
Why global sourcing? Why now?

Creating competitive advantage
in today's volatile marketplace

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Reaping the benefits of global sourcing

The heart of the matter

Global sourcing— What it is and why you need it

The economic downturn and escalating pressure on corporate profitability have combined to focus the spotlight firmly on organizational inefficiencies. To succeed in these tough times, global organizations must effectively manage complexity, gain efficiencies and reduce costs. Many companies have turned to global sourcing solutions to achieve these objectives.

Global sourcing, which comprises domestic and offshore outsourcing and shared services solutions, can be an extremely effective means to achieving strategic operational gains and cost savings. A recent PwC/Duke Offshoring Research Network¹ study found that the top four drivers of global sourcing are cost savings, access to qualified personnel, enhancing efficiency through business process re-design, and competitive pressures.

That said, the potential rewards often go hand-in-hand with risks and challenges stemming from rapid global growth, inadequate controls around current processes, and the difficulty of harnessing multiple ERP systems, to name a few. Faced with these and other realities, some companies have deferred their global sourcing implementation efforts, only to see their more proactive peers move forward to achieve efficiencies and reduce their cost structures.

In PwC's view, companies that have not yet implemented global sourcing in a material way are at a competitive disadvantage from both a financial and strategic perspective. Such organizations can no longer afford to delay—not with the significant opportunities that global sourcing can deliver. Recognizing this, these companies now find themselves scrambling to identify the appropriate processes to transition to a shared services environment or outsource to a third party.

Virtually every organization should now be assessing its operations to determine which processes are fit for global sourcing. Begin with back-office processes such as information technology, finance and accounting, human resources, procurement, and contact centers, as well as certain supply chain, marketing and legal processes. Then look ahead to the future state.

The maturity of available global sourcing solutions has advanced at a very rapid rate. In fact, for the most progressive organizations, "Global Sourcing 2.0" is just around the corner. And, as many countries around the world continue to make large-scale investments in the development of resources to support global sourcing, these capabilities are likely to become even more mature over the coming years.

Now that globalization and increased connectivity have enabled new ways of doing business, PwC is seeing leading-practice companies that have already outsourced their IT and back-office functions and/or established shared service centers for major support processes now moving forward to migrate higher end activities such as research, product development, tax and legal services to shared service centers or outsourcing providers.

The bottom line: Firms that leverage these alternative operating models and global capabilities can be much more focused on value-added activities and other strategic objectives, and much more nimble than their peers—thus positioning themselves to receive a greater return on their assets.

¹ Duke University Offshoring Research Network 2009 Service Provider Survey

An in-depth discussion

Maximizing
shared services
and outsourcing
opportunities

Global Sourcing Definitions

The term “global sourcing” refers to solutions designed to improve operating efficiencies and bottom-line results for global organizations with distributed operations across the organization, across the country and around the world. Global sourcing comprises both shared services and outsourcing solutions that can be implemented domestically and offshore.

Shared services

Concentration of an organization’s resources; performing similar activities, normally distributed across the organization, to service multiple internal partners with the common goal of achieving customer satisfaction.

Note: the term “captives,” used later in this paper, refers to offshored shared services.

Outsourcing

The provision by a third party of defined services (regardless of geographical location), which can involve a transfer of assets, intellectual property and/or staff.

