Conference KeyNotes

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The 2009 Strategic Outsourcing Conference: Maximizing Outsourcing Strategies in Challenging Times

As a community of business leaders, The Conference Board convenes senior executives to share cutting-edge ideas and best practices. These Conference KeyNotes summarize the discussions held by approximately 70 senior executives that attended the 2009 *Strategic Outsourcing Conference: Maximizing Outsourcing Strategies in Challenging Times* in Dallas, Texas in September. The views expressed are those of the presenters and participants of the conference.

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KEY ISSUES

Amidst the economic downturn, companies are outsourcing primarily to cut costs. But there are long-term benefits as well in productivity, service integration, and growth potential. It is not just about call centers anymore; organizations are also ramping up outsourcing of back office functions, research and development (R&D), and finance and accounting.

Offshoring Is Playing a Bigger Role in Corporate Strategy

Offshoring practices have been evolving rapidly in recent years and are becoming a major strategic concern for top executives, even at small and midsize companies.[1]

- Companies are now recognizing the importance of adopting a strategy to guide offshoring. This includes a set of goals and objectives. The number of companies that have implemented a corporate-wide strategy has grown by 30 percentage points since 2005. Corporate offshoring strategy has a wide range of drivers that go beyond cost savings, including access to qualified personnel, increased organizational flexibility, a broader global strategy, and growth. However, since the economic downturn, companies are more likely to offshore to save money than they are for growth.
- The functions most commonly offshored include IT, call centers, knowledge and analytical services, and innovation (including engineering services, R&D, and product design). Smaller companies are much more likely to offshore innovation projects because of capital and talent shortages.
- The financial services industry is the largest user of offshoring, followed by the manufacturing and software development sectors. Most of the countries that offshore have headquarters in the United States, Western Europe, or Australia.
- India has declined slightly in market share in recent years as the go-to outsourcing location for U.S. companies due to higher wages for Indian workers with master's degrees and PhDs, the rising cost of office space, and the issue of working across several time zones. Companies in the United States are increasingly choosing Latin America or Eastern Europe instead—for instance, Mexico, Colombia, Poland, Russia, Estonia, and Romania are growing in popularity.

The Economic Environment Has Spurred Evolution in Outsourcing

The economic downturn has accelerated the maturation of the outsourcing industry and is prompting the evolution of new outsourcing models, pricing structures, and contractual arrangements. It has also caused organizations to have a greater appetite for change.

Contracts

- Changes in the economy have led to deal restructuring. Organizations are looking at their core delivery models and core cost structures mid-contract to see if providers can continue to make margins while maintaining innovation. Companies are also renegotiating contract prices and moving away from a traditional client/vendor relationship; and they have been doing so with more of a win-win perspective than in the past. Companies want to make sure vendors are incented to provide quality work instead of putting their "third string" employees on the job. They are also more aware that constant price squeezing may put a provider out of business.
- Companies are working to put "guard bands" into contracts to prevent inadvertent pay raises or decreases based on fluctuating exchange rates. Many contracts are written in U.S. dollars, which can result in a pay raise for some countries—for example, the value of the rupee increased by 20 percent over the last year; workers in countries whose currency is pegged to the dollar, like China, did not receive a pay raise. Conversely, if the value of the dollar goes up, companies would have to pay the overseas workers more.

1 Ton Heijmen, Arie Y. Lewin, Stephan Manning, Nidthida Perm-Ajchariyawong, Jeff W. Russell, *Offshoring Reaches the C-Suite,* The Conference Board, Research Report 1445, 2009.

- Organizations need to build flexibility into the contract. For example: energy prices are expected to increase over the next three to five years, which will cause transportation and logistics costs to increase. Be clear that you may change the contract to meet specific pre-defined metric requirements, and include details. It is much easier to add these elements when creating the contract than trying to build them in at a later date.

Embracing change

- Outsourcing causes change in an organization, and all stakeholders need to be able to manage that change for the outsourcing venture to work. The first step is setting the expectation that change takes time.
- When a company first announces an outsourcing venture, everyone goes through a change curve that is similar to a "U" shape, with optimism on the upper left and acceptance on the upper right. In the lower middle is the "trough of despair." For a smooth transition, companies need to minimize the trough. This can be done by educating/coaching those who must champion the change so they can spread the word in the best light possible.
- Companies need to focus on the holistic aspects of change. They need to build a vision of what the change will look like and communicate that vision, along with information on job training for new positions, motivation for employees to excel in their current or new jobs, and new performance management structures. It would be wise to address the "what's in it for me?" factor (i.e., "If I'm losing my 500-person team to India, what will I get out of it?"), and provide seminars on the culture of the new location. Showing compassion to those who will lose their jobs is also essential.
- Conduct surveys and interview people to make sure everyone understands the change, and then determine where everyone is on the change curve. Then take action to bring resisters on board.
- Methods for helping smooth the change include sending key stakeholders to the offshoring site—India, for example—to meet offshore employees and see day-to-day operations, and then have them share findings with others back at home; bringing staff from the outsourcing site to the home office for an extended period of time; and constantly communicating strategy and performance expectations to complete the change.

