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Outsourcing

Overview, Context and Trends

Outsourcing - Origins

"By the end of 2004, one out of every 10 jobs in American software industry was moved to inexpensive emerging markets like India, Russia and China, as US companies rush to cut costs", according to global research agency Gartner Inc. "Globally, the finance and accounting outsourcing segment alone hit $40 billion in billables in 2002, and was projected to blossom into a $65 billion industry in just the next three years", according to IDC Corp., an IT and BPOresearch and advisory firm. "And in the U.S., end-to-end HR outsourcing, which has so far only been pursued by large companies, is reported to be at $8 billion in billings in 2002, and may very well triple by 2006", according to TPI, a Houston-based outsourcing advisory firm.

All of these excerpts establish a business model and trend that continues to evolve. "Outsourcing" continues to offer today's business executives an option to further a business strategy that will enable their organizations to create and sustain business value in the ever-increasing competitive global marketplace. "Outsourcing" has been applied to a multitude of business functions including Accounting, Finance, Human Resources and Information Technology.

As businesses struggle to reduce costs and grow revenues, "Outsourcing" initiatives are under way in many large, medium and small global companies. In a recent Gartner Group survey, 73% of mid-tier firms indicated they outsource some piece of their enterprise business processes. Outsourcing strategies are considered the "Silver Bullet" to resolve many organization's problems. Outsourcing has been touted as the "Holy Grail" for organizations to: reduce costs, focus on core business processes, improve services, enhance skills, reduce time-to-market and increase overall competitive advantage.

Although many of these attributes can be obtained in a well planned, implemented and managed outsourcing initiative, many organizations continue to struggle with the commitment and discipline it takes to reap these benefits. Too often, organizations fail to realize the impacts on their people, processes, methods and tools as they proceed along their "Outsourcing" journey - this frequently translates into an "Outsourcing" engagement with harmful consequences rather than the fruitful experience initially anticipated by the organization.

Generic "Outsourcing" Process

A conventional outsourcing exercise starts with a client's need recognition and ends with the end of contract. Though *Outsourcing Vendors* promote various approaches for delivering this outsourcing expertise, *Outsourcing Clients* should consider the outsourcing alternatives they have prior to engaging into an outsourcing engagement. The following seven stages identify a number of factors an *Outsourcing Client* should understand and consider as part of their outsourcing strategy.

Stage I - Know Yourself First

The primary goal of outsourcing is to gain business benefit by handing over a part of a business responsibility to someone who is expert at handling it. This stage requires self-assessment - business goals must be identified and questions must be asked (i.e. Organization should know which activities are consuming more resources? What is the importance of these activities and what business advantage could be earned if it were outsourced?). The *Outsourcing Client* should be aware of the effects of each component of their business and be able to establish outsourcing business factors and priorities. These factors and priorities are used to establish criteria that will be utilized to identify, select and oversee the products and services to be delivered by the *Outsourcing Vendor*.

Stage II - Request For Proposals

Once the *Outsourcing Client* has identified the business factors and priorities to establish the outsourcing criteria they are positioned to search for the *Outsourcing Vendors*. Request for proposals (RFP) are prepared (based on the approved criteria) and made available to potential *Outsourcing Vendors* - those who's services can map to the *Outsourcing Clients* criteria. The more concise the *Outsourcing Client* is in defining the criteria the less risk they have when evaluating and selecting the *Outsourcing Vendor* - this clarity also ensures a healthy competition for evaluating the "outsourcing" options promoted by the *Outsourcing Vendors*. The RFP should be designed to ensure *Outsourcing Vendors* are required to respond to common requirements and criteria - RFP responses can then be evaluated on a comparative basis.

Stage III - Evaluating the "Outsourcing" Vendor

RFP responses received from *Outsourcing Vendors* will include responses to the required (as per the RFP) information. The *Outsourcing Client* then evaluates all of the RFP responses against the pre-defined criteria to determine the *Outsourcing Vendor* who best meets the minimum requirements (strengths/weaknesses of each vendor should be noted) as part of this activity. It is advisable to measure all the *Outsourcing Vendors* on a common scale (measuring standards would depend on the type of industry and the specific business needs). The *Outsourcing Client* should also include intangible criteria (i.e. potential cost savings versus longevity, stability, future prospects, security, confidentiality, ethics, culture) as part of the evaluation process.

