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“Outsourcing – Pitfalls, Pratfalls & (Possibly) Profit”

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Abstract

The purpose of our article is to put forward a number of lessons we have learned from various case studies which can be used to better enable those responsible for making outsourcing decisions. In doing so, we intend to identify a number of challenges and pitfalls that usually threaten the successful outcome of outsourcing initiatives. Lastly, we will have a look at some of the trends we are observing, presently, in the field.

Increasingly stringent pressure on cost optimisation, innovation and *leanagility* have driven companies of all sizes and industries to look at out-sourcing parts of their business 'operate' , support and management processes. Globalisation, relaxation of international trade policies and continuous development of physical and digital infrastructures for transporting goods (material and/or data) have enabled the same companies to choose from a variety of outsourcing models, from domestic and captive outsourcing to off-shoring, 3rd party outsourcing and a variety of possibilities in between.

It is unquestionable that outsourcing, whilst probably being one of the fastest growing business practices of the century, is also one of the least mature. The body of knowledge is poor and scattered in various fields. Theory and practice tell different stories. Practitioners, as well as scientists, are left wondering what to make of both the success and failure stories present on the web, in the media and in literature. The public is split between those who strongly support it and those who see it as the cause of failure of the economies of western States. Actually, these authors have contrasting views too.

Therefore, it is not the aim of this article to make a case either pro or anti outsourcing/off-shoring. Instead, we acknowledge that outsourcing is happening, is inevitable and that it will continue, and we share a number of lessons we have learned that can lead to defining a better informed sourcing strategy. We have purposely decided not to focus on one process (e.g. human resources outsourcing) or industry (i.e. manufacturing versus service) or model (e.g. outsourcing or off-shoring). On the contrary, the lessons shared here are valid regardless of whether a business is outsourcing production to China, call centre services to India, transport to a neighbouring 3PL business or, indeed, is pondering the benefits of keeping everything in-house.



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Introduction

Part of the success of ancient Rome can be attributed to the distribution of free bread to every member of the populace on a daily basis. To achieve this feat for a city of 4.4 m. people in the first decade AD was unparalleled. It goes without saying that the authorities could not grow the wheat required to achieve this distribution in Italy – so they outsourced it.

Actually they conquered North Africa, not then covered by the Sahara but rather lush corn fields, and imported the grain they needed from Libya (where far inland the harbour rail system can still be seen at Leptis) and from Egypt.

THE “classic” example of effective outsourcing.

Sadly, in the chaos that followed during the next couple of thousand years this excellent idea was completely forgotten – apart from the small time efforts of medieval “manufacturers” to pay pennies to workers to produce goods in their own homes rather than build larger premises themselves. This piece work process continued well into the nineteenth century when the construction of large textile factories and other massive manufacturing enterprises brought the majority of workers into one location to provide economies of scale post the Industrial Revolution.

We agree with Rob Handfield in a “Brief History of Outsourcing” that the model, from the mid nineteenth century to the late twentieth, was that optimum profit and Return on Investment (ROI) came from hands on management and control of large, integrated companies where all operations could be directly commanded from a central headquarters function.

However, in the late 1980s a change occurred. Businesses, who had always considered themselves to be self sufficient (even though this was far from the truth as many had always looked outside for certain non-core services), had to drive for a greater competitive edge. This entailed seeking a means to reduce costs across the breadth of the operation and thus was outsourcing, as we know it today, brought into the business equation.

In this article we discuss the development of “outsourcing” and its known pitfalls, and suggest a number of lessons that can help you avoid, or anyway be prepared for, the risk inherent in this business practice. We give examples of businesses who have, in our experience, built their castles only to tear them down in short order, those who are perceived to have succeeded and those who have manifestly failed. We challenge the perceived order by comparing theory with practice and we try to present a realistic view of the most effective way to outsource for any business type.

In the pages to follow, we are going to use the term ‘outsourcing’ loosely to refer to that strategic decision of a business to stop doing ‘something’ (i.e. activity, process, function) in-house and to start sourcing that ‘something’ from outside the four-walls of the organisation. The several examples provided will hopefully show that the lessons we present are transferable and applicable to most industries, sectors and businesses.



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Outsourcing 101

In this section, we aim to provide a basic theoretical underpinning of what is, today, commonly known as “outsourcing decision making”.

Regardless of whether we are based in Edinburgh, Milan or Delhi, we operate in a global market and we interact with a number of people, businesses and geographies to deliver the service or make the product we are set up to supply. Key to success is the ability to both source for these various “relationship” and manage these global networks.

As such, sourcing is a process that affects every business in every industry in every sector.

