

A first of a series examining the operating impacts and risks a global pandemic could have on business viability and sustainability

The Perfect Tempest – Pandemics, Globalization, Aging Workforces, Regulatory Pressures

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It sounds like a robotic character from a science fiction film -- H5N1. Perhaps it's easier recognized by a more common name, the Avian or Bird Flu (the most talked about and virulent form of the virus is H5N1 – there are others). Thrust into the headlines with great regularity and public alarm by the media and government officials, ordinary citizens are pondering the implications and impacts on family, healthcare, and basic survival.

We also have learned not only from history, but the viruses themselves, that many things must come into proper alignment before a single event can trigger a watershed of loosely related developments. This tempest of events will severely strain not only the workforce, but the organizational recovery plans adopted under regulatory guidelines and business continuance. Most organizational mitigation and recovery plans deal with local outages – not widespread disruptions. Furthermore, the testing and real-life functionality of these plans has not been subject to long-term continuance, nor are they sufficiently structured to deal with a domino of disturbances which may invalidate assumptions and resolution guidance.

The news media focuses on singular events rather than the cascading affects that can be projected on corporate employees, infrastructure, products, profitability, and customer services. Only after the events have unfolded, do these “unrelated” actions make headlines or receive the proper in-depth analysis. Our failure to preemptively act before these events unfold will result in our organizations being ill-prepared to mitigate the risks created by a perfect tempest. If not dealt with holistically, these risks will begin to accumulate materially affecting the three fundamental organizational building blocks – people, process, and profits (*i.e.*, the “3P’s”).

Innovative organizations that are clearly prepared for the tempest will have not only a distinct advantage during the crisis, but they will also be able to utilize their relevant provisions to achieve distinct and defensible go-to-market results for customers, suppliers, and partners. With so many reports and soothsayers making and revising predictions and projections, let's try and create a framework for understanding, analysis, and mitigation.

The Pandemic -- Situation and Projections

First, let's review what is objectively known and generally accepted as fact. Today, Avian Flu is hard for humans to contract. However, when the virus acquires a human host, the global death rate for the 130+ cases is approximately 50%. The virus has not been able to mutate into a rapidly contagious strain capable of human-to-human transfer – at least not yet. The projections from healthcare experts and researchers is that these barriers for person-to-person transmission will be short-lived, and that a flu strain equally as potent as the prior three pandemic worldwide outbreaks of the 20th century will spread rapidly.

Global death toll projections range wildly from several hundred thousand to nearly 400 million or 6.2% of the world's population. However, the World Health Organization's (WHO) current estimate is between 2 and 7.5 million or .03% and .116% of the world population respectfully, which for most scientists is viewed as a very conservative assessment. A recent series of economic impact models projected a 0.5% fatality rate which translates into 32.3 million people. It is worth noting that the leading WHO researcher put the toll at up to 150 million or 2.3% of the world's population before his superiors retracted the projection. Non-WHO estimates have the U.S. death toll ranging from 100,000 to nearly 2 million depending upon infection rates, virulence, virus mutation abilities, and base assumptions used within the projection models. To put this into

perspective, during a normal flu season within the U.S. less than .01% or 36,000 people die from contracting the virus or subsequent complications according to the Center for Disease Control (CDC).

Second, let's get beyond the shock numbers and recognize the downstream impacts required to care for a large segment of the population. If the mainstream projections for infection are correct, at any one time between 15% to 20% of the population can be sick or show symptoms of the virus for a period of between one and three weeks. However, we also need to factor in the impacts and implications to families and friends resulting in another 10% to 15% of the workforce committed to caring for the sick and responding to extenuating caregiver requirements. In total, an aggregated 25% and 35% of the workforce could be sidelined not just in a one-off situation or locale, but in many cities spread throughout the globe for a period lasting between two and four quarters¹ assuming no repeat infections, a remedy, a vaccine, and a positive immune system response.

Bottom line with today's scientific understandings, there are too many unknowns to arrive at an objective measurement of death toll and impacts. That's the good news. Bad news is that whether it's this year, next year, or in 2010, our global workforces will face a widespread and vaguely understood pandemic.

