

Outsourcing: A review of trends and some management issues



Trends in outsourcing show that it is not only for the 'back offices' of banks and insurance companies, but that to be effective it has to be properly managed and founded on an appropriate relationship between client and provider.

Outsourcing is going from strength to strength with the Management Consulting Association reporting an upsurge of consultancy spend on that activity in the third quarter of 2003 of more than 20% of total income of the Association's membership.

Engaging in BPO (business process outsourcing) is akin to the 'make or buy' decision that managers are

familiar with. The difference being that instead of deciding to make or buy a widget there is a contract with an external organisation to take responsibility for the provision of services of a business process or function. To take an example from a company which is a household name, BT has outsourced its property operation valued at £2.38bn to take it off the balance sheet and reduce

its debt mountain. Telereal, the outsource provider bought 5,800 properties from BT, most of which were leased back on a contract to run for 30 years. Staff were, at the same time, transferred from BT to Telereal.

Trends in BPO

Trends in BPO may be analysed in terms of its extent, the functions involved and geographical destination.

That BPO activity is making increasing demands on the management consultancy industry has already been mentioned. It has also been reported that more than half of 'The Times top 100 companies' have chosen to outsource routine business functions. In the retail financial services sector 20,000 jobs have already reportedly moved to India with a further 40,000 in life and pensions and general insurance and 60,000 in banking likely to move in the next three to five years.

In the US the picture is the same, with a compound growth of more than 30% over the last five years. Sanmina-SCI Corporation (an electronics contract manufacturer with IBM as a client) has shown growth well in excess of that industry overall, and is able to provide considerable 'economies of scale' to companies in the electronics sphere.

BPO outside manufacturing has been made possible by improved computing and communications technology. Unsurprisingly early outsourcing activity focused on routine operations such as transaction processing like funds transfer - credit cards, mortgage handling, insurance policy administration and electronic banking helpdesking are prime examples.

A more recent trend has been along what is known as the 'knowledge continuum' or 'value chain' and embraces tasks which are non-routine and nearer the core of a business.

The outsource provider Evalueserve, which is headquartered in Bermuda undertakes projects involving the evaluation of the commercial prospects of inventions, provides research for hedge-fund databases and industry developments for a market research firm among others. Interestingly though, a recent review of HR activity in the UK revealed that some of the jobs had come back 'in-house' as technological developments have made for more effective e-HR within organisations.

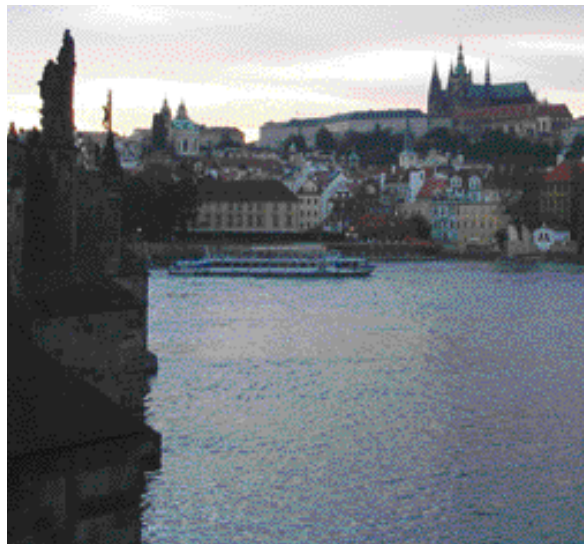
Outsourcing offshore is an important trend in BPO with India

frequently cited as the overseas destination. India is a major provider of IT-enabled services, particularly in the call centre industry and has seen the level of business grow dramatically over the past four years (70% during 2001 - 2002 amounting to an income of \$1.46bn). Revenue is expected to rise to \$16.94bn by 2008 with the country having captured 10% of the global market and employing possibly over one million people. Lower cost and improved quality are 'drivers' at the transactions end of the knowledge continuum. Labour costs are a fraction of what they are in the UK and the US and India has a large number of high quality English speaking university graduates.

Other countries also offer offshore outsourcing potential including Barbados, China, the Czech Republic, Mexico and the Philippines.

