

Outsourcing for Virtuosos

Webinar with Vinay Couto and Ashok Divakaran
December 6, 2006

strategy+business

Presenters and Authors

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| The Current State and Future of Outsourcing

Let's first define what we mean by "outsourcing" and "offshoring"

Models for Outsourcing and Offshoring

Who does the work?	Third Party	<p>I. Outsourcing</p> <ul style="list-style-type: none"> ▶ Traditional outsourcing to onshore third party providers in the US 	<p>II. Nearshoring</p> <ul style="list-style-type: none"> ▶ Outsourcing to a third party provider in Canada or Central America to take advantage of language, time-zone and labor arbitrage 	<p>III. Offshoring</p> <ul style="list-style-type: none"> ▶ Outsourcing to a third party in emerging centers like China, India, Czech Republic, Poland to take advantage of labor arbitrage and advanced capabilities
	Company	<p>V. Insourcing</p>	<p>IV. "Captive"</p> <ul style="list-style-type: none"> ▶ Establishing a company owned and operated shared service center to leverage labor arbitrage and advanced capabilities 	
		U.S.	Nearshore: Canada, Mexico, Costa Rica	Offshore: India, China, Eastern Europe
		Where does the work get done?		

Geographic examples assuming US-based

Outsourcing = the external sourcing of services from third-party providers

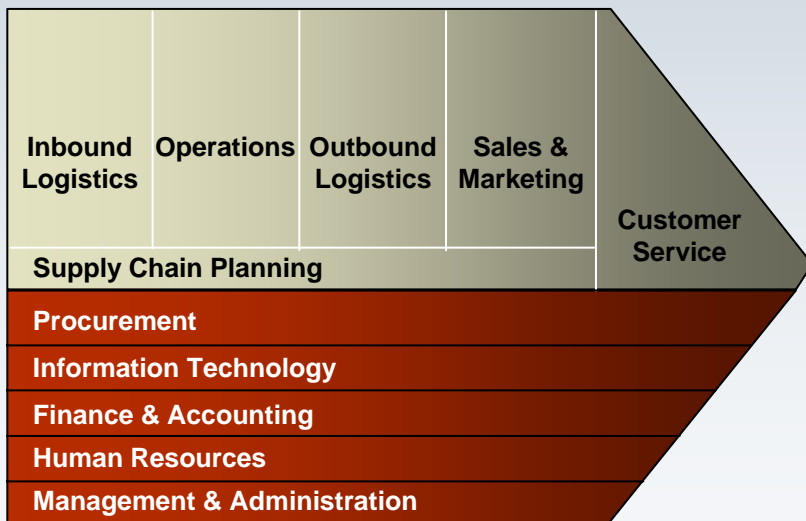
Offshoring = the global sourcing of services, both from third-party providers and internally (captive)

For convenience, we'll refer to both as "outsourcing" in the rest of this document

Outsourcing is, at its core, no more than an extension of a broader movement towards an allied enterprise model that has been gaining momentum since the 1980s

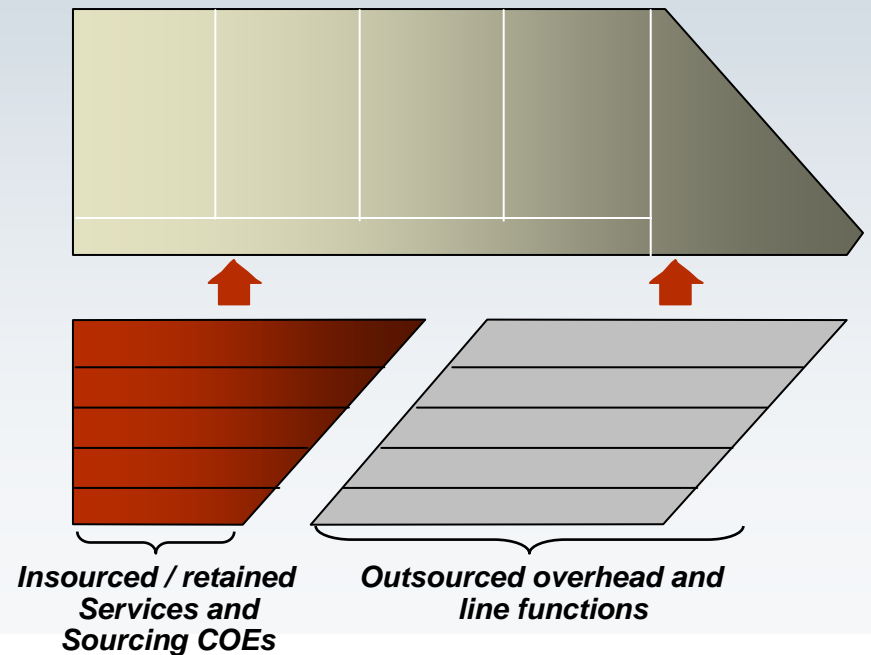
The Integrated Monolith

- ▶ *"We have to do it ourselves"*
- ▶ *Product driven capabilities*
- ▶ *Investment in production assets*
- ▶ *Product excellence mindset*
- ▶ *Competing for end customers*

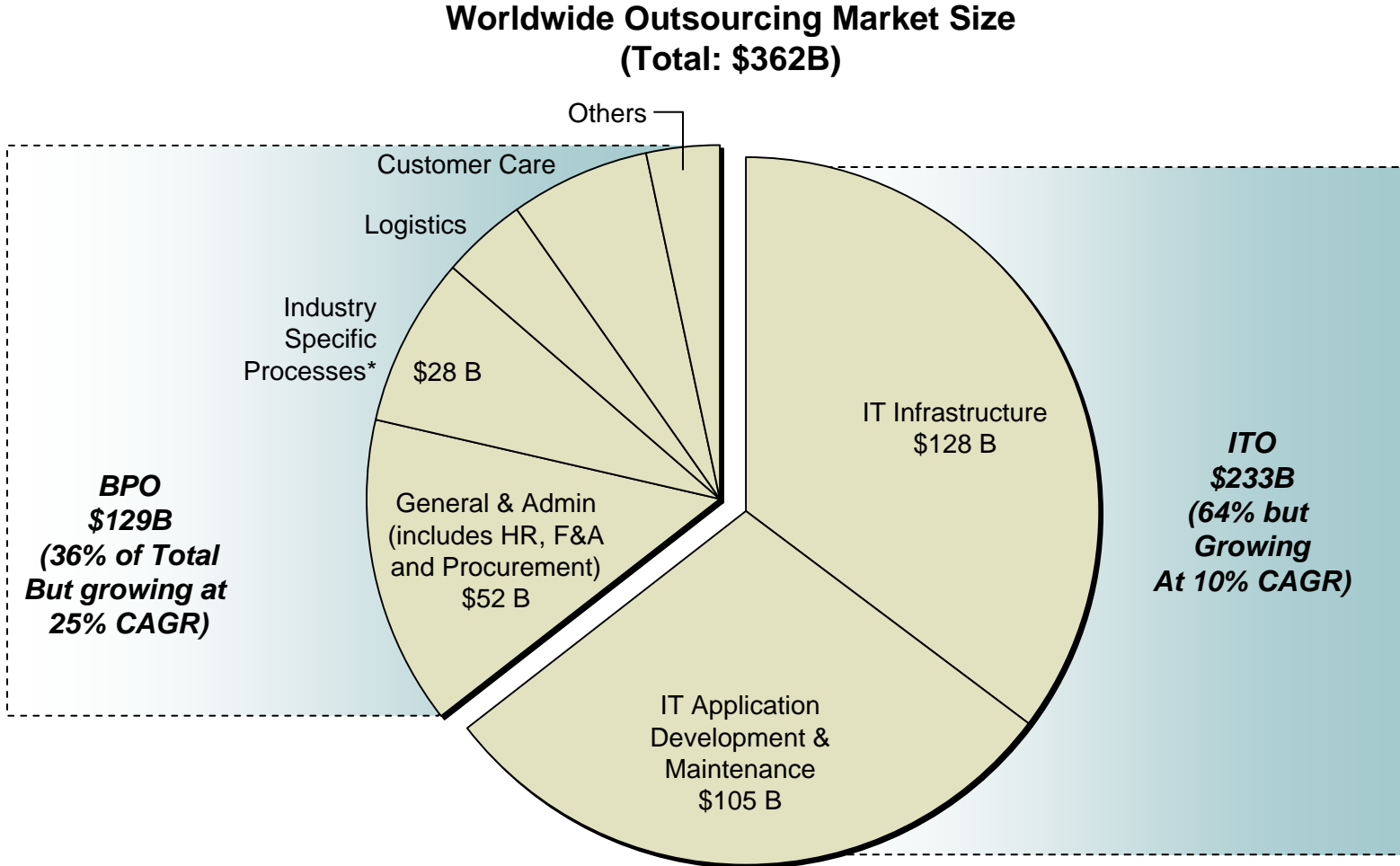


The Allied Enterprise

- ▶ *"We have to be in the center of a winning network"*
- ▶ *Solution driven capabilities*
- ▶ *Investment in knowledge networks*
- ▶ *Solution and relationship excellence mindset*
- ▶ *Competing for relationships*

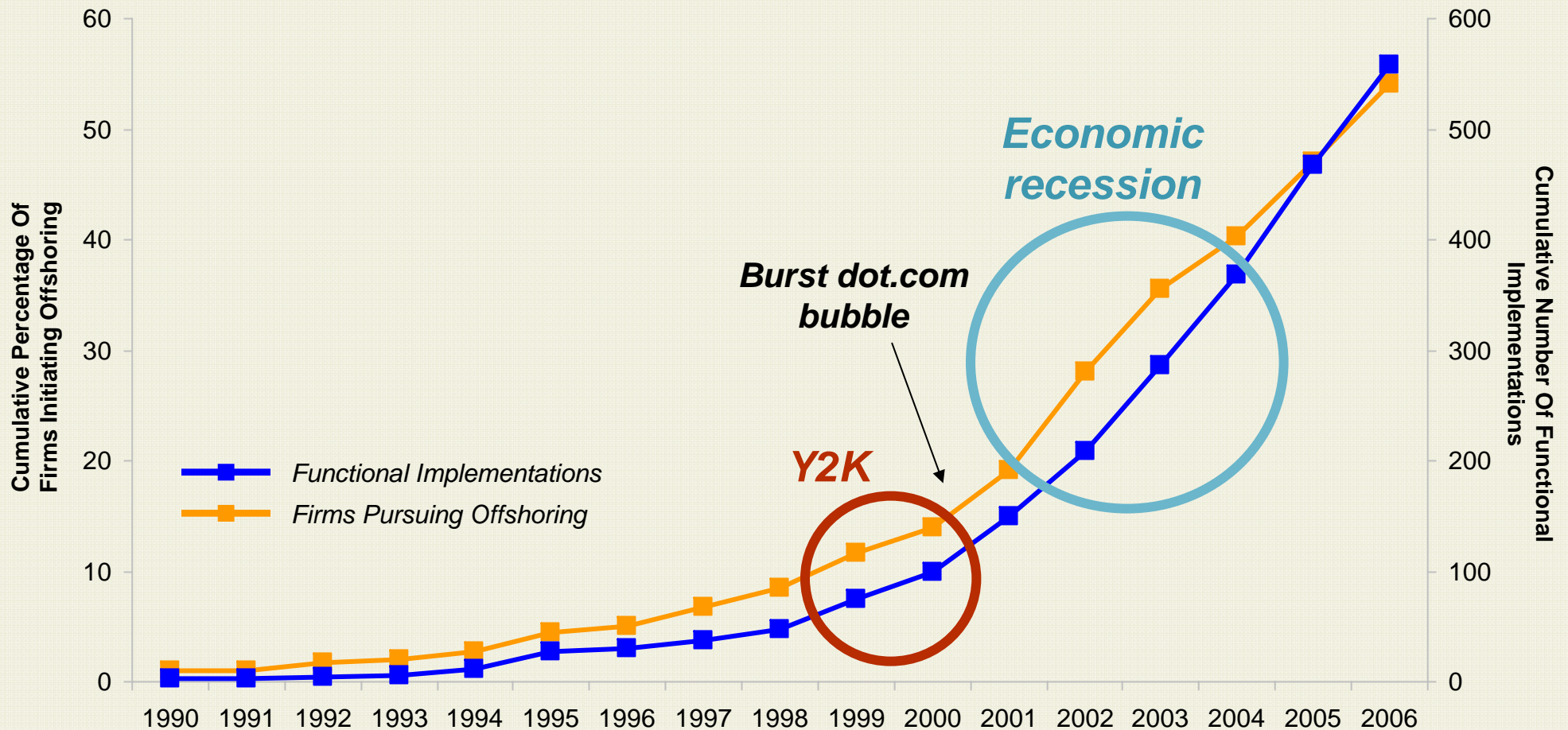


Outsourcing is currently a US\$362 billion market – IT outsourcing is the largest segment



