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Booz & Company

from **strategy+business** issue 44, Autumn 2006

reprint number 06304

booz&co.

Reprint

As the turbulent global services industry matures, a highly skilled cadre of master providers and customers is emerging.

How to Be an Outsourcing Virtuoso

by Vinay Couto and Ashok Divakaran

Not so long ago, some observers were nearly ready to declare outsourcing dead. A series of well-publicized corporate outsourcing and offshoring failures — involving Dell, Lehman Brothers, J.P. Morgan Chase, J Sainsbury, and Sears — had led to the conclusion that the future of the global business services industry was questionable. Some analysts predicted a backlash in public opinion, in which the loss of jobs in North America and Western Europe would make outsourcing politically unfeasible. Others argued that in a world of increasing political volatility and security risk, the offshoring of business services could not continue to grow.

These predictions have proven wrong.

Instead, the outsourcing industry — the international conglomeration of firms that provide services in information technology, customer care, finance, human resources, engineering, procurement, real estate and facilities management, and data analytics, among other offerings, that replace in-house selling, general, and administrative (SG&A) functions — is becoming ever more sophisticated and, for many customers, indispensable. In 2004, the International Data Corporation (IDC) valued the annual global business process outsourcing (BPO) market at $382.5 billion, a 10.8 percent jump over 2003. IDC estimates that by 2009 the market will hit $641.2 billion. Such growth — nearly 11 percent per year — is a testament to how thoroughly outsourcing is now woven into the fabric of international commerce.

This growth has also left suppliers with a variety of questions about the future of the services they provide. And for the corporate customers who contemplate

Illustration by Philippe Weisbecker

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introducing or expanding an outsourcing strategy, especially for those who have experimented with outsourcing unsuccessfully, a significant level of apprehension and uncertainty remains.

This dichotomy — visible but isolated failures on one side, complex but resoundingly successful outsourcing deals on the other — leads to two conclusions. First, the industry has not stabilized to the point where outsourcing any particular business activity is a guaranteed safe choice. Second, much value can be obtained from outsourcing if it's done right, and there clearly is a right way to do it.

"Most companies that are outsourcing for the first time don't know how to approach it," says Ralph Szygenda, the chief information officer of the General Motors Corporation. Over the last decade, Mr. Szygenda has taken his company through three distinct and highly complicated phases of IT outsourcing that have led to $12 billion in savings and a complete technological overhaul. An evolving set of skills, not just at GM but at dozens of companies on both the supplier and the customer side, is coalescing into a body of best practices as the industry matures.

The pioneers of these practices are today's outsourcing virtuosos. On the supply side, they're creating instruments of unprecedented power for delivering global business performance. And on the demand side, they're learning to play those instruments with unprecedented mastery. No individual or company has all the answers, but a clear view is emerging of how the industry should continue to meet the challenges of a fast-moving marketplace with ever more demanding customers and how companies can fashion the most effective outsourcing approach for the future. We discussed these insights with five leaders in charge of successful outsourcing programs at Procter & Gamble, Innovene (a chemicals firm), Duke Energy, General Motors, and Texas electric utility TXU, and with leaders of five prominent providers of outsourcing services: TCS, 24/7 Customer, Augmentum, Cognizant, and IBM.

The Industry Matures

To a casual observer, the outsourcing industry might well appear to share many characteristics with the dot-com economy. It is caught up in a classic boom business environment, with all the exuberance, hype, and dynamism that attend industries in the midst of wild expansion. The market appears to be going in two directions. On one hand, compelled by what appears to be expanding business opportunities, the BPO market is attracting many new firms from different segments of the IT services industry, such as software providers, data center outsourcers, and offshore application developers. On the other hand, the market has embarked on its first major wave of consolidation as the larger firms with deep pockets gobble up smaller competitors and expand their capabilities.

In this environment, pure-play process providers are finding it difficult to compete against established market leaders without an expanded offering and a world-class technology platform. Other firms with a limited number of BPO contracts are discovering that subscale operations cannot deliver the value necessary to grow their businesses. Several of these firms are dropping out of the BPO market or merging with larger firms that have the resources to compete. Service standards are still emerging and pricing models still evolving; legal protections are inconsistent, and the roster of providers and offer-

Outsourcing could eventually resemble a utility computing model, with services purchased à la carte, without costly up-front investments.

ings is always shifting. Hence the woes that many client companies have experienced with outsourcing.

