Outsourcing to Succeed in Any Economy

White Paper

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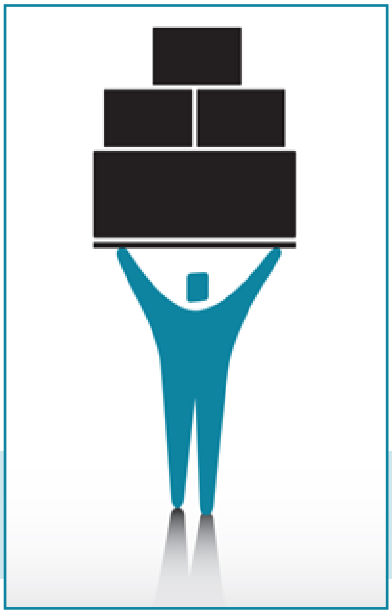
Outsourcing to Succeed in Any Economy

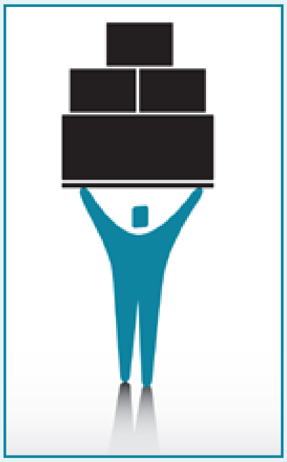


Introduction

Definition: What is Outsourcing?

What economic activity do you initiate when you hire someone to mow your lawn or clean your house? When you use UPS to ship a parcel, buy insurance or write a check? You are outsourcing. Outsourcing is simply defined as the use of an individual or an organization to perform a function, process or service on your behalf. People and companies have been outsourcing for decades, but the practice has come into the limelight recently as more and more knowledge-based jobs, or "white-collar" positions, are being moved to companies in foreign countries. Also in the news is the more recent phenomenon of offshoring, or the practice of outsourcing services to companies located in foreign countries. Offshoring is not be confused with nearshoring, which is the practice of using neighboring countries or regions for outsourcing. Nearshoring has received a lot of press because so many jobs have been lost to this type of outsourcing, and those who have lost their jobs remain unemployed.

Companies who choose outsourcing providers in foreign countries utilize what is called labor arbitrage as a business advantage. In other words, they take advantage of the wage gap between our industrialized nation and that of developing nations. Most people have experienced this firsthand when they have called for technical support for their computers or placed an order with a favorite catalog company. This type of outsourcing, however, is just the tip of the iceberg in modern-day outsourcing practices.



