



Outsourcing: The Next Ten Years

by Michael F. Corbett, Executive Director,
International Association of Outsourcing Professionals (IAOP)

Outsourcing: The Next Ten Years

Today we see organizations rethinking their global footprint and the role of outsourcing.

Sorting out the complexities of what should be sourced and from where should result in an ever larger portfolio of new outsourcing relationships.

But, says Chris Disher, a vice president at the global consultancy Booz Allen Hamilton, “For this to happen outsourcing professionals need to step up their game with senior management in leading the discussion on outsourcing governance, policy setting, opportunity identification, execution, and quality assurance.” Underperforming outsourcing relationships “will need to be restructured or moved and new skills and capabilities within the sourcing organization are going to be required,” adds Disher.

A brief history of outsourcing

Depending upon which version you prefer, in 1928 John D. Rockefeller, or Bernard Baruch, or Joseph Kennedy got out of the stock market because a shoeshine boy offered up a stock tip. The moral of the story being that when a market reaches that level of speculation it's time for the professionals to get out. Many of us probably wish we had heeded that advice ourselves in the late 1990s.

Since it's hard to find any industry or business idea hotter right now than outsourcing, might outsourcing, itself, be in a bubble? And, if so, could that bubble burst, as well?

Of course, the basic idea of outsourcing is not new. Having another organization do something that yours can not or chooses not to do for itself goes back as far as one cares to look. Even the term outsourcing is not particularly new. It was first adopted in the 1960s and '70s in manufacturing and has since spread across virtually every facet of the organization. Dun & Bradstreet estimates that outsourcing is now a US\$4 trillion – yes trillion - a year business. According to industry experts, today 25% of the typical executive's budget is outsourced; projected to grow to 34% by the end of next year.

Along the way, the value organizations get from outsourcing has expanded just as much. At first outsourcing was all about costs – finding someone who could do the same job better, faster, cheaper, or all three. Next, outsourcing became strategic – with the focus growing to include the even larger opportunity cost savings that come when an organization reinvests its freed resources back into even higher value producing activities. Most recently, the focus of outsourcing has expanded yet again. Executives now look to their outsourcing partners to do all of these things and to become sources of innovation – helping them create new ways of doing business and even brand new businesses.



So, why doesn't everyone outsource everything?

Since outsourcing started in manufacturing, an area that is today 70 to 80 percent outsourced, why isn't the rest of business a whole lot more outsourced?

One reason is that it takes time for supplier markets to develop. After all, businesses have to outsource 'to' someone and until there's a robust, competitive market of world-class suppliers, that's difficult to do. Atul Vashistha, CEO of neolT, a services globalization advisory firm and co-author of the recently published book, "The Offshore Nation," advises taking a look at the history of GE's outsourcing operations, particularly in India to understand how outsourced areas, skill sets and supplier capabilities have evolved.

Another reason outsourcing may not have yet reached its full potential is the natural resistance to change. Even if an executive knows that outsourcing makes sense in principle, there may be no compelling reason for doing it today. It often takes outside forces - like competition, shifting customer expectations, and new technologies - to make significant internal change happen. Studies have found that businesses in industries with short product lifecycles outsource 50% more than their counterparts in more stable industries.

But there's more to it than these factors. One of the biggest may be that outsourcing is really hard work. 'Many practitioners don't really appreciate the complexities until they're already in an outsourcing relationship,' says Robert Kane, head of BPO services for Mercator Dubai, a leading supplier of IT solutions for the global aviation industry.

There's a real lack of consistency, says David Barrett, a partner at the global law firm of Simmons & Simmons.

"Occasionally, companies go into it with enormous overkill; more likely they fail to devote enough resources, money, and particularly time to getting a workable deal," says Barrett.

Companies often don't choose partners with any degree of science and structure and then fail to appreciate that business is dynamic and the deal they negotiate today will probably be obsolete before pen is put to paper.



The other big factor may be that, as with any major undertaking, results simply can't be guaranteed. More than 30% of the respondents to a 2004 Booz Allen Hamilton survey reported being less than satisfied with their outsourcing results. More than 20% of the attendees at The 2004 Outsourcing World Summit said that they were losing a quarter of the value of their outsourcing contracts due to poor working relationships between the companies. Simmons & Simmons reports that 90% of organizations see major issues arise between the parties, with many leading to adjudication or litigation. Some of the most common problems are missed milestones, poor performance against the agreed-to service levels, and scope creep with unexpected charges for things the customer originally thought had been priced into the deal.