It is not limited to manufacturing and it is not limited to services. Although one could certainly say that, as a modern-era business practice, outsourcing was adopted first in the manufacturing sector and later got incredible and increasing attention when it started to be adopted in the service sector as well.

There are two main reasons for the spiralling attention given to the topic: firstly, when ICT and logistics infrastructure were good enough to start delivering services from India and/or supplying products from China, we started to see job losses in our domestic markets and the media picked up the bad stories immediately. Second because that coincided with the fall of the Berlin wall, the opening up of the Indian and Chinese markets and a generally more intensive global exchange of goods and services which eventually led to the situation we find today, a position where everybody is worried about their job and whether we will actually have a job in the future at all.

The Outsourcing Tower of Babel: understanding the meaning of terms

One of the effects that this rapid development has had is the creation of an incredible confusion over terminology. As if having tens of different terms was not bad enough, what's even worse is that, depending on the experience of whoever one talks to, you will meet different people who will use the same term with a different meaning.

Broadly speaking there are four groups of terms which you will come across most often:

1. Group A focuses on the *geographical dimension*. For example: off-shoring, near shoring, global sourcing, international sourcing, etc.
2. Group B focuses on the *sourcing structure*. For example: multi-sourcing, co-sourcing, home-shoring, etc.
3. Group C focuses on the *strategic versus tactical aspect* of sourcing. For example, purchasing refers to the operational act of buying, whereas strategic outsourcing refers to the strategic decision of sourcing from outside your own organisation.
4. Group D: focuses on the process or service being outsourced. For example ITO (IT outsourcing), KPO (Knowledge Process Outsourcing), BPO (Business Process Outsourcing), HRO (Human Resource Outsourcing).

Trying to reach a wide consensus over a set of accepted definitions would be a waste of time. Considering that language is defined as the set of words used and understood by a



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community, for the sake of this article and of the community of you, the readers, and us, the authors, let us provide our own definitions so that we can understand each other:

Outsourcing Jargon

We start by defining '**Sourcing**' as the simple act of obtaining something from a source.

Clearly, '**Outsourcing**' then becomes the act of obtaining something from a source which is outside the physical boundaries of the sourcing organisation.

We can then define '**Strategic Sourcing**' as the decision of a business to review the impact of obtaining a resource, a product, or a service from another source.

'Strategic' underlines the importance of analysing the impact of such a decision on the long term strategy and sustainability of the business. In this regard, sourcing is different from procurement and purchasing. Our way to distinguish between these is to look at:

- The decision's time-based impact on the business and
- The amount of information available to make such decisions.

Sourcing decisions are most likely to impact the long term shape of business. These will, most probably, have an impact on the manufacturing strategy, the HR strategy, the facility management strategy, etc. Thus they are capable of massively impacting the business. Furthermore, at the time of making such decisions, there is significant uncertainty around the supplier, its location, the selection procedures, and so on. Taking these issues together makes it absolutely vital to review this decision making process periodically.

'**Procurement**', on the other hand, is looking at the medium term. Typical procurement decisions are, for example, related to how suppliers are selected, how we monitor our contract progress, etc. Again, information here cannot be 100% known and a rule of thumb is that you will review these decisions twice as often as strategic ones.

Last, '**Purchasing**' decisions are related to the act of buying something from somebody. At this stage, you usually have all the information you need about the company policy (which has been defined during the procurement strategy exercise) and about the supplier at hand and you re-evaluate your decision on a case by case basis.

Finally, we use '**Global Sourcing**' as strategic outsourcing on a global scale and it implies looking at ways to exploit global opportunities to gain a specific competitive advantage, be that cost, access to new resources, access to new markets, coping with the actual financial crisis and so on.

Theoretical Underpinning

From the 1940s to the 1990s, several attempts have been made to formulate theories that could explain why and how a company should consider this question. We are now going to review the two most often quoted theories in this area: the *Transaction Cost Theory* and the *Resource Based View* or *Capability Theory*.

For various reasons, experience has proved that neither one of these two theories is capable of providing universal guidance to decision makers, i.e. they don't always lead to the right



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answer. Unfortunately though, since the early 90s we have not seen any significant improvement of these theories and neither have we seen any development of new theories.

As a matter of fact, nowadays, knowledge regarding this topic is mostly generated by industry for industry by means of case studies and anecdotal success or failure stories.

Transaction Cost Theory (TCT)

The basic concept behind TCT is that *any contract intended as a market transaction between two entities, can be defined or explained or investigated looking at the cost of that transaction as opposed to an alternative.*

The TCT analyses interactions between two assumptions on how we, as people, think and behave, namely *bounded rationality* and *opportunism* and two assumptions on the characteristics of the transaction, i.e. *asset specificity* and *uncertainty*.