But amid the ferment, several trends are shaping the offerings of the most successful providers:

• **An Expanding Global Footprint.** The marketplace for outsourcing is far more varied than it was a few years ago, with competitors of all sizes operating primarily from India, China, and the Philippines and offering their wares to customers around the world. Like their clients, they are spreading globally to make the most of international diversity, balancing the capabilities, language capacity, cultural affinities, and cost structures of a variety of regions. The more forward-looking suppliers include Western behemoths like IBM, which recently announced its intent to triple its investment in India to $6 billion over the next three years. They also include Indian providers such as TCS, which has offices in 34 countries on six continents, and 24/7, which is scaling up a center for global services based in the Philippines. With the leading players globalizing their operations, some distinctions between "Western" and "offshore" vendors are starting to erode, including their capabilities and even their pricing.

"The traditional regional outsourcer is going to have a very rough time competing with the global players," says Michael Cannon-Brookes, IBM vice president for business development in China and India. "You've got to have the talent, you've got to have the infrastructure, and you've got to have the processes."

As outsourcing customers develop globally standardized processes and systems, they are beginning to place more weight on vendors' abilities to provide equally standardized capabilities and processes. In the long term, for example, work delivered from a center in Bratislava, Slovakia, will have to be fundamentally the same as that delivered from Hyderabad, India. Much of this movement toward global harmonization is being driven by multinational giants such as GM, for which the benefits of standardization are immense.

"In 2003, GM truly started globalizing its business processes. Until then, we had different processes by region," observes Mr. Szygenda. "Now GM is beginning to run as one coordinated company throughout the world. We can design, develop, and distribute products from any part of the world to any other part of the world. There are no longer regional boundaries." This globally unified approach enables suppliers to build a powerful risk mitigation strategy, insulating them from catastrophe in the face of operational failures in portions of their supply chain. Says Mr. Szygenda: "We wanted [the vendors] to see that this wasn't just good for GM, it was good for them and maybe the IT industry."

• **Increasing Sophistication.** It has taken years for outsourcing to grow up. Analysts have long predicted that outsourcing would evolve beyond the commodity services that have been its bread and butter and into areas that are more critical to the global success of customers. But through the 1990s, the outsourcing industry was fairly stable, dominated by large North American and European players — Accenture, ACS, Capgemini, EDS, IBM, and a few others — focused predominantly on information technology. The industry came to be governed by mega one-stop-shop deals under which vast portions of the IT and administrative functions were bundled and outsourced to a single provider; a labyrinthine, rigid 10-year-plus contractual infrastructure; a measurement culture focused on cost rather than service levels; and shaky relationship management not always appropriate to the scope and demands of the engagement. This environment grew not only out of the suppliers' business model and cultural baggage, but also from the customers' own tendency to turn to outsourcing as a quick-hit panacea to reduce short-term costs, and a belief that contractual complexity enabled greater customer control.

Meanwhile, a quiet revolution was occurring abroad. Fueled by the Internet, plummeting telecommunication prices, government incentives, and growing awareness of the cost advantages and abundant skilled labor pool in India, offshore BPO made its first forays into Western enterprises on two fronts. First, a select group of companies, including General Electric, American Express, and British Airways, set up their own offshore units for processes such as customer call centers, back-office administration, and systems development. Second, a handful of Indian providers, including TCS, Infosys, Wipro, and Satyam — seeing opportunity in extending their service offering and aware of companies' growing appetite for cost reduction — began to expand beyond IT into the same areas of work that the privately owned captives were engaged in. Along the way, their investments in systems and scale began to pay off, and the case for BPO grew to encompass not just cost advantage but also increased quality and effectiveness. As Mr. Cannon-Brookes put it, customers saw that BPO could "take your mess for less, transform it, run it, and add real value."

Other companies soon began implementing their own comprehensive outsourcing arrangements. In 2003, Procter & Gamble contracted its IT processes to Hewlett-Packard, its HR services to IBM, and its facilities management to Jones Lang LaSalle. Each of these engagements has yielded improvements in service and efficiency. "We thought we were doing good work by any standards, but the rigor and the quality of the measures in a commercial partnership are on a completely different scale," says Filippo Passerini, P&G's chief information officer. "Our partners brought a whole new level of methodology and discipline to the process."