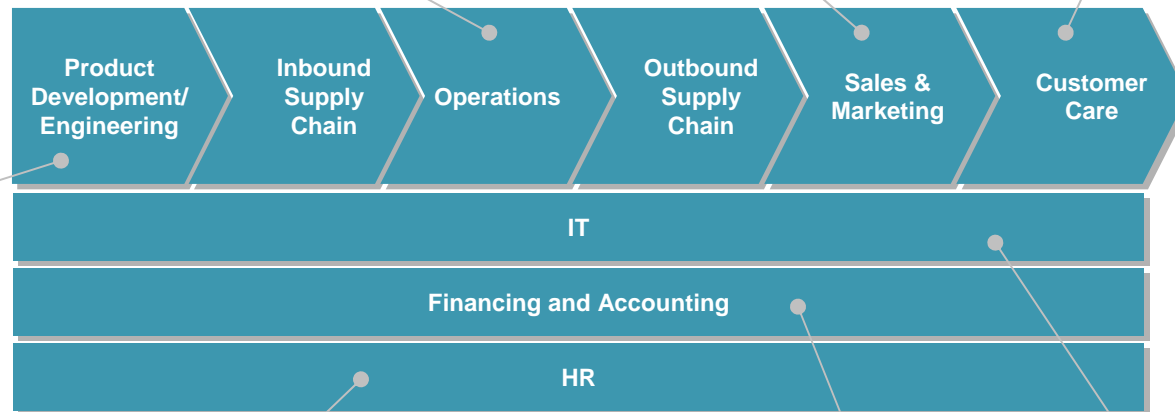
Note: Includes Claims, Banking, Settlements/Payments Processing
 Source: IDC Research, Booz Allen analysis

While offshoring does not yet dominate spend on global services sourcing, it is growing steadily



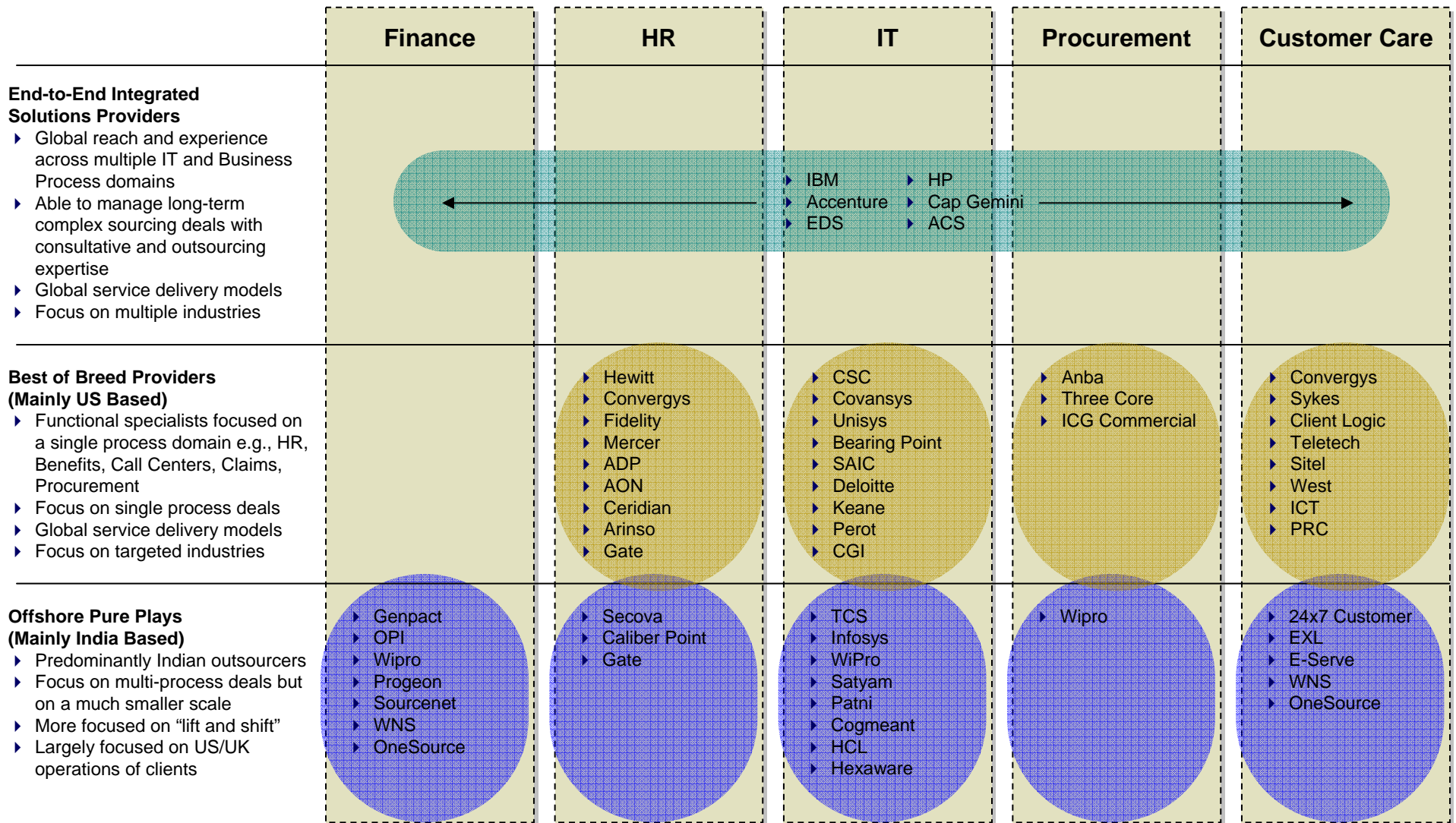
Source: Duke University / Booz Allen Offshoring Research Network 2006 Survey

Business processes and technologies have been outsourced and offshored successfully by marquee companies across their value chains



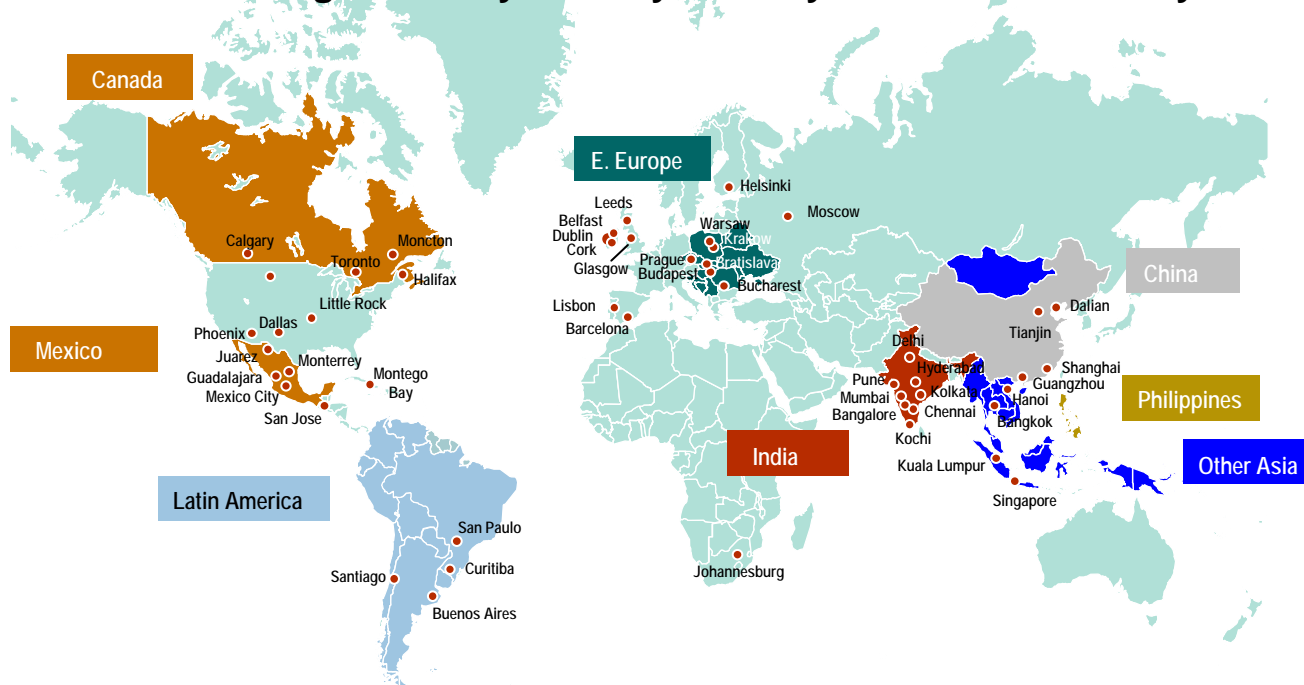
The BPO and ITO outsourcing supply base can be generally segmented into three broad categories

External Service Providers for BPO and ITO



But these categories are blurring as the integrated giants expand their global footprint and the offshore pure-plays expand beyond India

Size of Outsourcing Market by Country and Key Locations Picked by Vendors

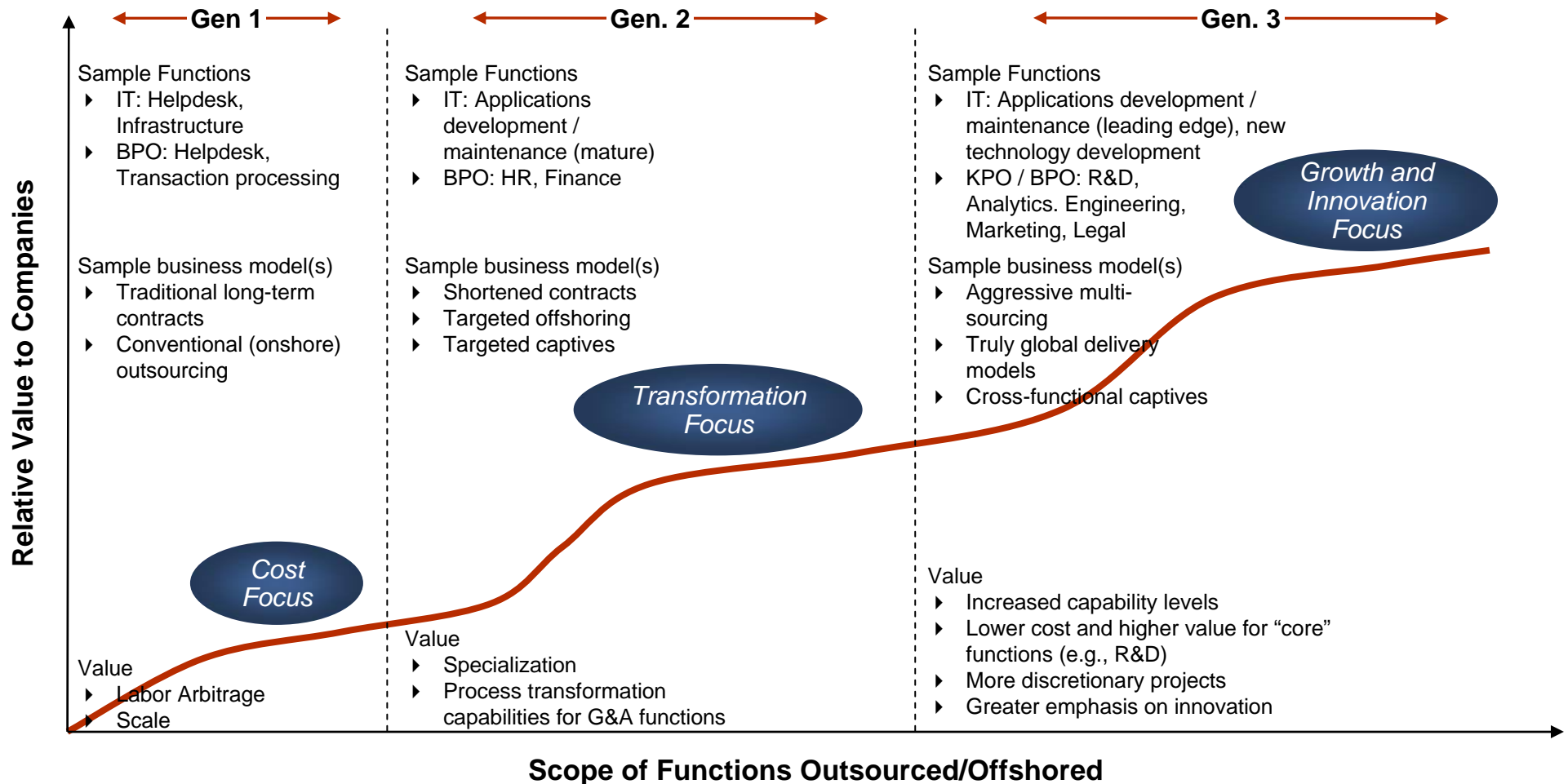


Offshore Presence of Leading US Service Providers

	Total Employees	Offshore Employees	India-Based Employees	Offshore as % of Total Employees	India as % of Total Employees
Accenture ⁽¹⁾	133,354	29,300	19,400	22%	15%
ACS ⁽²⁾	55,000	N/A	2,000	N/A	4%
CapGemini	63,680	6,250	4,670	10%	7%
CSC	78,000	6,800	4,900	9%	6%
EDS ⁽³⁾	129,000	27,000	15,000	21%	12%
IBM Global Services ⁽⁴⁾	200,000	N/A	38,000	N/A	19%