Implementing a Successful Outsourcing Venture

Is now the right time to outsource? By getting in the game now, while the economy is in a downturn, you're positioning your company to be in a stronger position when things turn around. The economic downtown is also an ideal time to partner with a challenged supplier.

- Key drivers of a successful outsourcing operation include strong leadership (operations and project management), transparency, effective and intense governance, a well-defined roadmap, appropriate planning and due diligence up front, ongoing monitoring of the new location, and employee retention and engagement programs.
- When entering into an offshoring agreement, companies need a strong governance structure that enables both parties to understand what it means to be in a partnership; clear rules of engagement, including behavior standards and communication guidelines; and methods for determining metrics. If the agreement goes awry, it's most likely because someone is not adhering to the governance structure.
- Use Six Sigma to implement an outsourcing program or improve the performance of a supplier, and then constantly monitor/measure your suppliers. If you don't pay attention, they'll slip.
- Obstacles to keep in mind when outsourcing include: lack of support across the organization, an IT system that is not capable of dealing with partnerships, leadership changes in which the new leader does not favor outsourcing, and a loose governance policy.

Retained versus outsourced

- One challenge in deciding whether to outsource a function is determining how much of the job being outsourced requires judgment calls versus simply the processing of transactions. For example, outsourcing certain aspects of accounting such as debits and credits can be easy, but dealing with a customer who pays regularly but is difficult to work with can be more complex.
- An increasing number of companies are offshoring jobs that require a greater amount of analysis. But sending such a job overseas needs to be done in incremental steps. Start with data entry and then build up to accounts payable, followed by the issuance of financial statements and notes. You will eventually rely less on teams in the United States and more on the leads in other locations.

Choosing a location and creating captives

- While finding cheap labor is still an underlying reason for choosing a particular location, companies are increasingly considering the location of the best provider in terms of geographical proximity, or "near shore." Political stability and governmental incentives in the host country also play a role in determining location.
- Companies in the United States are now considering new near-shore locations such as Mexico and Argentina because they provide further cost savings due to lower tariffs, and similar time zones alleviate the need for staff to work the third shift. India makes more sense for serving customers in Europe since it is only a few hours ahead of some European countries.
- Forming captives—company-owned bricks-and-mortar operations set up offshore—has a special set of challenges, including navigating changes in the visa policies for some countries, a recent uptick in visa rejections, and opposition and distrust by the governments in host countries (as has been the case for one company with a captive in China).

Risk Management: Political, Financial, and Contractual Issues

While outsourcing can bring cost savings, it also brings risks. Companies need to be aware of the perils that come with contractual issues, political instability in overseas locations, and fluctuating exchange rates—and have a plan for overcoming them.

- Organizations need to consider geopolitical unrest in host countries more than ever before, diversify their locations within those countries, and have contingency plans in place. Companies that had outsourced to multiple locations in India fared better during the 2009 terrorist attacks in Mumbai than those who only had operation centers in that city.
- Many deals are made with one party shouldering most of the financial risk. Both parties need to approach risk management together. This is particularly true when dealing with foreign exchange rates in relation to pay scales.
- Use enterprise risk management processes in dealing with suppliers. Often, the biggest suppliers are the riskiest in an economic downturn because they are highly leveraged. The challenge in assessing this risk will be obtaining data from privately held entities.
- Be aware of natural disasters such as earthquakes, fires, and typhoons, or large-scale events like the Olympics. In the summer of 2008, suppliers in China were affected by closed factories, highways, and airspace.

Service Integration and Value beyond Cost Savings

The future of outsourcing lies in moving beyond cost savings to greater revenue and business solutions. This means moving beyond transactional relationships to strategic partnerships with providers.

