

Outsourcing: Inside Out and Outside In

“Experience is a hard teacher because she gives the test first, the lesson afterwards”
(Unknown)

Outsourcing as a discipline has evolved rapidly over the last 5 years. Several major universities now conduct courses as part of their Management program that teach professionals on managing outsourcing programs and aligning outsourcing strategy with organizational growth objectives. However, today there is a plethora of choices available to outsourcing decision makers that makes the task far more complex than ever before. Besides requiring financial and operational number crunching and analysis, a typical initiative also needs a fair amount of judgmental and experiential acumen. And often, experience isn't enough, because of swift changes in the outsourcing landscape. The list of considerations in a typical decision matrix continues to grow - What processes to outsource? What is the optimum outsourcing model? Whether to go offshore and if so what is the right blend between onshore and offshore? How to time the transitioning phase to avoid an adverse impact on balance sheets (especially for public companies)? To go multi-vendor (best of breed) or single vendor (economies of scale)? Which is the ideal engagement model? Etc ... To make the task even more complicated, the ramifications of these decisions go beyond the immediate core group that is affected, necessitating involvement of different functional divisions within the organization – from IT, Operations to HR, Financial, Marketing and even Sales. No wonder that more and more corporations have been staffing up their outsourcing team with multi-faceted management talent and re-christening it as the “Global Sourcing group”.

One of the main benefits of a centralized Global Sourcing group is that it can de-couple the task of decision-making from various functional divisions (such as IT, Ops or Finance). Not only does this group take a more dispassionate and objective view of various cross-organizational processes that can be outsourced, but it also strives to develop a new chemistry with outsourcing service providers. However this requires a different thought process and management discipline to strategize, plan and implement major outsourcing initiatives. One of the outcomes of this approach is that Outsourcing partners can now be considered as a virtual extension of your organization - responsible not only for achieving measurable results but also for creating incremental business value.

This is a significant shift from the traditionally adversarial approach of maximizing cost savings by “beating down” the vendor for the lowest possible quote. Structuring contracts, negotiating pricing and defining SLAs now have a different objective. But how can an outside vendor inherit client processes, perform them at a better SLA, lower transactional costs and also create business value? The solution is through an intelligent blend of different levers such as – leveraging better process management practices, employing automation methods, dislocation of service delivery to a lower cost location and replication of domain expertise. Its when some of these levers are not utilized adequately that things start to go wrong and an outsourcing initiative falls apart.

Recently we have seen certain reports from Gartner proclaiming that Outsourcing is not delivering desired results and that cost-savings were not realized by customers. What's apparent from that analysis is that most organizations are not able to capture the true cost of executing processes inhouse. Hence it is difficult for them to estimate cost-savings accurately. Most outsourcing initiatives fail not because of mess-ups by either party, but because of misalignment of goals and outcomes. In order to win the contract based on lowest cost model, the service provider over-promises but cannot deliver the service profitably and thereby has to cut corners. More often than not, the company that is outsourcing fails to calibrate the savings properly or underestimates the amount of management bandwidth needed to govern the initiative. The result is dissatisfaction and discord leading to breakdown of the outsourcing relationship.

To achieve success, an organization's outsourcing decisions have to be rooted in ground reality and based on engendering a symbiotic relationship with the outsourcing vendor. Considering outsourcing vendors as partners or collaborators, with the same goals as the customer, is the key. This requires structuring contracts and setting SLAs that impart equal emphasis on the business value derived from "sharing" process ownership versus lowering costs.

Two trends that reflect this shift in outsourcing philosophy are – the emergence of gain sharing as a pricing mechanism and the decline in mega-outsourcing deals. In gain-sharing, the presumption is that there will be additional cost-savings achieved through business process optimization and that the customer will be willing to internalize those savings and share it there forth with the vendor. Giving an outsourcing provider a financial stake in the business for which it provides services is an incentive that can work well, yet few companies use this practice. The main reason for this is that most firms do not always trust the provider's ability to affect business-critical processes and it is often difficult to come up with appropriate metrics to measure such efforts. However, mature buyers catalyzed by progressive vendors have begun to look at gain sharing as a way to developing that elusive win-win combination.

According to Gartner, the number of outsourcing megadeals has declined in the recent years as companies instead opt for multi-sourcing options. In fact, some previously inked megadeals are being broken down into multi-sourcing arrangements to take advantage of best-of-breed skills. This clearly indicates a move towards specialized BPO players that understand an industry's organizational and process dynamics and enables successful embedding within the client organization. It doesn't necessarily ring the death knell for the large outsourcing firms since they still get a major chunk of these multi-sourcing deals, but it certainly augurs well for small to mid-sized BPO firms that believe in process expertise in certain verticals versus broad-based service offerings. These firms also have the ability to be end-to-end service providers, enabling customers to outsource the entire value chain rather than discrete tasks. Hence it is more likely that services such as Insurance and Mortgage processing will be dominated by verticalized business service providers rather than the outsourcing behemoths.

Rapidly evolving practices within the outsourcing domain and often contradictory advice in the market have created a profusion of choices as well as confusion. How can

executives rise above this noise and make the right decision? I think this is best addressed by Peter Drucker who had a slightly different take on the rationale and objectives of outsourcing than Jack Welch. According to Drucker: “Most look at outsourcing from the point of view of cutting costs, which I think is a delusion. What outsourcing does is greatly improve the quality of the people who still work for you. I believe you should outsource everything for which there is no career track that could lead into senior management.” Hence even the most core task (such as assessing risk for an Insurance underwriter) could be a candidate for outsourcing if it leads up a dead-end career path. Eventually this ties to how each organization views itself and its long term goals. Using improvement of work quality of its employees as a factor may be a contrarian way of making critical outsourcing decisions, however in the long run that is what separates the Good from the Great. More importantly, this does bring into question the use of the classical core versus non-core distinction for identifying outsourceable processes. The need of the hour is a more holistic approach that balances internal organizational dynamics with external desirable outcomes and a perspective that transcends the traditional Buyer vs Seller roles. To summarize – Inside is Out and Outside is In.