The menu of BPO offerings continued to expand. Sophisticated end-to-end services are now available in human resources, finance, and procurement, along with such forward-looking offerings as analytics, advanced customer care, and innovation. (See "Innovators without Borders," by Kevin Dehoff and Vikas Sehgal, *s+b*, Autumn 2006.) Many companies use BPO as a springboard for building capabilities in knowledge process outsourcing — a subset of business process outsourcing requiring a much higher level of expertise in such areas as product development, clinical trials, research and analytics, media production, and animation.

Over the last few years, new suppliers with nothing to lose and everything to gain — and, consequently, a mind-set that is more attuned to customer needs — have entered the fray. Pushed by buyers to demonstrate business value, service providers are building robust, highly tailored offerings that deliver economic, strategic, operational, and human resources benefits. Further, they are differentiating their offerings in some cases based on industry expertise. Within industries, service providers are standardizing business processes to meet customer demands for cost savings, as buyers now refuse to pay the 10 to 20 percent premium for tailored processes. This standardization is setting the stage for the proliferation of one-to-many solutions.

• **Consolidation of Suppliers into Two Primary Business Models.** Although the mix of supply options is still in flux, two types seem likely to prevail in the end: large, full-service vendors (Tier One firms) and specialist vendors (Tier Two firms) that serve niche markets, such as animation production houses for media companies. Because Tier One firms work on a global scale, with multinational clients and immense resources, there is not room for many of them. "When we started this business 12 years ago, there were 700 or 800 firms in India that had the same idea," says Francisco D'Souza, COO of Cognizant, a leading U.S. provider. "Today, there are four Tier One firms. That's just an artifact of a maturing market and of the importance of scale."

As the Tier One firms standardize their business processes and evolve their contractual practices, they will increasingly seek to help their customers transform their operations through outsourcing — with decisive impact on customers' processes, management approaches, and outcomes. Mr. D'Souza is convinced that this evolution offers a significant opportunity to engage more deeply with his clients: "It's not about delivering technology solutions. It's thinking about how we make our customers' businesses stronger at the end of the day. As a part of that, we've made a big effort to build within our teams experience and expertise about the industries that we serve. We want not just technologists, but technologists who understand, for instance, financial services, health care, or retail. Ultimately, everything you do needs to impact the top line or the bottom line or the cycle time of your client."

There are many barriers to this goal in the short term, including the providers' own relative lack of experience, but eventually such an approach could become the dominant method of the most successful players. Rather than task-based or time-based billing, "value-differentiated pricing is going to be very key," says Subramanian Ramadorai, CEO of TCS, one of India's oldest and largest outsourcing providers. "If I can improve the efficiency or performance of your process, we can structure a deal that benefits both of us. For example, if we automate a manual process — create a design model based on a CAD drawing into which you can simply enter your parameters — we can both share the savings." Further, Mr. Ramadorai would like to develop new services in partnership with clients. "We'll be able to charge for the intellectual property we help create, provided we can quantify the benefit to the customers," he says.

• **Interoperable, Commoditized Services.** At the same time, the market will evolve to become significantly more accessible. Or so predicts A.R. Mullinax, executive vice president of Duke Energy Business Services. He envisions outsourcing eventually resembling a utility computing model, where services are purchased à la carte, as needed, without costly up-front investments and transition times. "Instead of having to go through the formality of sourcing contracts with long, fixed terms, we'll buy services as one-time hits. It'll be more like a competitive retail market for commodities," says Mr. Mullinax. "Five years from now, customers will be able to say, 'I just want a commodity accounts receivable billing service.' That doesn't exist today. You have to go through a big contract or you've got to get the software and your own computer." In the future, instead of committing to a five- or 10-year agreement for accounts receivable services, customers will be able to plug into the service for short-term needs. Before this can become a reality, however, companies will need to let go of their proprietary processes and systems, and vendors will need to build capabilities and scale around a common set of standards.