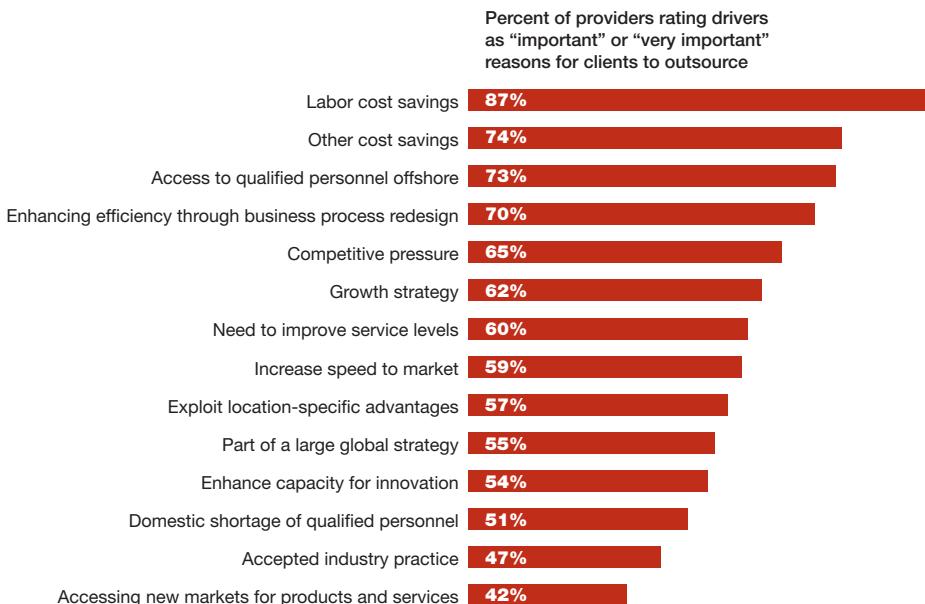
Note: The term “hybrid models,” used later in this paper, refers to solutions that embrace both shared services and outsourcing.

The business opportunities surrounding global sourcing are significant. Going beyond strict cost reduction, global sourcing solutions can also deliver important strategic benefits. But significant business risks and challenges go hand-in-hand with these potential rewards.

Despite the risks and challenges, the use of global sourcing is growing exponentially. What is driving this surge? According to a recent PwC/Duke Offshoring Research Network study (Figure 1), the top four drivers of global sourcing are:

1. cost savings,
2. access to qualified personnel,
3. enhancing efficiency through business process redesign, and
4. competitive pressures.

Figure 1: Renewed emphasis on cost savings and efficiency



Source:
Duke University Offshoring Research Network 2007/08 Service Provider Survey
Duke University Offshoring Research Network 2009 Service Provider Survey

Some of the drivers we see most often:

Rapid global growth.

Many companies that have established or acquired multiple entities and operations—often with redundant processes and functions—have finally decided, after years of allowing those operations to operate independently, to consolidate their back-office functions in order to achieve greater efficiencies and utilization.

Fragmented interdependent business units.

Increasingly, interdependent business units are recognizing the need for strategic alignment and the ability to execute initiatives at a rapid pace. One of the key enablers of this alignment is global sourcing.

Threats from emerging economies and competitors with different economic models.

Industry globalization is forcing some firms to create leaner, more variable cost-driven support functions that will allow them to focus their more limited investment funds on customer-facing, value-added activities.

Stagnating internal performance improvement and innovation efforts.

Many companies are finding that their fragmented, internal performance improvement and innovation efforts have either stagnated or are providing only marginal incremental benefit. They are looking for transformative, game-changing approaches that can facilitate a move toward more leading-practice process performance. Establishing and monitoring proper sourcing service levels is an important step toward this type of transformational goal.

Failure to extract sufficient value from ERP implementations or upgrades.

Despite having invested tens or even hundreds of millions of dollars on systems consolidation, some companies still are unable to reap the expected rewards of those systems. They recognize the need to consolidate back-office functions into shared services environments that would allow them to focus on process and resource efficiency.

Inadequate controls and regulatory compliance.