- Human Nature Assumptions:
 - *Bounded rationality* basically indicates that we as human beings are mostly rational but our rationality is limited and therefore we sometimes act irrationally. Take a very simple example: you know that every time you drive too fast you are likely to get a fine. Rationally, as an intelligent human being, you should know not to speed. In reality, when you are driving home on a Friday night after a way too long un-planned meeting, you make the irrational decision to speed on your way home. Same thing applies in business.
 - *Opportunism* refers to the fact that, in certain situations, as humans, we tend to do whatever it takes (within certain limits) to achieve our objectives. Sometimes, we take calculated risks such as copying at a written exam or cheating our partners. These particular behavioural assumptions have a particularly important impact on business relationships. In global supply chains it is impossible for the various businesses to plan in advance for opportunistic behaviours on the part of one or another member in the network. Making decisions in this situation clearly becomes complicated.
- Transaction Nature Assumption:
 - *Asset specificity*: transactions, on the other hand, should be looked at from the point of view of what would happen if you transferred your assets (*asset specificity*) to an external supplier. The more specialised the asset, the riskier the market transaction becomes by comparison with keeping it in-house
 - *Uncertainty*: surrounding the transaction, for example not knowing the partner or not knowing how the political situation will affect the business were we to decide to move our production to India.

In conclusion, according to the TCT, answering the make or buy question becomes an issue of efficiency depending on the characteristics of the transaction. As a general rule of thumb for low asset specificity and uncertainty buying is a good option, whereas the more specific the asset and the more uncertainty, for instance, the behaviour of our partners, the better it is for us to make.

Resource Based View (RBV) and the Capability Theory

The fundamental principle of the RBV is that *the basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm's disposal.* A firm is therefore seen as a bundle of "valuable resources".



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To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile. Effectively, this translates into valuable resources that are neither perfectly imitable nor substitutable without great effort. If these conditions hold, the firm's bundle of resources can assist the firm sustaining above average returns. More precisely, resources are defined as:

- *Valuable*: when they enable a firm to conceive or implement strategies that improve its efficiency or effectiveness
- *Imperfectly inimitable*: because of a combination of three reasons: unique historical conditions, causally ambiguous and socially complex.
- *Rare*: as opposite to valuable resources which are possessed by large numbers of competing firms and which, therefore, cannot be sources of competitive advantage
- *Non-substitutable*: indicating that there cannot be strategically equivalent valuable resources that are themselves either not rare or imitable

In conclusion, based on the capability theory, having resources which are valuable and rare can lead to short term competitive advantage. However, to ensure long term competitive advantage your resources need also to be inimitable, non substitutable and immobile.

As a general rule of thumb, you should 'buy' if you neither have these resources in house, you cannot develop these resources in-house nor can you acquire these resources in-house. In any other case, you should invest in keeping the process in-house (i.e. 'make').

Does the theory work in practice?

We all know that, in theory, everything is pretty much black and white. In business though, there are all sorts of colour variations and the conditions under which we find ourselves making a decision are not always as clear cut as the theory tells us.

In this section we therefore present 10 key lessons we have learnt over the years, working on numerous projects trying to put the theory into practice and, in so doing, learning its shortcomings and challenges.

Lesson 1: If it ain't broke, don't mend it.

Against any popular belief, outsourcing is NOT the answer to everything. This has to be said, as one of the issues that the authors have come across on a number of occasions is that companies appear to think that outsourcing is a panacea which will cure all ills.

Over the past few years, we have witnessed a general trend where companies would jump on the cost-saving bandwagon that off-shore outsourcing seemed to promise. First manufacturing companies (e.g. Italian companies moving their production to Eastern Europe first and China later) than service companies (e.g. UK service sector moving their call centres to India).

Just before the most recent financial downturn kicked-in, we were actually witnessing an inversion in the trend, with several companies bringing back in-house their outsourced processes. Why? To put it simply, because they realised that short-term cost savings translated very often in long-term loss of – very un-happy - customers.



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It is key in the process of deciding on an outsourcing strategy to understand where the business wants and needs to be over the long term. There would be little advantage to be gained from outsourcing payroll to a small local bureau who can service the current staffing levels if the business's growth strategy is to add 400 personnel in the next 2 years who will be based in Azerbaijan. The decisions have to support the business in achieving and maintaining long term goals. If you are intent on outsourcing then the solution must be scaleable and viable for the business going forward. Defining the strategy and choosing the providers accordingly is key to generating the desired benefits.