Outsourcing Related Terms

Outsourcing – procuring of services or goods from an outside provider

Offshoring – outsourcing to a foreign company

Nearshoring – outsourcing to a neighboring country or region

Insourcing – outsourcing to "inside" personnel, as in a department

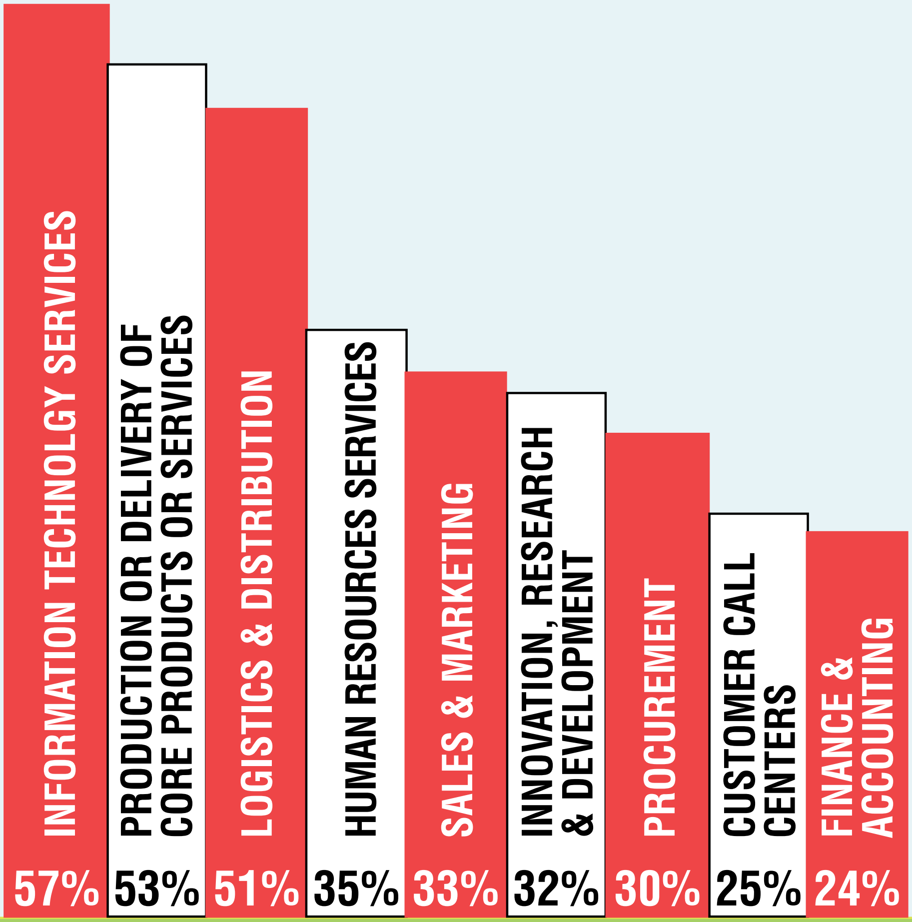
BPO – Business Process Outsourcing, or outsourcing operations and responsibility for specific functions

Trends in Outsourcing: From Cost Savings to Business Process Outsourcing

The practice of business outsourcing began about 50 years ago in the manufacturing industry as a means to reduce costs and, therefore, improve profit margins. Because product manufacturing has a very discernable breakdown of components such as labor, parts, and research and development, the cost benefits of outsourcing are easily computed. Accounting methods such as cost analysis can be applied easily to these discrete units in order to justify the outsourcing. Milton Hershey benefited from the first well-known success in manufacturing outsourcing when he moved the sugar farms of the Hershey Chocolate Company to Cuba to take advantage of lower wages. [1]

Knowledge-based outsourcing began in the 1980's when companies began to out-task their payroll and financial tasks to others. Because these tasks are repeatable and easy to reproduce, a specialized outsourcer can provide huge cost savings. The success in these areas established a benchmark and provided a business model for the outsourcing of information systems. In the 1980's and 1990's, information technology outsourcing saved companies an amazing 30% in operating costs. [2]

The trend toward outsourcing has continued and expanded to include entire business processes. Business process outsourcing (BPO), where companies outsource an entire process such as human resources services, has become much more prevalent as efficiencies and cost savings are realized.



TOP OUTSOURCED SERVICES

The bar graph shows the industry distribution of outsourcing contracts, as reported by the PriceWaterhouseCoopers' 2007 Global Outsourcing Survey.

The expansion of outsourcing, however, has brought to light potential risks and failures for the unprepared company. Failures most commonly arise from mismanagement of operational and cultural risks. According to a Gartner report that analyzes global outsourcing transactions for 2007, a trend toward shorter and smaller contracts has begun, and that trend is most likely due to such failures. A more limited contract size allows the company more management oversight and control over deliverables. The report found that megadeals, those valued at more than $1 billion, represented only 6.8% of the total contracts, while those valued at less than $50 million comprised 39.5% of the total.[3]

How to Outsource: Four Simple Steps

Many might think that the decision to outsource will bring on nothing but headaches and undelivered promises. With the right approach and follow-through, however, outsourcing can achieve significant financial results. Outsourcing a product or service can be broken down into four simple steps:

1. Definition of strategy and scope of project
2. Evaluation and selection of a company
3. Development of the contract
4. Management of the relationship

1. Definition of strategy and scope of project

The first step in the process is critical to the success of any outsourcing venture. Develop an overall philosophy for your organization's outsourcing needs at the outset of your decision-making, and you will create a firm foundation for a successful transition. If you know your project scope and the overall direction of your strategy in detail, those details will allow you to clearly define your expectations and communicate them to your outsourcing service provider. And, the best way to get what you want is to simply ask for it.