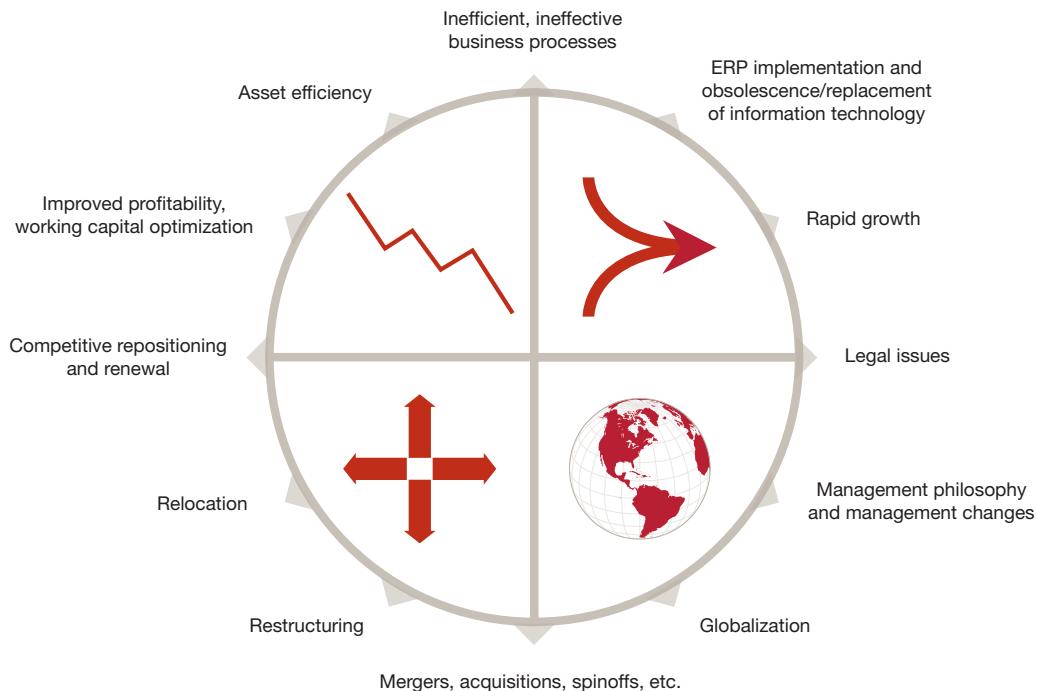
Many companies—especially those in highly regulated industries—struggle with the risks and exposure associated with inadequate controls and compliance. They find that the most effective means of gaining transparency into these risks is through process standardization facilitated by the consolidation of back-office activities.

Distractions that steal focus from the core business.

Many companies look to global sourcing—whether shared services or outsourcing—to take over the more routine transactional processes, as well as some value-added processes, thereby freeing their business leaders up to focus on the core business while driving dramatic cost reduction through labor arbitrage. The continued growth and maturation of the workforces in locations such as India, China, Eastern Europe and Latin America provide a cost-reduction opportunity that would not have been achievable a decade ago.

Figure 2 provides a high-level overview of the primary global sourcing drivers that PwC sees at its clients.

Figure 2: Global sourcing drivers



Investing sufficient effort up front—A critical success factor

To navigate today's complex sourcing options, organizations must apply the same rigor to the evaluation, management and execution of their global sourcing initiatives that they would apply to any strategic business initiative. So where do you start?

Looking at the big picture—Building a compelling business case

As organizations embark on developing global sourcing strategies, it makes sense to leverage leading practices and lessons learned from the firms that have gone before them. The approach to determining which activities should be sourced is significantly more robust and mature than it was even a few years ago.

Going beyond a high-level identification of non-core processes that may be candidates for sourcing, organizations should perform a process-fitness and readiness assessment exercise and develop a detailed business case to determine the value associated with migrating the processes—and also to identify inherent risks associated with moving those processes into a global sourcing environment.

Assessing the quantitative and qualitative feasibility of various sourcing strategies (i.e. outsourcing, shared services, captives and hybrid models) is an important requisite to building a strong business case. Leading-practice organizations frequently examine all back-office functions concurrently to determine the appropriate process candidates. Then they stage the implementation to meet their own strategic and risk profile. This helps ensure consistency of approach and evaluation.

