

view

Outsourcing and Shared Services
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From providers to partners

How outsourcing relationships
are changing for the better



By Paul Horowitz, David Gordon, and Swarna Kuruganti

The business case for outsourcing? It used to be simply about lowering costs. Today, however, motivations range from market and geographic expansion to improved flexibility and access to talent. Companies have moved beyond procuring commodity information technology services and on to higher-value business process outsourcing and even to core activities like research and development. Yet, all too many companies find that their outsourcing deals fall short of expectations.



In our recent global outsourcing survey, less than a third of respondents said their arrangements had fully delivered on promised benefits. Even so, a full 91 percent said they would continue to outsource, regardless of their level of satisfaction.¹

The mismatch points to a fundamental problem experienced by many companies: While their reasons for outsourcing have moved beyond cost cutting, little else has changed in how they—and their providers—approach the business relationship. Often, it's an adversarial one, with each side pointing fingers, particularly if the project falters.

Customers blame service providers, and service providers in turn point to the inability of customers to manage their outsourcing projects.

Forward-thinking companies and service providers with strong leadership, however, have recognized that something's got to give. They are shifting from traditional

buyer-seller relationships to collaborative models. They understand that the stakes connected with working together to achieve strategic goals are higher than ever before. Today's new breed of collaborative outsourcing partners base their relationships on clearly defined business benefits, shared risks and rewards, and increased transparency with regard to pricing, strategic planning, and joint governance.

More than a vendor relationship

To succeed, companies are finding that their outsourcers must fully understand their strategic needs, operational requirements, and culture. For example, Nike, a company that has built its business on outsourcing, illustrates the value in collaborative sourcing relationships. In 1963, the company began selling shoes made in Japan in the United States. Subsequently, Nike became the core of the athletic footwear industry in South Korea and Taiwan. Because costs there climbed about 10 years ago, the company migrated its primary manufacturing base to countries with lower costs, such as Vietnam and China. Ramping up relationships with several manufacturers in those and other

¹ PricewaterhouseCoopers' 2007 Global outsourcing survey.

low-cost locations, Nike promised “more support, more orders, better people, more infrastructure” to help them manage some of their risk. When we spoke with Eric Sprunk, vice president and general manager of global footwear at Nike, he recalled thinking: “This can’t be just a vendor relationship. We’re going to have to have a bit more of a partnership relationship.”

As consumer appetite for new footwear technology has increased, Nike has been brainstorming concepts to speed its pace of innovation for alternative footwear construction with four or five manufacturers it considers strategic partners. “The future is not in chasing where the most affordable or the biggest labor pool is but in figuring out an entirely different way to manufacture the product. Those are the kinds of conversations we are having with our strategic partners,” said Sprunk.

In addition, the company outsources all of its desktop support for employees around the world, as well as data storage and other business processes that it once handled internally. However, Nike remains strict about keeping the innovation, R&D, and proprietary technology that are important to the Nike brand in the United States.

Working together whether it’s one or many

A move toward true collaboration is needed in order to navigate the changing outsourcing landscape. According to a Gartner report analyzing global outsourcing transactions for 2007, the trend toward smaller and shorter contracts—compared with the larger, megadeals (those valued at more than \$1 billion) of the past—continues. In 2007, for example, megadeals represented 6.8 percent of contracts, while those valued at less than \$50 million made up 39.5 percent of contracts.²

Such contracts result in outsourcing arrangements that are dynamic and complex. Executives in our survey said that while they will continue to use the

traditional approach to outsourcing—relying on a single service provider—newer models are gaining momentum. Half of the executives said they expect to increase multisourcing (using more than one provider for a service), while 45 percent plan to increase their use of joint ventures, and 35 percent plan to ramp up their use of open, public business models that are made up of networks of partners and customers. Unlike traditional single-source transactional outsourcing, these more complex approaches intrinsically require more collaboration. They encompass multiple provider relationships, address both operational and performance management challenges, take innovative approaches to allocation of incentives, and often center on intangibles like intellectual property.



