



Outsourcing 'fashion' and generalisations are destroying operational strategy and hindering growth

The latest wave of outsourcing has clients, advisors and suppliers all focusing on the number of FTEs to take offshore and the average cost of those FTEs in low cost locations. This has been motivated by executives wishing to cut costs and reduce the administrative burden of managing large back office functions. As conceptually simple and fashionable as this may be for company boards faced with volatile and declining revenue streams, it only leads to an increase in the very problems companies are trying to resolve! The pressure and complexity of executing on such mandates coupled with supplier pressure to increase their own revenue, means suppliers and advisors blindly follow the directive with little or no push back on their clients.

Offshoring and outsourcing are no silver bullets. Success can only be achieved if this activity fits with the broader company strategy and the company makes the effort to understand the risks and benefits to its longer-term operational strategy. Anyone suggesting taking a step backwards to assess the service, revenue and operational effect of these decisions are often criticised for slowing the process down and missing the point. In fact quite the reverse is true. Those companies that take the time to do this analysis are the ones who succeed in getting their objectives delivered in a sustainable way, increasing efficiency and creating the appropriate focus on their own revenue generating activities.

It is often felt that once executive management has decided to explore outsourcing/ offshoring that getting a 'price' as quickly as possible is of primary importance. Destabilising the existing organisation, achieving shareholder short-term demands, meeting the supplier sales cycles and demonstrating progress are all reasons cited in this regard. The result of taking a step back from all these short-term pressures is dramatic. Using the change and investment needed to execute on the 'simplest' of outsourcing/ offshoring initiatives with more planning and alignment to the company strategy always delivers a larger and more sustainable result.

This paper discussed two ways in which this pressure manifests itself in the use of company resources for sub-optimal outcomes, namely selecting the areas to outsource and a focus on cost and not service.

Selecting the areas to outsource

Executives and the industry at large agree that standardised processes that are common across many companies are the ideal place to start such a journey. This inevitably leads management to conclude that areas such as IT, Finance and HR are the places to start this activity. Whilst this is not wrong in principle, very little consideration is given to the effect of change, the use of management time and the investment cost when compared to the actual cost savings possible. Outsourcing one or two of these functions, or even parts of these functions, brings with it the same scale of investment (management time, costs and change) as outsourcing a more 'strategic' function that could have a greater impact on the stated objective.

There are many statistics quoted with regard to the cost of functions, such as Finance, HR and IT, within a company's cost structure (expressed as a percentage of sales or turnover etc). Suppliers will quote figures that show a client is 50% more expensive than one of its competitors in order to create the desire to outsource quickly.

What few companies realise is that a 50% reduction to a cost that is 2-10% of its total cost base, while attractive, is not going to solve its problems. This is even truer when you consider that senior management (i.e. CIO/CFO and a number of their reporting managers) will spend 25-50% of their own time during a year on such an initiative. How much more value could the executives in these roles create if this time was focused elsewhere?

This is not to say that by using this argument, companies should not outsource or offshore. Rather the way management should view such an initiative is to have laser-focus on getting the most benefit from this investment in time and money. Taking the time to consider how such an initiative can deliver over and above a simple 50% saving on 2-10% of the cost base, will deliver far more benefit to the company in the long-term. In many cases it also improves the first year investment issue remarkably. As an analogy, not taking this time is like removing a car's whole engine in order to change the oil rather than working out that the oil can be drained without such a step.

There are many outsourcing advisors who tell their clients that you should not outsource an inefficient area. Rather management should take the time to create their own internal efficiency and then to outsource the process once it is efficient. Whilst there is some truth in this statement, it is a generalisation that is wrongly used. This is certainly true for processes that are differentiating and unique to a business. For industry standard processes why would one consider doing this when a plan is in place to use the standardisation and efficiency that the market place (i.e. suppliers) have created in order to make their own margins?

To take the car analogy further, you would not consider overhauling your car's engine before you signed a service contract to provide you with transport supplied from a car pool (one of which was your original car). You may not even consider this overhaul if you were looking for a service that managed and maintained your current car. In this instance you would consider the competence of the supplier coupled with the time and investment you will need to perform the overhaul yourself. You would assess against the opportunity costs of using your scarce resource elsewhere and the relative risks of each option.

This should be no different to outsourcing. However, advisors, suppliers and generalised words of wisdom from specific situations often drive the inappropriate use of investment and time.

The inappropriate focus on cost and not service

All businesses are under pressure to be more efficient and to reduce costs. This is a necessary ambition. Unfortunately, due to the nature of our organisational models and the simplicity of viewing people costs in FTE terms, this leads to an inappropriate focus on in-scope FTEs and the associated costs.

Your people provide a service. It is this service that should drive the focus of attention when seeking to reduce costs. In almost all organisations there is a 'one-size fits all' culture that does not allow for the fine-tuning of service according to the business needs.

The most acute example of this is in the investment banking community. Trading floors in this environment demand a 24 x 7 service from technology in order to ensure that traders can make and close trades within seconds. This makes sense, as the cost of this service bears no comparison to the revenue opportunities to be lost should the service be unavailable or of poor quality. However, there is no need for the clerk performing the Nostro reconciliation in the back office of such a bank to demand the same level of service. An organisation geared to service the trading floor's technology demands finds it very difficult to adjust its service to areas that do not have the same revenue/ loss risks associated with that service.



What outsourcing therefore does is to provide organisations with a unique opportunity to move from an FTE management model to a service management model. In almost all cases an understanding of the service needs of the business and designing the appropriate channel, responsiveness and availability mechanisms, will give a far better cost-saving result than a FTE and pricing model that forms the focus of advisors and suppliers in the market today. Furthermore this service approach could actually improve overall business performance.

What this demands is a change to the client's management style and culture. Managing a service demands a different skill than managing a department, an often ignored factor in the success or failure of outsourcing contracts. With the right strategic understanding of the value at risk in business functions coupled with an appropriate service management framework, organisations can dial up service in key areas and dial down service in others, with an overall reduction in cost.

Conclusion

Regardless of the pressure to outsource, it is always better to step back and understand the operational strategy and service needs of each part of the organisation before either selecting the area to outsource or executing on the outsource process. The time invested in this activity will pay back in better performance of the business and a far more appropriate use of management time and investment resources.



About the Author

Stephen Newton is the CEO of Elix-IRR and leads the Sourcing Advisory division of the business.