2. Evaluation and selection of a company

The second step is to evaluate and to select an outsourcing provider. Once you have determined your outsourcing strategy, which includes your overall direction and scope, you should be able to walk smoothly through this step. For instance, if you have decided that you want to outsource your Internet marketing efforts to include Web design, graphics and text within a defined budget and objective, the search for providers and the evaluation of the options they provide will be efficient and productive.
No matter which service you seek, you should consider all the following when you select a provider:

- Culture and Fit
- Customer Service and Responsiveness
- Experience and Scope

"You shouldn't have something in your back office that exists in someone else's front office."

-Jack Welch

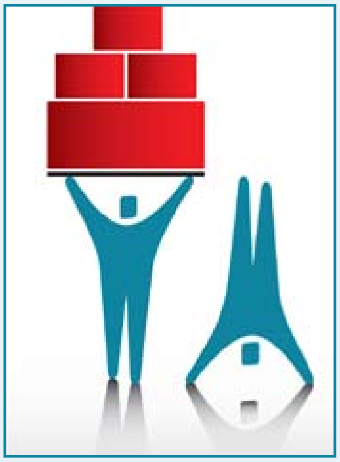
> *"If you deprive yourself of outsourcing and your competitors do not, you're putting yourself out of business."*
>
> **-Lee Kuan Yew**

3. Development of the contract

The third step allows you to "iron out all of the wrinkles" in the relationship with your provider. When you negotiate with suppliers, focus on points such as price, time frame, transition and terms for the termination of the project. During this process, consider how each component will affect your business and how it will lead to a successful partnership with your supplier. The creation, at this point, of any type of adversarial relationship will not help you achieve your objectives, so make sure that you have established your position before going into negotiations. A good understanding of your business needs will allow you to negotiate terms that lead to both a professional and a mutually beneficial relationship with your supplier.

4. Management of the relationship

The fourth step is often the most forgotten step. In order to capitalize on the benefits of outsourcing, you need to nurture and to manage the relationship with your supplier. Both parties should understand that both the supplier and the client company can succeed only if there is a reciprocal sharing of insight and knowledge. Both parties should emphasize open communication, the establishment of guidelines and the commitment to achieve common goals. In fact, the proper management of the relationship can lead to not only achieving your goals, but exceeding them.



Outsourcing Success Factors

1. **Executive-level support for the outsourcing mission**
2. **Ample and transparent communication to affected employees**
3. **Ability to manage outsourcing service providers [12]**

Define Your Core: the Path to Successful Outsourcing

Historically, companies choose to outsource for two primary reasons: 1) They cannot perform the task effectively or efficiently, or 2) they want to realize some cost savings. However, managers have begun to realize that they can achieve far more with an outsourcing partnership than they can on their own. Successful outsourcing initiatives allow companies to access talent, to take advantage of economies of scale, to accomplish growth goals, or to achieve a myriad of other objectives. In addition, managers are more able to focus on their core competencies and to provide excellent customer service. As Jack Welch, former CEO of General Electric who was named“Manager of the Century”by Fortune Magazine, observed,“You shouldn’t have something in your back office that exists in someone else’s front office.”[4]

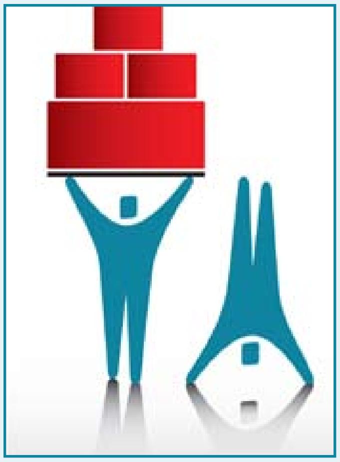
To create a successful outsourcing plan, you need to first determine your company’s core competencies. A competency is a company asset, skill or process that provides a sustainable competitive advantage and cannot be easily duplicated by others. If you think outside of the box when you perform this internal inquiry, you may be surprised to find that your core competency is not necessarily the activity that generates your revenue. For example, if you manufacture a quality widget, your core competency may not be the quality of your engineering. It may be, instead, your ability to offer your customers products that take advantage of advanced technology and innovation. Imagine what this change in perspective could mean to your future business plans.