The time and effort you invest during this phase will pay off down the road. Here are some of the key questions you should be asking yourselves at the outset:

- Is there a clear, strong business case for global sourcing? What are the global sourcing drivers at our company?
- Have we selected the right processes? Do the criteria used truly delineate the need for centralization versus proximity to the core business?
- Should we focus on shared service centers, or should we outsource? Or both?
- Where should our shared service center(s) be located?
- Have we identified global sourcing interdependencies and interactions with other operational processes?
- Have we identified and quantified the global sourcing risks and opportunities?
- Have we fully considered technology constraints and improvements to enhance global sourcing?
- Have we considered effective designs for the global sourcing metrics, contracts, service levels and governance with the business units? Will they deliver measurable results and help us effectively manage risk?
- How will we accomplish the transition of existing processes?

The answers to these and other key questions will not only serve as a checklist to help ensure that the resulting business case touches on all the critical areas of a fruitful global sourcing initiative, but it will also facilitate your journey through the ensuing design, implementation and transition phases, thereby enabling your company to more quickly achieve the financial and strategic benefits that global sourcing can deliver.

A proper business case addresses the financial and operational implications of various global sourcing alternatives. It also addresses the sequencing of the selected initiatives, aligning them with other related strategic endeavors. A detailed understanding of the current state—headcount, detailed activity analysis, costs, and performance levels—forms the foundation for the business case. It is only through a robust and detailed understanding of the “as is” environment that companies can forecast the expected changes stemming from alternative sourcing scenarios.

Designing an effective global sourcing operating model

It is equally important that the organization hold detailed, fact-based discussions (as opposed to the “back of the envelope” variety) on the merits of the alternative approaches and the financial, operational and organizational impact those approaches will have.

At this point, the merits of the alternatives have now been discussed and agreed, and you have made the decision to move forward. Certain organizational communications will need to take place that will impact how the company operates in both the short and medium term. Now the detailed planning begins in earnest.

Since very few individuals have gone through this type of transformation in the past, this phase is often filled with anxiety about the unknown, and this is true at both the executive and staff levels. Proactive planning, risk mitigation, and leveraging lessons learned from experts are essential to the success of this phase of the transformation. To address the complexity of the design process, you will need subject-matter experts in sourcing, process improvement, IT, people and change, regulatory and compliance, tax and, potentially, real estate. Further, since recovering from early missteps can be a challenge, it is essential to involve these skills up front.

To cite one example of such a misstep, PwC often sees companies make the mistake of trying to fix all broken processes before moving into a shared services environment. As a result, these companies end up realizing only small, incremental benefits. By contrast, co-locating headcount so that all are sitting in one place positions organizations to more effectively drive efficiencies and to optimize process redesign in a much more informative and impactful way, thus facilitating performance-improvement efforts.

Another potential misstep occurs when companies fail to think through specific service levels that the shared services environment is going to provide to its internal customers. To illustrate, let's say that an organization has numerous decentralized finance and accounting functions sitting out in 50 different businesses around the world and it now wants to consolidate those in a shared service center. However, the organization fails to initially put in place a proper Service Level Agreement designed to help ensure that those businesses would be provided with significantly better service after the migration than they were experiencing while finance and accounting were decentralized. What is needed is a commitment from the shared service center stating that it will improve process efficiencies by X percent over what they had been prior to the migration, and that, in return, the center will charge the organization Y amount (which would then be allocated to the various businesses). The organization's expectation would be that those businesses would now get better services at much less cost and that, as efficiencies improve on an annual basis, the chargebacks to the businesses would be appropriately adjusted.

The key takeaway: It is absolutely critical that companies do not underestimate the transformative nature of global sourcing. The benefits can be enormous, but the journey is fraught with risks. Walk first, walk some more, and then run.