Stage IV - Selecting the "Outsourcing" Vendor

After determining (from Stage III) the viable *Outsourcing Vendors,* the Outsourcing Client is positioned to determine the "selected" *Outsourcing Vendor* (formal decisions to be documented). As part of the "selection" process, the *Outsourcing Vendors* must continue to provide access to any additional information (documentation, samples, process audits, etc.) requests made by the *Outsourcing Client*.

Stage V - Finalizing the "Outsourcing" Contract

A legal and binding contract/agreement (based on certain terms and conditions) between the *Outsourcing Client* and the *Outsourcing Vendor* is authorized. It is in the interest for both parties that the contract/agreement be completed in the presence of learned legal personnel. The outsourcing contract/agreement must be absolutely clear between both (*Outsourcing Client* and *Outsourcing Vendor*) parties in all respects. This ensures provisions are in place to address any "unforeseen" issues and promotes a healthy and sustainable relationship. Specifics (i.e. benchmarks, standards, roles, methodology, deliverables, etc.) should be mentioned as part of the contract.

Stage VI - Measuring Performance

Regular performance review and oversight are activities of every effective outsourcing process. This includes both the products being delivered by the *Outsourcing Vendor* and the process they are applying to develop the products. Pre-defined criteria (i.e. methodologies, frameworks, deliverables, touchpoints, reports) are used as the benchmarks for measuring the performance (product & process) of the *Outsourcing Vendor*. Performing a regular performance review also ensures the parties have a mechanism to address status, issues, risks, schedule and quality. This review ensures big surprises (cost, schedule, quality) between the *Outsourcing Client* and the *Outsourcing Vendor* will be avoided in the delivery of the final product - it also makes ensures the *Outsourcing Vendor* remains accountable for the output.

Stage VII - End of Contract

Though differing in duration, all outsourcing contracts come to an end. In some cases original contracts are extended, in other cases new contracts are developed, in other cases the outsourcing relationship ends. It is recommended that the *Outsourcing Client* should utilize the knowledge they have gain through any outsourcing engagement to improve their capability (i.e., refining criteria, incorporating new touchpoints, revising activities and roles) with future outsourcing engagements.

Generic "IT" Outsourcing Delivery Models

The generic outsourcing process (mentioned above) acts as a basis and is applicable to each of the following outsourcing delivery models.

"Offshore" Outsourcing

The "offshore" outsourcing delivery model utilizes resources (other than North American) to deliver products and services. Potential advantages may include access to a large pool of technical skills and expertise, reduction in labour costs (relative to NA), expertise in delivering outsourcing services, and execution of mature (in relation to industry recognize standards and frameworks) delivery processes. Potential disadvantages may include dependence on business climate and culture of *Outsourcing Vendor* location, security (access and data), communications (language and time change), process linkage, taxation, and legal resolution mechanisms.

"Near/Onshore" Outsourcing

The "near/onshore" outsourcing delivery model utilizes resources (North American) to deliver products and services. Potential advantages may include access to a large pool of technical skills and expertise, reduction in labour costs (relative to NA), communications (language and time change), taxation, and legal resolution mechanisms. Potential disadvantages may include security (access and data), process linkage, lack of mature (in relation to industry recognize standards and frameworks) delivery processes.

"Global" Outsourcing

The "global" outsourcing delivery model is the most elaborate outsourcing model amongst all the other models. It’s a combination of onsite model and offshore model but unlike the onsite/offshore model wherein the offshore development center of *Outsourcing Vendor* is located at only one place, in the global delivery model the *Outsourcing Vendor* has its offshore development centers spread out across the entire globe. The *Outsourcing Vendor* need not have their own offshore development centers across the globe but they can use the resources of their partners located around the globe, and thus follow a global delivery model. This provides the *Outsourcing Client* with a large working team with varied qualities and expertise in different fields.

