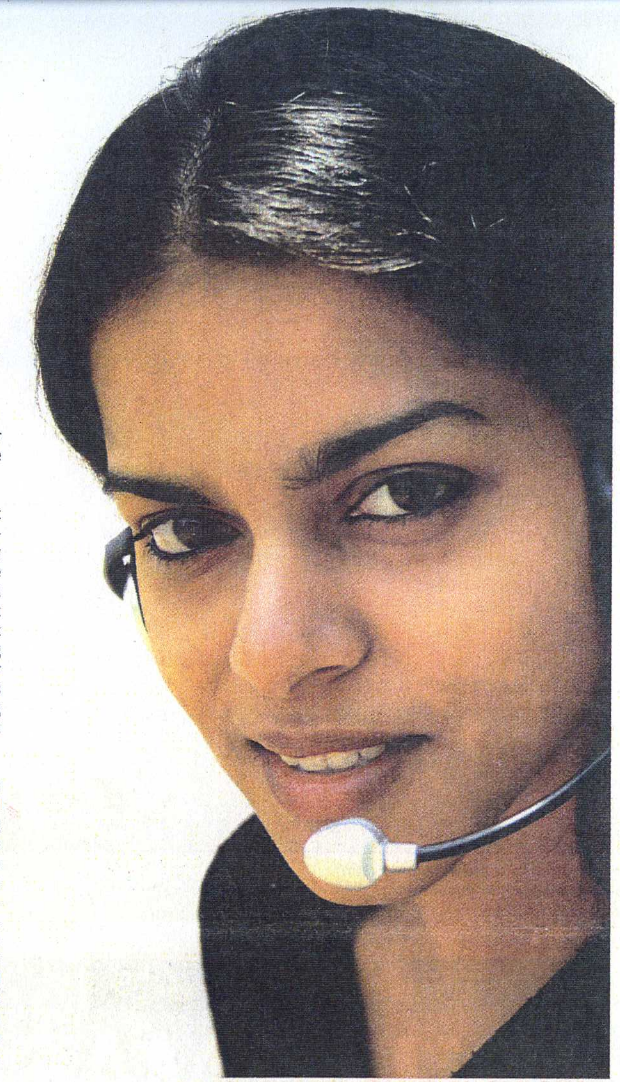
Outsourcing: still on the learning curve

Outsourcing is here to stay, but companies still have much to learn if they are to benefit from it. Here Leslie P. Willcocks, Professor and Director of the newly established Outsourcing Unit at the London School of Economics and Political Science, explains the issues



There are many signs of medium term rude health in the business process outsourcing (BPO) market. Global revenues from outsourcing business processes and back office functions – examples include Human Resources, Procurement, Accounting, Administration, call centres - now exceed $US140 billion. The market is set to grow at between seven and ten per cent annually over the next five years, and may exceed IT outsourcing (ITO) revenues by 2011. Outsourcing is not a fad, but is here to stay. This makes it all the more crucial to utilise the practice carefully and manage outsourcing in ways that achieve business advantage.

But ITO, BPO and offshoring practices are still very much on the learning curve (see graph on right), as we have discerned in our research at the Outsourcing Unit, set up specifically to research, educate and advise on the phenomenon. If we are finding more recent evidence of moves from hype and cost focus toward maturity amongst clients and service companies alike, the learning has often been painful and slow. Organizations sometimes regress, or do not transfer well the learning from say ITO to BPO, or try new models, practices and service offerings they are not actually set up to deal with. In BPO the supply side is less mature in its ability to deliver compared to ITO; clients need to check out carefully supplier claims of superior delivery, transformation and relationship capabilities. Offshoring will continue to be very dynamic, with, at last count, over 120 locations around the world already, and a revenue growth rate of possibly more than 25 per cent per annum over the next five years, demanding a close in-house watching brief on content, timing, cost, capability and location.