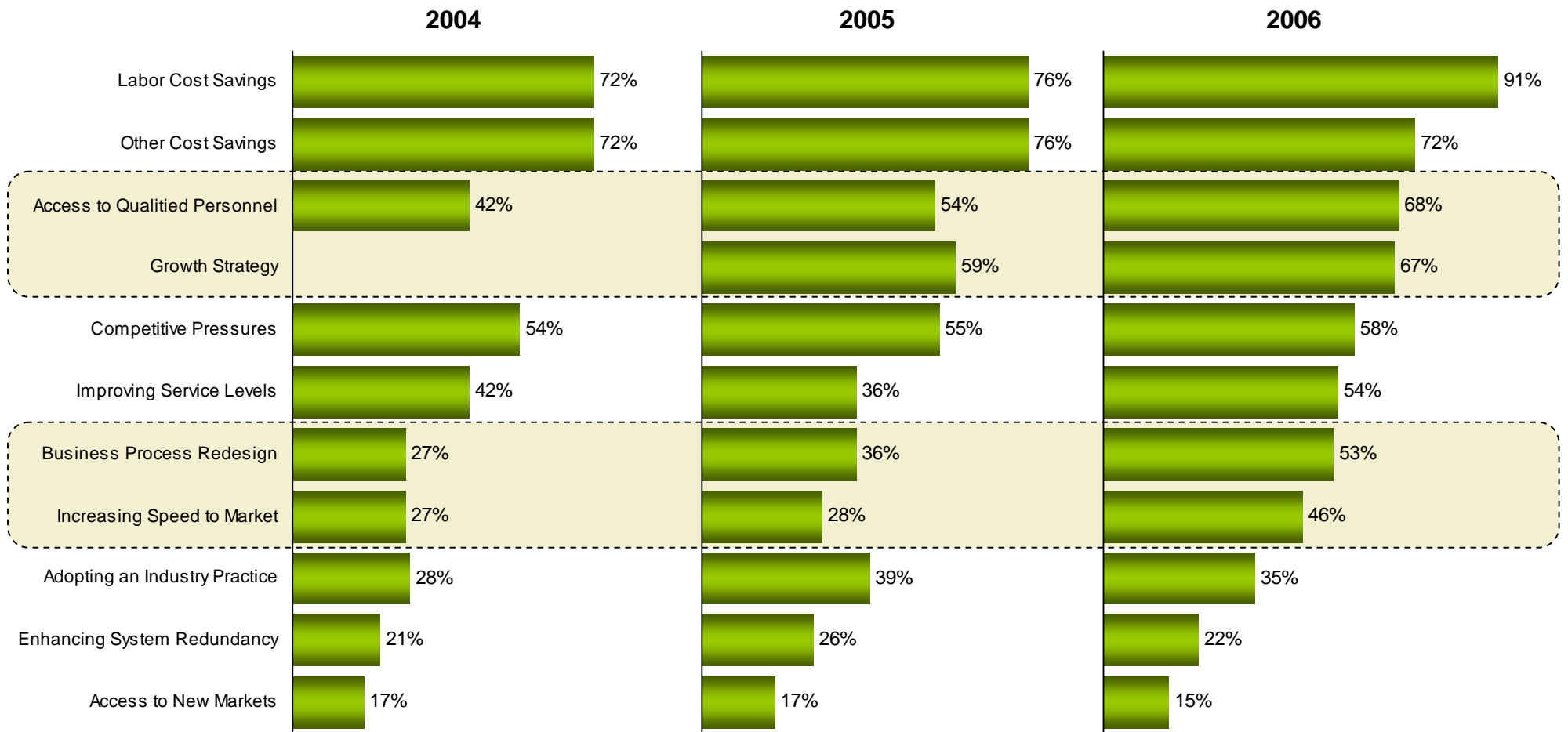
More generally, the industry is also beginning to move beyond its initial cost focus to becoming an enabler of innovation and growth as well

Evolution of Outsourcing



This is particularly true of offshoring, which is now increasingly about powering growth through sourcing talent and accelerating speed to market

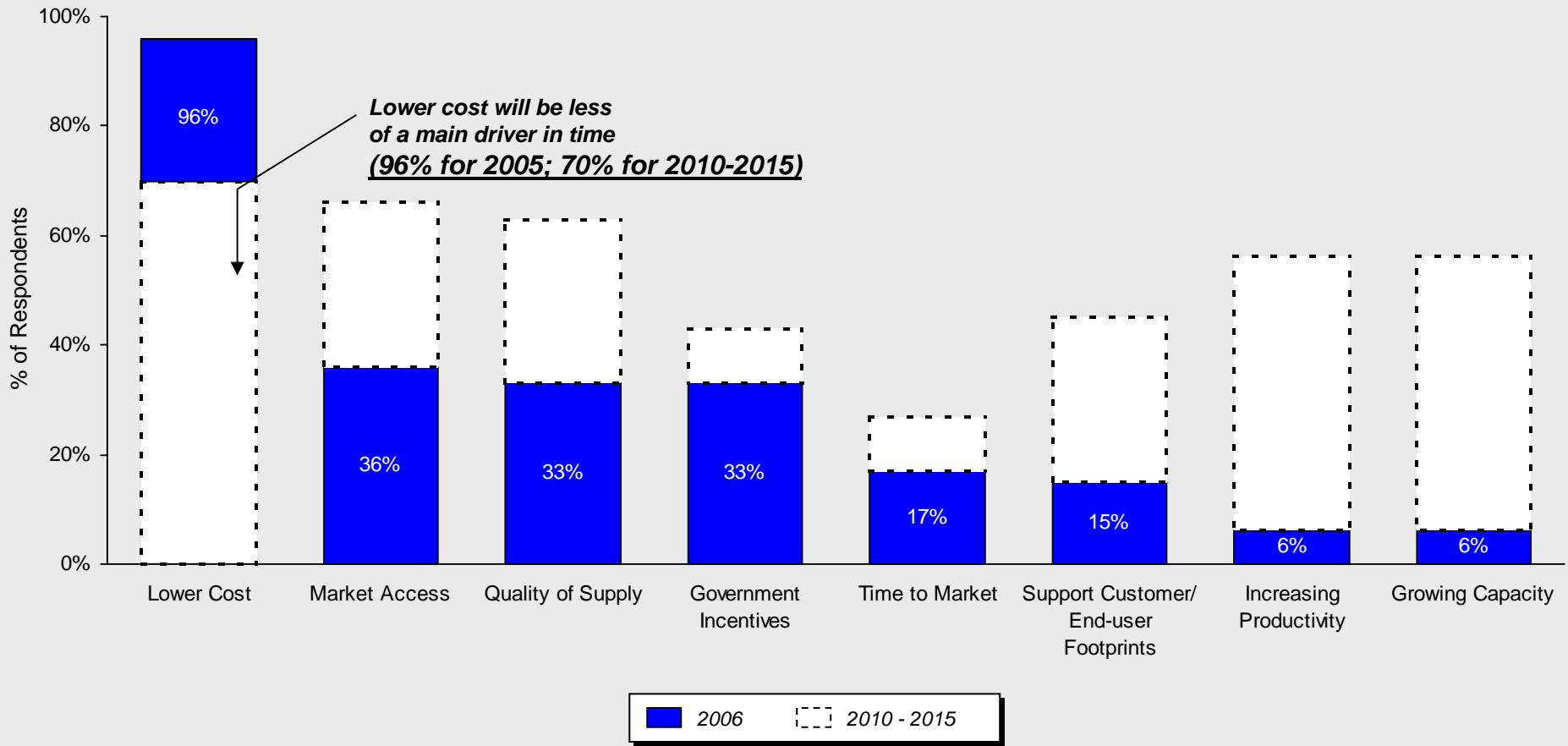
Reasons Driving Companies to Offshore



Source: Duke University/Archstone Consulting Offshoring Research Network 2004 and 2005 Surveys; Duke University Booz Allen Hamilton Offshoring Research Network 2006 Survey₁₁

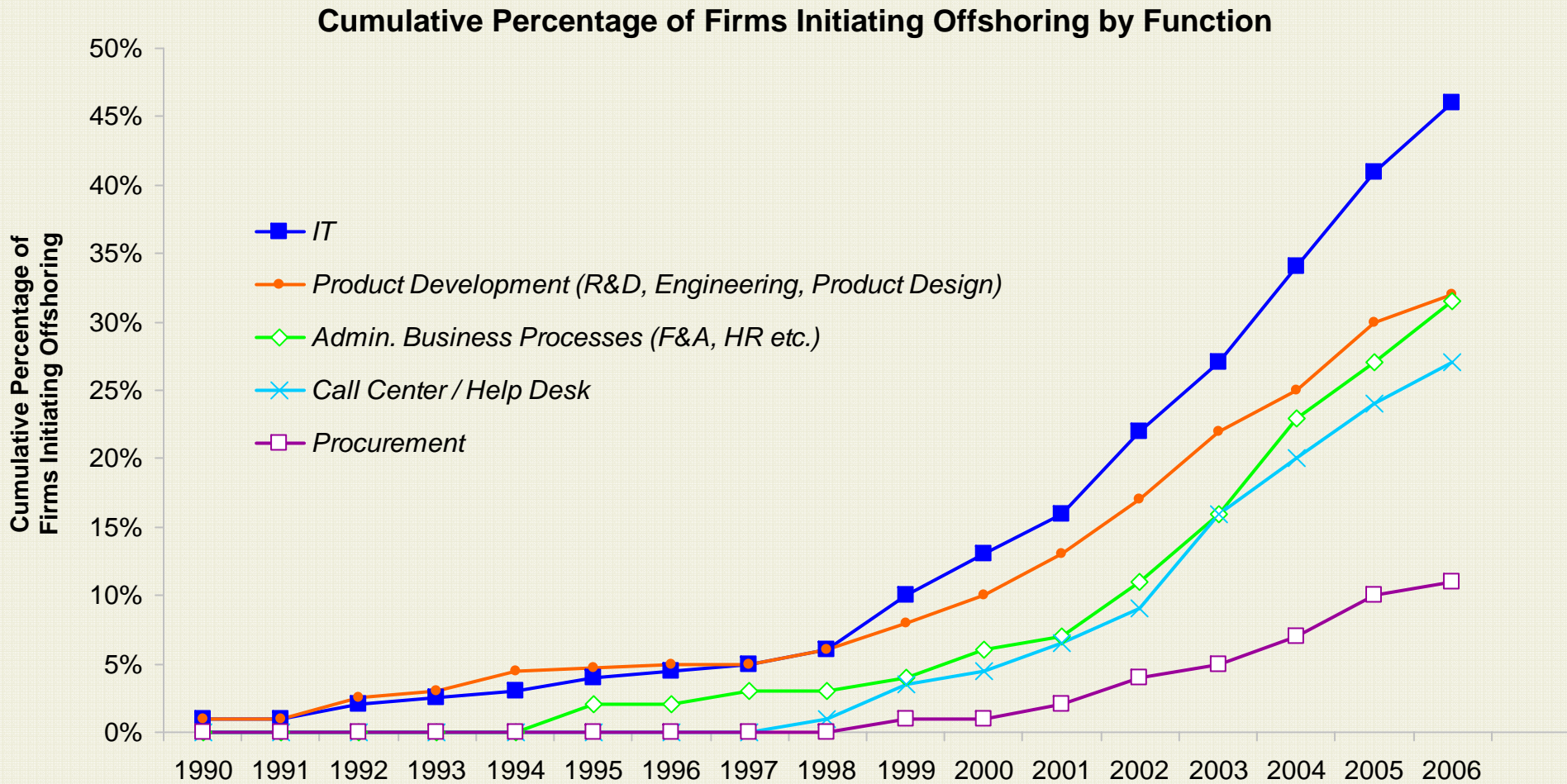
The value proposition of offshoring is expected to continue to shift away from cost reduction over time

