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Strategic outsourcing for success

Summary results of the 2008 outsourcing report

Making an informed decision

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Outsourcing is generally recognised as a strategy for producing cost savings, however, by simply following a traditional cost-focused approach, companies may be missing opportunities to gain further competitive advantage.

Why Settle For Less? Deloitte Consulting 2008 Outsourcing Report is a global survey report that addresses this issue. The report outlines the findings of a comprehensive research effort to analyse the outsourcing approaches that companies are currently taking, and identify the leading practices, common pitfalls, and lessons learned from the outsourcing experience.

The survey team polled over 300 business and IT executives representing outsourcing buyers, outsourcing vendors, and legal firms.

Cost reduction is the primary factor motivating most outsourcing decisions

Did you know?

Our survey found that a large percentage of the companies that implemented outsourcing reached their financial objectives and averaged a strategically-important Return on Investment (ROI) of over 25%. However, a much larger than expected level of company-outsourcer conflict was reported, and many of the companies expressed disappointment with the outsourcers' overall ability to provide continuous process and technology improvements.

While a majority (70%) stated that they were 'satisfied' or 'very satisfied' with their arrangements - the highest level we have ever seen reported. On further review we found that this 70% felt that they could be achieving more from their outsourcing arrangements. For example:

- Only 34% of the executives reported that they had gained important benefits from innovative ideas or transformation of their operations
- 35% of executives, including 55% of executives who were not very satisfied with outsourcing, wished their companies had spent more time on vendor evaluation and selection
- Asked what they would do differently if they were able to restart their outsourcing projects, 49% of the executives surveyed said they would define service levels that aligned better with their companies' business goals
- The dissatisfied respondents noted underestimated scope; higher-than-expected costs; and poor quality communications, service, and reporting from their service providers

Our survey included 31 service provider executives, who suggested that companies may not be positioned to realise the full benefits of outsourcing. By a 3-to-1 margin, these service provider executives felt that their client companies were not prepared for outsourcing - that is, the companies didn't have a solid plan, didn't have the operational data needed to make sound outsourcing decisions, and/or didn't understand how the 'to-be' organisation would really work.

Treating outsourcing as a strategic objective - Are you looking at the bigger picture?

In reality, successful outsourcing - and in particular, outsourcing that drives transformation and helps achieve broad strategic goals - requires companies to follow a disciplined process that keeps them focused on taking the right steps and making the right decisions. In short, outsourcing initiatives succeed by design, not luck.

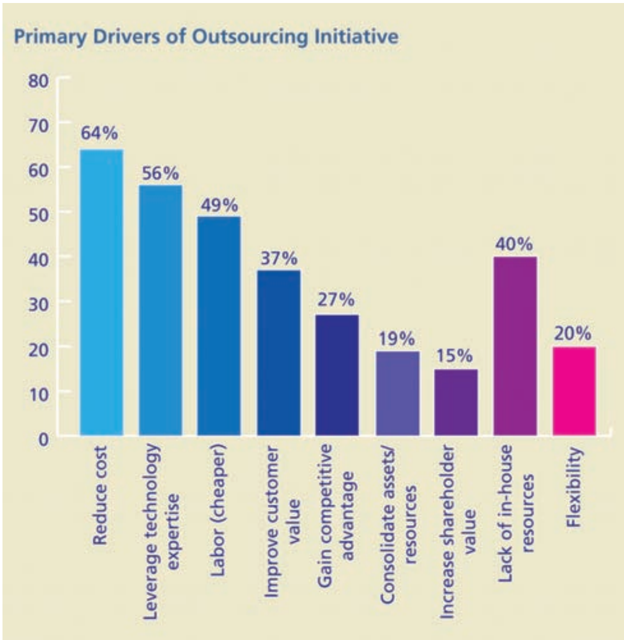
The report explores the key dimensions of this design - five main dimensions of the outsourcing process that companies must progress through, as well as the factors that must be considered within each in order to reap the full benefits of the outsourcing. These dimensions are:

1. Rightsizing the deal
2. Building a solid foundation
3. Vendor selection now means something different
4. Striking the deal
5. After the deal is signed

1. Rightsizing the deal - Are you outsourcing the right things for the right reasons?

The survey results (see figure 1) confirmed that cost reduction is the primary factor motivating most outsourcing decisions. The second most important reason was to gain access to technology expertise. In contrast, other strategic objectives were rated far lower. Overall, the emphasis on cost reduction and access to a vendor's skilled workers reveals a procurement-oriented mindset that takes a narrow view of the potential benefits of an outsourcing relationship.

Figure 1: Cost Reduction and Access to Expertise Key Drivers



Move beyond a cost-driven strategy

Executives should look at cost reduction as a basic requirement in an outsourcing arrangement - as a 'given' - rather than as a primary driver. Taking a more transformational approach can lead to dramatic results. It can be used as a tool to improve the company's competitiveness and performance across finance, marketing, customer satisfaction, R&D, and other critical areas.