- Most organizations rarely look beyond cost savings when deciding to outsource. However, they should take the next step to service integration this is the “secret sauce” to winning operations and creating greater value. By integrating buyer—and supplier-delivered services, companies can also reduce cycle times, increase market share, and innovate—in addition to cutting costs.
- Strategic partnerships are based on outcomes and solutions for the long term, not just cost savings. When putting together such a relationship, governance needs to come first; then you can move on to the strategy alignment, vision, and decision-making guidelines; and then finally to engagement and value creation.
- “People focus” is key—you need to have the right people in the right place with the right skills and capabilities. The right level of chemistry between the buyer and supplier side is also essential, so changing people around may be necessary. After everything is implemented, revisit the governance structure and be sure the metrics are at the level you want them to be. What you initially outlined may not be what you need to continue.

Document Outsourcing: The New Frontier

Outsourcing doesn’t just stop at call centers, software development and technology, or finance and accounting. There is a growing trend in outsourcing back office functions and other business operations. Document outsourcing includes having a third party manage all office printers, scanners, copiers, and faxes; create and manage digital forms; archive paper and digital documents; manage medical records, electronic and paper billing, invoice processing, bank or mortgage statement processing, and other critical documents; and provide printing and design services.

- Document outsourcing has been relatively unexplored but can lead to immediate cost savings, particularly for the banking, mortgage, health care, and automotive industries. Not having to focus on the proliferation of paperwork leaves resources available for business growth.
- Document outsourcing includes integrating scanners, printers, and copiers with the internet, creating content management systems, standardizing forms, and storing and managing documents such as banking forms or medical records in an online repository.
- Outsourcing documents can also make a document more effective. For example, when bills and other documents are managed from a central repository they can be customized for target groups and sent to mobile devices.

BENCHMARKS

Conference participants were polled on the following questions:

Chart 1

Which best describes the extent to which your company engages in outsourcing?

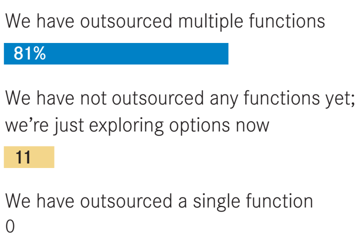


Chart 2

Which functions (or activities within functions) have you outsourced?

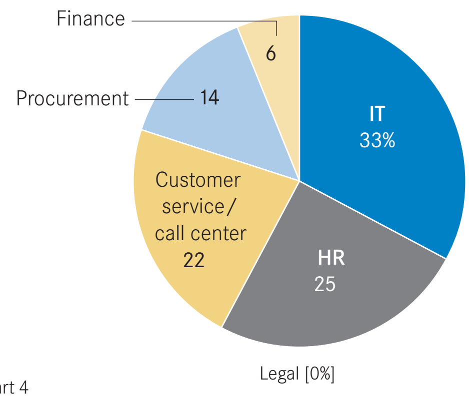


Chart 3

During the past year, in response to the economic downturn, our company has…

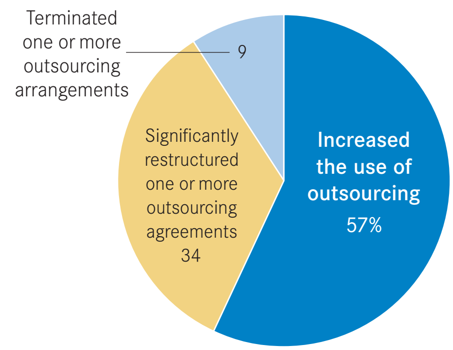


Chart 4

How would you describe the overall value derived from your company's outsourcing arrangements post-implementation compared to what was expected pre-deal?

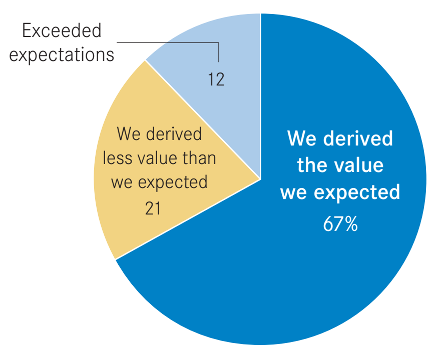


Chart 5

What are your company's top objectives for entering outsourcing agreements?

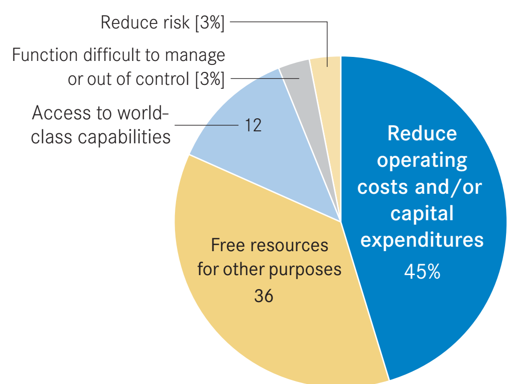


Chart 6

Which of the following are the most significant factors in the success of your outsourcing arrangements?