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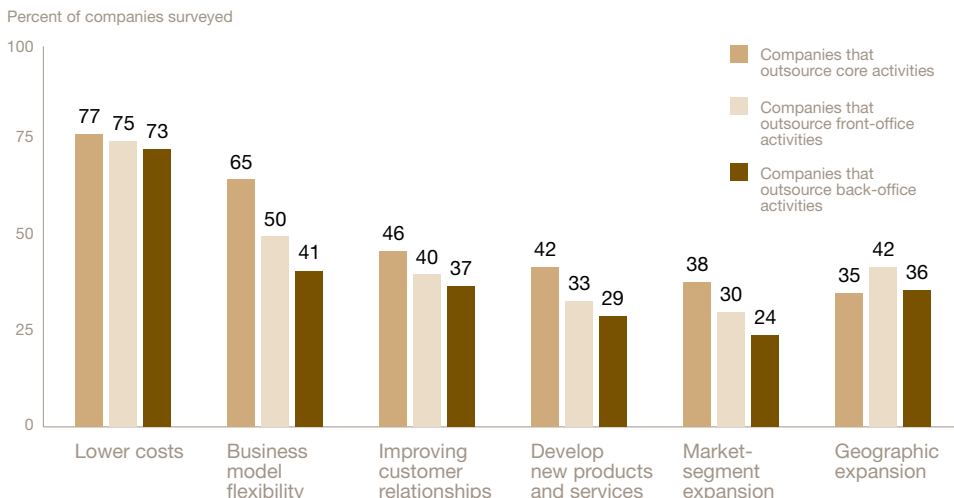
² Gartner, *Market Trends: Outsourcing Contracts, Worldwide*, 2007, June 2008.



Figure 1: Reasons to outsource

Lowering costs still leads Why companies outsource

While outsourcing is no longer just about the bottom line, lowering costs remains a key driver, no matter what type of business function is involved. The respondents to our global outsourcing survey fell into three groups: core activities sourcers, front-office sourcers, and back-office sourcers. More than half of the respondents outsourced core products and services, which they defined as fundamental to their business. Twenty-six percent reported outsourcing back-office functions such as procurement, IT, and human resources, while 18 percent outsourced front-office functions like marketing and sales. When asked to rate which of the following factors was important or very important in making outsourcing decisions, each group cited the lowering of costs as the leading driver.



Source: PricewaterhouseCoopers' 2007 Global outsourcing survey

Of course, a collaborative approach brings benefits, whether a company is working with many different service providers or a sole provider. This has certainly been the case in our experience working with Tenet Healthcare and Tenet's single-source IT provider, Perot Systems, with which Tenet has had a relationship for nearly two decades. When asked about the decision to stay with a single provider, Steve Brown, Tenet's chief information officer, told us, "We were fortunate to have some early successes with Perot, and as time went on, we both began to realize there were some mutually beneficial opportunities that could be pursued. Now we have the additional advantage that after a long relationship we both have a lot of understanding of the people, capacities, and capabilities."

As Tenet's business objectives have changed, so too have the company's arrangements with Perot. The company renegotiated its contract four times through the years, as business objectives changed from cost savings to innovation. Tenet also collaborates with Perot on creating additional opportunities—for example, international expansion, which benefits both parties. Perot Systems entered

76%

of respondents to PwC's Global Outsourcing Survey cited deal structuring as the most challenging part of managing outsourcing relationships.

India in August 2003 by acquiring Vision Healthsource, a provider of billing and claims solutions for the US healthcare industry. "We became an initial seed user of some of [Perot's] early services out of India," said Brown. "We shared some risk in doing that but then harvested the benefits later on."

Shared risks and rewards go both ways

In a collaborative partnership, the reverse situation can also be true. The service provider assumes risk in expanding into new markets. In our survey, 37 percent of all respondents cited development of new products and services and market-segment expansion as two reasons they rely on outsourcing, while 33 percent cited geographic expansion.

When an outsourcer enters a new market in order to support a client, it assumes some risk, but it can also reap considerable rewards. On the risk side, it might take responsibility for site selection, government permits, tax compliance, personnel recruiting, cost control, technology deployment,

and more. On the reward side, it receives additional business volume from the client, attracts other prospective clients, and gets the opportunity to penetrate promising new markets.

This has been the experience for India-based WNS Global Services and its clients. For example, WNS has developed such a relationship with a cosmetics manufacturer for which it provides global contact center services and high-end finance and accounting functions. "We have an alignment plan with this client that as they grow into different geographic locations, we will follow them," says WNS senior vice president Becky Dennis. In its discussions about future locations, WNS is open about projecting the costs and explaining what is behind them so that both parties are satisfied and can get what they need.