For our organizations, how will we be prepared to assist our employees? Deal with the costs of time-off or sick workforces? Are we prepared with contingencies and rehearsed scenarios to deal with widespread disruptions to products, services, trading partners, or profits? What are the touchpoints that create exposure for our employees, supply chains, and survivability? Will our processes, ERP, and IT systems be able to deal with non-standard change in the timeframes demanded? Who will ensure the changes are accurately completed?

Globalization -- Our Dependence on Foreign Service Workers

Depending upon the research organization you value and their inherent assumptions, the implications, valuation, and market share of outsourcing diverges considerably. However, the current consensus points to more contractual relationships but with smaller top line valuations. The trend away from larger, sole source contracts will be evidenced during the next 12 to 36 months as nearly one half (*i.e.*, \$38 billion over a 100+ contracts) of the total outsourcing market contractsⁱⁱ come up for "renewal." It is anticipated that 25% to 35% of these contracts will be broken up into many smaller contracts by companies seeking a "best-of-breed" solution thereby compartmentalizing processes and workforces into a virtual organizational solution set. Pessimistic projections even predict that market forces may reduce top line outsourcing revenue by up to 10%.

Further studies project that outsourcing export countries like India (>\$12+ billion services market share), China, and other Asian nations stand to gain the most from the need for improved cost-to-performance over traditional outsourcing arrangements spearheaded by household name firms like IBM, EDS, and Accenture. This globalization of resources has placed increased demands not only upon the logistics and infrastructure of our global marketplace, but also upon a workforce and healthcare systems in emerging economic countries still struggling with Polio and Small Pox.

Our current actions and relationships are no longer just directly with a supplier, but with a series of highly segmented and specialized firms assigned to deliver the best possible product or service for the least cost. Perhaps counterintuitive to our own beliefs, these trends are clearly demonstrating that the key outsourcing differentiator is now price as compared against "value-added" services. As a result, we have either directly or implicitly created a "layering" of global relationships spread throughout our delivery channels, product cycles, and supplier relationships.

With over 90% of the Fortune 1000 having significant outsourced relationships, the risks are not always obvious nor anticipated. Factor in the latest and fastest growing area of globalization, business process outsourcing (BPO), and the contractual market obligations are nearly double the traditional outsourcing relationship with projected valuations topping over \$200 billion by 2010ⁱⁱⁱ

with over 30% being performed offshore. By 2015, this latter trend could top \$135 billion in offshore spending^{iv}.

Increasingly, outsourced relationships are in turn compartmentalized to other firms and parts of the world in an effort to increase contract profit margins. These "hidden" or implicit layers in times of crisis can have a pronounced impact on not only process execution, but also on top line revenue. Of the estimated 150+ million U.S. workers predicted by the US Bureau of Labor Statistics in 2010, it is anticipated that 10% to 20% will be either filled with global resources or shipped overseas (with some of this created by a retiring and aging population). These complex relationships filled by individuals and organizations can have a marked impact not only on delivery but also on privacy, security, end-to-end information integration, and regulatory requirements.

Consequently, when a global health emergency is realized, how will your corporation deal with a decrease in qualified personnel thousands of miles away? Even with local managers, in-country personnel, and diversity within the workforce, we cannot hope to halt the temporary and permanent loss of highly qualified and trained employees and contractual relationships. While I continue to be an advocate of globalization, we cannot blindly ignore the significance of a pandemic impact on our back-office operations, imports, contact centers, research and development. Increased emphasis must be given to enterprise risk analysis for uncovering and mitigating these extranet relationships among not only our suppliers, but the entire delivery and service chain.

So, what are the hidden costs in our efforts to achieve higher margins with global resources? How long and with what financial impact could we expect if we lost 15% of the workforce for two weeks, one month, or three months? How would we train new workers, could they be found, and at what cost? What are we doing now to prepare our contingency plans for a convergence of events? Who is responsible, by name, for the planning, controls, and operations in such a series of circumstances? Have we conducted an independent enterprise risk assessment (ERM) on our global exposures and expectations?

