Outsourcing in a Strategic Context – Essential for Success

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Outsourcing is increasingly used to reduce organisational costs and / or expand capabilities. However, unless the strategic rationale is understood and applied rigorously in partnership mode, outsourcing may destroy rather than create value.

Outsourcing is increasing in scale and range

Globalisation and IT have radically changed the nature of competition across all sectors with the result that the ability to leverage critical capabilities is often far more important than their ownership.

Many organisations thus face fundamental decisions on outsourcing to maintain competitive advantage with traditionally core functions up for consideration. Outsourcing has moved up the value chain from a cost focused functional approach (eg facilities, IT, etc) to a business process strategic approach and has matured from an adversarial relationship towards a partnership one.

Outsourcing is here to stay and has become an essential business practice - 91% of customers in a recent survey (PwC Global Outsourcing Survey 2007) said they will outsource again, whether completely happy or not.

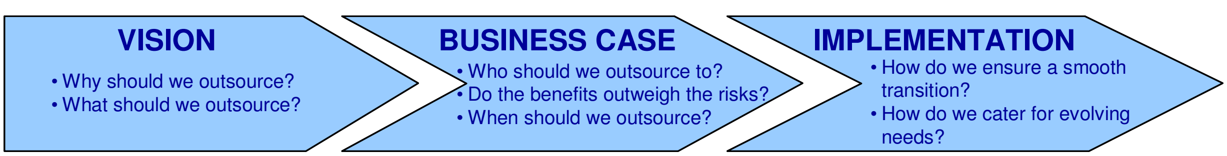
Outsourcing does not always work and success requires a strategic approach

Many outsourcing programmes do not meet expectations, even on cost terms, particularly where sourcing decisions are made on a piece-meal basis. While benefits are available, the risks arising need to be assessed and managed.

Benefits	Risks
• Reduced costs with less uncertainty through: – economies of scale – ability to match resource with demand – sharing of risk and reward • Improved service quality • Access to new technology without capex • Increased strategic flexibility • Resources freed for core business	• Scale and complexity underestimated • Price escalation through service variations • Deterioration in service quality over time • Supplier encroaching upon core business • Loss of critical skills and dependence on supplier • Reduced innovation capability
⬇ **Value created?**	⬇ **Acceptable?**

Successful outsourcing decisions must be set in the context of a vision for the organisation rather than just being seen as tactical cost saving or problem avoidance measures. Many tactical outsourcing implementations fail because they focus on cost savings only, lack flexibility or miss opportunities for more fundamental restructuring.

A structured approach as below ensures that outsourcing decisions are evaluated comprehensively and aligned with the strategic vision. Each step is outlined in more detail below.



VISION: Develop the vision – why and what?

The outsourcing vision must reflect the top-down strategic approach and the philosophy of the organisation. This vision must also be clearly articulated and communicated internally, to outsourcing partners and to external stakeholders.

Screening of outsourcing opportunities is carried out in two stages:

- A primary **core** / **non-core** filter to identify those business areas which offer distinctive, sustainable competitive advantage or which are closely tied to the corporate strategy;
- A secondary filter to **prioritise** the remaining areas against criteria of feasibility, benefits and risk.

The core / non-core assessment poses questions for each service area with the key one, from a greenfield perspective, being:

- Would you do it yourself if starting out today?

The service is a core one where the answer to this question and those below is mainly 'yes'.

- Do you have unique knowledge and experience of providing the service?
- Does it provide you with sustainable long term competitive advantage?
- Would your customers be concerned if you outsourced it?
- Would other firms hire you to do it for them?
- Is tomorrow's CEO likely to come from there?

Some core services may actually provide opportunities for insourcing, i.e. the company provides them externally to other companies.

The remaining options, judged to be non-core, are screened against three criteria to determine their suitability for outsourcing:

- What is the **feasibility** of outsourcing - are there practical, operational, IR, regulatory, etc features which make it impossible or unenforceable?
- What are the likely **benefits** of outsourcing? Where do direct or indirect benefits arise? What is the payback when implementation costs are taken account of?
- What are the **risks** of outsourcing? Are there major organisational change problems? Is implementation very complex? How committed are management likely to be? How robust are the cost and benefit estimates? Will revenues be impacted?

The output of the screening process, as below, will be a list of areas classed as not suitable, possibly suitable or highly suitable to outsourcing, with priorities designated.