Managing the transition to the chosen operating model—It's a journey

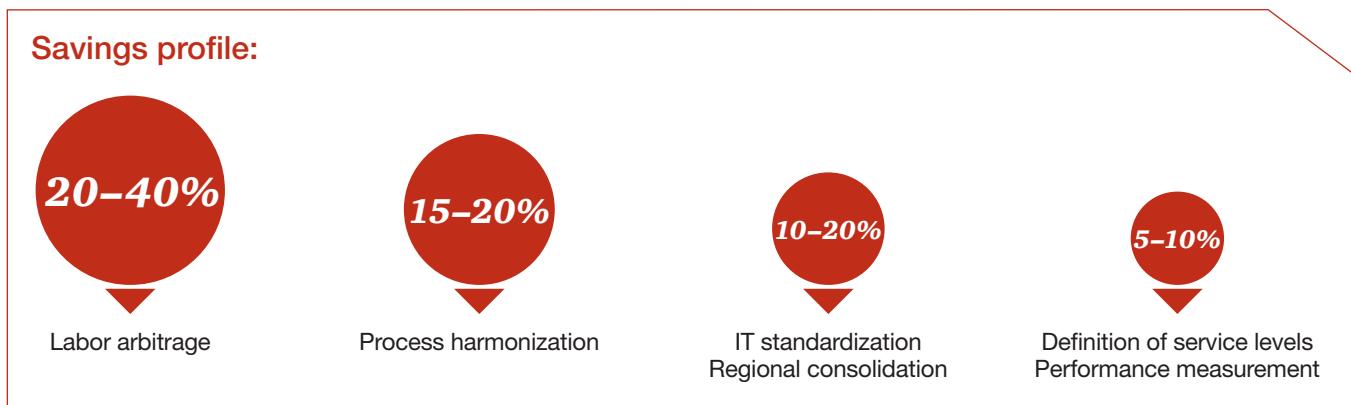
Advancing the maturity of your global sourcing approach

This is where informed design planning will begin to pay off. If you have planned properly and started slowly, you will now quickly start seeing benefits—in some cases in less than two years. Every organization has unique challenges, and here is where you will get a sense of those your own company is facing. The lessons you learn in this phase should be built into the transition of the remaining processes. At this point the transition becomes much more programmatic and disciplined.

Early-stage, global sourcing initiatives are typically justified by headcount consolidation and labor arbitrage to drive cost reduction (“lift and shift”). But, as organizations continue the journey, they are able to drive other significant benefits.

Figure 3 provides a sense of the benefits that leading-practice organizations frequently achieve via global sourcing. Typically, the “savings pie” comprises these six areas. For each, the graphic shows the percentage of the total savings achieved from each of the global sourcing value drivers. Depending on how things actually play out for a given company, the percentages will fluctuate but they tend to fall within these ranges.

Figure 3: Global sourcing savings profile



Typically these initiatives start with management looking at the company's current headcount and weighing the costs of moving to a lower-cost location versus hiring new people, redeploying certain processes, and consolidating execution of those processes into one or two different centers on a global basis. For example, highly routinized transactional processes like accounts payable lend themselves to global sourcing.

Then, as enterprises start achieving success, it is natural for them to consider migrating additional higher-value services—such as fixed assets, billing, journal entries—to a shared service center or to outsourcing providers. Further, management may elect to take a broader functional scope.

Process harmonization and the establishment of a proper service level/chargeback approach are essential to success in advancing the maturity of a company's global sourcing approach. While these can drive significant value for shared services, they are also fundamental to a healthy partnership with an outsourcing provider.

Whether via process redesign, leveraging technology, or both—the standardization of processes can dramatically impact the effectiveness and efficiency of global sourcing. Staff—whether your own or at an outsourcing provider—can be significantly more efficient if they need only be trained on a limited number of process variations. This often requires an investment in technology. Similarly, well-crafted service-level agreements and appropriate chargebacks serve to establish an arms-length relationship that creates a healthy tension between internal customers and the shared service center or the outsourcing provider.

