Build Relationships Around Service Provider Strengths

By Peter Bendor-Samuel, CEO, Everest Group

How do you drive the most value from an outsourcing relationship? That leading question lies at the heart of this four-part series on value creation. This article offers one answer to that question. After years of studying outsourcing relationships, we believe there is a formula for creating successful, beneficial and enduring relationships: build them around distinct service provider strengths.

Creating an enduring relationship is an important goal, because breaking up is hard to do, especially in the outsourcing world. Divorce is expensive - emotionally and financially - for both parties. Buyers, who originally made a significant cash outlay to outsource, now are dependent on the service provider's services. Switching costs for them can be just as prohibitive as 10 years of child support. Service providers, on the other hand, have made a considerable up front capital investment to improve the buyer's process. Both sides experience significant hardships when the relationship doesn't work.

For these reasons, buyers and service providers need to work together at the outset to create enduring outsourcing relationships. The best way to do this is to build the relationship around a long-term value proposition. That includes aligning the business solutions and the business objectives of both parties. The easiest way to do that is to shape a solution around a service provider's strengths.

In the past we have structured service provider procurement by developing rigorous specs for the relationship and then outlining them in an offering package. Interested service providers competed for the business in an adversarial atmosphere.

This method did produce the lowest cost for the buyer. But the adversarial stance often got the relationship off on the wrong foot. Moreover, basing the relationship on the lowest cost often obscured the true value the service provider could offer.

After more than a decade of working with buyers and service providers, sometimes in remediation disputes, at other times watching relationships prosper and grow, I believe the best way to build great outsourcing relationships is to wed the buyer's true business objectives with the seminal strengths of the service provider. This allows them to travel down the tough road of business with the same destination.

Different Service providers Have Different Strengths

Different service providers have different strengths. To select the best outsourcing partner, buyers need to understand each service provider's strengths, taking into account the distinctive leverage points where the service provider can add value. Then, select the service provider whose culture best fits your own. Those two characteristics -- a similar business culture and the ability to add value - are the two decisive factors in this decision.

Here's how this approach works. Buyers looking to outsource human resources (HR) realize there are three industry leaders. Service provider A has built shared services centers that allow it to share its infrastructure, people and software with many customers. This creates large economies of scale for its buyers. Service provider B, which has decades of IT experience, has the industry's best data processing prowess in the HR world. Service provider C has the most practical process experience. Buyers must evaluate these differentiating factors and select a service provider based on the best fit for their business needs.

For example, Exult, a pure-play HR service provider, has a well-developed self-service vehicle. Companies who want to add this popular capability to their HR roster and who need to move quickly would find Exult a good fit -- as long as the business cultures are compatible.

The same principle applies to vertical industries as well as business processes. In the insurance arena, CSC, an IT and BPO outsourcing service provider, has an unequaled software library for the insurance industry. Insurance buyers interested in using this software in their outsourcing engagements will select CSC as the best fit for them.

Assessing Apples-To-Oranges Comparisons

However, when you base your comparison on a service provider's distinct strengths, it is impossible to compare apples-to-apples. By definition, this is an apples-to-oranges comparison. The best way to assess service provider strengths in a thoughtful and effective way is to develop individual specs matching buyer needs with service provider strengths. Intermediaries like the Everest Group are ready to help buyers through this much more complex service provider assessment, using their experience to make an enduring match.

Next month I'll discuss how outsourcing creates value through its impact on the overall corporate strategy as well as other departments in the company that weren't outsourced.

Lessons from the Outsourcing Journal:

- The best way to create enduring outsourcing relationships is to wed buyer's business objectives with service provider strengths.
- Every service provider has different strengths. Selecting a service provider that adds the most value is the best recipe for long-term outsourcing success.
- Select a service provider for its strengths as well as a business culture that's compatible with your own.
- This kind of evaluation is no longer an apples-to-apples comparison. Intermediaries like Everest can use their knowledge of the service provider community and their outsourcing experience to help buyers with these apples-to-oranges comparisons.

The Pros and Cons of Shared Services

By Peter Bendor-Samuel, CEO, Everest Group

Often, people new to outsourcing confuse BPO with shared services outsourcing. The two are quite similar except for one big difference: Shared services outsourcing allows a company to outsource a function and keep its eye on its core mission while still keeping this function under its corporate umbrella.

Shared services outsourcing happens when a company creates a conglomerate or holding company and then creates a separate entity to perform a specific contextual or non-core process. These corporations chose to operate this way because they want to have their entire focus on their core business and not be distracted by necessary but contextual issues. Still, they feel uncomfortable outsourcing this function to a third party. So they create a shared services center.

The petrochemical industry has been one of the leaders in shared services outsourcing. Shell and Texaco, for example, have separate corporate entities that provide back office functions for data processing, real estate management, and finance and accounting. Shared services build economies of scale and leverage operational efficiencies around basic, non-controversial services.

These companies behave and act in the same way as a BPO outsourcer, operating very much like Arthur Andersen (AA) or PricewaterhouseCoopers (PwC). Often, BPO outsourcers like AA or PwC help these companies establish their shared services centers or form joint ventures with them to do this.

Shared Services Hybrid for North Sea Oil

BP Amoco created an interesting hybrid by forming a joint venture with a large BPO provider. The oil and gas company, the third largest in the world, joined hands with Andersen Consulting to build a BPO operations center in Europe. The original impetus was to help the oil and gas company handle its financial and accounting functions for its North Sea oil rigs.

Both firms shared the capital costs and the risks of building this center. They also established the modus operandi for the BPO outsourcing. Andersen Consulting employees monitor all aspects of the exploration, refining and marketing operation. For example, Andersen employees are based on the oil rigs, monitoring the oil drilling operations. Their colleagues are visiting the gas stations, examining receipts at the pump. Robert Brown, an senior analyst with GartnerDataQuest in London, says this outsourcing alliance has refined 65 pence per barrel from the price of petroleum thanks to the cost savings produced through the shared services center. He discusses the benefits of this hybrid BPO arrangement in this issue.