Align the outsourcing strategy with the business strategy

All too often, outsourcing initiatives, transformational or otherwise, are designed in isolation - without articulating a clear outsourcing strategy and linking it to the broader business strategies and goals. Indeed, only 6% of the vendor executives surveyed said that clients had a clear outsourcing strategy that was tied to their business strategy (see figure 2).

Figure 2: Few Companies have Strategic Readiness

Having a clear strategic focus makes it easier to determine what capabilities to look for in a service provider, and to define realistic service levels that are tied to company business goals. Lack of a distinct strategic focus can completely skew the entire initiative and dramatically lessen results.

Understand business themes and drivers

Developing an operational case that takes a look at current processes and describes the changes that will take them to the desired "to be" state is an important part of aligning the outsourcing strategy with business goals. Understanding both the business themes and the business drivers is essential to developing an outsourcing solution that is aligned to the business strategy.

Companies must select the right vendor for their needs right from the start

2. Building a solid foundation - have you defined and quantified what you expect from your outsourcing initiative?

Before reaching out to vendors, a company must develop a sound business case clearly outlining the business value of outsourcing, and how the outsourcing initiative will support the company's strategic objectives.

Return on Investment (ROI)

The business case should delineate both the desired state of the process after outsourcing and the expected business benefits that will result. Ideally, it should quantify these benefits in the form of an expected return on investment (ROI), taking into account increased revenues and cost savings, as well as the costs involved - paying particular attention to hidden costs. The costs beyond the actual contract costs can be substantial. Severance costs can add 3% to 5% to project costs, the additional complexity in offshore contracts can add 6% to 10%, and initial software development can add from 1% to 10%.

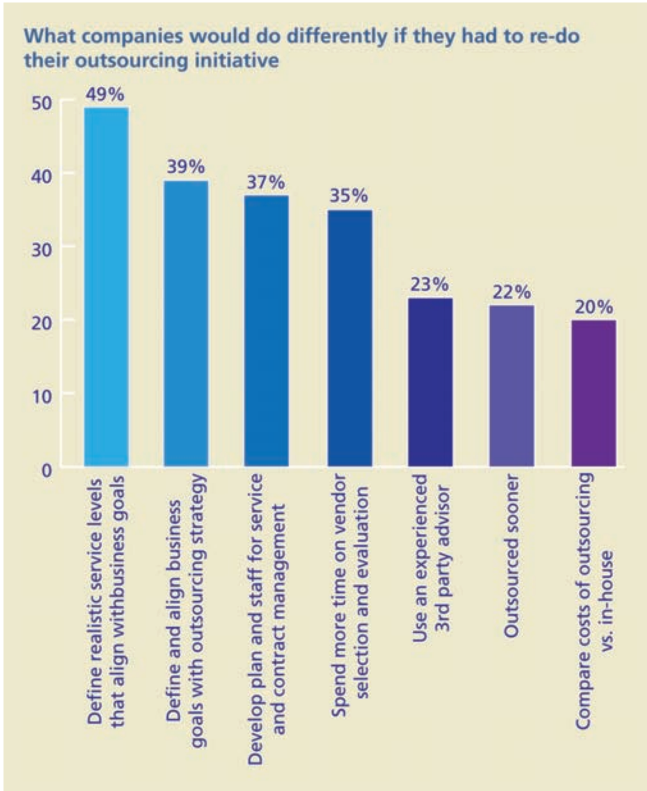
Use the business case beyond the immediate justification

The business case can have a long life beyond the immediate justification of the outsourcing effort and can be used to support decision making throughout the outsourcing process and on implementation and ongoing operations. It can provide a mechanism for objectively developing the scope of services and service level agreements (SLAs) during the service provider selection and contracting stages.

3. Vendor selection now means something different - have you chosen the right service provider?

In order to succeed, companies must select the right vendor for their needs right from the start. This is another area where companies tend to shortcut the process, and in so doing, leave significant value unrealised. This tendency was clearly reflected in the survey results (see figure 3).

Figure 3: Lessons Learned: better Alignment with Business Goals is Key



The Request for Proposal (RFP)

The selection process begins with the creation of an RFP that incorporates the company's strategic requirements and should be based on the outsourcing business case. An RFP should be detailed enough to give vendors a clear understanding of the company's goals and the critical capabilities and skills required as well as desired service-level targets.

Personal motivations often drive the process

Careful selection of the employees who participate in the evaluation process is critical. Do not underestimate the potential desire of current staff to prefer less qualified service providers for personal reasons. It's also important to keep senior management involved. While more senior-level executives tend to design the outsourcing strategy, mid-level managers often create the RFP and evaluate the service providers.

Collaboration, flexibility and time required from both sides

The service providers and the company may well need to go through several iterations of proposed plans. As service providers gain more data and insight into the operation, they will usually revise their cost estimates, recommended solutions, and expected results. Based on what it learns from these discussions, the company can refine its requirements and expectations.

4. Striking the deal - Is your contracting process mutual and flexible?

Continued involvement by senior executives in the contracting process is important to guard against having the procurement department narrow the focus exclusively to cost-oriented, transactional issues - or having legal counsel develop a dry, complicated document that overrides the intended spirit of the service provider/company relationship.