Overall Offshoring Value Drivers Across Study Sectors
(2006 – 2015)



Source: Booz Allen / NASSCOM study 2006

Product development is emerging as the next frontier for offshoring

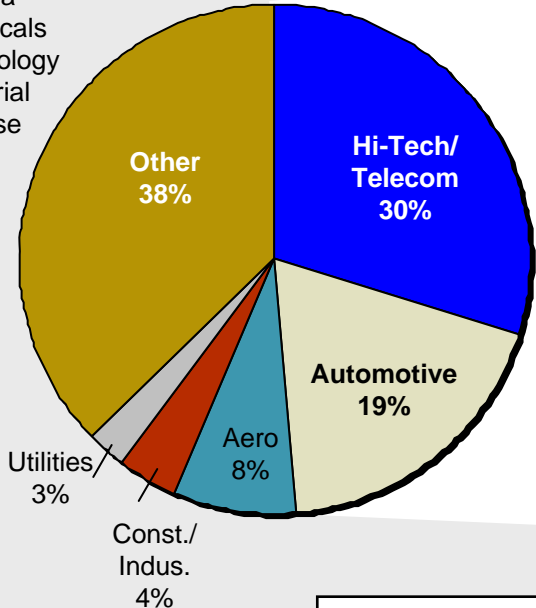


Source: Duke University / Booz Allen Offshoring Research Network 2006 Survey

Global spend on engineering, research and development is projected to exceed \$1 trillion by 2020 ...

Engineering Spend By Sector (2004)

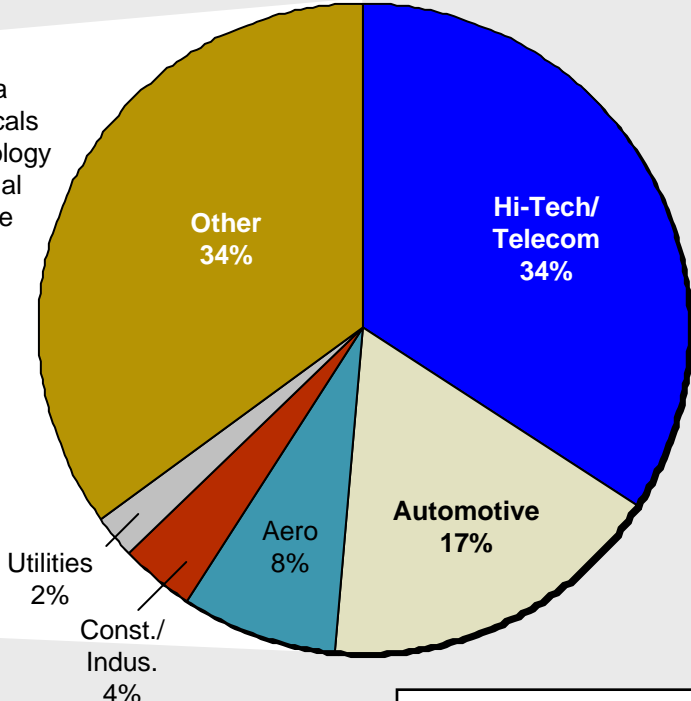
- ▶ Pharma
- ▶ Chemicals
- ▶ Technology
- ▶ Industrial
- ▶ Defense



Total = \$746 Billion

Engineering Spend By Sector (2020)

- ▶ Pharma
- ▶ Chemicals
- ▶ Technology
- ▶ Industrial
- ▶ Defense



Total = \$1,100 Billion

... and the spend is under pressure to produce increasing returns

Strategic Drivers

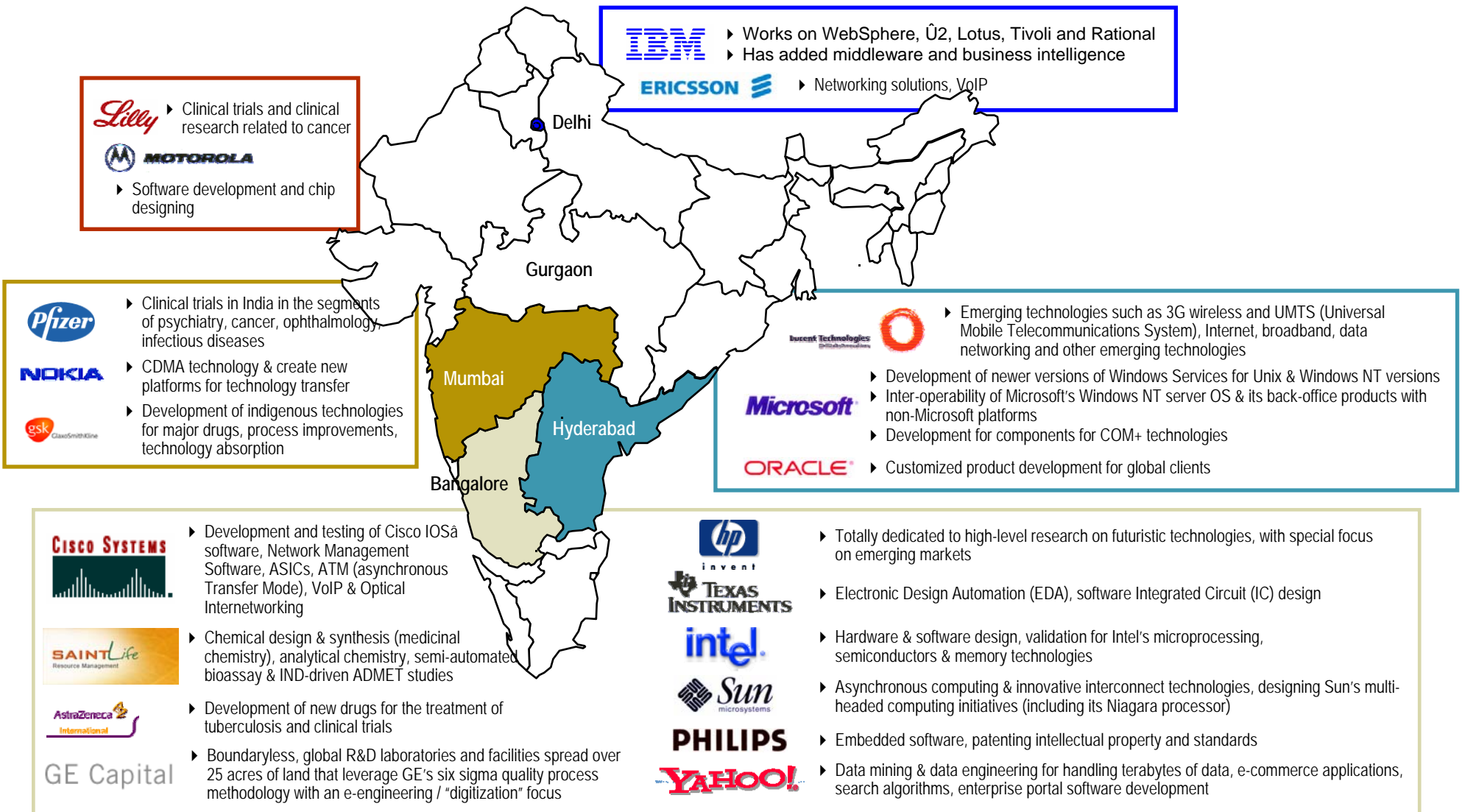
<i>Universal pressure to...</i>	<ul style="list-style-type: none">▶ Reduce cost
<i>Strategic imperatives to...</i>	<ul style="list-style-type: none">▶ Get access to high quality talent and capabilities▶ Cut time-to-market▶ Increase productivity▶ Grow engineering capacity
<i>Tactical opportunities to...</i>	<ul style="list-style-type: none">▶ Get access to new markets▶ Provide direct support to customers and end users▶ Exploit government incentives



- ▶ **Top-line growth**
- ▶ **Return on R&D investment**
- ▶ **Product Development speed & efficiency**
- ▶ **Higher margin / higher value products and services**

Consequently, R&D global sourcing is on the rise – a number of major players have established sizeable footprints outside of their home base