Area	Core / Non-core	Feasibility	Benefits	Risks	Result
A	Core	n/a	n/a	n/a	X
B	Non-core				✓
C	Non-core				?
etc					

Highly suitable | Some queries

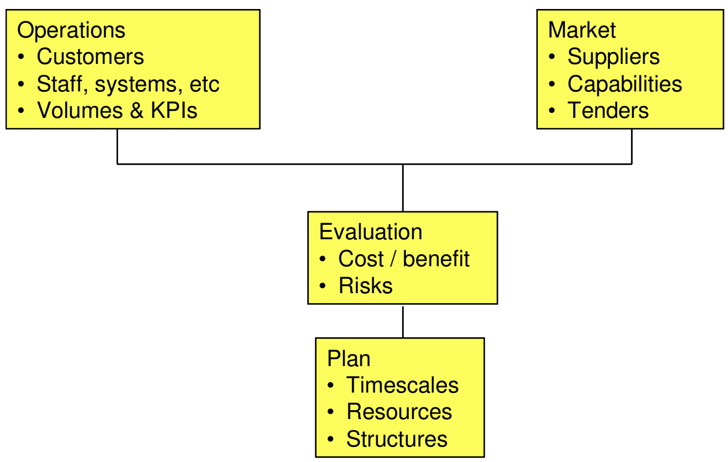
BUSINESS CASE: Reviewing the business case – who and when?

The business case must be assessed in detail for each outsourcing priority against value drivers which reflect the vision and core objectives, ie:

- Service – nature, performance levels and demand profile;
- Market – maturity, supplier constraints and capabilities;
- Commercial – preferred contract approach and pricing regime;
- Transfer – staff and asset base.

The assessment process aims to:

- Understand the operations in detail and build a high level specification of requirements;
- Confirm the availability of suppliers and procure tenders from a short list against a comprehensive performance-based ITT;
- Define the costs and benefits of outsourcing and screen against the corporate objectives;
- Assess the key areas of risk and
- Prepare an implementation plan, if viable.



Choosing the right supplier

A robust supplier evaluation process is essential given that outsourcing contracts are long term and not easy to switch - references, modelling, multi-level contacts and due diligence all contribute. Suppliers are evaluated in two main ways in forming a short list and in final selection:

- Economic standing - normally by evaluating financial statements;
- Technical capability - experience, client base, understanding of services and flexibility.

The tender process must ensure that:

- Service levels are defined, together with penalty / reward mechanisms;
- Tender data permit a comparison between tenders as well as against inhouse operations;
- Supplier margins and USPs are understood, eg scale, technology, capability, etc;
- Promised performance can be validated by current information, including references;
- Contingency plans are defined together with arrangements to prove them in advance.

An evaluation team – often with technical and commercial sub-teams - works towards a signed contract. The preferred tender is assessed by a detailed due diligence before the contract is placed.

The final decision is based on criteria of price, quality of service, continuity and innovation, underpinned by a compatible culture. The chemistry is vital and an ability to work collaboratively is as important as performance issues.

While all contracts seek innovation, it is less frequently delivered and requires:

- A shared understanding of objectives between the company and the supplier;
- SLAs which provide for innovation and continuous improvement;
- Collaboration in planning, forecasting and problem solving;
- Regular communication and openness throughout both organisations;
- A genuine risk / reward sharing in pricing - and flexibility to evolve to changing needs.

Modern contracts generally entail some sharing of risk and reward as below.

IMPLEMENTATION: Managing the transition and the ongoing contract – how?

The transition is planned in detail with roles, timescales, etc defined and tightly controlled to ensure a smooth changeover. This will entail:

- Joint company-supplier teams to transition and fine-tune processes, reporting to a Steering Group;
- KPIs defined and monitored on quality, service and cost - all within supplier control;
- Full communication with employees and collaboration in knowledge transfer.

Outsourcing usually entails the transfer of assets – property, inventory, hardware, software, etc. and an appropriate transfer mechanism must be agreed for each depending on the contract period, risk of early termination, etc.

In many cases staff will transfer to the supplier under TUPE (Transfer of Undertakings, Protection of Employment) legislation. This has advantages in that current personnel provide continuity and know the processes.

Ongoing management arrangements to deliver the outsourcing goals will include:

- Monthly progress reports addressing performance, pricing / costs and any issues;
- Formal monthly meetings at which progress is discussed, problems identified and changes considered;
- Less frequent senior management meetings;
- Informal contacts on a regular basis;
- An escalation route for issues and problems;
- Annual reviews with lessons learnt incorporated in revisions.

CONCLUSION

It is essential that the strategic goals for outsourcing are defined and kept in mind at all stages from business case testing to supplier selection to transition and ongoing contract management.

As business needs evolve the outsourced service must be responsive to them. A ‘partnership’ relationship with collaborative rather than adversarial behaviour at all levels is critical in this.

MDR Consulting specialise in performance improvement consultancy and have supported a number of major outsourcing projects and helped organisations define their outsourcing strategy. Tom Moriarty can be contacted at tommoriarty@mdrcl.com or 086 2423778.