Opportunities for Action

Achieving Success in Business Process Outsourcing and Offshoring

The list of companies that have launched efforts at business process outsourcing (BPO) and offshoring grows daily. Many of these organizations, however, are destined for disappointment. Indeed, research by The Boston Consulting Group indicates that roughly half of the companies that engage in BPO and offshoring will have underwhelming results. Making matters worse, few of them will know where they went wrong or what to do about it.

What are the keys to a successful BPO/offshoring program? In our experience, much of the outcome hinges on preparation and planning. Specifically, a company should be able to answer three critical questions before launching its effort:

- What will be the strategic impact of our BPO/offshoring decision?

- Which operating model will best meet our needs?

- Is our organization ready to adopt that model?

Consider the Strategic Impact

Most enterprises view BPO and offshoring as a cost-cutting opportunity. While cost is obviously an important factor, it is not the only one, since any savings can often be easily replicated by competitors. Instead, companies should aim higher and seek to capture benefits that create long-term value and fundamental competitive advantage. (See Exhibit 1.)

Long-term value can be derived from a range of inputs, including higher revenues and improved productivity and processes. Consider the case of a large U.S. financial institution that moved part of its operations to India to gain access to the country’s vast pool of talented, inexpensive labor. The company captured a host of benefits, including productivity increases of up to 30 percent in accounting, transaction processing, and customer service. (Those gains were accompanied by a 60 percent reduction in accounting errors and a 50 percent reduction in the transaction-processing backlog.) The company also reaped an increase of 10 to 15 percent in collections, resulting in an improved cash-flow position.

Competitive advantage can result from enhancements to key capabilities, such as a greater ability to manage business cycle volatility and an increase in strategic flexibility. General Electric’s initial attraction to India’s labor pool was cost. Over time, however, the company has made increasing use of the country’s depth of talent. In the last eight years, it has hired more than 15,000 highly skilled individuals—a number it would have had difficulty matching elsewhere—and significantly expanded the range of tasks that its India-based centers perform. These tasks...
include such complex activities as high-end analytics (for example, customer retention analysis) and financial modeling. The effort has provided crucial support in the company’s pursuit of its strategic objectives, which include new growth and enhancements to customer service.

Choose the Right Operating Model

Selecting the right operating model for a BPO/offshoring effort can be difficult. There are no off-the-shelf solutions—each company’s situation is unique. Four basic models should be considered:

Offshoring to a Vendor in a Low-Cost Country. Companies that employ this model are looking to seize the advantages of low-cost countries but are willing to cede at least some operational control.

Offshoring to a Captive Center, or Wholly Owned Subsidiary, in a Low-Cost Country. Approximately 70 to 80 percent of offshoring activity is based on this model. It allows companies to benefit from the cost and scale advantages that low-cost countries afford yet still retain full operational control of the offshored activities. Proponents of this model include Lufthansa and Philips, which have established captive centers in Poland to manage and support such functions as IT, transaction processing, finance, and accounting.

Outsourcing to a Local (Onshore) Vendor. More than 95 percent of outsourcing is still being done onshore. Examples span most process bundles, from IT and logistics to HR, finance, and accounting. Common to many of these deals is that the vendor assumes control of some or all of the client’s employees but utilizes a more effective structure and optimized processes.

Doing the Work In-House. Outsourcing and offshoring are not always the best solution. A European pharmaceutical company was considering offshoring its data-management activities to a vendor in India. After an in-depth analysis, the company determined that because of the savings that could be achieved by doing the work internally and the operational risks associated with moving the work offshore, its best solution was to upgrade its internal capabilities and keep the work in-house.

Choosing the right model requires an analysis along five dimensions:

• Strategic impact, encompassing the effort’s strategic relevance, the potential to gain competitive advantage, and considerations relating to intellectual property. Some key questions a company should ask: Will the outsourced process be critical to our business in the future? Does the process help differentiate us from competitors?

• Financial impact, encompassing the impact on revenues, costs, and the balance sheet. Key questions: Will outsourcing translate into significantly lower labor costs? Will it help us penetrate new markets?

• Business impact, encompassing service levels, access to skills and technologies, and the potential for greater flexibility and reduced complexity. Key questions: Will outsourcing increase our ability to deliver services? Will a vendor have better access to the tools, technologies, and skills necessary for this process?

• Business risk, encompassing strategic, brand, vendor, country, and operational risks. Key questions: Will outsourcing hurt our brand? Is the vendor operating in a region with high geopolitical risk?

• Feasibility, encompassing the vendor’s market, legal constraints, location logistics, and process maturity. Key questions: Do vendors have the
necessary experience and scale? Will we need ongoing capital to maintain the required knowledge and skills in-house?

Choosing a model requires striking a balance between impact and the degree of control your organization is comfortable with. (See Exhibit 2.) The latter will largely depend on your confidence in the vendor and your previous outsourcing experience. If you find an experienced vendor and your organization has outsourced in the past, you will likely be content with strategic control coupled with a close monitoring of the process. If the vendor is new to you or your outsourcing experience is limited, you will probably want to maintain some operational control—for example, by keeping some of your staff at the vendor’s site for the first couple of months to ensure that everything goes according to plan.

Remember, though, that no matter which operating model and level of control you choose, you still have to be involved in the effort. Outsourcing a process does not mean that the process goes away. Recognize, as well, that successful outsourcing usually entails some degree of process reengineering. It makes little sense to outsource flawed processes. Instead, fix the process in advance so that you know your optimal cost base and what type of service level you can reasonably expect from a vendor.

Evaluate Your Organizational Readiness

BCG surveys have shown that as many as half of the companies that have outsourced and offshored processes are not satisfied with the results. One common cause of their disappointment is their lack of readiness at the time they embarked on the effort. For your BPO/offshoring program to succeed, you must gauge whether your organization’s capabilities will support it. This means examining and addressing such things as governance structures, the complexity of formal and informal networks, the level of process standardization and documentation, and your company’s general tolerance for change.

Proper handling of cultural and change management issues is a particularly critical component. Engaging your work force to ensure success requires aligning all levels, functions, businesses, and regional operations with your strategic outsourcing vision and gaining a collective commitment to your objectives. Most companies recognize the importance of this task; few, however, translate that knowledge into action. More than half of the companies we surveyed had neither a communications plan nor a change management program in place before they outsourced their processes. Many of those companies, not surprisingly, said that their outsourcing experience was less successful than they had anticipated.

Another crucial element is the commitment of dedicated resources to the outsourcing relationship. This is important even if you outsource to a captive center. BPO deals run from five to ten years, on average, and go through different phases. Accordingly, they must be understood and managed as a long-term and continuous life cycle—one that requires concentrated monitoring and care.
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A critical part of this effort is making sure the right people are involved. One position you’ll need to fill carefully is that of vendor-relationship manager. This person will perform a range of key tasks:

- Building and managing the relationship with the vendor or captive center
- Addressing changes in business requirements, the market, and the relationship over the life of the agreement
- Evaluating whether the vendor or captive center is delivering value as planned, and taking action if it is not
- Challenging the assumptions that drove previous decisions and examining new options

The manager’s ability to execute these and related functions will have a major influence on the outcome of the effort.

Achieving success in BPO and offshoring demands considerable thought and planning. In particular, it requires a willingness to think strategically and view BPO and offshoring as an opportunity to fundamentally reshape the business, rather than simply as a tool to cut costs. Those companies that take this perspective and can address the challenges in implementation stand to achieve a lasting and significant competitive advantage.

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