Challenges and Caveats

Outsourcing is now entering a transitional period in which the most sophisticated suppliers and customers will shape the structure of the business-to-business service environment around the world. Every business, large or small, will eventually be plugged into this network of interoperable, interwoven processes. Tapping this network will be an absolute requirement for success. Not plugging in will cost a company its competitive edge.

To be sure, a number of challenges will inhibit the industry. These include credibility: Vendors will still need to convince would-be customers that they are capable and reliable, particularly for more knowledge-centric work. They will also need to reassure customers that sensitive information is safe in their hands. Says Leonard Liu, CEO of Augmentum, a supplier based in Shanghai: "It's a problem that can be managed. We have a very stringent security system. But more important than that — the really, really important thing — is the culture. We must have a culture of high integrity, ethics, and discipline, so our people will not misuse our customers' intellectual property."

There are also profound implications for work-force management as the key differentiators change from cost to quality and service effectiveness, the offerings shift from simple transactions to higher-end segments of the value chain, and the delivery model moves from local to global. The business model of the future, with vendors serving as extensions of a company's internal work force, and the need to manage a standard and interoperable business model globally, will require a clear labor sourcing strategy along with global training and knowledge management programs. It will also require a focus on such intangibles as cultural alignment across several dimensions, including the customer's business culture and goals, the customer's own customers, and the cultural norms of each country that the supplier serves. The longer-term direction toward transformational outsourcing will also drive vendors to invest far more heavily in people who oversee the customer

Progress Report: Smaller Businesses Extend Their Reach

by Chris Disher, Arie Y. Lewin, and Carine Peeters

Offshoring, having blossomed in the run-up to Y2K, when companies turned *en masse* to Indian programmers to ward off a catastrophic systems crash, is still a relatively recent phenomenon. But an ongoing study by Booz Allen Hamilton and Duke University's Center for International Business Education and Research (CIBER) has found that the practice of outsourcing business activities across international borders already displays some distinctive characteristics.

Offshoring is evolving through three distinct phases, according to the study. In the first phase, it is used by clients as a tool to capitalize on lower-cost overseas labor; in the second phase, it is focused on broader savings through the redesign of entire business processes, like accounting and human resources; and in the third phase, it seeks to create value, innovation, and growth. The three phases are not necessarily discrete; they can coexist as a company gradually formulates its overall outsourcing strategy.

Until recently, offshoring was mostly the province of large corporations. In early years, offshoring deals typically involved long-term commitments, replete with complex (sometimes byzantine) contractual and administrative obligations, which put them outside the reach of most smaller companies. But as reducing expenses gives way to value creation as a motive for offshoring, and contracting arrangements become more flexible, smaller companies are jumping in as customers. Among the 157 companies surveyed by Booz Allen and Duke CIBER, the rate of new offshoring engagements is expected to rise 27 percent among Forbes 2000 corporations and 57 percent among small and medium-sized businesses (those with fewer than 500 employees). More than half of those smaller businesses' outsourcing engagements involve engineering, R&D, and product design; nine-tenths of them are viewed as growth strategies. In other words, most smaller companies that are offshoring operations are doing it to extend their capabilities rather than to reduce costs of existing operations. For them, offshoring is a growth strategy.

Among the study's other findings:

- Although traditional IT and contact centers remain the most frequently offshored functions, nearly one-third of all implementations are related to product development (engineering services, R&D, and product design). (See Exhibit 1.)
- Most firms with only one offshore implementation turn to Indian providers. But as the number of implementations climbs, companies tend to spread the work across the globe. (See Exhibit 2.)
- Few organizations are practicing third-phase offshoring. Companies experiment first with subcontracting simpler low-value activities such as invoice processing before moving on to more complex and higher-value work such as product design.

These findings will certainly morph over time, as the outsourcing industry continues to develop more sophisticated offerings and evolve its business models to become more accessible to companies of all sizes. Launched in 2005, the Booz Allen–Duke CIBER study is the first ever to track the complete range of offshoring activities — including IT, business processes, engineering, and product design — across a broad array of industries, including financial services, manufacturing, technology, computer technology, media, software and programming, energy, defense, and automotive. Booz Allen and Duke CIBER continue to collect data on companies in all phases of offshoring: those that are doing it currently, those

relationship and steer the ship — project managers and account managers.