The immediate effect of outsourcing, particularly in the case of transformational outsourcing, (for example moving from in-house IT to outsourced or moving a factory from a high cost area to a lower cost economy) requires balancing the initial expenditure which, in some cases can be substantial (land purchase, building costs, moving production lines from continent to continent) against the potential long term savings. By taking this initial "hit" the business's long term sustainability should be assured if the decision to outsource is taken for the right reasons and at the right time.

We have seen examples, particularly in the healthcare sector where new factories have been built in South East Asia, production lines moved in their entirety from the United States and whilst the initial outlay had been factored in to the long term vision there have been some fundamental omissions. Firstly the additional time taken to transport finished goods from the new location to market as a result of increased distance, poor local infrastructure and unsuitable local transportation (old, unsafe trucks or rolling stock) proved more costly than expected. Secondly, the production line labour is cheaper but local management costs have been proved to be somewhat higher. Thirdly, companies have found customer acceptance of product manufactured in the Far East to be an issue. Finally, in this example, the lack of control resulting from language problems (including having to translate an ERP system for local characters as opposed to the Latin alphabet) were sufficient to bring into question the decision to move the factory.

The intention is good, the long term rationale is valid but the payback period can be considerably longer than was initially anticipated.

The Call centre industry is a further example of outsourcing leading to dramatic consequences when the focus is on short term savings and no importance is placed on considering the impact of the decision on long term customer satisfaction. Just a few years ago in the UK, we have witnessed customer service companies rushing their decision to outsource off-shore their call centres to India and the Philippines in an effort to exploit the large labour cost saving opportunities offered by the so-called low cost countries. We are now seeing how some of the same companies have realised that the short term cost saving turned their customers away. Several companies in the service sector are now building marketing campaigns designed to win back those customers who moved to the competition. A common slogan for a bank's TV commercial, for example, would quote something like: "Come to us and you'll speak to agents in the UK".

Lesson 2: If it's already broke, it's going to stay broke

Another effect of thinking of outsourcing as the silver bullet, is that many companies believe that if a process is fundamentally not working they will hand it over to the third party supplier sure that they will mend it.



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Sadly this is absolutely not the case. In fact the exact opposite is true. If it is broken it will stay broken and potentially get much worse in the hands of the supplier.

Outsourced processes need to be optimal when they are transferred to a third party.

One of our experiences in the market is of a company whose Logistics and Distribution processes were going from bad to worse as the company grew. It manufactured a premium product, was a sole supplier and had been an early adopter of manufacturing in globally diverse, low cost producing countries. However, its distribution, which it had handled itself, was deteriorating as the supply chain became increasingly stretched. It needed to be recovered, understood internally and revitalised before it was outsourced to a 3PL. However, management misunderstood its responsibility, did insufficient research into the methodology of its chosen supplier and merely transferred the responsibility for warehouse management and logistics to the 3PL.

The result was an almost unmitigated disaster, customers were lost as goods were not shipped on time or arrived not fit for purpose and the 3PL was held to blame. It was not their fault. Finished goods were collected at the factory gate by the 3 PL and warehoused and shipped to its customer's requirement. It had no visibility of the issues that were besetting the customer and it therefore shipped to the customer's customer on time and in full. It was the responsibility of the manufacturer to ensure that it addressed its internal process disconnects before it outsourced.

Thus a process which had over time become increasingly dysfunctional, but was almost manageable when the manufacturer could send out replacement items, from numerous sites, on receiving a customer complaint, broke down when a third party sat between it and its customer.

Whereas outsourcing can be an effective strategy in order to solve an internal inefficiency, the assumption must not be made that the supplier should be responsible for redesigning the process or service in order to solve the problem. The process should be 2-phased where, before the full process hand-over, supplier and customer work together to fix the problem.

Lesson 3: if you don't know where you are going, any road will take you there.

Having taken the decision, in principle, to outsource the most important next step is to examine the business and rigorously, if not ruthlessly, judge exactly what are the core competencies of the company that must be kept in-house. Conversely the more difficult decision is to be able to admit what are the non-core capabilities that can be outsourced. Further there may be core skills which should be and that is the hardest of all both to assess and to let go.

In order to reach the optimal outcome it is necessary to follow a rigorous and structured process, examining the many and varied areas of the business to undertake this assessment and the writers believe that this is best achieved with objective outside advice.