Aging Workforces -- The Baby Boomer Impact

It has arrived. Already we are beginning to witness the exodus of the first of the 80+ million US Baby Boomers (those individuals born between 1946 and 1964) in terms of voluntary and downsized retirement. Within these highly skilled individuals resides a great deal of learned behaviors to deal with crisis and organizational uncertainty. A primary demographic implication for corporate executives is that the domestic workforce median age will increase to a historical high resulting in greater demands for healthcare, benefits, and job security.

As a consequence of aging and organization actions, corporations both in the U.S. and Europe are facing a rapidly growing dependency on foreign workforces, partners, and alliances. Spotlighting this trend is a projection that corporate growth in the U.S. will be hindered by a shortage of three million workers in 2012^v. This is increasingly important when factored against a progressive European population decline of 1.9% by 2025, while the general world population is expected to increase 23% during the same period.

In examining a United Nations report on population aging, it should also be noted that the median age in economic powerhouses of China and India will also rise considerably. In fact, around 2025 the median age in China will surpass the United States against a population base four times as great. India will present a new set of challenges as their population is expected to increase nearly 50% by 2050 with their median age matching the U.S. and their aggregated masses exceeding China's^{vi}.

An unexpected effect of the political debates of 2004 surrounding job creation and loss has been an actual increase in offshore or near shore outsourcing. Fueled by increased awareness of their options and a decrease in visa availability, domestic managers and executives looked overseas

for new workers and higher profit margins. In view of these shifts, this age bracket of workers has become increasingly disenfranchised from the corporate workforces. In extreme circumstances, there are accusations of organizations intentionally discriminating against older workers to avoid rising costs of healthcare, benefits, and salaries in favor of younger, less skilled workers both domestically and globally.

Now, let's revisit the projection of a health emergency that significantly impacts the global workforce. We have achieved a global workforce via outsourcing or direct employment, and on average replaced them with a younger base of individuals. In spite of that, what happens when a pandemic is realized that equally affects our base regardless of age? In the prior outbreaks, greater proportions of young and old were afflicted. Nonetheless, we also witnessed large numbers of individuals between 20 and 55 struck down – the prime ages for our workforces.

Complicating recovery matters are the aforementioned aging populations. Our workforces will be challenged not just caring for their children but also their parents. This double care impact has previously not been seen nor accurately forecasted for these widespread health emergencies. As business leaders, it would be irresponsible to assume that existing contingency strategies will insulate our organizations. The corporate "youth" and "cost-avoidance" strategies quietly adopted since the start of the decade have created enterprise liabilities and hidden risks could be lethal for many corporations. The key resides in workforce diversity, preparation, and integration with siloed corporate initiatives.

What have we done to ensure that our meticulous processes, technologies, and operational procedures can cope with non-standard situations or will we suffer a similar fate witnessed in the face of recent natural disasters? Have we invested properly in automation and process improvement to avoid redundant or ineffective actions? How will our decisions and information flows be affected with large gaps in the personnel chain of command? Have we audited our contingency efforts, outsourcers, and suppliers to determine our exposures? Can we articulate what our "weakest link" is and the mitigation plans to cope with it? Have we established "extended lines" of workforces using prior employees part-time or in a virtual situation?

Regulations -- Pressures, Demands, and Costs

We are all familiar with the regulations -- SOX (*i.e.*, Sarbanes Oxley), "Know thy Customer," CFR regulations, Gramm-Leach-Bliley, Basel II, and 15,000 more global, federal, state, and local compliance demands. Recently, domestic and international organizations have decided to forgo being a public entity, not listing on the U.S. exchanges, removal of ADR's (American Depositary Receipts), or even take their companies private all in an effort to reduce the burden of government regulations and reporting. The cost of corporate governance for many public firms has been quoted as increasing 80% to 560% since 2002. Some market analysts are even attributing the rapid rise in M&A activity to the pervasive burden of dealing with onerous regulations and multi-fold increases in audit fees.