Technology R&D Outsourcing to India



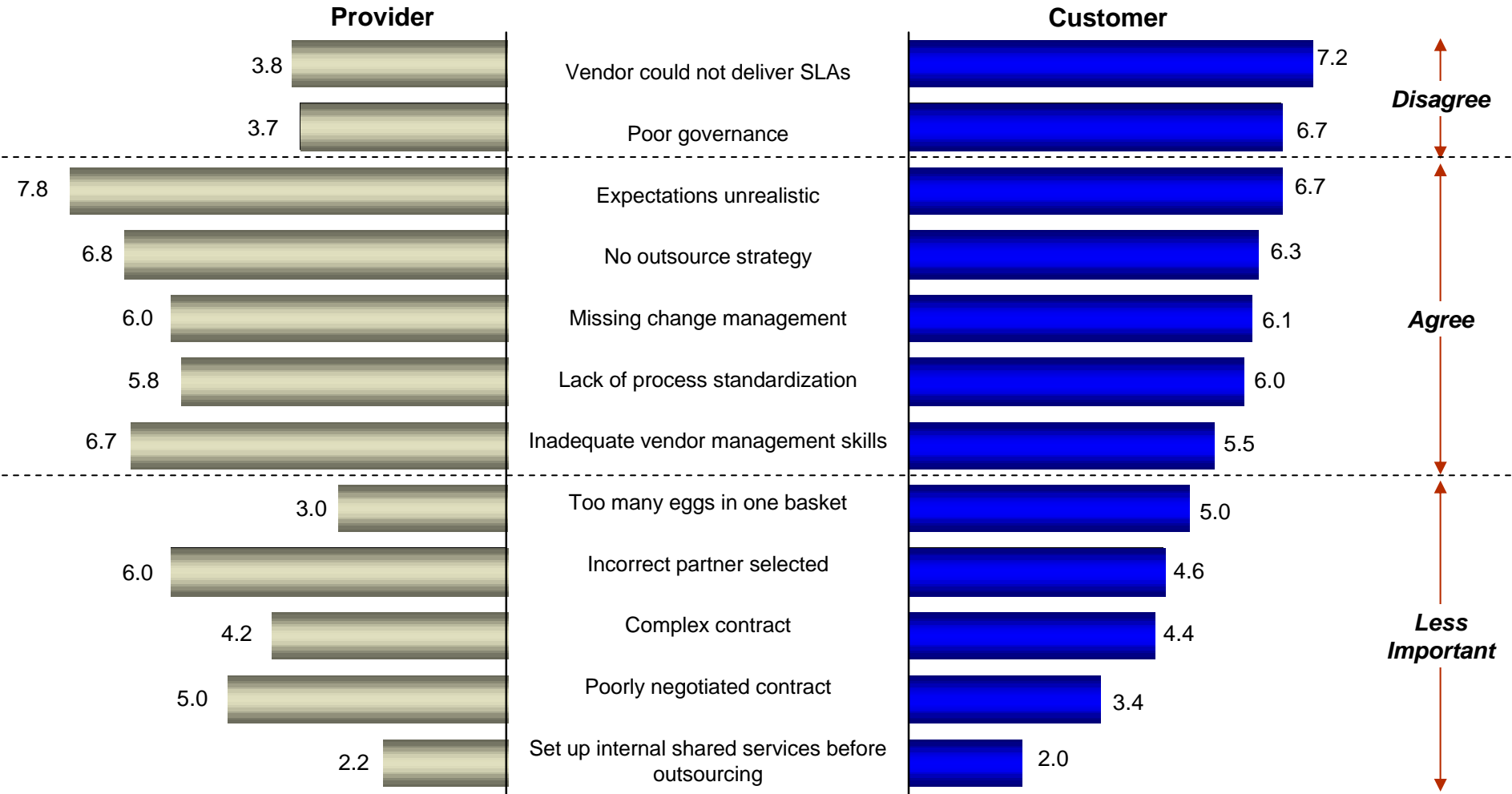
Things to expect in the coming years

- ▶ **Companies will increasingly broaden their outsourcing and offshoring lens** and consider less and less to be “off-limits”, fuelled by
 - Growth in supplier capabilities
 - Increasing comfort with the concept and practice of outsourcing
 - Continued margin pressures and the difficulty of triggering sustainable organic growth
- ▶ **Supplier business models will continue to converge**
 - Bigger Western-economy-centric players (e.g. IBM) building significant offshore capabilities, otherwise can't compete with lower-cost offshore players
 - Conversely, Asian offshore players will build global footprints themselves to meet multinational clients' needs for broader coverage and to mitigate their own supply chain delivery risks (e.g., geopolitical risk, labor shortages)
 - As in any growth industry, there will be a further wave of consolidation
- ▶ **Cost will cease to be the primary differentiator**
 - Partially driven by converging vendor business models
 - And by companies' growing sophistication of how they view outsourcing – i.e., the need to achieve the balance between cost, service effectiveness, culture, and risk
- ▶ And of course, **there will continue to be “failures” of outsourcing** caused by any number of factors – but the belief that this is because the concept of outsourcing is fundamentally flawed will disappear

Getting It Right: Outsourcing Best Practices

Outsourcing benefits are not a slam-dunk – many companies are unable to capture the full value of outsourcing

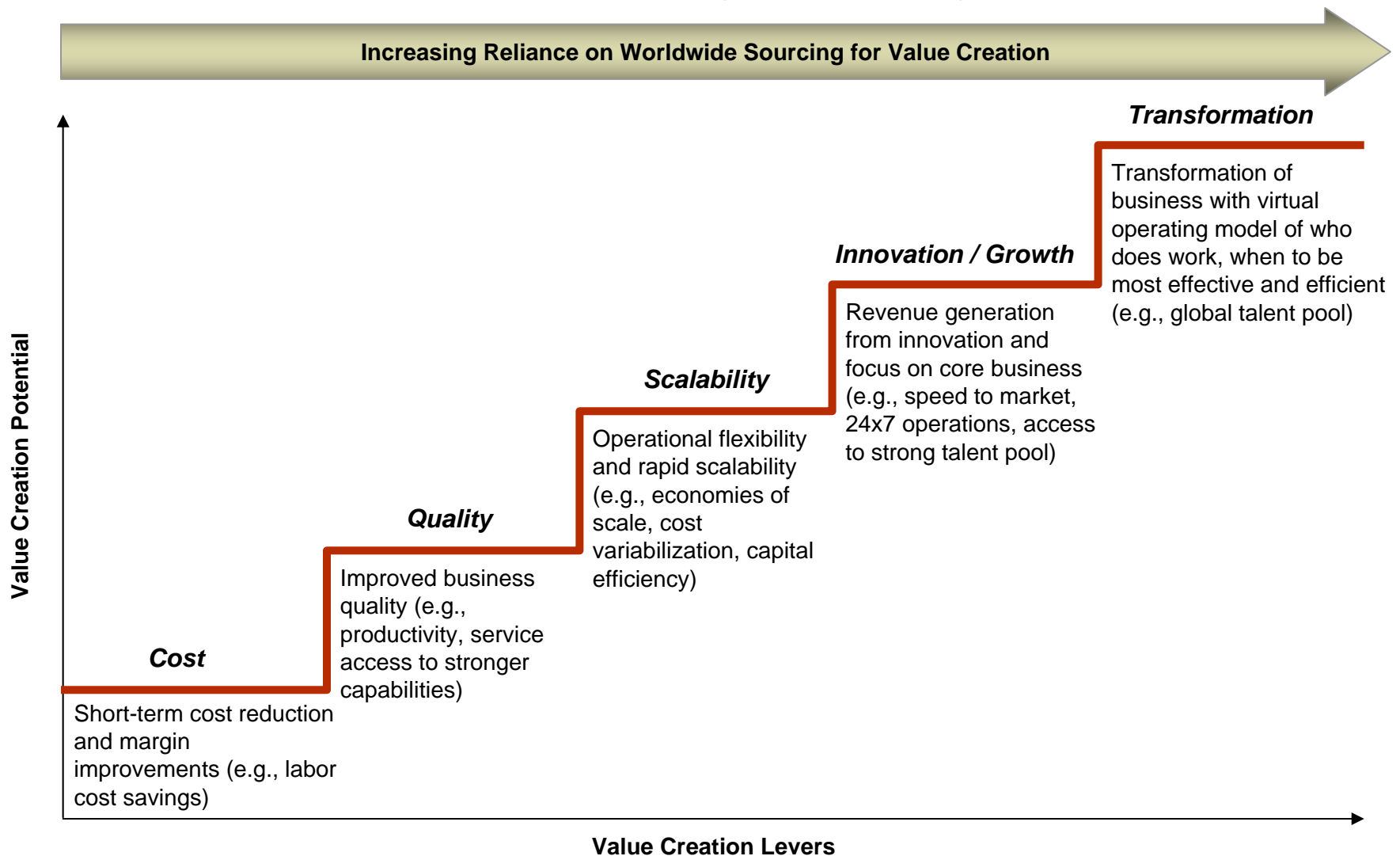
BAH Survey on the Relative Importance to Outsourcing Failure



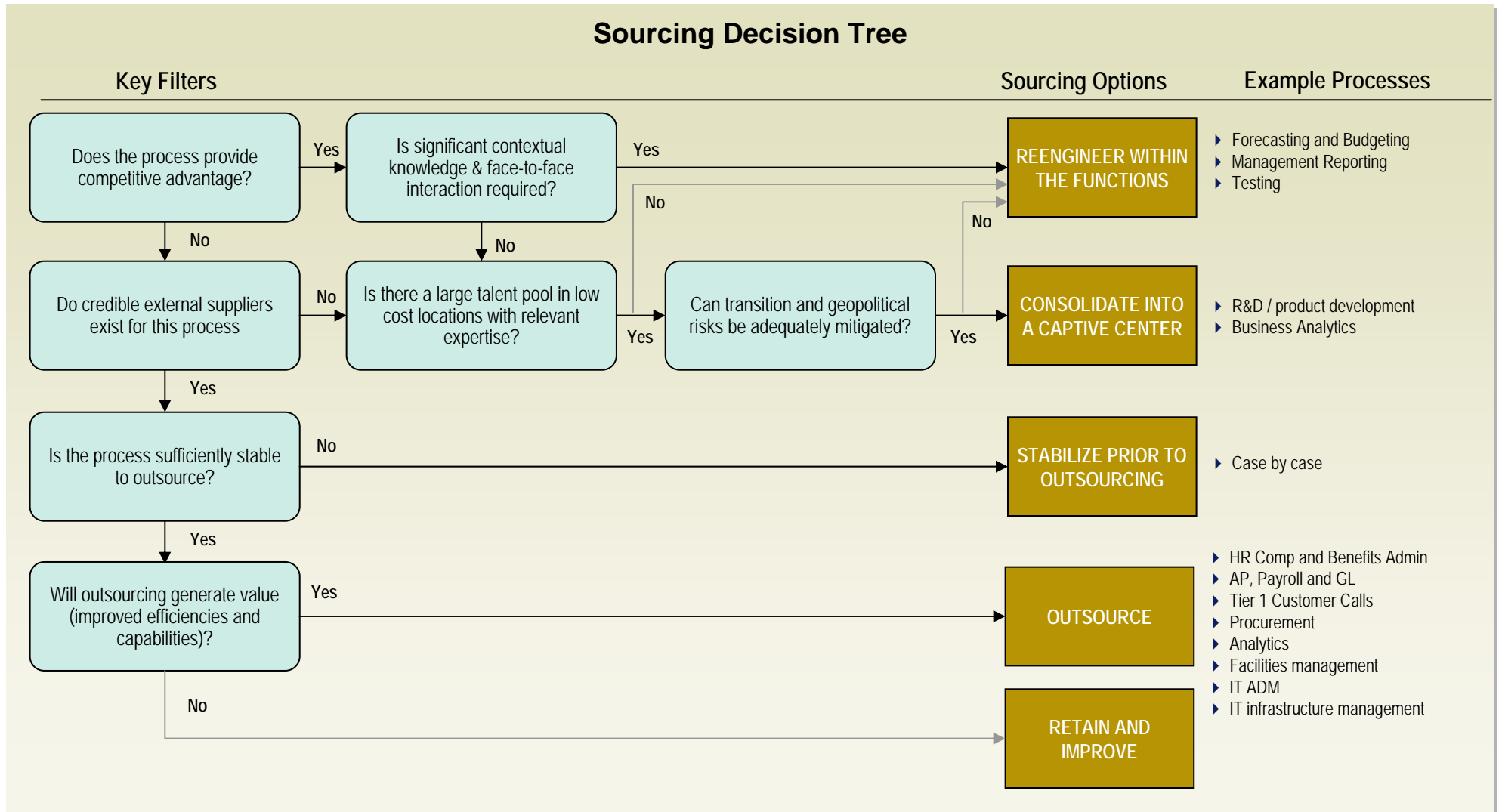
Source: Booz Allen Hamilton

Senior management must be clear on the rationale for outsourcing – there must be a genuine and shared “burning platform”

Rationale for Pursuing Global Sourcing



Leadership must determine what processes are outsourcing candidates based on a logical, fact-based approach ...



Source: Booz Allen Hamilton

... as well as whether to pursue a “straight to outsourcing” route rather than a “fix it then ship it” path

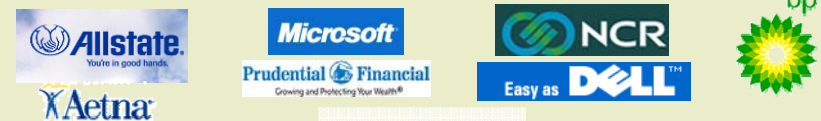
Strategy: Fix it then Ship It



- ▶ “Lean out”, simplify, consolidate, automate using six sigma design techniques
- ▶ Establish and monitor service levels and performance metrics
- ▶ Then pursue outsourcing

- ▶ Significant value to be captured through BPR and a desire to realize savings nor share them with vendors
- ▶ Willingness to invest in resources, expertise and capital to reengineer internal processes
- ▶ Recognition that processes are unstable and require adequate controls prior to outsourcing
- ▶ Desire to become “mature buyers” by learning how to manage internal services capably first
- ▶ Concern that loss of company process knowledge to a vendor may result in loss of competitive advantage

Strategy: Outsource once you know how your processes can be fixed



- ▶ Understand what it will take to fix sub-optimal process, the cost to fix and the potential benefits
- ▶ Work with outsourcer on a clear plan to reengineer and share the benefits while making the outsourcer finance the up-front costs
- ▶ Embed reengineering economics into the deal structure