Outsourcing Model (Offshore, Onshore, Global) Considerations

Outsourcing suffers from a multitude of business issues. One of the biggest disadvantages of outsourcing is the increase independence the *Outsourcing Client* must rely on others. Traditionally, the *Outsourcing Client* will not initiate into an outsourcing relationship until a cost advantage can be realized, however, after outsourcing has been initiated the *Outsourcing Client* loses control over that activity - the overall business result will depend on how the *Outsourcing Vendor* performs. In order to achieve desired performance, firms are compelled to part with certain information or activities, which are of strategic importance - this has the potential to make the *Outsourcing Client* more exposed and vulnerable to business risks.

Outsourcing Terminology

Generic "Outsourcing" Definition

'Outsourcing" - an organization (*Outsourcing Client*) leverages the expertise of another entity (*Outsourcing Vendor*) to contribute or enhance the efficiency and delivery of required business functionality and service.

Out-Tasking

Out-tasking is an emerging concept. It defines the boundaries necessary to explain to a work force that it is being evaluated for possible outsourcing. With the uncertainty of today's business climate, most managers are reluctant to discuss an outsourcing possibility until the certainty of the benefits is conclusive. The concept of out-tasking makes the explanation easier and is restrictive enough to help employees understand the overall and final effects of it.

Downsizing

This is a source of much anxiety to the employees of companies looking at complete outsourcing or out-tasking of specific functions. The *Outsourcing Vendor* uses the term 'downsizing' in front of employees in presentations to management teams exploring outsourcing or out-tasking. "Downsizing" becomes synonymous with a reduction in work force immediately after the outsourcing implementation.

Right-Sizing

To alleviate some of the anxiety caused by downsizing, *Outsourcing Vendors* have developed a new concept called right-sizing. While performing on-premise evaluations, the *Outsourcing Vendor* recognizes the numbers of support personnel are at the same levels as they were when the total company population used to be much higher. The *Outsourcing Vendor* begins to use the term 'right-sizing' to described the proposed reduction in support personnel headcount.

Core Business

As an organization grows so does its need to diversify. The more an organization diversifies the more it removes itself from business that made it successful (i.e. a food company obtains ownership in a transportation company). Today's economic conditions are forcing organizations into assessing and focusing on their "core business". By outsourcing non-core business functions to an *Outsourcing Vendor*, the organization can go back to what they do best - their core business.

One-stop Shopping

The presence of multiple *Outsourcing Vendors* allows a potential *Outsourcing Client* to minimize the number of proposals necessary to make an outsourcing decision. In the last five years, both the number of multi-service providers and the number of business entities looking at outsourcing or out-tasking multiple functions have increased. Five years ago, if a company wanted to out-task two or three functions at the same time, the final solution would have been multiple outsource providers, each performing a single function. Today, one-stop shopping offers the *Outsourcing Clients* a minimal number of proposals to be evaluated and allows multiple functions to be outsourced or out-tasked for a better price. The primary *Outsourcing Vendor* will be the focal point of the outsourcing engagement requiring additional sub-contractors to deliver products and services.

Value Addition

With the advent of one-stop shopping, outsourcing and out-tasking can be provided at a lower price. Rather than having multiple *Outsourcing Vendors* performing singular functions with supervision in each segment, the one-stop shopping *Outsourcing Vendor* offers all functions to be outsourced or out-tasked with one level of management. This creates the concept called "value addition" - more value for less money.

Process Re-engineering

The savings to both the *Outsourcing Client* and *Outsourcing Vendor* in any value-added scenario come from improved process procedures. By looking at each function and breaking down the number of steps per function, the *Outsourcing Vendor* decreases the number of steps and increases productivity and profitability.

Internal Customers

As the concept of outsourcing has spread across corporate North America, employees have been re-classified as internal customers of services provided by both internal and external suppliers.

Outsourcing - Initial Considerations

Outsourcing is a powerful business strategy that requires a shift in the way global business is conducted. Harnessed correctly, outsourcing can deliver key outcomes including: cost reductions, ability to focus on core business competencies, improved quality, enhanced skills capabilities, reduced time to market and competitive advantages. Done incorrectly, outsourcing can produce the opposite effect. Organizations that strive to make outsourcing a core competency will be well positioned to be competitive in the 21st century global marketplace. Organizations embarking on an outsourcing initiative must understand that being successful requires the implementation of a disciplined outsourcing lifecycle methodology, from strategy formulation, planning, requirements definition, RFP creation, vendor identification, evaluation and selection, contract formulation, negotiation to comprehensive outsourcing governance. This requires a commitment of skilled resources from executive management and supporting cross-functional organizations with a clear unambiguous understanding of the organization’s strategy, goals and objectives. Organizations that are already in an outsourcing relationship should proactively and regularly assess their existing outsourcing relationships. Benefits should be recognized and promoted. Deficiencies and problems should be identified and addressed to mitigate potential risks.