Once the two partners have honed the process, they begin to market their BPO offering to others. Some of the largest oil and gas companies are now outsourcing their finance and accounting operations to this center, Brown reports. The partners have used this BPO center as a springboard to grow the center's volume globally.

In contrast, PwC has decided to go it alone in a pure BPO play. The firm has been successful in establishing global centers, like the fulfillment center it built in Krakow, Poland. PwC selects sites where there is an educated, talented workforce that is available at lower labor rates than typical U.S. urban centers. PwC retains full accountability for the results in this BPO overseas operation.

From my observation, shared services centers can be painful to put together. Sometimes they are hard to sustain unless the outsourcing mission is very, very clear. Like all outsourcing ventures, they must have access to top flight talent.

Trouble Attracting Top Talent

Talent is one of the reasons shared services outsourcing rarely works well. In reality, they are just a cost center for the corporate sponsor. This kind of environment doesn't spawn great challenges, a prerequisite for top producers.

BPO outsource providers, on the other hand, have the ability to recruit the stars because they feel they can make a difference in work they like. Also, the BPO vendor can compensate them through equity in the company. Attracting and retaining this type of talent over time results in better quality products and services for the provider's customers. This, in turn, yields lower costs, another buyer benefit.

In addition, shared services centers suffer from lack of outside capital. The revenue they generate goes back to the mother ship. Therefore, they must find the resources to continually improve their process.

BPO outsource providers, on the other hand, generate their own revenue streams. They can use this cash to update and add offerings.

When are shared services centers a good idea? I believe only when a company does not want to outsource a specific process to a third party. They are also valuable overseas, especially when the service includes divisions that do business in many countries. The shared services center becomes the expert in the different governmental rules.

Companies who form shared services centers, however, must understand they are inherently unstable because they have a tendency to become bureaucratic. This can create friction with the sister company.

And their success is by no means guaranteed. The big companies who are their clients like to pit one against the other and then work with both.

Lessons from the Outsourcing Primer:

- Shared services companies make sense when a corporation does not want to hand over a contextual process to a third party.
- Pure BPO providers can attract the best talent and can improve their services from their own revenues.
- BP Amoco and Andersen Consulting created a hybrid by creating a joint venture to build a BPO operations center for North Sea oil finance and accounting.

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Why go offshore?

Why do companies go offshore? The obvious answer is that it saves money. The recent decline in the economy has prompted companies (ACS included) to take a serious look at their bottom lines. Belt tightening and smaller budgets are the norm, not the exception these days. Thus the offshore alternative has become a popular method to streamline costs. In light of the recent economic decline some question the rationalization of setting up shop abroad while there are plenty of folks here at home looking for work. But therein lies the catch. Companies operating on tighter budgets simply cannot afford onshore talent and stay afloat in an increasingly competitive global market. In fact, many realize dramatic savings by using a mix of offshore talent in combination with their slimmer domestic resources. It's important to note that offshore outsourcing is not a new phenomenon of the 21st century. Although not a common practice, large corporations were sending large portions of work offshore even during the economic boom of the 90s; however, the recent downturn in the economy has emphasized a greater need for all companies, large and small, to watch their balance sheets and look to offshore opportunities to cut costs and save money.

So what are the benefits of going offshore, especially in these lean times? Offshore outsourcing can be extremely cost effective through the use of global delivery services. A company can gain access to a global pool of high quality talent at very affordable rates. Due the scarcity of good quality jobs in offshore markets, U.S. companies can take advantage of the best labor pool, motivated workers and lower turnover. Not only are they saving in terms of production, but also staffing costs are usually lower. These low-cost offshore resources working in tandem with domestic teams can deliver results in half the time. By increasing their speed-to-market time, companies realize their return on investment more quickly. Outsourcing provides flexibility. With the shrinking budgets and hiring freezes that are common today, it is difficult to hire additional staff when it is needed most. Offshore outsourcing allows the flexibility of adding resources as needed. Other advantages to going offshore are:

- Easy to offload non-core functions
- Save on manpower and training costs
- Avoid capital expenditure
- Minimize overheads and free up resources
- Avoid heavy taxation

While opponents of offshore outsourcing claim it sabotages the U.S. economy, others say it could in fact benefit the U.S. economy as a whole. "Opponents of offshore outsourcing ignore the large benefits that it brings to the U.S. economy, says Sunil Mehta, Vice President of the National Association of Software and Service Companies (Nasscom) in India. Mehta estimates that U.S. companies will save up to $11 billion in 2004 by outsourcing to India and that India will purchase $3 billion in high-tech imports from the United States in that time. "I think it is really a two-way mutually beneficial argument," he says. "If IBM is able to lower its cost structure, the U.S. economy benefits as a whole."[1] The U.S. benefits by allowing U.S. companies to market goods and services competitively in the U.S., increase trade with countries who benefit from outsourcing operations and infuse the global economy.

Speaking of the ACS offshore operations on Guatemala, Lynn Blodgett an ACS Group President said, "We cam here because it would be the right thing for our customers and because it's a way to help the economy."[2] Workers learn skills, get better-than-average salaries and have opportunities for career growth, including education and career counseling.

Today, offshore outsourcing is an inevitable trend. The U.S. economy is already intertwined with the global economy through offshore outsourcing, thus a strong global economy would also lead to a healthier and stronger U.S. economy.

[1] http://www.cio.com/archive/090103/

[2] Crayton Harrison, "Tech Firms Open Opportunities for Latin American Workers", The Dallas Morning Star, 4H