The contract is not just about what the vendor will do; it's also about what your company will do

An effective outsourcing contract should accurately reflect the strategic goals that have been established for the initiative and clearly define expectations - for both the vendor and the company, encompassing both the pre-transition and the post-transition environments.

The pricing question

The contract should clearly delineate the pricing for two types of activities: those required to maintain the baseline of service levels in the operation and those required to enhance services or products which would justify additional charges. Minimising costs is generally a concern however, companies should maintain their focus on driving business value by leveraging outsourcing to achieve their company's strategic objectives.

Be 'futuristic' when drafting contracts

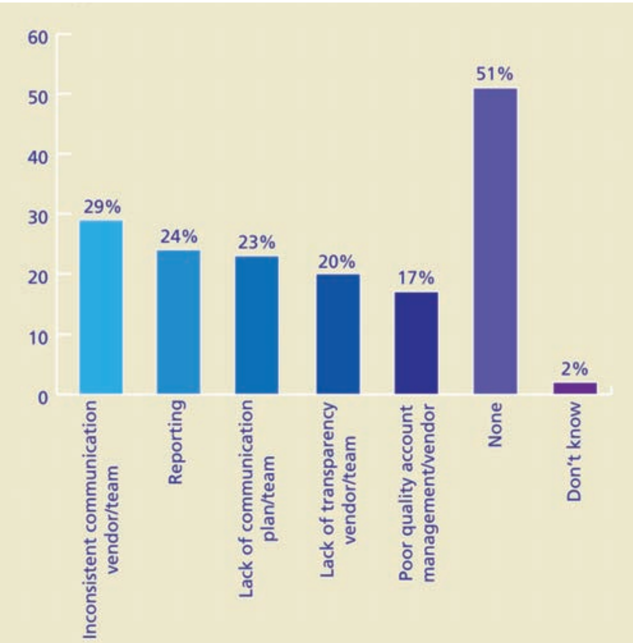
Outsourcing contracts need the flexibility to adapt to evolving business requirements. Consequently, more and more companies today are adopting a 'futuristic' mindset when drafting contracts, using a variety of techniques to introduce the requisite flexibility for negotiating any unforeseen curves up ahead. These include; shorter term contracts, adaptable contract frameworks, mid-term reviews, benchmarking, well-defined exit strategy and multi-sourcing.

Outsourcing contracts need the flexibility to adapt to evolving business requirements

5. After the deal is signed – are you getting what you paid for?

Many companies still question whether they're getting what they paid for. Among all the executives surveyed, roughly two-thirds reported experiencing problems that had to be escalated to the level of senior management over the past year. Communications-related issues, particularly reporting and transparency, were some of the most commonly cited challenges (see figure 4).

Figure 4: Problems with Communications and Relationship Management



From outsourcing to competitive advantage

All outsourcing deals are to some extent transformational in nature and are built on trust and two-way communication. Some affect daily operations, while others affect the strategic direction of the organisation. The evolution of the outsourcing market is leading to a new approach that emphasises this transformative aspect whereby companies are looking for ways to gain competitive advantage in the face of greater global competitive pressures.

Managing the relationship

Managing the service provider relationship and monitoring performance is a full-time commitment. Companies need to invest in the service provider management function with the appropriate people and relationship management skills, along with legal, financial, and planning skills. Finding executives with this set of skills is not easy. In many cases, it will be necessary to recruit aggressively to fill these senior positions, either within or outside the organisation.

Monitoring performance

A critical component of performance management is Service Level Management (SLM) - the monitoring of compliance to service levels specified in the contract, and reporting on the performance of the outsourced activity. SLM should be based on a holistic view of the relationship, looking at SLAs, costs, quality, and other factors to present a single view of service provider performance. These factors should be clearly understood by both parties.

When performance is not adequate, the company and the service provider should work cooperatively to identify and remedy the cause of the problem. It is also important to remember that problems in an outsourcing initiative are not always the service provider's fault. Often, the company shares some or all of the responsibility for inaccurate information or poor management.

Governance

Governance structures and processes give the company and the service provider a mechanism both to manage daily operations and also to deal with the unpredictable issues and changing business realities that inevitably arise. Strong governance allows a company to ensure that the service provider's operations remain well aligned with the company's outsourcing strategy.

Governance structures should be established at three levels:

- Executive committee - to review service provider evaluations, review critical issues, and resolve important service provider management issues.
- Programme management team - to review critical status reports on progress and to review reports on the financial impact of the initiative.
- Service delivery management team - to monitor status of the initiative and compliance with the SLAs.

In summary

In an ever more competitive world, companies need to take full advantage of the tools at their disposal - and outsourcing is a significant one. Yet, by following a traditional cost-focused approach to outsourcing, we believe most companies are under utilising this key strategy, and missing opportunities for tremendous benefits. Companies that view outsourcing in a broader strategic context, and implement it systematically, can gain a competitive edge over those that remain stuck in a traditional procurement mind set.

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