Outsourcing - Ten Common Implementation Deficiencies
The following common deficiencies plague many organizational outsourcing initiatives and inhibit them from maximizing the return on their outsourcing investments.

Lack of Executive Management Commitment - organizational staff must know that Senior Management are driving and performing oversight on the outsourcing initiative. This will ensure staff will remained engaged and committed to the initiative.

Lack of an Outsourcing Communications Plan - all resources (*Outsourcing Client*, *Outsourcing Vendor*) must be kept informed on the outsourcing initiative throughout its life-cycle. This ensures staff can remain familiar with the roles, activities, oversight, support infrastructure, implementation schedule being used on the initiative.

Minimal Knowledge of Outsourcing Methodologies - all resources (*Outsourcing Client*, *Outsourcing Vendor*) must have a general and common knowledge of the outsourcing process, delivery models, and terminology. This enables the resources to speak the same language and understand the same objectives.

Failure to Recognize Outsourcing Business Risks - potential risks (financial, legal, corporate image, culture, career) associated with an outsourcing initiative must be identified and assessed prior to engaging into an outsourcing engagement. This ensures the initiative can be managed pro-actively once it has started.

Failure to Obtain Outside Outsourcing Professionals - all resources are exposed to a learning curve (*Outsourcing Client* - outsourcing process, *Outsourcing Vendor* - business specifics) and require knowledge and support throughout the initiative. Outside outsourcing expertise ensures all resources receive the knowledge and support they require to fulfill their roles throughout the life of the outsourcing initiative.

Not Dedicating the Best and Brightest Internal Resources - internal resources will be required to understand, incorporate, and adjust to outsourcing processes. This requires a knowledge of existing practices, an aptitude to learn the outsourcing process and an understanding of how the two (existing and new) intersect. Having seasoned internal resources as part of the outsourcing initiative will increase the likelihood of a successful implementation.

Rushing Through the Outsourcing Requirements, RFP, Vendor Selection and Contract Lifecycle Phases – the outsourcing process (end to end) contains many variables - a very fluid and dynamic environment – its implementation complex. Too frequently, not enough consideration is given to the "cause and effect" of certain decisions made at certain points of the process. An example, faulty or inaccurate outsourcing requirements (based on urgency to complete) are used as a basis for selecting an *Outsourcing Vendor* - result - faulty selection and legal contract because the *Outsourcing Vendor* was unable to deliver to the actual outsourcing needs. Recommended - *Outsourcing Clients* recognize the outsourcing process as a whole and take incremental steps to implement it.

Not Recognizing the Impact of Cultural Differences - resources (*Outsourcing Client* and *Outsourcing Vendor*) will be required to work together throughout the outsourcing initiative. When implementing any operational change, resources are require to adapt to new processes, roles, and activities. When implementing an outsourcing process delivery model there can be (depending on the outsourcing model) additional factors (language, time change and scheduling, prioritization, accountability, job security) that must be identified and managed as part of the implementation.

Minimizing What It Will Take To Get The Outsourcing Vendor Productive - in following the outsourcing delivery process the *Outsourcing Client* establishes a legal contract with the *Outsourcing Vendor*. In some case the outsourcing contract is vague and open-ended in other cases it is definitive with little room for misunderstanding. In either case, the outsourcing contract is open to interpretation. The *Outsourcing Client* must ensure they have the proper mechanisms (clear and concise outsourcing contract defined, legal jurisdictions defined, and "changes to contract" procedures) in place to effectively administer and oversee the *Outsourcing Vendor*.

No Formal Outsourcing Governance Program - the success of every outsourcing relationship is based on both organizations (*Outsourcing Client* and *Outsourcing Vendor*) having a collective understanding of how the process is being performed and the methodology to be applied. To accomplish this both parties must identify the variables required to measure the performance, establish performance thresholds, identify who and how these measures will be evaluated, and pre-define a procedure that will be used to address performance deficiencies.