As a business leader is anyone prepared to admit, openly, that there are parts of the business that a specialist can do better? Having taken the decision to outsource one would expect that the answer would be yes but it is surprising to us to note that it may often be areas where the company is competent that are more easily delegated to a third party. We believe that



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this is often because the business does understand them and as a consequence believes that it can retain control, whereas if it turns over an area where it has less understanding it will be relinquishing it to third parties who can then "run rings round them".

It is a perverse theory in business practice but not in terms of human psychology.

The outsourcing process is not one to be undertaken lightly or quickly. Having decided on the business areas to be outsourced the company must consider the numerous options available and undertake a systematic process to examine each including thorough vetting of the various suppliers and their methodologies. One size definitely does not fit all in deciding on who is going to run a part of the business on its behalf. Hence we suggest that running feasibility studies based on such criteria as location, language, time zone differences and logistics amongst others are a key part of the decision making process. For example if the business is outsourcing its HR function the key decision is going to be based around the supplier's knowledge of local employment laws and tax regimens. Is one supplier based in the company's country of origin (and legal and financial reporting) going to be capable of managing a workforce spread across different jurisdictions? Experience relates that the answer is absolutely not. The supplier of choice for HR needs to be a multi national agent and it may well be that the associated costs charged by such a firm will outweigh the benefits of outsourcing this function.

By contrast a single supplier, based in a low cost economy, will be perfectly capable of running the company's IT requirements, managing everything from hardware, through databases, the ERP system down to day to day desk top support. Thus the questions to ask are much simpler. Does the third party have the knowledge and can it operate to suit the principal's working hours (e.g. does the supplier have a "follow the sun" support function?)

Outsourcing, as we have stated, is simply not running the particular function in-house. The key to success is deciding where it will be most effectively supplied from. It may be cheapest in the Far East but will the savings gained provide real value or create issues that it is difficult and expensive to address? Hence the requirement to stop thinking about simple outsourcing and start thinking about strategic outsourcing: conduct comprehensive and rigorous criteria to the requirements for each business area and each supplier to whom a business function is being outsourced.

Lesson 4: Don't put all your eggs in one basket

Following on from the example we have described above regarding the dangers of outsourcing broken processes and the need to adopt a low risk approach by addressing process issues prior to outsourcing we have introduced the topic of risk management. Not only is outsourcing not a panacea but there are bigger crocodiles in the river for those who do not adequately assess the risks inherent in "letting go". Whilst we can make a strong argument for outsourcing, in principle, (and as we have indicated the authors themselves are not in agreement on its intrinsic worth) there are real issues involved with failing to adopt a viable risk management strategy when considering the processes to be outsourced and the suppliers to be used.

As we discussed in Lesson 3 the type and location of the third party supplier is an essential factor to be weighed in the balance. However, a mistake which we have observed on a number of occasions is finding that supplier and then assuming that they can take over all the areas which the company wishes to source externally.



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Not only is this an extremely high risk strategy for the reasons we have indicated above but also it creates an unacceptable dependency on a single supplier. What happens if the third party ceases to trade, discontinues operating in certain countries or stops offering some of the services that the business is now dependent upon receiving?

Firstly, the customer is required to either bring the processes back in-house or find another third party. Both options are expensive, time consuming and have the potential to distract management and thus have a deleterious effect on profits and margins. Secondly, if it is a key process, such as distribution, the need to source a new supplier is so urgent that it places unacceptable pressures on the business resulting in the possibility of costly errors and lost customers.

We suggest an uncomplicated risk management strategy be adopted. The first rule is simply to choose various suppliers – in plain terms “don’t put all your eggs in one basket”. This should go some way to mitigating risk.

Secondly we recommend choosing suppliers not just for their capabilities (which should go without saying) but also taking into account their location. Outsourcing in multiple geographies may not be the cheapest option but it is undoubtedly the safest strategically. Further, as we have already stated, there is no gain in using a supplier that does not have the local knowledge required either fiscally or legally. That way despair lies.

The authors also believe that a multi-sourcing strategy means that the customer considers whether processes that it might prefer to outsource would actually be more sensibly kept in-house. At the least it is recommended that a company outsourcing e.g. its HR and Finance functions retains qualified representation within the company who can either verify the suppliers output and oversee/manage its personnel if necessary or in an emergency take the function back in-house with minimal disruption.

Lesson 5: Education, Education, Education!

One of the key issues that must be addressed, once the decision to go with any outsourcing partner has been taken, is the education process.

It is unquestionably a shock to the system!

It may well be that there is internal resistance and it is important to address the “fear factor” particularly as the move to a third party supplier may have caused job losses or redeployment of staff. As with anything new there will be resistance to change – human psychology is all too frequently forgotten in the name of profit. If the staff “back at the ranch” are not on board with the concept then the potential savings from outsourcing processes can be devoured by the cost of replacing and rehabilitating disaffected employees in the home office.