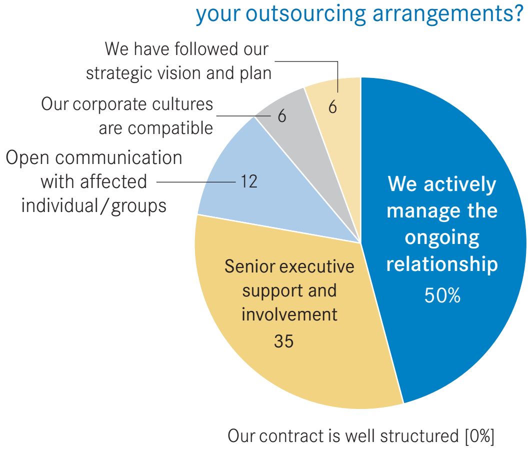
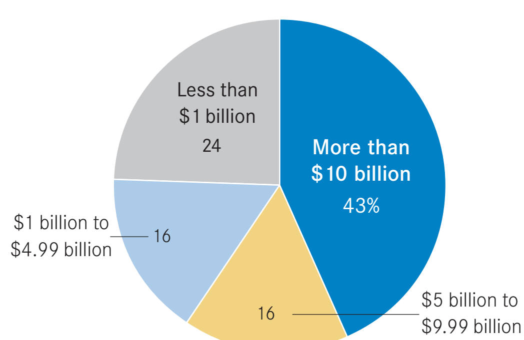


Chart 7

What is your company's annual revenue?



ACTION PLANS

What actions will participants take after the conference? These answers to a post-conference "action survey" highlight a range of objectives.

Assessment

- Apply a "results" versus "resources" assessment to each relationship and determine what clarifying changes should be in upcoming objectives.
- Evaluate further opportunities in the area of analytics and other services (i.e., facilities, legal).
- Develop a 360-degree assessment for customers, suppliers, and outsourcers to see how they perceive the effectiveness and health of the relationship.

Strategy

- Review, update, and refine rules of engagement. This includes outsourcing providers and customers. Move away from a "tactical" approach to a relationship-based one. Be respectful of each other's profit and loss statement (P&L).
- Calculate governance costs and divide activities that contribute to governance processes to get a clearer sense of costs. Then adjust our definition of governance and possible roles and responsibilities.
- Brainstorm the possibilities of transitioning from variable cost to fixed cost for a section of our outsourcing work.
- Evaluate locations (i.e., Eastern Europe, Malaysia, etc.) that I had not considered.
- Engage internal stakeholders on optimizing areas of business process outsourcing (BPO) that need work.
- Focus on the management of providers and handoffs.
- Optimize mature supplier relationships.
- Consider the outsource provider/team as part of our own, and engage associates with the "one team" approach to relationship and service delivery.
- Explore the idea of building an effective relationship with outsource providers and put more thought into partnering strategy.
- Implement "culture swaps." I have found that mutual site visits with the operational team is key to a successful outsourcing relationship.
- Speak to our CIO about a new process for IT offshoring/outsourcing deals. It will mandate new steps to ensure strategic direction, service integration, and governance. I will recommend that our internal outsourcing experts remain actively involved during transition or initial set up, instead of only doing semi-annual governance reviews.

For more information

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Other Strategic Outsourcing Resources from The Conference Board

Research Reports

Offshoring Reaches the C-suite
R-1445-09-RR, June, 2009

Assessing Offshoring Risk
R-1431-09-RR, January, 2009

Meeting the Challenges of a Dispersed Workforce: Managing Across Language, Culture, Time and Location
R-1432-08-RR, November, 2008

Executive Action Reports

Innovate Today, Grow Tomorrow
Executive Action 288, October 2008

Bridging the Logistical Divide: Integration of Poor Countries in Global Supply Chains
Executive Action 281, August 2008

Councils

Asia-Pacific Functional Excellence and Shared Business Services Council

Asia-Pacific Supply Chain Council

Council of Shared Business Services Executives

Council of Shared Business Services Executives II

European Council on Purchasing

European Council on Shared Services

European Council on Strategic Manufacturing and Global Supply Chain

Global Operational Excellence Council

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Strategic Sourcing Leadership Council

Supplier Diversity Leadership Council

Supplier Diversity Leadership Council II

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