Advantages

Find a Competitive Advantage through Outsourcing

The potential competitive advantages of outsourcing are vast, so much so that many companies have found success with the inclusion of outsourcing in their business model. In fact, according to the 2007 PriceWaterhouseCoopers' Global Outsourcing Study, 87% of respondents say that outsourcing delivers the benefits that were projected in the original business plan. Furthermore, ninety-one percent (91%) of those surveyed say they plan to outsource again.[5] The most common benefits of outsourcing are cost savings, the ability to provide new services and markets, improved quality, an international presence, and improved access to talent.

Outsourcing began as a way to save money. Companies found that other suppliers could provide products or services at a lower price than they could provide them internally. One of the first ways that companies realized outsourcing benefits was to capitalize on labor arbitrage, the advantage of paying lower wages by offshoring products and services to undeveloped countries. That was soon followed by the use of suppliers that are also able to save companies money because the suppliers can achieve economies of scale the companies cannot. Outsourcing providers can offer the product or service at a lower price because they can do it more efficiently by specializing in a certain area. Suppliers like Convergys Corporation have helped companies such as DuPont redesign and administer its human resources programs. DuPont's prediction of savings is 20% in the first year of implementation and 30% a year afterward. [6]



Outsourcing Advantages

1. Realize Cost Savings
2. Provide New Services and Products
3. Improve Quality
4. Increase International Presence
5. Improve Flexibility
6. Increase Access to Talent

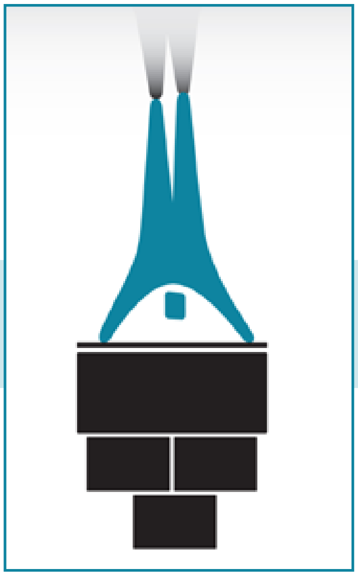
Outsourcing not only lowers production and operating costs, it also offers companies numerous ways to grow their business. For example, suppliers offer access to different markets, supply chains, and customers, which can fuel growth because this access allows companies to reach new buyers. An additional competitive advantage is the time savings achieved by outsourcing, time savings that allow companies to get products into the hands of customers faster.

The use of specialized suppliers allows companies to concentrate on the fine-tuning of their products and services. "Smart use of offshoring can juice the performance of established players, too."[7] When employees are not overburdened, they are free to focus on the company's core competencies. Penske Corporation, an international transportation services company, found this especially true in the distribution of permits and specific documents at weigh stations for their trucks. Through the use of a centralized call center in India, the processes that used to take two hours to complete now take 30 minutes. This has not only cut costs, it has also improved efficiency and customer service.[8]

One of the most obvious advantages outsourcing offers is an international presence. When you decide to execute a global growth strategy, outsourcing to foreign suppliers can quickly provide access to benefits not found in normal business processes. In addition to their location, these suppliers often allow you to provide customer service in various languages, as well as make available their products and services to customers in more time zones.[9] An often overlooked advantage of using international suppliers is the ability to do business in the local currency of the suppliers.

In our increasingly knowledge-based economy, access to talent has become a distinct competitive advantage. Outsourcing to consultants with advanced qualifications, experience, and education can catapult your brand ahead of your competition's brand. Outsourcing also allows flexibility in the management of the work schedules of your workforce so that, as demand fluctuates or special projects emerge, you do not overtax your current employees or reduce customer service levels. Procter & Gamble (P&G), a giant in the consumer goods industry, has announced that they want half of their new products to come from outside talent – an increase of 30% over their current amount. Outsourcing partners have been varied in the past and have ranged from academics to entrepreneurs to researchers in government laboratories.[10] The focus of P&G's external innovation strategy is the pursuit of ideas that can be brought quickly and easily to market.

Risks



Outsourcing is not the answer for every situation or every organization. According to a Forrester Research survey, an estimated 25%-50% of outsourcing initiatives are considered failures by the respondents.[11] Outsourcing, of course, involves risk, as does any business venture. The risks of outsourcing can be categorized as either cultural risk or operational risk.