The stress needs to be on emphasising the positives to those staff and to that end introducing an effective education process both before the business areas to be outsourced are transferred, during the cutover and continuous improvement as the third party supplier takes the lead will be an aid to ensuring a smooth transition.



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We have already described the necessity to address any dysfunctional process prior to its being outsourced and this can be used as a learning within the business. **This is how we do it better and this is why we are outsourcing it.**

Whether the process is a back office function that is moving to a local bureau (HR, payroll, finance) or a move to manufacturing in a low cost geography the way that the third party communicates with the business will be different. The internal staff who will have dealings with that third party need to understand this whether it be as simple as a payroll query being handled via e-mail as opposed to running down the hallway to talk to Gianni. Staff need a program which sets out the new process and thus provides a comfort factor. They must learn how to communicate their issues and what sort of a response to expect. This can easily be simulated and simple one time courses set up at minimal cost.

For the man on the shop floor outsourcing is a sea change and if it is not well communicated it will not yield the expected cost savings. This is even more obvious with the move to overseas manufacturing and far more costly to the business if staff are not educated as to the why and the how.

It is more than likely that counterparts in the new geography and the home office will find there is a language barrier. The time zone difference will increase the psychological effects. The authors have witnessed, at first hand examples of staff coming to the end of their working day have difficulty in communicating with those for whom it is morning let alone the fact that one set is probably not speaking in their mother tongue. It should go without saying that people act differently in the morning to their modus operandi after a long day. However, we have seen this in practice and if left unaddressed it can be disruptive.

There is no easy solution to this type of problem but again effective education on both sides can minimise, if not eliminate, the potential damage. If staff understand the problem their natural inclination is to work with it not against it and team building exercises by video conference or, optimally, in person are an obvious solution. Whilst potentially costly in terms of working time lost as well as the financial outlay required this approach pays dividends in the medium and long term.

It is imperative to break down as many of the psychological and cultural barriers as possible as quickly as is feasible if outsourcing is to succeed. Mr. Xiao who is just clocking off in Shanghai must be able to communicate with Giorgio who has just arrived in Torino if there are issues that the latter's shift need to be aware of - orders not completed or items not despatched.

To quote New Labour's manifesto in a subtly different context:

"Education, education, education!"

Lesson 6: Be Prepared!

Machiavelli (1446 – 1507) once said that: 'It must be considered that there is nothing more difficult to carry out nor more doubtful of success nor more dangerous to handle than to initiate a new order of things'.

Lesson 5 leads us neatly to the importance of internal communication and change management. Whilst these might be thought of as two separate issues they are two sides of



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the same coin. Effective internal communication should be part of the change program and the latter should include a "comms" plan.

Change management, communication and by extension continuous improvement require a company to adopt an ongoing process to address the company's moving targets in terms of strategy and to stabilise, as far as possible, its procedures. The authors believe that there are none too subtle differences between process and procedure. The first is dynamic and should be capable of quick and possibly radical moves towards a different way of working. The latter refers to the more mundane (such as payroll or preparation of accounts). It is far more fundamental, will never stop happening and changes in procedure can be ponderous. They are potentially more likely to have an immediate effect on and be more visible to the workforce. Thus they need to be well communicated as we have detailed above – why, when, how will it affect an individual?

In the context of this topic the business needs to examine the opportunities for change to both process and procedure as some of the outsourced areas will be around process and others may be around procedure (HR/payroll e.g.). Theoretically it should be easier to change the procedures than the dynamic strategies which need to reflect speedy reaction or even be pro-active to address a different direction that the business believes its market will take. It could even be considered to be predictive change in that management is taking a view on the way its business and thus its processes MAY develop.

The whole is contained within the phrase "organisational development" which encompasses all the ambitions of the business to move forward. It is not radical but measured. However, parts of this strategy will need to be fast moving as economies become part of the "global village" and companies address the cultural differences and issues that we have discussed above. This last is key to outsourcing manufacturing, global sourcing, new approaches to logistics and distribution – in fact any process which is taken outside the local area and is not procedural by nature.