Labor sourcing, in particular, is a growing challenge. The battle for talent has become intensely competitive in China, India, and other emerging markets. Finding and retaining the right people, especially highly educated employees with the skills to take on complex assignments, is the biggest headache for most service providers, especially in the face of burgeoning demand. "We were very clear we were not going to grow too rapidly in the first two years," says P.V. Kannan, CEO of 24/7 Customer, a leading Indian BPO provider with relatively low churn rates. "We controlled growth until we understood how to scale without losing quality. Our biggest focus was developing a process for taking new employees who didn't know anything about call centers or claims processing and making them very competent in a specified time period." That discipline has paid off; 24/7 is now one of the most highly regarded outsourcing players, with 100 percent yearly growth since its that are contemplating it, and those that have decided not to do it. If you would like to participate, contact the project director, Jeff Russell: jrussell@duke.edu. To learn more about the study, visit https://offshoring.fuqua.duke.edu/about.jsp.

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Exhibit 1: **Product Development Outpaces Other Functions**

Companies offshore IT and contact centers more than they do any other single kind of activity, but when considered together, the functions related to product development — engineering, R&D, and product design (light blue below) — are most likely to be offshored.

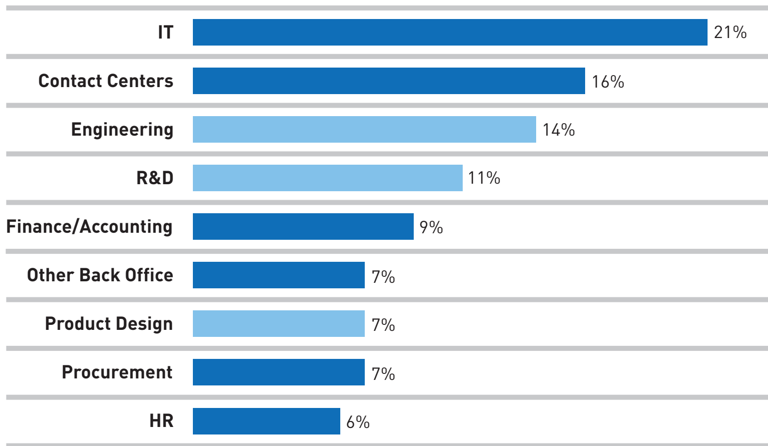
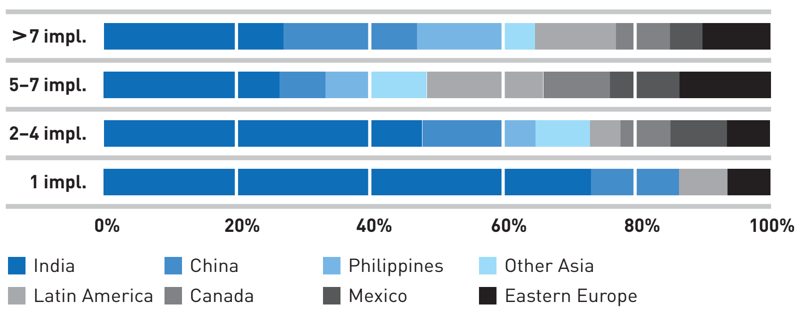


Exhibit 2: **Spreading the Work**

The greater the number of offshoring implementations a company undertakes, the more likely it is to send its work to a variety of countries. For companies with one implementation, 77 percent are located in India. For companies with five to seven implementations, only a quarter are in India.



Source: Booz Allen Hamilton and Duke CIBER

founding in 2000 and exceptionally laudatory service rankings from its customers.

Mr. Kannan's concern does not stop at 24/7's walls. He also expresses interest in improving the Indian public education system. "We are talking to competitors about various education proposals. For example, can we just make all our training materials open source? Can 24/7 contribute some of what we've learned about quality for everyone to use as a basis for training?" he asks. "How do we create a talent engine?"

Masterful Customers

For most users of outsourcing services, successful design and execution of an outsourcing plan is extraordinarily difficult to pull off, especially when the processes make use of several companies with separate global supply chains and footprints. But it's possible to do it right, especially given the fundamental power shift in the outsourcing market. The customer is the new king. As global buyers have progressed along the learning curve, they have gained the knowledge and buying power to demand service excellence and significant cost savings from providers. Insights from the leaders we consulted, along with our own experience, suggest that there are five requirements for any company embarking on an outsourcing strategy — approaches that are indispensable to successful execution.

