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Outsourcing 101
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Businesses small as well as large are flying high on the benefits of outsourcing.

By Sheryl Nance-Nash

Outsourcing—or offshoring—has been around too long to be considered a transient business buzzword. In fact, its adoption by corporate America is becoming ever wider and deeper.

“Outsourcing is clearly here to stay. While there are bound to be some missteps, I believe it will continue to increase in scale and scope because, if managed well, significant cost savings are attainable,” says Ron Hira, co-author of *Outsourcing America* (AMACOM, 2005).

It’s moving up the value chain, he continues. “It’s not simply lower skill-level work; it’s moving into fields beyond call centers, IT, back office and finance, into animation, engineering services and many other fields.”

While the majority of large companies have utilized outsourcing for strategic advantage for some time, the new twist, says Colin White, director of marketing for Patni Computer Systems, is that midsize and even smaller firms are now jumping onboard. “Where larger firms might use outsourcing to cut costs and focus on core competencies, smaller firms are dipping their toes into the outsourcing waters to help them grow faster and access talent that they might not have available locally,” he explains.

Outsourcing cuts across virtually all industries, with growth being driven by several factors, including:

Management drivers. According to White, management drivers consist of “poor return on investments; inadequate performance metrics; the need for margin improvement; reduced time to react and make decisions; and the inability to effectively and profitably take bundled offerings to market.”

Regulatory drivers. These include “increased cost of compliance; the increasing number of disclosures and statutory reports; the need to generate regulatory filings and reports with minimum investment; and the need for an adaptable IT environment with adequate security and policy frameworks,” says White.

Operational drivers. These drivers may include the need for appropriate technology that facilitates collaboration across multiple entities; the need to enhance customer service levels and reduce service times; increased productivity; and the ability to effectively plan and track product and service rollouts.

Revenue drivers. Specifically, "Companies have short and shrinking product lifecycles; they want to minimize customer churn; they want to effectively acquire new customers; they want to be able to quickly expand into new products or new geographies; and they want to be able to spot and address revenue opportunities at the right time," says White.

Globally, the total spent on outsourcing was an estimated $422 billion in 2006, a growth of more than 10 percent since 2005, says John Bugh, president/North America for Intelenet Global Services, an India-based provider of business process outsourcing services that has more than 40 Fortune 500 clients in North America and Europe. Obviously, corporate America is willing to pay handsomely for outsourcing services. In fact, according to a recent Capgemini survey of executives, nearly 60 percent of respondents said their companies have spent up to $50 million on outsourcing, 18 percent have spent up to $100 million, 9 percent have spent between $100-$200 million, and another 9 percent have spent more than $500 million.

Even with this kind of price tag, the study suggests that outsourcing services users have gotten their money's worth. Almost 85 percent said they have saved at least as much as they've spent on outsourcing, and nearly 27 percent reported that their savings were at least twice the size of their investments. Nearly every executive said he/she has used the savings to improve operational performance, drive innovation, support growth and implement other initiatives that have improved shareholder value.

The rewards can be many. But so can the mishaps. Here's what you need to know to optimize your outsourcing experience.

Outsourcing 101 Outsourcing assumes many different forms, each with its own positives and negatives, says Bugh.

Third-party service providers. "In this model, a third party, rather than the client organization itself, builds and maintains the offshore presence. The main advantage is that the firm can get the real benefits of cost savings as the third party assumes responsibility of the process. The drawback is that control is difficult."

Dedicated centers. A dedicated center is operated by a service provider, but the staff, equipment and facilities are exclusively dedicated to one client company. These centers tend to involve some shared processes and some long-term risk-sharing, including co-ownership or co-leasing of facilities in some cases. The main advantage is that firms are able to dedicate efforts for a particular client. However, the service provider will have to block a portion of its resources for a client.

Joint ventures. A client organization invites an offshore supplier to partner with them in a joint venture relationship, in which each shares a percentage of the revenues. In some cases, the joint venture will include two or more global companies, each of which can benefit from the other. However, there can sometimes be a clash of interests between the client and the service provider.

Build-operate-transfer (BOT). The BOT relationship is one in which the entire offshore center is built by one entity—usually a major offshore supplier—and then transferred to another; this is usually the foreign buyer. In simpler terms, an existing center is sold to the client organization complete with staff and equipment.