Whilst it is not appropriate in this article to attempt to write another change management bible (although no doubt both authors have that in mind) so we show below the key steps (prosaically there are seven that we perceive as key and for which we are indebted to Oliver Rickles for the principals):

- The surprise factor – where staff are not doing work that is a previously known aspect of their jobs. Hence communicating the change is of immense importance to address this
- The denial phase – "it worked the way we used to do it why are we changing now?" Again we emphasise a good communications plan to overcome this resistance
- The age of understanding – the communications plan is working and staff realise why change has occurred or needs to occur
- The crisis phase – perhaps the most important where only if management has created the understanding for the need to change will the organisation begin to accept it and adopt new working practices
- The learning phase – having gained buy-in from the workforce people start to act differently and the outsourcing approach, with all the vagaries we have described above, allows staff to begin to work differently and to continue to learn more about the new process(es)
- The dawning of understanding – through adopting different working practices and using them on a daily basis the workforce starts to understand the why and the fear



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and surprise dissipate. This needs to be reinforced through good communication – “the business has improved through your efforts”

- The final assimilation – staff integrate their new way of working with their thinking and new behaviours are reinforced both psychologically and by management's effective use of communication.

Lesson 7: Lead your troops

Leadership: The art of getting someone else to do something you want done because he wants to do it. Dwight D. Eisenhower

However, everything we have described in Lesson 6 will only work if, in the first instance, the end to end adoption of the outsourcing strategy has been accepted by and is key to management strategy. One dissenting voice can destroy any confidence, the best change management and communication strategy and bring the entire policy crashing down.

At all levels it is crucial to have top down buy in to outsourcing. Despite the views of some members of the workforce management are also human beings and they too will be resistant to change. The Finance Director may feel his position has been undermined, the Operations Director is exhausted and never wants to see the inside of an airport again as he flies from factory to factory, globally, as opposed to walking from his office to the shop floor. Even the CEO's life will see radical change. If any senior or middle manager demonstrates doubt overtly to the workforce that individual is capable of sowing the seeds of doubt regarding the new strategy.

We believe that the title of this section says it all. Management believe that outsourcing is the correct strategy and their tactic should be to convince, by whatever means, the workforce such that the new approach is actually led bottom up. The workforce see the benefits to them, welcome the opportunity and drive its success

We appreciate that this sounds easy but might be considered to be an impossibility in the real world. However, we believe that if management presents a united front, communicates the reasons for change effectively, involves the workforce at all stages e.g. mending broken processes, canvassing opinions, keeping them informed on progress rather than generating the fear factor they will create a culture of acceptance and comprehension which will drive the move to outsourcing to be a successful and profitable change for the business.

Management must be the catalyst for change and whilst it may be argued that they should not have to “sell” the decision to outsource they are materially changing the lives of their staff by adopting the strategy. If managers are not demonstrating a united front “this way lies despair” to quote Kirkegaard.

A good business case presented by a strong, convinced, united management can demonstrate why the need for change makes good commercial and financial sense and the benefits that it will bring to the whole of the business. It supports planning and decision making and when to implement the change all directed to maximising value created by the effort.



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Lesson 8: Everyone *must* be a winner

The key to successful outsourcing is to make it a win-win relationship for all parties. The natural state of any business, and management in particular, is to be secretive. Continue along this path when the company is outsourcing one or many processes and the venture will almost certainly fail. In an article in Information Week in 2006 this question was posed: Outsourcing Is A Win-Win For Business And Consumers, So Why Are Corporations So Shy About Their Offshore Plans?

The answers were somewhat controversial but are still as valid in the view of some critics today. Briefly, it discusses job losses in the business's home country, the use of euphemistic terminology rather than admitting that a product is coming from a low cost producer and much that we have detailed herein.

However we would argue that the solution is simple in theory but more complex in practice as it requires a fundamental change in behaviours. Management needs to be open with the workforce and its customers and the workforce needs to feel that it has been involved, as we have examined above, and can now critique the new current state.

Having followed the strategy that we have discussed above and outsourced various processes to different suppliers there needs to be an awareness by each that the others exist. The authors have first hand experience of a company putting a number of its processes out to tender, awarding multiple contracts and then not being prepared to divulge who was doing what to the various suppliers. They are almost inevitably going to have to work together and it is more than possible that they are geographically closer to each other than to the end customer. What justification is there for creating barriers between the third parties? For an outsourcing strategy to be effective and return the required costs savings all the participants must stay connected.

In short every individual and entity involved is a stakeholder in the outsourcing venture. They all have something to lose but conversely all parties have much more that they can gain. The suppliers have won a new client and improved their economies of scale. The customer has achieved its goal of outsourcing non-core capabilities and gained the associated cost savings. Management have proved their point and the workforce is, at worst, resigned to the new position and if change and communication have been effective then working with the new processes and the new suppliers productively. Meanwhile customers have gained as they have the opportunity to buy at reduced cost with no loss in quality or detriment to delivery time.