1. Commit from the top and move quickly. Like any transformational initiative, outsourcing requires explicit resolve from senior management. Outsourcing efforts tend to involve multiple functions — many that are decentralized and owned by autonomous divisions — and carry significant implications for spending and for individual staffers. They are thus vulnerable to internal resistance, and senior management's unequivocal support is essential. Top-down determination can help sweep away much internal resistance. At TXU, Texas's largest energy utility, C. John Wilder set the tone and paved the way for success. "Our chairman and CEO said, 'We're going to move from concept to reality without delay,'" recalls Kris Hillstrand, chief information officer. "This wasn't an exercise in 'I wonder if we should do this.' It was an exercise in 'We're going to get this done.'"

For companies that have decided to move forward with an ambitious outsourcing arrangement, the most successful programs are enacted quickly. P&G completed its deal with Hewlett-Packard in only five months. "We had the critical junctures of the deal process scheduled down to the day, down to the hour," says Mr. Passerini, P&G's CIO. "I learned a lot of things in that process. For example, large meetings with a lot of people are inefficient because they dilute accountability. For the HP deal, which was very complex, we held well-organized, all-day meetings in which all the key players — 70, 80, 90 people — would call in or come by at appointed times, participate, and then move on. That enabled us to make 30, 40, 50 key decisions in a single day and not bog down the process or the people involved."

Aside from its operational and cost virtues, executing swiftly and deliberately sends an unmistakable message of resolve. "The biggest risk of all is indecision," says Duke Energy's Mr. Mullinax. "Know what your strategy is as a corporation, align with it, know that you're accountable for delivering it, and then make some decisions and move forward."

2. Understand why you're doing it and articulate the reasons clearly. It is far easier to get people to mobilize behind a potentially controversial initiative if the business reasons for doing so are clear. Some executives can spin a great story at first, but can't get others to follow through because the executives don't seem to believe it themselves, or they contradict it with halfhearted, "flip-flopping" decisions. The decision to outsource must have a compelling business rationale. Management must have an acute grasp of what the company is trying to achieve — cost reductions? optimized processes? better service levels? more for less? innovation? — and keep these priorities in mind as it evaluates options.

Equally critical, the outsourcing decision should be based on a business case that is built on hard analysis. Without a granular understanding of the underlying costs, both tangible and intangible, of each process, a precise grasp of the potential benefits is nearly impossible. No one will really know what constitutes success, and such uncertainty can lead to evaporation of senior and line management support. At TXU, "we worked hard to establish our baseline operating costs with real accuracy," says Mr. Hillstrand. "Our finance folks had to assemble, disassemble, slice, dice, understand overheads and allocations and all of the components of cost associated with a large component of the business. Then they had to articulate it crisply, in a way that could be consumed by the third-party providers. Getting that baseline straight was a very intense and important effort."

3. Be partners, not just customers. Many companies try to manage service providers not as partners but as virtual lackeys, negotiating them down to prices that are unsustainable over the long term, holding them to encyclopedic contracts with impractical service-level and reporting commitments, and micromanaging the process of service delivery beyond the point of usefulness. This approach is fundamentally misaligned with both the basic objectives of an outsourcing arrangement and the realities of the new, more complex outsourcing world. When relationships between the parties focus primarily on the transaction, with each side seeking the better deal, the result is often antagonism; even when the relationship remains amicable, it is not conducive to long-term success.

By contrast, executives who have gotten the greatest benefit from their broad outsourcing arrangements have built relationships of mutual trust with their vendors. "You have significantly less control than you would have with people reporting directly to you and salary management control, performance reviews, and other tools at your disposal," says Mr. Passerini of P&G. "This new model is more challenging, and more demanding to manage, but it is significantly better for our business."

Outsourcing customers place an extraordinary

Enlightened outsourcing customers rigorously manage the outcomes, not the inputs. That frees up the provider's thinking.

amount of knowledge — and faith — in the hands of service providers. They entrust vendors with critical business processes, sensitive data, proprietary business knowledge, and even basic control over implementation and ongoing quality. "If you're going to outsource a service, you must turn its delivery over to the supplier rather than use them as a body shop; you have to focus only on putting the proper processes in place to monitor how they're delivering," says Ray Mohundro, former CIO of Innovene.