The partnership mentality comes naturally for WNS, which originated as a wholly owned India-based subsidiary, or *captive*, of British Airways. Dennis said that because of its history as a captive, WNS approaches



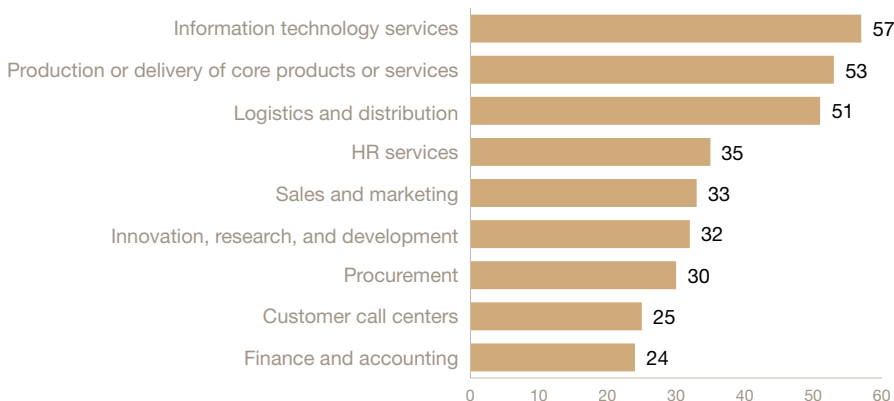
a client relationship with a long-term vision of bringing high-value benefits because such approaches are embedded in the WNS culture. "I think that as business process outsourcing matures, we have the advantage of learning lessons about the gain-sharing model and actively applying them versus a change order environment from the IT services era," said Dennis.

Another example of a collaborative relationship is that of Genpact and a major car manufacturer. The manufacturer presented Genpact with a strong objective: Deliver savings globally by reducing the company's sales, general, and administrative (SG&A) expenses. Additionally, the manufacturer sought to expedite its transitions and optimize processes through consolidation and standardization, automation, and elimination of waste. Genpact ramped up its own operations in Hungary (serving European operations), China (serving Japanese operations), and India (serving North American operations). It demonstrated its commitment to the manufacturer with dedicated training of its global organization, including Six Sigma.

Today's complexity requires joint governance

With more than just cost cutting on the line, the management of outsourcing relationships—whether collaborative or more traditional—requires considerable attention. In our survey, respondents pointed to deal structuring as the most challenging aspect, with 76 percent rating it as difficult. Other key areas singled out for improvement included managing the transition (75 percent), ongoing management and monitoring (71 percent), strategy development (70 percent), renegotiation (69 percent), and business case development (66 percent).

Figure 2: Top outsourced services



Source: PricewaterhouseCoopers' 2007 Global outsourcing survey

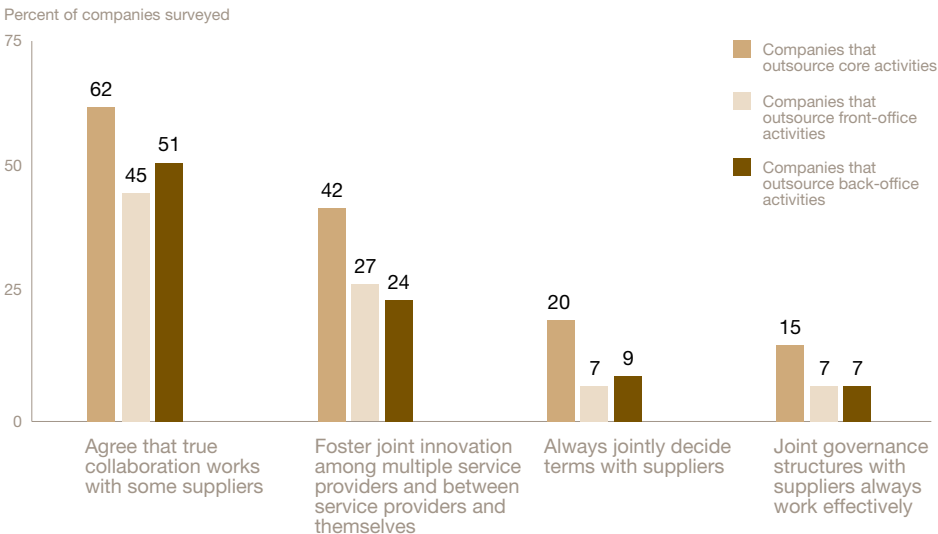


Figure 3: Views on collaboration

The customer-provider relationship

Finding true collaboration

Talking about collaboration is one thing, but not all companies have the same mind-set when it comes to working with their service providers. Our recent outsourcing survey found that companies that source core products and services externally are more likely to nurture collaborative relationships than are companies that outsource front-office or back-office activities.



