



THE OUTSOURCING UNIT AT LSE

A New Resource

The Outsourcing Unit, at the LSE, assists the Board to extract enhanced value from its investments in IT and business process outsourcing. The Unit, which is independent, specializes in working with CEOs and Boards to clarify the cost implications of different outsourcing approaches, to manage complexity, to facilitate innovation, to evaluate and manage risk and to ensure retention of core capability. In addition, the Unit provides individual mentoring, group workshops, facilitation for team building, and independent analysis of strengths and weaknesses of current approaches.

Why Outsourcing is a Board issue

Outsourcing is a strategic Board issue because of its size, complexity, risk dimension and its longer-term implications, both for shareholder value, and CEO credibility. There are 5 ways the Outsourcing Unit can assist the CEO and the Board:

1. Moving to strategic thinking

Share price is a fundamental barometer of corporate performance, and one that is communicated to customers, shareholders and suppliers equally. Research shows that when a company announces large outsourcing deals for its IT infrastructure or back offices, the share price increases. Investors view this announcement as a positive action indicating tightening of cost control and “hands on” serious management. In practice, this impact on share prices can last between three and ten months. Outsourcing is identified with positive action, prudent investment, and reflects positively on the supplier.

The CEO is in the frontline where he/she often needs to buy time while under pressure to fulfil City and investor expectations. The danger is he/she may be swayed by short-term share price issues rather than by the inherent business and strategic logic of a particular outsourcing option. Research shows that long-term outsourcing contracts signed for short-term reasons are invariably the source of much CEO and organisational disappointment. The CEO needs to make outsourcing contract decisions on a strategic basis. The Outsourcing Unit provides the expertise to establish the necessary shift.

2. Constructing strategy against changing market conditions

Research shows that long-term outsourcing contracts are often abandoned because of unforeseen strategic implications. Either the existing contract limits the room for strategic manoeuvre, key members of the Board change, or some take over bid necessitates a different strategy. Two high profile examples of this over 2000-2006 have been the Sainsbury's experience, and JP Morgan Chase Manhattan bringing IT back largely in-house. The CEO is in the front line because strategic decisions to merge, acquire, or enter new markets can incur substantial unforeseen damage, delay and costs, where existing outsourcing arrangements need to be refocused. The Unit can assist in the necessary thinking to provide contracts that allow for strategic evolution, in the face of changing market conditions.



3. Retaining capability

Outsourcing contracts have often included a transfer of staff to the supplier leaving the company with a capability vacuum. Even the ability to manage the contract has on occasion been lost.

In one example, after the announcement of poor financial results, a CEO of one company signed a 10 year \$US 520 million IT outsourcing deal with a single supplier. Within 17 months, the CEO had been removed and the contract was then terminated prematurely. As well as paying supplier fees, the company incurred \$US 50 million implementation and \$30 million termination costs. Additional costs went towards rebuilding in-house capability and shifting to a multi-supplier model.

Maintaining and building capability requires a commitment to secure and manage existing expertise and to build new specialist knowledge. Updating and providing this knowledge in a practical way can be done with the assistance of the Outsourcing Unit.

4. Introducing innovation

CEOs are faced with the challenge of how to introduce innovation and where to find the right market opportunities. Outsourcing can provide a company with the means to test out innovative ideas or scenarios while mitigating the risk. Increasingly leading organisations utilise forms of outsourcing and partnering to:

- penetrate new markets more quickly;
- operate in new geographies, e.g. Boeing sourcing IT in Malaysia to sell core products there, Dell looking to sell into China;
- achieve strategic agility (e.g. ramp volumes up and down to adapt to business cycles, provide business continuity in times of crisis);
- achieve strategic sourcing (e.g. offshoring or using offshore competition to get better prices and service, best of breed sourcing); and
- enhance strategic capabilities by partnering with a complementary supplier.

5. CEO opportunities

Why should the CEO care? The answer is that outsourcing is a high risk, hidden cost option where strategic risk mitigation is fundamental. Furthermore, the evidence is that pursuing an operational, cost reducing outsourcing approach can drive costs down but at the expense of other expected benefits. CEOs can be assisted to adopt the following strategies where relevant through outsourcing:

Financial restructuring; redirecting the business and IT into core competencies; strengthening resources, services and provide strategic flexibility; business transition; business innovation; develop new markets through joint venturing with vendor partner.

The Outsourcing Unit at the LSE has the resources to address these issues with members of the Board.