Enlightened companies have figured out how to strike the right balance between rigor and flexibility, so that they don't micromanage but also don't "turn over the keys" to the outsourcer. They rely on such mechanisms as governance structures with clearly defined decision rights — agreed on in advance by both parties — from the executive level all the way down to the day-to-day users of the service. In addition, service-level agreements, performance dashboards (which deliver live data from the suppliers), formal business reviews, and rewards and penalties for meeting or falling short of service levels all help to minimize surprises. These companies rigorously manage to outcomes (the "what"), not to inputs (the "how"). That frees up the providers to bring invaluable new thinking into the process. "We didn't tell the companies where to move people and how they were required to meet our needs in various places throughout the world," says Mr. Szygenda of GM. "They had to come up with innovative ideas, and they were able to do that. Not having that requirement internal to GM let us move unbelievably fast."

An outcomes-based approach takes much of the administrative burden off the shoulders of the customer, and providers are often better equipped to deal with those burdens. "As it turns out, the market does a better job configuring itself than we would have," says Mr. Hillstrand. "When the market configures itself to your scope, the configurer owns the seams and that's desirable." For example, when Capgemini subcontracted certain facets of its TXU work, the provider did a much better job, in Mr. Hillstrand's view, of shaping the subcontracts than TXU would have.

4. Embrace complexity and learn to manage it. Outsourcing was once a fairly simple affair: Pick from a fairly limited menu of options (IT applications and infrastructure, payroll, accounts payable or receivable, benefits administration, basic customer support), frame up some RFPs, send them off to a few big vendors, negotiate a 10-year deal, and get through a predictable, often painful transition period.

No longer. Complexity has crept in on every front: the number of vendors, the number of countries from which they can deliver services, delivery models (onshore, nearshore, or offshore), and the sheer scope of offerings have all expanded considerably over the last few years. So has the variety of commercial and contractual models (Will risks and gains be shared? If so, to what extent? Will it be a bundled deal with a single vendor or a best-of-breed partnership with a network of multiple vendors?). In addition, the industry thinking is evolving, calling into question many so-called best practices, such as signing long-term deals, building offshore captives, and sourcing multiple functions or processes with a single vendor to maximize leverage. These apparent complexities and increasing degrees of freedom have added to the overall confusion, and erected an intimidating barrier to entry for companies that have little experience with outsourcing.

But this complexity can work to the customer's advantage; it translates into greater choice, and thus greater customer empowerment and better results in the long term. Although the emerging best-of-breed model implied by the larger field of choices may mean more up-front work prior to the deal, and more management complexity afterward, it will almost always result in an outsourcing arrangement that is well adapted to the needs and characteristics of individual customers. And industry leaders are harnessing this complexity to their advantage.

GM, for example, announced in February that it would split its $15 billion contract for information technology services among a number of providers — EDS, HP, IBM, Capgemini, Covisint, and Wipro — to encourage competition, to decrease risk exposure, to increase competition, to take advantage of offshore pure plays for discrete activities, and to challenge providers to address the automaker's needs. GM also slashed the contract term from 10 years to five years to shield itself from long-term financial risk, improve management of outsourcing deals, and ensure more accountability from outsourcers.

To manage multiple sourcing contracts without spiking budgets and creating suffocating bureaucracy, companies are becoming more adept at managing the multiple delivery models, pricing structures, and business metrics contained within multiple vendor relationships. They are installing centralized vendor management functions with talented personnel who are skilled at overseeing strategic vendor relationships, monitoring vendor performance, ensuring compliance with service-level agreements, and keeping vendors abreast of evolving company strategies and priorities.

5. Be a visionary. As outsourcing becomes increasingly strategic, so too must the role of the business leaders who control IT and business process outsourcing. The new generation of outsourcing leaders is always thinking beyond the boundaries of their own function and, in some cases, even beyond the boundaries of existing market capabilities. They wear two hats: that of the functional leader who is accountable for excellence in service delivery; and that of the senior enterprise leader who sees how this vibrant new market of innovative services can solve the broader business's most pressing challenges.