Source: PricewaterhouseCoopers' 2007 Global outsourcing survey

And in a more collaborative arrangement, those factors become even more crucial if both parties are to be rewarded for delivering economic and process enhancements. A strong governance structure shared by provider and client alike is needed. Unlike a traditional vendor relationship, more-collaborative approaches stress seeking input from the service provider on how the client operates and also require input on more-effective governance of the relationship both with the vendor and with the business. Such an arrangement emphasizes transparency and accountability as well as better integration between the two parties.

As part of its governance structure with its cosmetics client, for example, WNS has agreed to drive a fully variable cost model that aligns cost of operations to scale of business for the client. Additionally, WNS has built a formal gain-share mechanism that drives high-impact business ideas for revenue impact through the tenure of the relationship. As with all key clients, the company has been assigned an executive sponsor. In this case, the company had direct access to the CEO. The WNS relationship seems to be mutually beneficial: Its cosmetics client has realized \$15 million to \$20 million of annualized savings and enhanced customer service levels, while WNS ended its fiscal year with over 32 percent growth and a client renewal rate in the high 90s.

Evolving relationships

Like all relationships, those between customers and outsourcers change and grow. Collaborative arrangements are successful only inasmuch as they continue to meet current business needs

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and are structured to accommodate future objectives. To achieve the benefits from outsourced relationships, businesses should clearly define and internally articulate the business objectives of their outsourcing initiatives and obtain internal buy-in for the business case for outsourcing. An up-front understanding of the drivers and the expectations is critical to effectively selecting the right service provider and structuring and executing the agreement. Adopting a partnering

outlook with a trusted service provider can release the strategic value of the relationship through collaborative behavior, such as sharing data freely, structuring incentives for innovative ways to deliver returns, and, when appropriate, inviting service provider input into operational decisions. It is important to treat an outsourced relationship as an extension of your own organization at multiple levels—however, with strict performance objectives and accountability requirements.



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Outsourcer strategies

How providers can use effective workforce management to achieve successful collaboration

By Tom Puthiyamadam and Shashank Aggarwal



Business process outsourcing (BPO) providers must satisfy two primary customer demands: (1) They must deliver services at world-class efficiency and reliability levels, and (2) they must increasingly provide higher-level strategic services and innovation that align with customer strategy. The key to successfully meeting both objectives lies with provider talent. Additionally, as the BPO segment matures and becomes more of a commodity, providers will need to pay even greater attention to managing their people resources in order to both meet customer expectations and drive greater margins.

With increasing demand in the next decade for outsourcing services, the most collaborative outsourcers will distinguish themselves by anticipating the talent they will need to serve major clients or industries. To accomplish this and distinguish

themselves from competitors, providers will begin to eliminate the walls between their business operations and human resources functions. This new approach to managing talent requires unbundling roles and responsibilities, aligning resource inventories with corporate business strategy, and applying supply chain techniques to talent management.¹

Unbundling roles and responsibilities

Acquiring and retaining top talent to perform higher-value customer work can be costly. Yet, providers can better balance such costs by reevaluating their operations and unbundling work activities and business processes into discrete sets of tasks.

¹ PricewaterhouseCoopers, *Strategies for service providers to transform workforce management into a competitive differentiator*, 2008.



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Unbundling will enable outsourcers to successfully leverage dispatch models for resource deployment on standard, repeatable transaction-based tasks while reserving higher-cost talent for more-value-added functions.

Aligning resources with corporate strategy

Providers continually make crucial decisions about what aspects of their business they want to sustain and grow, yet they often fail to align their talent inventories with these decisions. This type of examination requires that providers take a wide-angle perspective on how their strategic objectives, operational processes, and talent

pool should invigorate each other. By focusing on this alignment, providers will be able to establish talent profiles that are consistent with driving maximum business value, to realign third-party contractor spend on particular skills, and to develop adaptable models for internal people development.

Taking a supply chain approach

Some providers talk about establishing a deep talent bench, yet this approach is costly, not unlike that of maintaining excess inventory in a manufacturing environment. To effectively obtain, deploy, and train resources, providers need to apply supply chain management principles

that enable them to forecast future needs, minimize excess “inventory,” and quickly deploy resources in a just-in-time fashion.

Workforce management as the key

By adopting these three interdependent approaches, outsourcing providers will make their talent a competitive differentiator and an exceptional collaborative tool. This will enable them both to better deliver customer value and to achieve operational excellence.

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