So, the real questions are: Can the level of investment needed to make outsourcing work be reduced? And, can the outsourcing success rate be improved?

Here are some ideas for doing just that:

1) Training

A recent survey conducted by the outsourcing information portal Firmbuilder.com found that the field still relies on 'on the job' training as its top source of skills development. In fact, 20% of the respondents said there was simply no outsourcing best-practice training available any where. Better training would get the knowledge about what does and doesn't work where it's needed - in the hands of the people directly involved in creating and managing outsourcing relationships.

2) Professional Certification

Professional certifications, based on industry recognized standards, already exist in most fields. Accounting, administration, customer service, engineering, marketing, meeting planning, project management, and systems engineering are just a few examples.

Standards for outsourcing professionals, such as those being developed by the International Association of Outsourcing Professionals (IAOP) and the Outsourcing Standards Board (OSB), will bring ever-better skills to what is one of the most complex tasks in business today. Standards for scope definition, financial analysis, contracting, pricing,

negotiating, contract management, and dispute resolution will all help professionals in this field step up their game.

3) A Focus on Outcomes

Legendary investor Warren Buffet recently offered the following as the best advice he had ever received, "You're not right because others agree with you, you're right because you have your facts right."

But the way most organizations go about outsourcing is determined far more by opinion than fact. Very little work has been done to establish a benchmark for high-performance outcomes and to identify the processes that lead to superior results. Without the facts, improving outsourcing's ROI will be hard to do and even harder to prove.

4) Putting Providers to the Test

Providers have to raise the bar, as well. It's no longer good enough to offer customers a better, faster, cheaper solution for what they are already doing today.

If customers are going to outsource more, or even continue to outsource what they already are, service providers must work with their clients to keep developing and implementing new solutions well ahead of their customers' needs. "The best relationships are those in which the client can communicate to us its strategic direction. This lets us know where we can add most value for the client and encourages us to look for innovations in those areas," says

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Mercator Dubai's Kane. The bottom line, service providers need to invest in R&D - just like any other industry - if they are to continue to out-innovate and out-perform their customers.

5) Putting Technology to Work

While multiple studies point to outsourcing failure rates of 30 percent or more, experts believe that the right software tools can help bring this risk down to 10%.

Technology helps improve the flow of information and of management's control. This, in turn, helps companies improve their outsourcing ROI in two ways: 1) they avoid waste from duplication of services and billing errors, and; 2) they reduce the management costs that tend to grow exponentially as outsourcing grows. Using technology to link all of the company's internal and external people and processes will enable companies to build and manage what will have to become not just 'outsourcing' but a truly global corporate ecosystem.

6) Governance and Management

Outsourcing programs require governance and ongoing management to ensure success. Governance ensures that the client and the supplier understand the what, when and how of outsourcing, along with the role each party plays.

On-going management ensures that return on investment does not just come from labor arbitrage but also from improved productivity. NeoIT data shows that best practices firms invest 5 to 8% of the contract value in governance and ongoing management. This investment ensures that the value of cost, productivity, quality and speed are captured and realized now and in the future.

Looking back on the next ten years

Every time an organization outsources successfully it lowers its costs, improves its balance sheet, reduces its business risks, and expands its capabilities. But, if outsourcing is to continue to grow over the next ten years the way it has over the past ten organizations need to produce better results with greater regularity and at lower costs. Doing this will take a collaborative effort across the global community of outsourcing professionals - customers, providers, and advisors alike.



About the Author

Michael F. Corbett is one of the best-known experts in the field of outsourcing and Executive Director of the International Association of Outsourcing Professionals (IAOP). Working with leading customer, provider, and advisor organizations around the world, IAOP helps companies increase their outsourcing success rate, improve their outsourcing ROI, and expand the opportunities for outsourcing across their businesses.

Mr. Corbett is also the author of *The Outsourcing Revolution: Why It Makes Sense and How to Do It Right* which has been called 'the definitive work on outsourcing.'



Lexington Park, North Building Suite B
1133 Route 55
LaGrangeville, NY 12540
Phone: 845.452.0600
Fax: 845.452.6988
www.outsourcingprofessional.org
memberservices@outsourcingprofessional.org

Michael F. Corbett, Executive Director
michael.corbett@outsourcingprofessional.org