A benefit of the BOT model is that there are no upfront costs for the outsourcer, since the service provider takes on amortization of capital expenditure for the tenure. Also, the outsourcer benefits from the experience and varied learning of the service provider, while still being able to retain a higher degree of control. The disadvantage is that employee attrition may take place at the time of transfer.

Managing relationships There's a lot you have to think about before you take the outsourcing leap. As Bugh explains, "In order to maintain effective and seamless long-distance relationships, firms have started exhibiting near-shore/onshore capabilities. This ensures clients that the service providers can set up at close geographical proximity to the client should the need arise."

One of the most significant potential disparities is cultural alignment between clients and vendors. "Cultural awareness and the ability to adapt effectively to another culture's way of doing things are complex skills," Bugh explains. To get around this drawback, companies are sending staff to the client site in the hopes of adapting the client's work culture offshore.

John Bostick, CEO of dbaDirect, which provides data infrastructure management services, recommends "selective sourcing or disciplined multi-sourcing." Companies manage a small amount of "best-in-class service providers instead of holistically outsourcing to a large all-in-one-service provider." He favors this because, "Distributed risk through disciplined multisourcing increases business stability and flexibility." In other words, you don't put all your eggs in one basket.

Communication is also key to the success of your long-distance relationship. "Communicate continuously with everybody," says White. "Just as important is having a clear business case for your outsourcing program from the outset. Then, be sure your organization is ready for change. Start with a meaningful pilot and set realistic expectations." Be sure there's no confusion about the cost model.

Avoid the pitfalls There are various reasons why outsourcing projects fail. White highlights some of them.

Loss of defined goals. "Often there is a disconnect between the identified goals of the project and the goals set when working with a service provider."

Difficulty filling the resource gap. "Criticality of projects can mean resourcing quickly is a challenge and the sourcing choice is incorrect."

Ineffective service provider selection. "The proliferation of consulting and systems integration companies in the marketplace creates confusion, and the service provider is ineffective."

Difficulty managing the relationship. Namely, "Mismatches in communication styles, difficulties in understanding each other's context for making decisions, and differing expectations from unclear contracts."

To avoid these glitches, research your outsourcing partners with the utmost care. What are you looking for? Firstly, "Someone with structured processes and the ability to manage geographically dispersed processes," White advises. Secondly, someone with the ability to manage larger-scale programs and who possesses a measurement-driven approach to governance. "And you want someone with the ability to address regulatory requirements," White adds.

"The key to success is for the service provider to really understand the customer's strategy and how the customer creates value from end to end," says Gagan Ahluwalia, president and CEO of GlobalStep, a Dallas-based provider of offshore professional services to the legal, accounting and financial services industries

Quite simply, says David Ramon, CEO of USA.net, one of the world's largest providers of hosted email services, "Do your homework on whatever service provider you're considering. Talk to existing customers." And understand fully how to compare the cost of outsourced services versus in-house services.

"For example," he offers, "know to what degree your vendor can provide complete, appropriate, end-to-end, customized solutions and ongoing, 'high-touch' value-added support. Although not everyone knows it, in today's marketplace, given the complexity of the modern email and electronic-messaging environments and the sheer level of expertise needed, you can often get a more highly customized solution and a greater level of service and support from a hosted vendor than you can from an in-house operation."

When a company gets outsourcing right, the payoff can be huge, not only in terms of cost savings or the ability to focus on core competencies, but in "soft" areas as well. As White explains, "Outsourc-ing can change an organization's culture for the better—they learn how to operate virtually, for example. It often creates opportunities for re-engineering internal processes and allows organizations to transition to a global operation."

For that reason, outsourcing is not going away anytime soon, Says Ahluwalia. "Essentially, we will become a global service village with a dual focus: A local focus on customers and their needs and creating for them, combined with a global focus on accessing the best resources and deploying world-class processes to deliver value to customers," he explains.

White adds to that: "It won't be called outsourcing; it will just be called sourcing, where companies of all sizes will hire resources and capabilities from not one or two offshore locations, but wherever in the world the talent and capabilities reside." □

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