

How to improve outsourcing

By: Patricia Grace and Pari Annamalai
Published: 21/01/2009 at 12:00 AM
Newspaper section: [Business](#)

In the wake of recent financial scandals and collapses, companies and executives are starting to question the risk versus reward of outsourcing, particularly such important processes as those of the supply chain. Customers have many lingering questions about outsourcing their important business processes, such as:

- Have I sacrificed service levels or other metrics in the name of cost savings?
- Have the systems and processes that provide structure been truly optimised?
- Why I am not seeing my costs go down as much as I would have expected?
- Why does my outsource partner require more people to run the business than when it was done in-house?
- Why is my internal cost still so high? Have we not outsourced this activity?

What we have found is that many companies just follow a simplistic blueprint to move headcount from their books to those of the outsource partners without looking at the opportunities to optimise their processes at the point of implementation. They may also be failing to manage continuous improvement initiatives aimed at squeezing out every last percentage of efficiency.

A recent study by a leading professional services firm found that 44% of companies are not seeing any, or only modest, benefits from outsourcing. Companies often find that they see some cost savings in the first year but over time they see a degradation of results. This could be attributed to two factors, as follows:

Low-cost sourcing strategy: An overriding consideration in selecting an outsourcing partner is, of course, cost. Typically, most outsource partners will add a provision for an escalation of costs in a multi-year contract with a lower cost in Year 1. These escalation costs can vary quite dramatically and, due to cost pressures during the sales cycle, most outsource providers will quote a very attractive price in Year 1 with an escalation cost for Year 2 and beyond.

Costs in this global environment are affected by such factors as supply and demand of talented professionals, exchange rates and many other factors. Take the case of India. Salary costs for technical personnel in cities such as Bangalore have been going up by double digits for the past several years. At the same time, the Indian rupee has been getting stronger, by almost 10.5% against the US dollar in one recent stretch.

Outsourcing partners are in business to make money and have to address these issues. They will be forced to pass these costs on to the customer or look for ways to reduce their costs such as using less experienced personnel and moving to even cheaper locations, either domestically or to the next up-and-coming country. It thus becomes clear why chasing the low-cost market is not a sustainable model in the long term.

Misalignment of business objectives: The typical outsourcing model for the most part does not align the objectives of the company to the outsource partner's commercial objectives. As business changes, companies must constantly change their approach to business which includes their business processes.

Let's take a recent example of a high-tech company that outsourced its customer support. The installed base of clients is increasing every day and so are product offerings. The outsource contract is based on typical metrics such as service level and an overall cost-plus factor. As the number of products and their complexity grow, the outsource partner argues it needs more customer support personnel and over time it increases its headcount and passes the cost on to the company.

But usually, the service provider does not have an incentive to look at continuous improvements because it makes more money as it adds personnel. However, with some of the current technologies available, scalability does not necessarily mean adding more people. Companies need to encourage their outsource partners to engage in continuous improvement initiatives through commercial arrangements such as sharing part of the savings.

So what's next? The answer is complex. It first requires the formulation of a future vision for the company based on the supply chain strategy and core competencies. Second, it requires a top-down approach to understanding both the data elements and the granularity necessary to meet goals, and how information needs can be both accessed and presented.

Third, an "IT enablement" or "hands-free" approach is needed to the transition of that information throughout the supply chain. Fourth, an understanding is needed of the type of management skill set that must be retained or developed in order to make decisions across a far wider breadth of responsibility and greater depth of knowledge. Finally, one needs the ability to thread all functional components together in a way that works.

Next week, we will discuss a structured approach to business process outsourcing of supply chain processes.

Patricia Grace and Pari Annamalai are with Planvisage Pte Ltd (<http://www.planvisage.com>). Weekly Link is co-ordinated by Barry Elliott and Chris Catto-Smith CMC of the Institute of Management Consultants Thailand. It is intended to be an interactive forum for industry professionals; we welcome all input, questions, feedback and news at:

bjelliott@abflconsulting.com

cattoc@cmcthailand.org