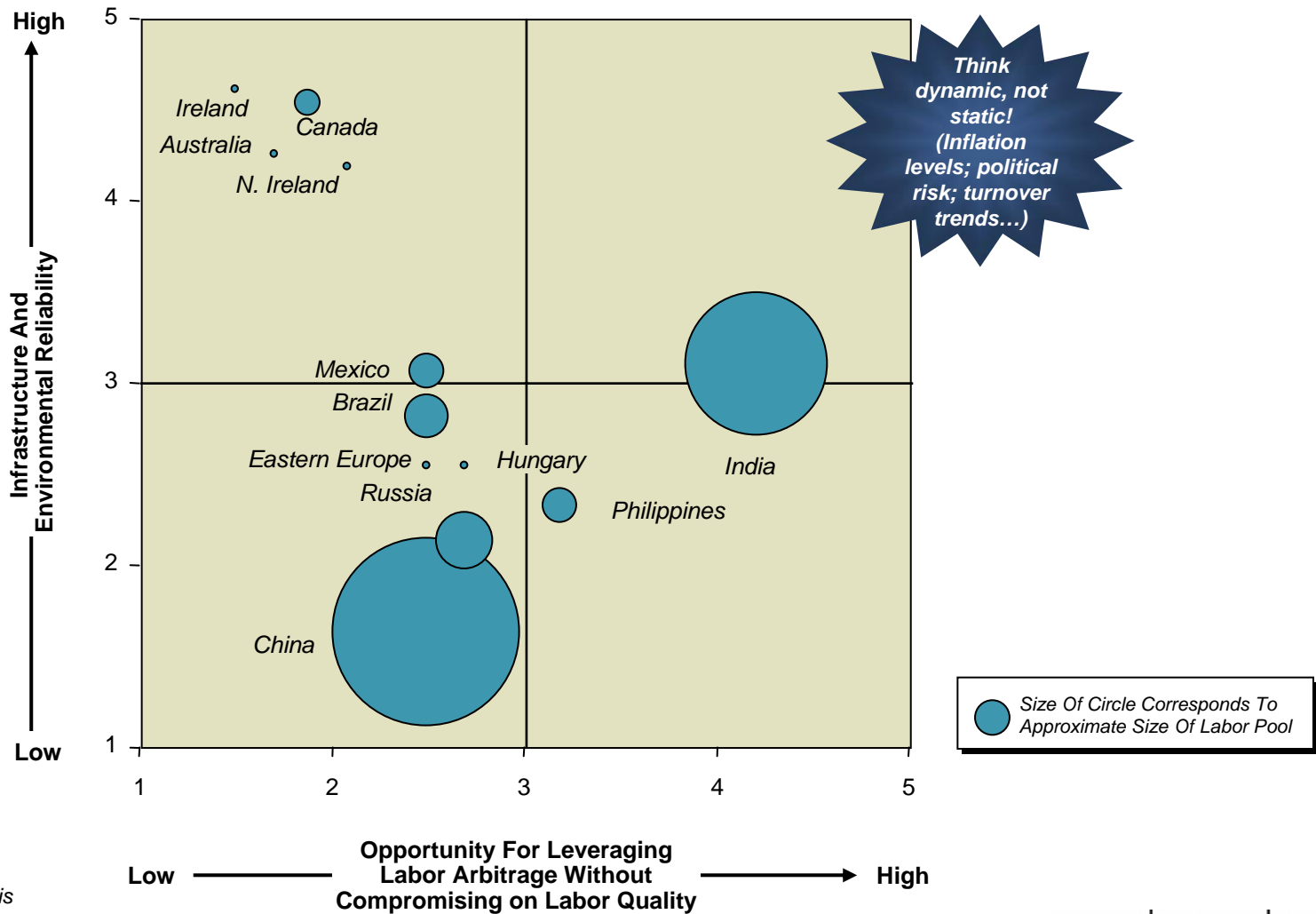
- ▶ BPR has run its course – no more to squeeze
- ▶ BPR requires leveraging scale and factor costs that are challenging to access in current business model
- ▶ Facing an immediate profitability crisis, and costs need to be radically reduced over the next 18 to 24 months
- ▶ Company does not wish to be distracted with internal reengineering of non core processes
- ▶ No skill sets or experience internally to make the to run a remotely located operation and manage effectively

Potential delivery models for in-scope processes must then be determined...

	Captive	BOT	JV	Direct
Definition	Do it yourself	ESP build, operate and transfer	Split investment and revenues between client and ESP	Enter into a fee-based contract with an ESP
Initial Investment	High	Low	Medium	Low
Control	High	Initially medium, high after transfer	High (if the client has a majority stake)	Medium with the right governance
Management Effort	High	Medium initially, High after transfer	Medium (depends on the share holding pattern)	Medium
Operational Risk	High	Medium initially, Low after transfer	Medium (majority stake) / Low (small stake)	Low
Financial Risk	High	Medium	Medium	Low (could be high with small pure plays)
Scalability	Medium	Low/Medium	High	High

... as well as potential locations for the future service delivery footprint

Relative Attractiveness of Countries As Viable Offshoring Supply Bases

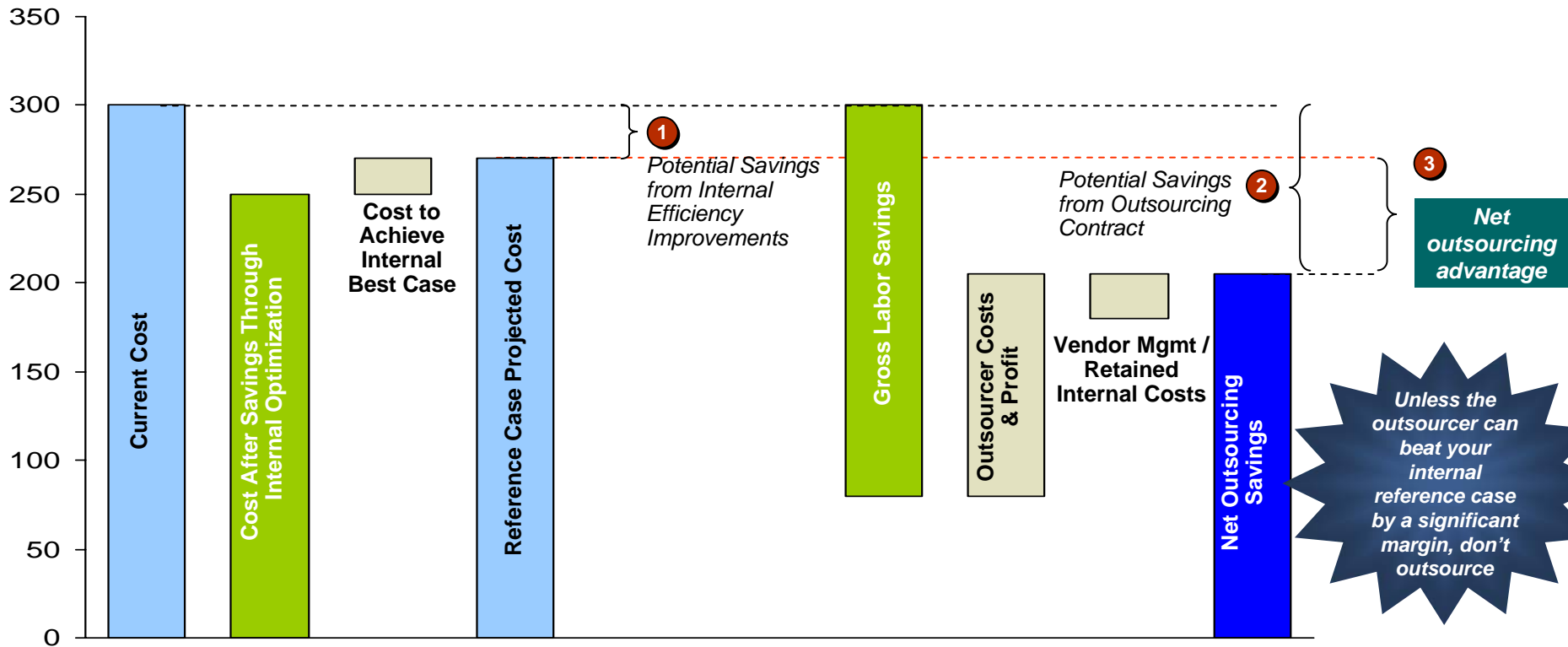


Source: BAH research and analysis

The eventual decision on whether / what to outsource should rest on a rigorous business case based on realistic internal costs and solid vendor economic forecasts / benchmarks

CLIENT EXAMPLE

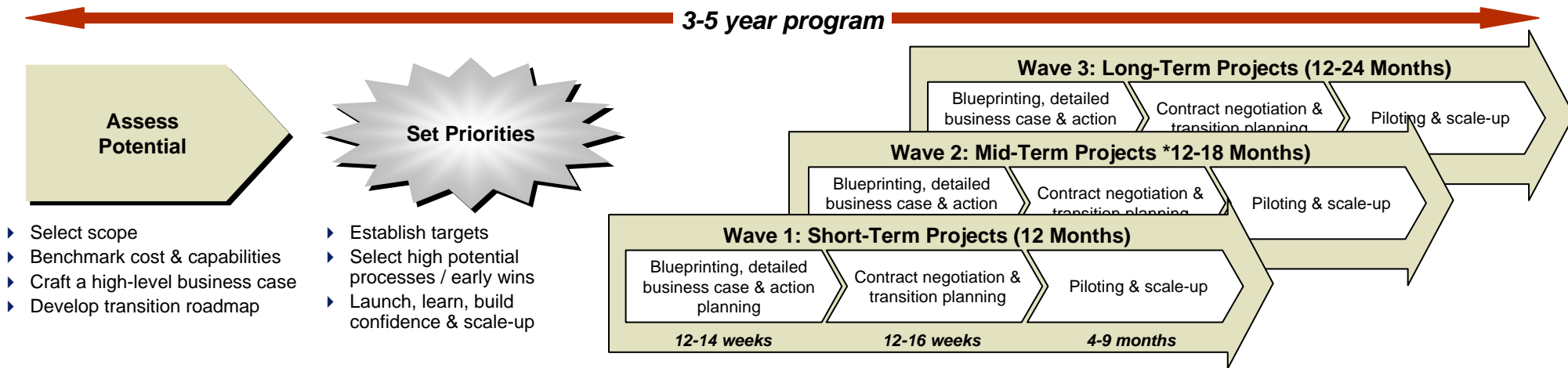
Example Breakdown of Offshore Savings Opportunity
(in \$MM)



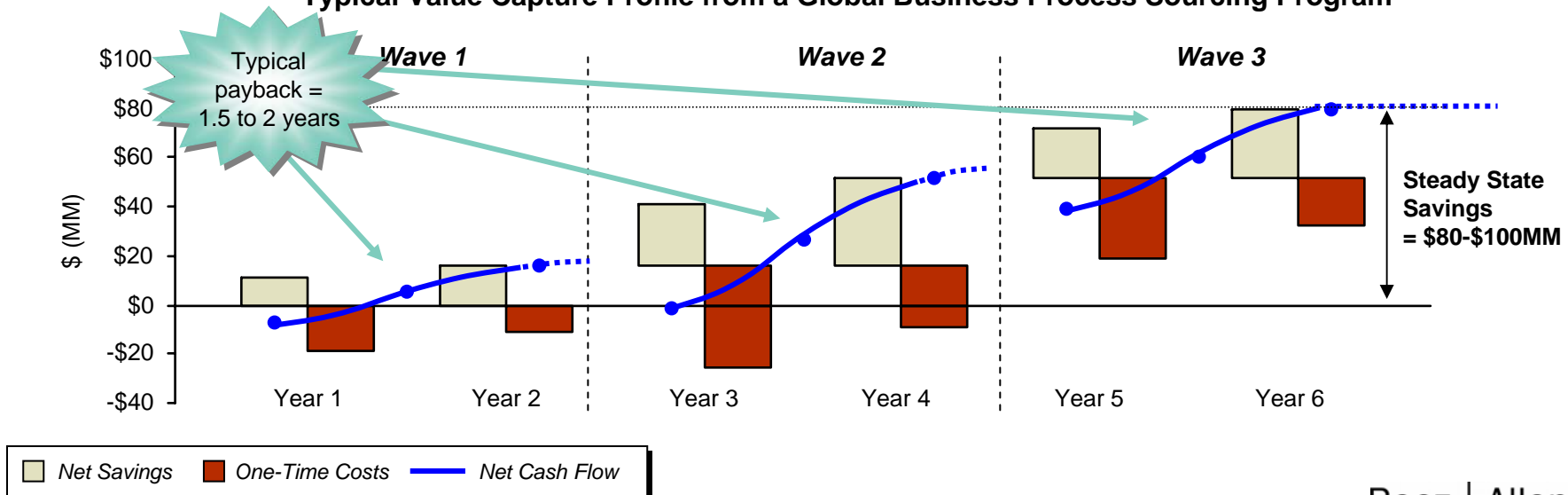
Source: BAH analysis

Once scoping decisions have been made, structure an outsourcing program that recognizes that meaningful change will occur over years – not months – particularly for large programs