Further, as organizations advance their global sourcing initiatives, a focus on governance and performance management becomes critical. To date, many companies have taken fragmented approaches, with the CFO, COO, CIO, Chief Marketing Officer and other senior executives each having his or her own uncoordinated initiatives. In such cases, there is very limited sharing of leading practices and lessons learned, and little-to-no consideration of broader organizational requirements from shared services and outsourcing. PwC frequently sees situations where clients have shared services and are using five, 10 or even more service providers without any governance over their entire portfolio. The disadvantages of this approach are obvious, as are the increasing risks resulting from it.

What's more—since most outsourcing contracts span three to five years or more, and since unwinding those relationships can be very challenging—the risks and challenges related to the silo approach serve to underscore the critical need for organizations to be more proactive during the planning phase. An effective global sourcing strategy should be developed across all geographies and functions from the very beginning. From PwC's perspective, this is the only way to gain visibility into what will be needed in the future. For organizations that have already implemented some global sourcing, this requires a revisiting of the overall objectives and current performance.

Last, but far from least, your current IT platform and footprint can have a significant impact—both on your global sourcing plans and on your ability to execute. We have worked with clients that run the gamut from being on a single ERP platform to having more than 20. Organizations on a single platform will have a relatively straightforward approach to transition, presuming there is already some sense of process standardization. As for companies with multiple ERPs (often the result of significant merger and acquisition activity), it will come as no surprise that this fragmentation poses greater complexity in the strategy and implementation of their sourcing efforts. That said, PwC has found that there are still considerable global sourcing opportunities to leverage.

Whether leveraging existing systems (“direct entry”), or creating a standardized front-end in the shared services environment (“common platform”), or migrating to cloud services, most organizations will see dramatic impact from global sourcing.

What this means for your business

Reaping the benefits of global sourcing

Is your company on board yet? The time to act is now

Yes, there are risks and challenges to meet before you can reap the potential rewards, and yes, there are a myriad of complexities in the way. But you can't afford to wait any longer—not with such significant opportunities at stake. Leading-practice organizations have done this right, and they have provided a road map to get you where you're going.

Involving the right subject-matter experts early in the process will enable you to successfully navigate through the maze—asking and answering key questions to make sure that nothing vital is missed as you assess your company's unique situation, identifying the processes fit for outsourcing or shared services solutions, and tailoring those solutions to the organization's specific needs and circumstances.

There are no short cuts. Investing sufficient time and effort up front to evaluate your company's various processes and crafting a strong business case for change is critical to success. The detailed business case that you build up front will serve to set you on the course that is right for your company, and to facilitate the subsequent design, implementation and transition phases so that you can start seeing results more quickly.

But leading-practice companies don't stop there. Rather, they look at implementation of global sourcing initiatives as an ongoing journey. As they begin to see benefits accrue from the migration and consolidation of their highly routinized transactional processes, they turn their attention to doing the same with some of their core, value-add processes.

Global Sourcing 2.0 is just around the corner for the most progressive organizations. As many countries around the world continue to make large-scale investments in the development of resources to support global sourcing, these capabilities are likely to only become more mature over the coming years. Given the progress and benefits achieved through global sourcing, any organization that has not explored and taken advantage of these opportunities will find itself at a competitive disadvantage from both a financial and strategic perspective.

Reaping strategic benefits—Growing the bottom line

Clearly, global sourcing translates to very tangible benefits for bottom-line impact. For example, PwC has seen:

- A diversified global manufacturer achieve 40% cost savings via finance and accounting shared services
- A global power company save more than 30% of its annual cost of delivering back-office services via outsourcing
- A global consumer products company save 25% on its back-office processes via shared services
- A global distributor of office products and services reduce its support function costs by 40% via shared services

Long story short. Firms that leverage these alternative operating models and global capabilities can be much more focused on value-added activities and other strategic objectives, and much more nimble than their peers—thus positioning themselves to receive a greater return on their assets.

The bottom line: Successful global sourcing initiatives translate to a competitive advantage in today's volatile marketplace.

***For a deeper discussion around
putting global sourcing solutions
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