed in the FTSE All Share index across seven industry sectors.

2. Forecast Analysis & Total OutsourcingData in the UK Input-Output tables published by National Statistics were used as a measure of the value of operating expenditure on services in the UK as a broad proxy for outsourcing. The ‘ Input-Output Supply and Use balance’ displays the transactions of all goods and services in the UK economy each year.

Transactions are presented in matrix form showing expenditure by each of 123 industry sectors in each industry (123×123 matrix). The sector expenditure can then be broken down into operating expenditure on products, operating expenditure on services and capital expenditure.

Operating expenditure on services by one industry sector in another (across the matrix) is used to approximate the level of total outsourcing by UK plc. Cebr took 53 of the 123 industry categories specified by LogicaCMG and therefore ‘ outsourcing’ refers to the operating expenditure across these industries. This breakdown into sectors specified by LogicaCMG has been updated and extended taking account of updated National Statistics data as well as forecasting from a start date of 2005. Cebr calculated the impact that these forecast projections will have on UK GDP, profits, investment and consumer spending to 2010. Cebr calculated the impact in terms of an additional three metrics: market capitalisation, economic value added and market value added.