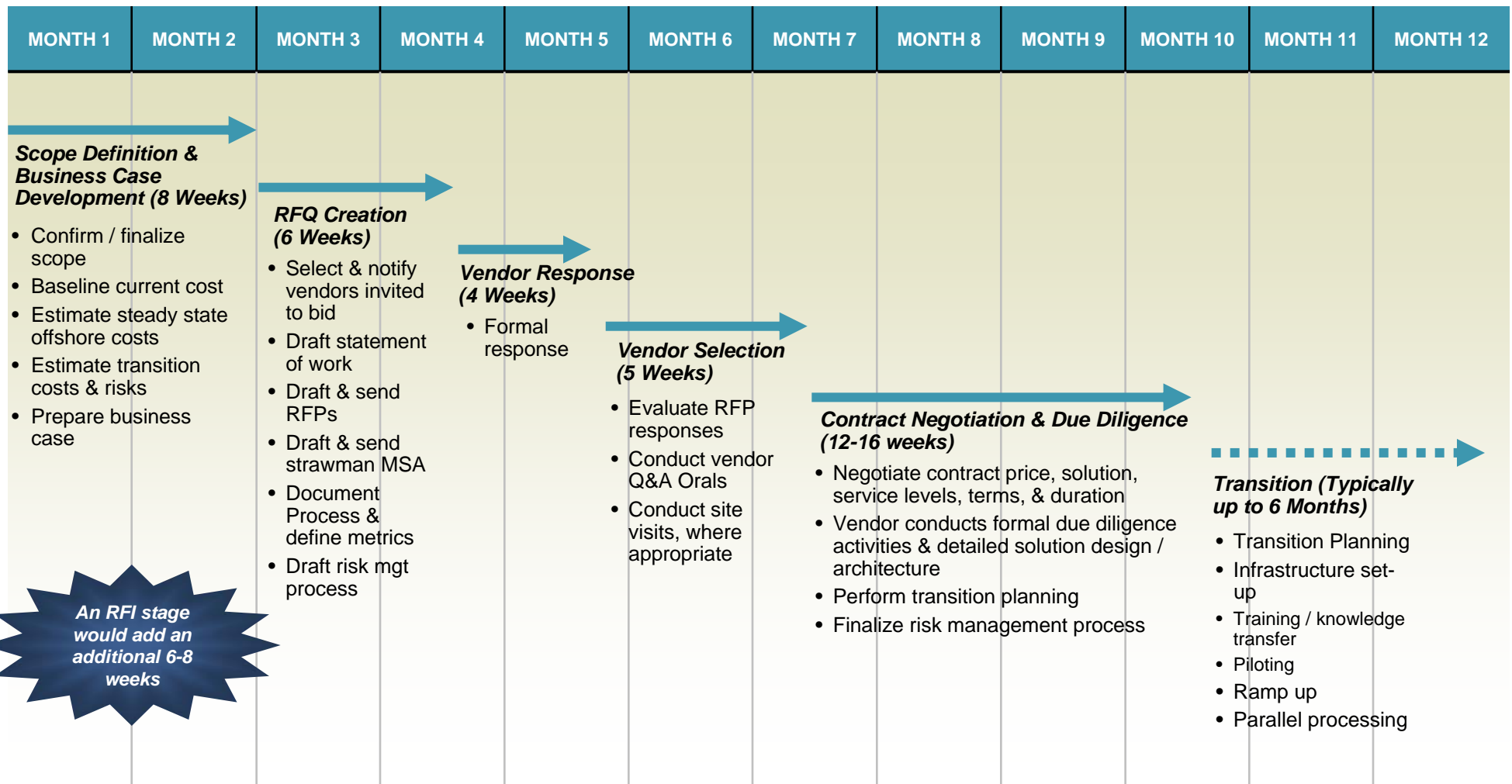
Typical Global Sourcing Program for Best Practice Companies



Typical Value Capture Profile from a Global Business Process Sourcing Program



Then, execute with speed and precision – it takes 8+ months to select vendor(s) via an RFP process, negotiate the contract, plan transition and go live



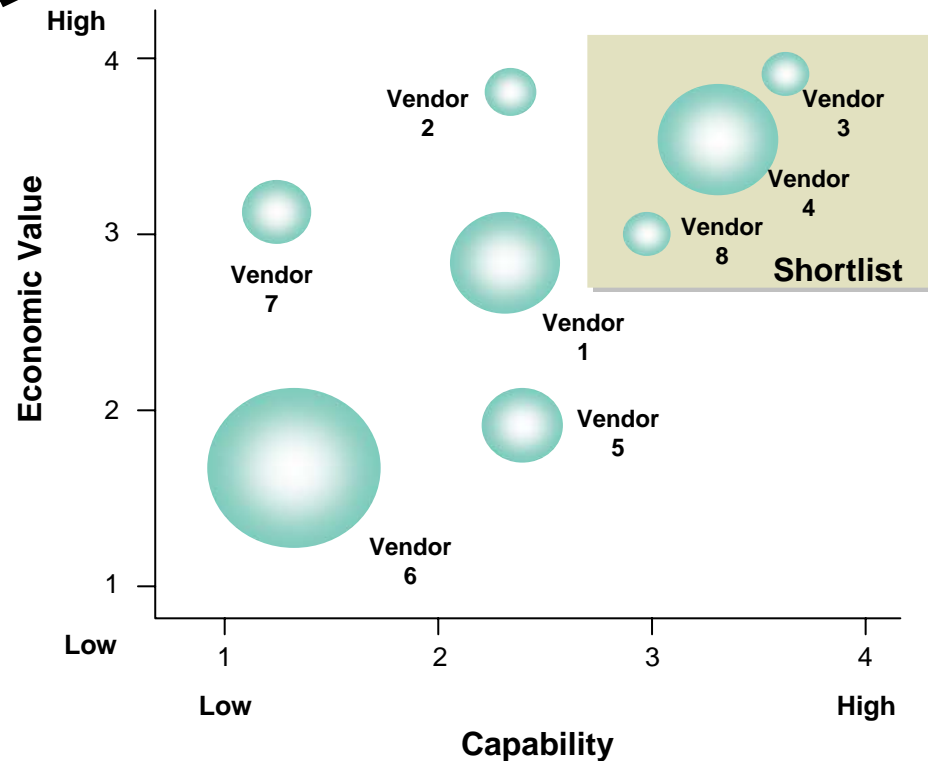
Drive the vendor selection process through informed choices based on capabilities, economics and risks

Best Practices during Vendor Selection

- ▶ Understand **strengths and weaknesses** of vendors across a **range of criteria** (e.g., process capabilities, geographical coverage)
- ▶ Assess early whether a **single or multiple** vendor can provide the “best” Solution
- ▶ Evaluate **cultural fit** of vendor to minimize service issues
- ▶ Evaluate vendors **ability to scale** in order to support strategic goals (acquisitions, spin offs, etc.)
- ▶ Investigate possibility of vendors’ ability to **internalize your own staff** in order to minimize one time – severance and parallel operation cost
- ▶ Understand **market positioning** of the vendor to assess risk, if any, from future vendor consolidation and disruption

ILLUSTRATIVE

RFP Assessment Summary: Process #1



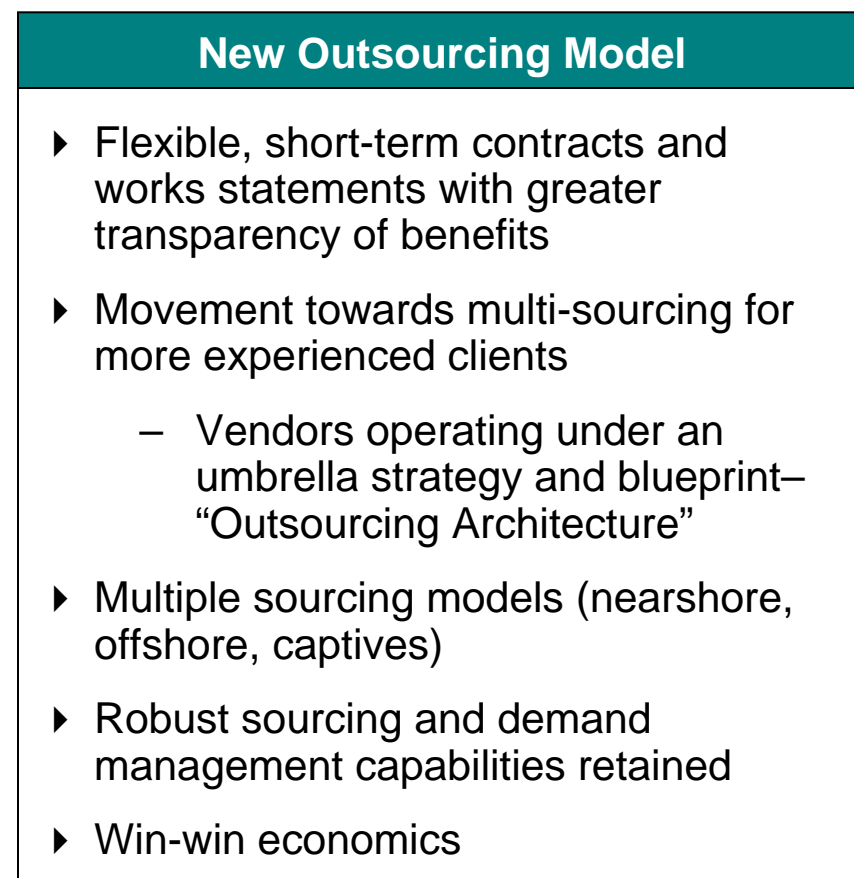
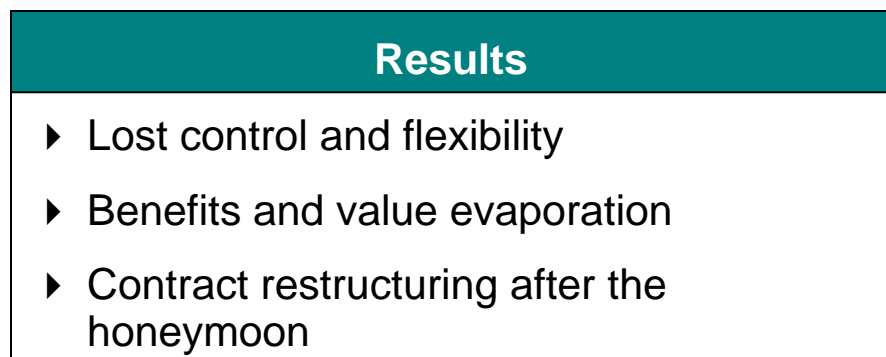
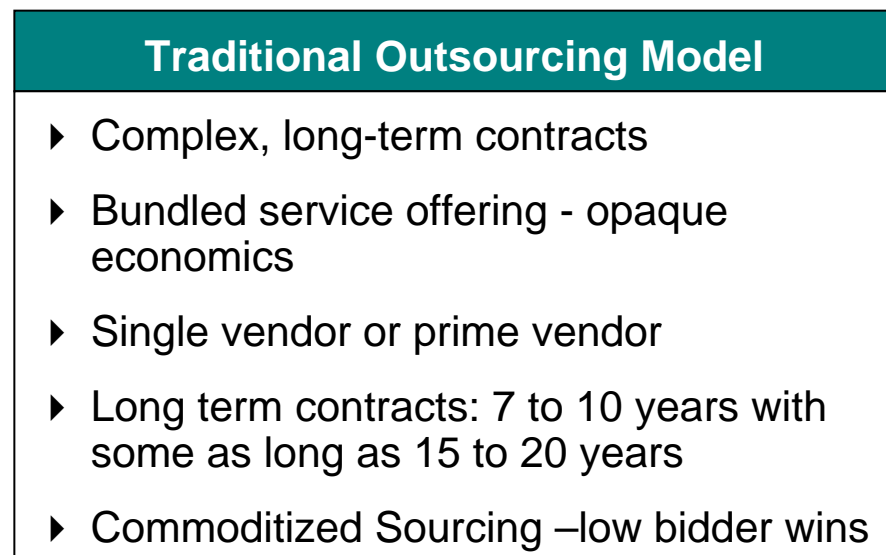
Note: Bubble sizes are proportional to risk mitigation ability
Larger bubbles represent superior ability