Cultural risk involves a variety of differences between the home environment and the offshore environment. For example, communication problems arise often, due to language disparities and/or time zone differences. Other cultural issues that could affect the success of an outsourcing initiative are differences in standards, in business practices and in religious beliefs and practices.

Business interruptions, employee morale and poor service are all operational risks associated with outsourcing. Any of these problems can lead to a high turnover rate, declining customer service, lower product quality and a diminished production capacity for the company. In addition, contracts must be flexible enough to adjust with changing business needs.

However, with the proper preparation and with due diligence, the risks and failures of outsourcing can be minimized and its advantages can be realized. For your outsourcing initiative to succeed, you must first align your business objectives with your outsourcing objectives. This allows you to clearly define the project scope and service requirements so that you can then communicate them explicitly to your supplier. Be aware of the risks that may transfer from your chosen provider to you. Do they have a documentation process in place? If they do, will they share comprehensive documentation? Are key employees available to answer your questions? Does your provider have a high turnover rate? To maximize your outsourcing success, seek suppliers that will focus on an ongoing partnership. And remember that such a partnership includes mutual training and the mutual transfer of knowledge.

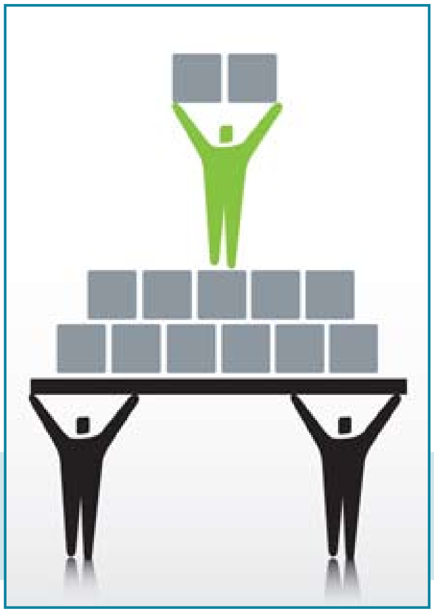
Communication Is the Key to Motorola's Success with Outsourcing

The outsourcing process at Motorola, Inc. provides a successful example of how the exchange of mutual knowledge through constant communications enhances outsourcing relationships. At Motorola, successful outsourcing includes four basic steps: discovery, agreement, transition, and delivery. Motorola provides an excellent example of how these four steps can be defined and utilized, especially in the way in which the company applies proprietary best practices to ensure success during each phase.

In the discovery stage, Motorola employees draw on their vast knowledge to customize a strategic solution. During the service agreement phase, Motorola and its outsourcing partner discuss capabilities and risks and determine penalties and rewards that may be assigned to performance. While in the transition phase, a dedicated team addresses technical, business and human factors. In the last step, service delivery, experienced staff members utilize leading edge tools in proven best-practice processes in order to achieve excellence in execution. The result is a successful collaborative partnership, as well as satisfied customers.[13]

Motorola's 4 Steps for Outsourcing Success

1. **Discovery**
   - Customize solution
2. **Service Agreement**
   - Agree to terms
3. **Transition**
   - Establish transition program
4. **Service Delivery**
   - Execute with excellence



Conclusion

In today's fast-paced and competitive environment, outsourcing can provide a unique competitive advantage. If you approach outsourcing with caution and with clearly defined objectives, your company can realize benefits such as cost savings, improved service and quality, achievement of its growth goals, rapid international expansion and increased flexibility in the management of key resources. Also, if you focus on the creation of a partnership with your supplier, you can do more than just accomplish your business goals. A collaborative arrangement that includes clearly defined objectives, provides good communication tracks and shares risks and rewards also serves to create the guidelines that will establish a partnership that can quickly meet the inevitable changes and demands of the marketplace. Unlike current outsourcing business models in use, a collaborative agreement accommodates future business objectives and allows for quick responses to shifts in market activity.

END NOTES

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Marketing Resource

Writing an effective white paper requires a command of certain basic skills: writing, interviewing, general analytic skills, specific market research and analysis, a working knowledge of marketing and sales approaches, and a familiarity with the appropriate use of explanatory and illustrative concepts.

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