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Over the years the organizations that succeed with outsourcing, whether ITO or BPO, exhibit certain attributes. They are smart in their ignorance and do not overstretch themselves initially. They mitigate risks by outsourcing areas they understand and can write detailed contracts for, then become flexible with suppliers as they gain trust and confidence earned from actual supplier performance. They invest in building in-house capability that allows them to: develop a sourcing strategy aligned with business requirements over 3-5 years; understand suppliers' strategies and capabilities and buy competitively and informedly from the market; maintain control of their process architecture and technical trajectory, negotiate the deal that incentivises the supplier while delivering on the client's outsourcing goals; and they build strong internal capability for post-contract management.

Much has been headlined about jobs going offshore, and to some extent this has been a phoney war, an early part of a much bigger and long term move towards the globalisation of work facilitated by information and communication technologies. The simple equation of offshoring equals job loss has already been bypassed. For example, in the IT field the leading ITO/BPO markets of USA and UK report considerable skills shortages over the next five years. We are also seeing major Indian companies moving to a 'bestshoring' model, as we found with Tata Consultancy Services, for example, servicing ABNAmro bank from Mumbai, Sao Paulo, Netherlands, Benelux and Budapest. Such companies are already moving more work onshore and recruiting locally as they move up the value chain. We are also seeing signs of 'rural outsourcing', as suppliers both onshore and offshore, move work to cheaper locations within a country, for example Minnesota and Arkansas in the USA.

In all this BPO prospects are good, but volatile. The potential for improving back-office functions is considerable. Frequently they have not been invested in, utilise information technology poorly, have a legacy of inefficient processes, and do not receive the requisite senior management attention to change any of this. Outsourcing the right activities to a capable supplier can be a real catalyst to major cost savings and service improvements. But achieving this presents some major management challenges to suppliers and clients alike.

We see suppliers having to get used to alliance supply networks, which may well become the norm in large-scale outsourcing deals. As multi-sourcing dominates suppliers will have to get used to more customers in lower value deals, though some will continue to seek semi-exclusive 'multi-tower' deals with their major customers. There will be constant downward pressure on costs fuelled by optimization of labour arbitrage, cheap locations and streamlined uses of technology and processes. Customers are likely to manage relationships more as strategic assets, and will expect suppliers to become more entrenched in the client's business.

And as they outsource more, so clients are going to have to bite the bullet on investing in outsourcing management. On our figures, based on over 400 outsourcing deals, between eight and ten per cent of contract value needs to be invested in building a high performing in-house capability to run outsourcing governance, elicit and deliver on business requirements, ensure technical capability, and manage and leverage external supply. Too often clients discover this the hard way three or four years into a deal littered with problems, cost escalation and fire-fighting. In such cases it is all too easy to blame the supplier. We find time and again it rests at least 60/40 with the client. For the client on the learning curve here is one sure-fire way of moving in the right direction. ▶

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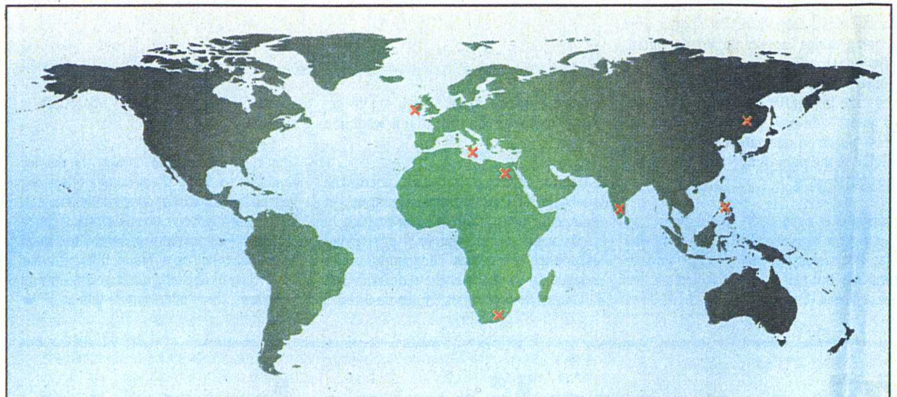

Key global BPO destinations

The Sourcing Learning Curve