In many instances, visionary business leaders are helping shape the market for future growth. GM's Ralph Szygenda was instrumental in driving several vendors to globalize their capabilities to meet one of GM's key requirements — a worldwide delivery model. He says, "I talked to the CEOs of the IT companies and I said, 'Hey, I've got this problem. Not only is this an issue for GM, but you're impeding the growth of your own business. Every time you go into a new engagement, you're reinventing processes to run your business. And by the way, hardly anybody's going to use one IT company ever again, given significant off-the-shelf products, ubiquitous telecommunications, and integrated IT services. So now why don't you make it easier for customers, from an integration viewpoint?' I urged them to build the foundation, to do the fundamental process work to standardize collaboration across their businesses." Mr. Szygenda's efforts encouraged GM's outsourcing partners to retool their businesses for the long haul. He helped them understand the evolving needs of major clients, and together they created fungible processes that the partners could in turn offer to other clients.

Similarly, P&G enabled its suppliers to enhance their offerings. According to Mr. Passerini, "for all three of our suppliers, our business was not flat-out outsourcing. It was a way for each to build internal capabilities to go to market. For example, HP had declared that they wanted to move into the IT business services industry. P&G's business gave them instant credibility in the market. IBM already was strong in IT outsourcing, but wanted to move into HR, so they created their HR division, acquiring our world-class assets, people, processes, and systems. Jones Lang LaSalle already was working in facilities management, but it was not as multinational as we were. So the P&G business gave it an instant global footprint." Clearly, only the largest multinationals have enough influence to shape the vendor base. But the implicit point holds for any customer: Don't settle for the market's status quo. A proactive approach might just pay off in services that can transform your company.

Mr. Szygenda, Mr. Passerini, and the other leaders we spoke to are learning to take calculated risks that lead to significant upgrades in efficiency and quality. They all have developed what Mr. Passerini calls "a completely new set of skills" for dealing with a strategic tool that constantly shifts shape. "The world is no longer about monolithic integration of businesses. It is about agility, responsiveness, flexibility, and, more and more, working within a network. So we really had to learn how to operate in a networked business," he says.

Integral to that new set of skills are the ability and willingness to look beyond the "core functions" — traditionally the partition that separated indispensable competitive advantage from transactional services — when considering what activities to outsource. In recent years, the notion of what functions must stay in-house to maintain a company's competitive edge has become far more fluid. Industries such as financial services, pharmaceuticals, and consumer electronics have led the charge by outsourcing such "core" areas as product development, market research and analytics, advanced customer care, and clinical trials.

"You must always focus on what it is you're in business for," says Mr. Mullinax of Duke Energy. "We're a utility business. We generate and deliver power, and we collect for the services; we move natural gas. We make our money by having very reliable service and having the expertise to deal with the regulatory bodies. Everything else behind that is a service that you can source in a variety of ways."

Like Mr. Mullinax, Mr. Hillstrand of TXU rejects the standard core-versus-noncore dividing line. "I don't think we'd impose any artificial limits" on what to outsource, he says. "Every time we look at our business, we look at it with an eye to making it better. Do I think that we're married to our own steel? Or that there are certain things that we simply would never let go of? Not necessarily." He is always searching for better ways to serve TXU's constituents. "We don't hesitate to look at the tools that are out there, whether that's development of joint ventures, disposition of assets, or reconfiguration of businesses into a synthetic arrangement of ourselves and best-in-class providers to achieve a financial and operational outcome that's really desirable to us." This attitude is integral to the "distinct competency around outsourcing" that Mr. Hillstrand says TXU is developing in its leadership.

Over the past few years, academic researchers like Charles Handy and Shoshana Zuboff have written about the deliberate design of "flat" and "networked" corporations. But ironically, it's the rough-and-tumble world of Asian and emerging-nation outsourcing providers that has created actual networked businesses as a model for the future. There's a growing awareness that, despite the potential pitfalls, outsourcing has become the *sine qua non* of the successful global corporation. "Every day some part of our business — and this is an evolving discipline for TXU — is asking itself, 'Are we the natural owner of function X?'" says Mr. Hillstrand. That kind of continuous self-examination may ultimately turn out to be the most significant aspect of the new outsourcing — and potentially the gateway into yet another, still more sophisticated wave of virtuoso activity. ✚

Reprint No. 06304

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