Has the regulatory scrutiny of revenue and balance sheets gone too far? Regardless of the statistical source used, the expense burden of compliance has increased -- there can be little room to dispute this axiom. However like the other three tempest categories we have discussed, each is typically viewed within their unique silos and much of their results or impacts are seldom leveraged into generating revenue, improving efficiencies, or as a strategic market differentiation. Our organizational inability to understand the interrelationships among these taxonomies has created missed opportunities to improve performance, reduce cross-divisional expenses, market differentiation, and risk mitigation.

Have community and government regulations eliminated the risks while resulting in improved organizational transparency and accountability? The simple answer is we don't know. The debate rages on and the costs, at present, continue to mount for public corporations. In researching this article, I rapidly discovered nearly 20 studies articulating divergent impacts, implications, economic effects, and conclusions. Nonetheless, for organizations to profitably deal

with increasing regulations, they must be proactively tied to the overall corporate agenda and fully integrated into all aspects of delivery and reporting.

Just as we witnessed in the storms of September 2005, state, local, and federal governments were forced to "temporarily" repeal regulations in the face of unprecedented calamities and a domino of miscalculations. If we face a pandemic, a crisis of governance will present itself. For example, the controls demanded by regulations may result in certification delays, wild stock price fluctuations, loss of investor confidence, and unforeseen expenses to "guarantee" and test make-shift procedures needed to deal with significant losses of personnel, intellectual capital, operational capacity, and compliance controls.

If a health emergency afflicts the global workforce, the politics of regulations will also temporarily vanish. World leaders are just beginning to appreciate how the economic impacts have the potential to send the global economy into a moderate to strong recession when factoring in debt servicing burdens, consumer crisis of confidence, and commodity prices (e.g., oil, gas, food staples, plastics, chemicals, and metals). For businesses, this can spell economic disaster that will in turn ripple up and down the supply chains creating a harmonic disturbance that will gain strength from the complexity of regulatory obligations.

While we all recognize the benefit regulations have during "normal" economic cycles, have we analyzed the business and risk impact compliance mandates will have in times of crisis? Who will represent or lobby for the company/industry interest with government officials before the crisis is upon us? Do we have any objective analysis on how the compliance mandates financially or operationally create benefits or liabilities during crisis? How will we achieve compliance with a rapid and/or sustained breakdown in controls? What are the opportunities to expand revenue and profits if compliance is attained during a health emergency? With the political climate in Washington today, how confident are we in fast government reaction given an inability to even agree on preventative pandemic measures?

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It has been nearly 40 years since we've been on the threshold of a natural biological threat envisioned by scientists and health officials and 88 years since 50 million people were rapidly struck down in the prime of their lives by a killer virus (with a global mortality rate of 2.5%). Granted, our medical procedures and knowledge have infinitely increased, but can we be so confident in our abilities to battle a new viral enemy that we find ourselves ill-prepared for a macabre event with significant downstream business and profitability ramifications?

As the late Peter Drucker knew and tirelessly advocated, it is people that make the organization, lead to innovation, and provide the sustainability for growth. We cannot base our corporate response to the pandemics in the same manner as we have prepared against previous natural calamities. The tempest we have discussed cannot be mitigated using the same techniques and strategies deployed for a terrorist threat. Furthermore, they are not just a one-time, short-term event that can be made up with longer hours or a shifting of work to another geographic locale.

The pandemic is the catalyst for larger issues and challenges facing our global markets and profits. Like avoiding a health crisis, preparation and planning will ensure organizational viability. In the next article, we will examine methods and procedures to identify and mitigate these converging risks and operational impediments.

ⁱ Asian Development Bank report released November 3, 2005.

ⁱⁱ "Total outsourcing contracts rise while per contract value shrinks," SBPOA, October 22, 2005.

ⁱⁱⁱ As posted on www.rttsworld.com and attributed to LogicaCMG, August 2005.

^{iv} A study attributed to Hewitt, March 2005 as posted www.rttsworld.com.

^v U.S. Bureau of Labor Statistics

^{vi} “2005 World Population Data Sheet,” published by the Population Reference Bureau.