Outsourcing - Future Trends (according to Gartner Inc)

Gartner Says Outsourcing Will Continue to Grow in 2009 Despite Economic Slowdown
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STAMFORD, Conn. — The outsourcing industry is not immune to the ripple effects of the widespread economic volatility, however, in an economic downturn, cost will trump value considerations, according to Gartner, Inc. “Although things look gloomy for the larger global economy, the outsourcing market represents a dichotomy: on the downside, organizations’ cost-cutting outsourcing strategies may negatively impact market growth, but at the same time, the upside is that outsourcing will be adopted by more organizations to help them work through financial and competitive challenges,” said Allie Young, vice president and distinguished analyst at Gartner. “The well-educated buyer and provider will have the advantage. The potential for outsourcing to address immediate cost pressures as well as long-term recovery goals will be unprecedented. However, only organizations that are diligent about understanding and avoiding the pitfalls of cost-focused outsourcing and that apply business-outcome-focused outsourcing will be successful.” The fifth annual “Gartner on Outsourcing, 2008-2009” report shows that the global economic slump has meant that outsourcing clients are re-evaluating their contracts to improve efficiency and costs. This is affecting provider selection and retention, how services are or will be delivered, delivery location and contract pricing. Beyond the drivers of efficiency and cost, however, many organizations will also experience business change as a result of repercussions of the economic crisis, which will impact current outsourcing or plans for

outsourcing. For organizations that are outsourcing, contract terms may be altered in response to corporate change: some will downsize, others will expand, acquisition and divestiture will impact others, and still others will cease to exist. Many organizations that are not outsourcing will consider or move aggressively to outsource their IT or business processes to focus on their core business. More than ever, buyers and providers must be attentive to contract issues to ensure a certain level of flexibility, since business change is almost certain.

In 2009, Gartner expects competition for outsourcing deals, particularly for standardized IT outsourcing (ITO) services, to be fierce. Some buyers will be lured by low prices from providers trying to make quarterly revenue goals or build market share. In 2008, based on analysis of Gartner's Outsourcing Contract Database, about 76 percent of announced outsourcing contracts represented new deals; the remaining percentage was a combination of contract extensions, expansions or renewals. "Almost one-quarter of these contracts were a continuation of outsourcing with an incumbent provider. With the continued uptake in selective outsourcing, a provider can remain a key supplier of services to a particular client, yet potentially lose a portion of its historic contract value," said Ms. Young. "Key providers are betting their future on forming enduring, long-lasting client relationships. In uncertain economic times, outsourcing relationships can prove (and test) the durability of relationships and the outsourcing value proposition. "Alternative delivery and acquisition models (ADAMs) will see a net boost in adoption due to the economic conditions in 2009. ADAMs will deliver IT services through new approaches, such as software as a service (SaaS), business process utility (BPU), infrastructure utility (IU), remote management services (RMS) and Web platform/cloud computing. IU is defined as a key initiative for IT organizations during the next 12 months by many organizations. Providers that de-emphasized IU investment will react to the growing "everything as a service" buzz by refreshing their messages, creating new service bundles and reactivating investments. IU will gain more market share at the expense of traditional data center outsourcing service, which will put pressure on traditional IT outsourcing providers to deal with the pricing pressures that IU services represent and create change in their service portfolios and within their client bases.

"ADAMs are becoming more pervasive in many, if not all, aspects of IT development, delivery and management," said Ben Pring, research vice president at Gartner. "Market excitement over new delivery methods is intensifying and whetting buyers' appetites for new options and services that promise greater flexibility, speed-to-solution, lowered capital investment, and pay-for-use models." "During the next five to seven years, a broad set of new and alternative IT delivery models — already in use by aggressive early technology adopter organizations — will become mainstream," Mr. Pring said. "Since these models have been gaining attention from enterprises in recent years in relatively benign economic market conditions, they are likely to become of far greater interest to buyers as economic conditions worsen through 2009." Additional information on what happened in outsourcing in 2008 and what Gartner expects in 2009 is available in the Gartner report "Gartner on Outsourcing, 2008-2009." The report is available on Gartner's Web site at

http://www.gartner.com/DisplayDocument?ref=g_search&id=844219&subref=simplesearch.

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