BPO and leveraging resources

Initially, BPO contracts dealt with narrowly defined transaction processes with the prime objective being to drive down costs in highly competitive markets. Offshore outsourcing, to India for example, does allow for significant savings which typically lie in the 30-40% range. Gains also arise from levels of employee absenteeism, which are much lower in India than the US or UK. An added bonus may also be an improvement in the quality of work performed, which has often been found to be at a better than expected level overall.



Increasingly however, the opportunity offered by BPO is in respect of a wider range of objectives beyond those of cost and quality in

Prague

'The opportunity offered by BPO is in respect of a wider range of objectives beyond those of cost and quality in relation to routine operations'

relation to routine operations. Two McKinsey consultants Quinn and Hilmer say that businesses lever resources in four ways:

"First they maximise returns on

New Delhi

internal resources by concentrating investments and energies on what the enterprise does best. Second, well developed core competence provides formidable barriers against present and future competitors that seek to expand into the company's areas of interest, facilitating and protecting the strategic advantages of market share. Third, and perhaps the greatest leverage of all is the full utilisation of external suppliers' investments, innovations and specialised capabilities that it would be prohibitively expensive or even impossible to duplicate internally. Fourth, in rapidly changing marketplaces and technological situations, this joint strategy reduces risk, shortens cycle times, lowers investments and creates better responsiveness to customer needs."

Cost advantages are not guaranteed

While BPO is seen as having great potential for improving business performance as the above quotation demonstrates, care needs to be taken when embarking on the outsourcing route as the experience of a number of organisations in the UK has shown. Camelot (the National Lottery provider) and a number of central government departments have had less than satisfactory experiences from external IT system providers. A recent study in Germany found that the internal costs of IT provision were frequently much lower internally than in outsourced locations. The authors of the study claimed that outsourcing based on an excessive focus on perceived core competencies led to a lack of integration between business and IT strategies.

The use of offshore suppliers has also raised questions related to how well funded their operations are and more general concerns related to political stability, physical infrastructure and cultural and social differences, though effective training can redress the aforementioned.

Managing the BPO relationship

With the above in mind good management must be applied to BPO. A BPO provider will be a critical business partner who lies outside the explicit control of the business outsourcing its activities. BPO thereby poses 'a risk' which requires careful management. Deloitte and Touche's experience with what its consultants call the 'extended enterprise' (the outsourcer and service provider/s) has led it to develop a risk management and value creation model to aid in its identification, evaluation and





Mexico City

management of risk. Emphasis is placed on the importance of service level agreements which amongst other things spell out precisely what is to be provided and how it is to be measured. Performance measurement can become increasingly difficult when there is movement away from more routine operations. Others have pointed to the importance of disaster recovery and contingency planning in any contract with a BPO provider.

‘Attention needs to be paid to the relationship between the outsourcer and the service provider, which can be complex at the more strategic levels’

Choosing an appropriate relationship
Attention also needs to be paid to the relationship between the outsourcer and the service provider which can be simply contractual and at arms length at the routine/ transactional level, but is more complex at those which are more strategic. Accenture, the management consultancy, has developed a ‘relationship compass’

which allows organisations to identify an appropriate relationship which is based on the following key questions.

- How deep should the relationship be? Contractual may suffice but it may require more dialogue and be cooperative where a provider is required to deal with say, an evolving product;
- How broad should the relationship be? Is a narrow and clearly defined process such as payroll to be outsourced or accounts receivable, accounts payable and financial report processes which need to be integrated?;
- How far does the outsourcer’s way of working have to be transferred to the provider? If the provider’s service, process or unique technology needs to be accessed quickly, the provider’s way of working may have to be adopted.
- To what extent are assets transferred to the provider? Covering people, physical assets and technology and the speed of acquisition, ease of maintenance and development, cost and quality. As noted earlier, BT transferred people and property but such transfers do not typically take place when, for example, offshoring a call to India.

Outsourcing to retain a competitive advantage is likely to remain an

option open to businesses and in relation to an increasingly diverse set of objectives. Experience has taught, however, that the process requires careful management and evaluation of costs and benefits going beyond a focus on cutting costs but looking at business performance in its entirety.



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