Consider selective bundling of multiple processes to a vendor, particularly if you do not bring a lot of volume in any one function to the table

Impact of Bundling Two or More Functions to a Single Provider

Best-Of-Breed Sourcing		Bundled Sourcing	
PROS	CONS	PROS	CONS
<ul style="list-style-type: none">▶ Better pricing from pure-play offshore providers▶ Access to deep domain expertise▶ Diversification provides balance and competition▶ Improved controls from physical separation of processes by vendor	<ul style="list-style-type: none">▶ Decreased integration between IT and business processes▶ Increased complexity in vendor management - more complicated startup due to large number of vendors▶ Lack of accountability: multiple hands in the pie	<ul style="list-style-type: none">▶ Increased scalability and better initial pricing▶ Clear accountability▶ Better integration between IT and business processes▶ Reduced vendor management complexity	<ul style="list-style-type: none">▶ A single vendor may not have deep domain expertise in each tower▶ All eggs in one basket<ul style="list-style-type: none">– Loss of negotiation leverage– Increased risk– Potential governance and control issues due to conflict of interest

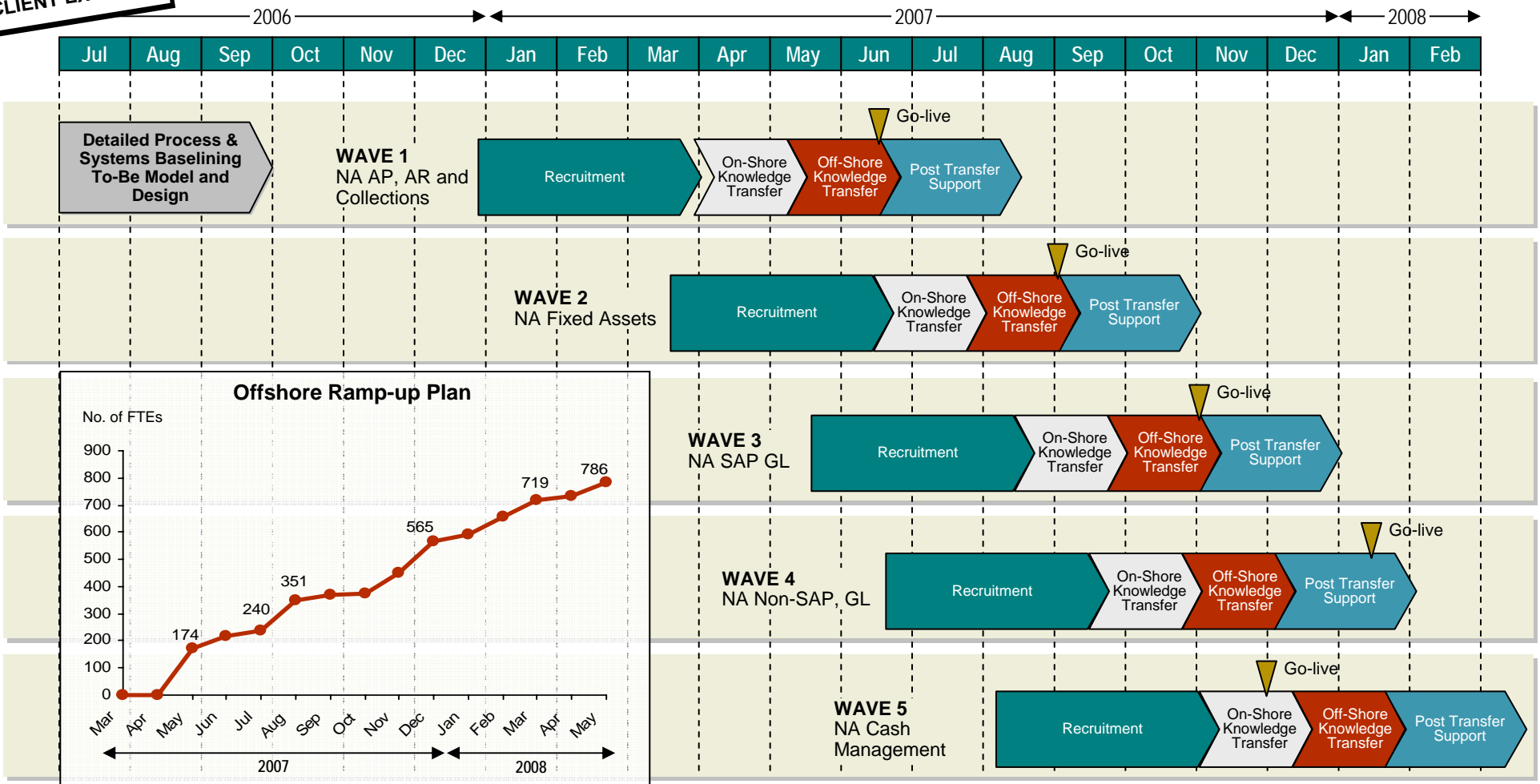
But resist mega-contracts – the traditional outsourcing model of large and long-term monolithic contracts has outlived its usefulness because of dramatic evolutions in the supplier landscape



Recognize that outsourcing transitions take at least 18-24 months before steady state savings are generated

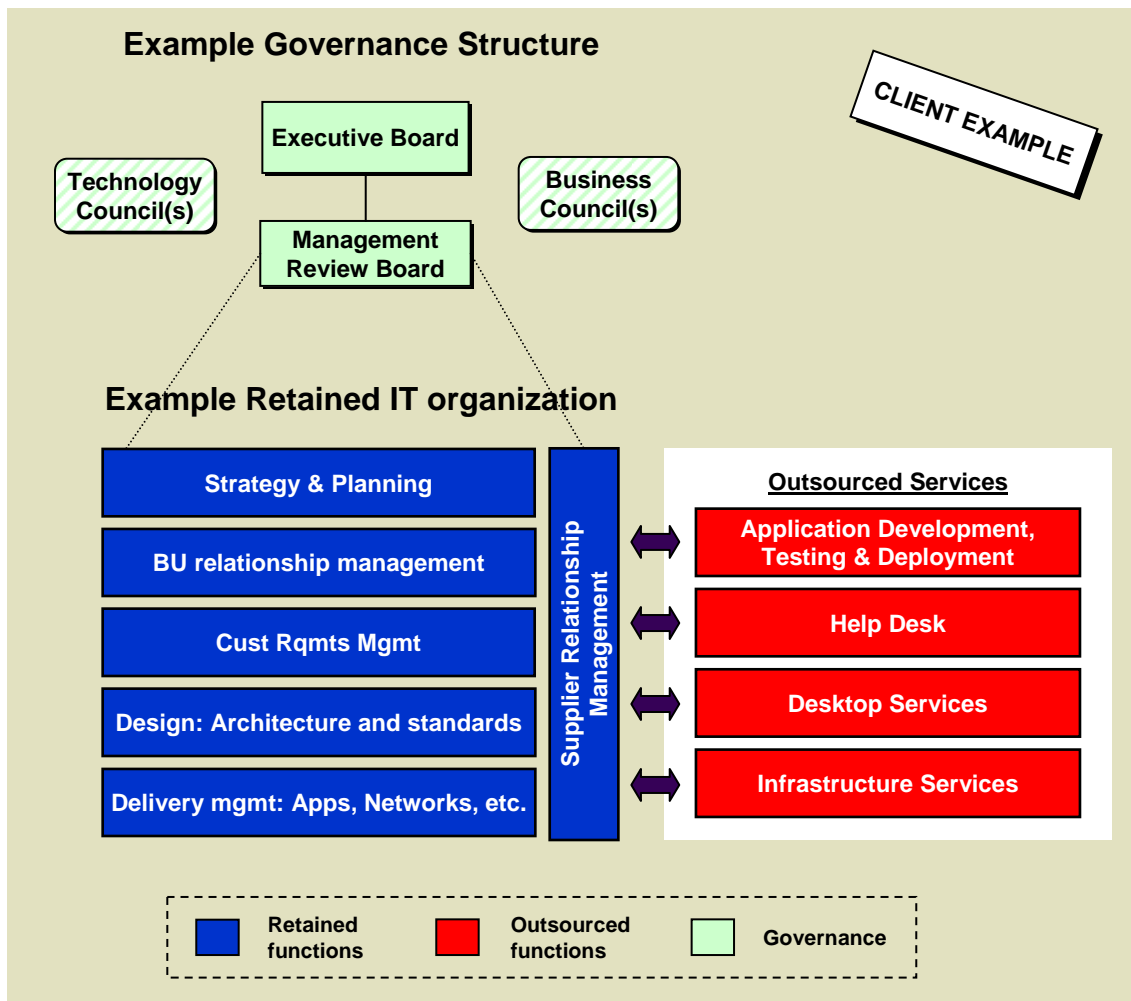
CLIENT EXAMPLE

High Level Transition and Ramp-Up Approach



Source: Booz Allen Hamilton client experience

Ensure that appropriate governance and strong retained organization capabilities are in place to drive and sustain positive results



- ### Characteristics of Best Practice Governance & Retained Organizations
- ▶ Strong governance bodies ensure that outsourcing decisions support business & IT strategies
 - ▶ Retained organizations are led by senior staff with enough authority to enforce performance standards
 - ▶ Roles and responsibilities of the retained organization are clearly defined...
 - ▶and delineated from expectations of the outsourcer
 - ▶ Retained organization staff is skilled in relationship management, not just contract administration

In summary, outsourcing can drive tremendous shareholder value — if done with care



TYPICAL
PRACTICE

“Do the deal to get rid of the headache”

- ▶ Sourcing of entire sets of capabilities and systems (including all the complexity)
- ▶ Source immature and unstable processes
- ▶ Specify soft and fuzzy service levels
- ▶ Little understanding of cost structure and drivers
- ▶ Little visibility into the cost structure of the provider
- ▶ Threat process and technology outsourcing as a “commodity” strategy
- ▶ De-emphasize the human factor – the far-reaching changes in people processes, leadership, culture and communications
- ▶ Assume that we will fix adverse user behaviors by shifting work outside the four walls of the company
- ▶ A response to frustration at the workforce



BEST
PRACTICE

“Engineer the arrangement to meet the overall business need”

- ▶ Start with an understanding of business requirements - internal and external customer needs
- ▶ Know your processes, their performance and their stability — then decide which ones to source
- ▶ Clearly establish and communicate business case for outsourcing, based on fact-driven logic
- ▶ Secure executive consensus and advocacy
- ▶ Make the supplier selection process competitive but not a large “beauty contest”
- ▶ Select suppliers with alignment between buyer / supplier cultures, capabilities and philosophies
- ▶ Establish contracts with service level agreements, penalties and credits
- ▶ Build the internal capabilities around contract , vendor and transition management
- ▶ Effective measurement, with both the outsourcing team and supplier accountable for results

Further resources

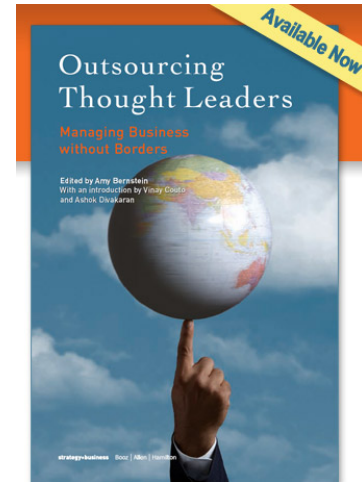
To view the article, “How to be an Outsourcing Virtuoso”, please use the following link:

<http://www.strategy-business.com/press/article/06304?pg=0>



To obtain copies of the book, *Outsourcing Thought Leaders, Managing Business without Borders*, use the following link on the strategy+business website:

<http://www.strategy-business.com/oasreader>



Slides and recording: A recording of the event and slides will be posted within 48 hours at:

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