Lesson 9: Use measures to improve, not punish

Once the decisions are made and the contracts are signed all parties have a legal obligation to adhere to the terms and conditions. Part of the negotiating process will have been to put in place Service Level Agreements, performance metrics, problem management and the like.

Having the advice of an objective third party with existing experience of negotiating such agreements is useful if not a prerequisite. If this is the first experience a company has of negotiating outsourcing contracts it may think it knows what it needs but experience relates that there will be inevitably be omissions. How quickly must an IT Support desk answer a call is very different to how quickly they must SOLVE the issue being reported. First hand



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experience tells us that a global defence company had to resort to litigation, which it lost, with its partner when Help Desk calls were mounting and the supplier claimed that it was answering all calls within the specified time period. The customer argued that these calls were not being resolved and was directed to the clause in the SLA which stated that only problems which related to issues which would bring the business to a halt needed to be concluded within the time span (4 hours) that the customer was expecting.

This is an extreme example of an early outsourcing venture and in today's market it would be unlikely to occur, however it emphasises the crucial nature of understanding the nature of an SLA and having the proper Performance Measures in situ.

An SLA needs to state, with clarity, the requirements and expectations of the customer with regard to the service being provided, the responsibilities of both parties, any guarantees or warranties and priorities such as those detailed in the example above.

Where minimum, target and optimum service levels are agreed this provides the basis for the metrics to quantify performance by the suppliers.

We cannot emphasise strongly enough the importance of setting goals and measures which indicate how all parties are performing at each step of the outsourcing process and fine tune any issues that require adjustment.

Lesson 10: Prepare for full transformation

It is indisputable that outsourcing usually leads to a transformation of businesses. Whether these are always for the better is open to question and perhaps is dependent on the viewpoint from which the reader is approaching it.

It is of vital importance to integrate people, processes and technology to achieve the desired and required benefits. However, if the business approaches its outsourcing policy expecting to see an immediate return on investment it will inevitably be disappointed. The transition takes time and cost money. The introduction of the existing workforce (and management) to new working practices can be disruptive if the measures we have discussed herein for change and communications are not conducted effectively and this bears a cost both in time and financially. There may well be quality issues where product is being manufactured in low cost countries and the need for the low cost producer to "up their game" needs to be factored in to avoid losing customers.

But if outsourcing is approached practically and sensitively it transforms the business and its people, costs are ultimately reduced, product quality is assured and the benefits are demonstrable to all concerned.

There are exceptions that prove the rule and these cannot be ignored. Whilst some companies have successfully transferred call centres to low cost geographies there are many others (European banks and some of the larger finance houses in Anglophone countries) who have found that customer resistance is so great that they have had to transfer this process back to the homeland. Three of the major UK banks actually advertise the fact that customers will be speaking to someone in their own country.

With this notable exception, in general, outsourcing non-core capabilities is the obvious approach for any company whatever its size and its sector. For a small company to use an



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external payroll and accounting function and to have its IT handled by a third party is, in today's market, almost a given. There is no need to add the extra overhead of the staff required to undertake these basic roles when there are bureaux both local, national and overseas whose sole purpose is to undertake these fundamental, mundane tasks. We have already discussed the changes this brings about but they are not going to threaten the well being of the business.

When one considers the magnitude of outsourcing a company's entire production to a lower cost supplier or moves its factories to low cost economies there are far greater considerations that could cause issues and again we have discussed these. Quality, time zones, language problems are the first ones that spring to any practitioner's mind.

Ultimately, however, if approached with sensitivity to everyone involved in the Supply Chain, from suppliers' suppliers to customers' customers, the communication lines are kept open and positive and negative feedback is acted upon promptly then the business should quickly gain benefits from outsourcing.

Keep everyone talking to each other, take note of any warning signs if, for example, SLAs are always slipping and MANAGE the transformation such that it shapes in the way that executive management wants rather than allowing it to change the business. The key to a successful outsourcing experience is to rule it rather than allowing it to determine the direction the company has to take to accommodate it.

Conclusions

We have stated above that the authors do not necessarily agree on the success of outsourcing business processes. Part of that disagreement is based on the differences in their own experiences and backgrounds. The old argument that theory and practice never equate is the key to our fundamental disagreement.

However this poses an important question: does outsourcing fail because practitioners fail to adopt best practices from theory or does it fail because the theory is wrong?

In this article we have attempted to give you both sides of the coin, covering first the theory behind the age old 'make or buy' question and then complementing that with 10 key lessons we have learnt over several years of experience in working with global supply chains.



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