Outsourcing: still on the learning curve

Outsourcing is here to stay, but companies still have much to learn if they are to benefit from it. Here Leslie P. Willcocks, Professor and Director of the newly established Outsourcing Unit at the London School of Economics and Political Science, explains the issues.

There are many signs of medium term node health in the business process outsourcing (BPO) market. Global revenues from outsourcing business processes and back office functions — examples include Human Resources, Procurement, Accounting, Administration, call centers — now exceed $100 billion. The market is expected to grow at between seven and ten percent annually over the next five years, and may exceed $200 billion by 2011. Outsourcing is not a fad, but is here to stay. This makes it all the more crucial to utilize the practice carefully and manage outsourcing to win in ways that achieve business advantage.

But IT outsourcing practices are still very much on the learning curve (see graph on right), as we have discerned in our research at the Outsourcing Unit, set up specifically to research, educate and advise on the phenomenon. If we are finding more recent evidence of moves from hype and hypomania toward maturity amongst clients and service companies alike, the learning has often been painful and slow. Organizations sometimes regress, or do not transfer well the learning from say IT to BPO, or cry new models, practices and service offerings they are not actually set up to deal with. In BPO, the supply side is less mature in its ability to deliver compared to IT, and clients need to check out carefully supplied claims of superior delivering, transformation and relationship capabilities. Outsourcing will continue to be very dynamic with, at last count, over 1,200 locations around the world already, and a revenue growth rate of possibly more than 25 percent per annum over the next five years, demanding a close-in house watchful brief on content, timing, cost, capability and location.

“Outsourcing the right activities to a capable supplier can be a real catalyst to major cost savings and service improvements”

Over the years the organizations that succeed with outsourcing, whether IT or BPO, exhibit certain attributes. They are smart in their ignorance and do not overreach themselves initially. They mitigate risks by outsourcing areas they understand and can write detailed contracts for, then become flexible with suppliers as they gain trust and confidence earned from actual supplier performance. They invest in building in house capability that allows them to develop a sourcing strategy aligned with business requirements over 3-5 years understand supplier strategies and capabilities and buy competitively and informally from the market. Management of their process architecture and technical trajectory, negotiate the deal that incentivizes the supplier while delivering on the client’s outsourcing goals and they build strong internal capability for post-contract management.

Much has been heard about jobs going offshore, and to some extent this has been a phoney war. An early part of a much bigger and longer term move towards globalisation of work facilitated by information and communication technologies. The simple equation of offshoring equals cheap labour has already been bypassed. For example, in the IT field the leading IT/BPO markets of USA and UK report considerable skill shortages over the next five years. We are also seeing major Indian companies moving to a “bestourcing” model, as we found with Tata Consultancy Services, for example, servicing IBM’s mainframe backend in Mumbai, Sao Paulo, Netherlands, Belarus and Budapest. Such companies are already moving more work onshore and sourcing locally as they move up the value chain. We are also seeing signs of “rural outsourcing”, as suppliers both offshore and onshore, move work to cheaper locations within a country or region, for example Minnesota and Arkansas in the USA.

In all this BPO prospects are good, but volatile. The potential for improving back-office functions is considerable. Frequently they have not been invested in, unlike information technology poorly, have a legacy of inefficient processes and the risk not receive the requisite senior management attention to change any of this. Outsourcing the right activities to a capable supplier can be a real catalyst to major cost savings and service improvements. But achieving this presents some major management challenges to suppliers and clients alike.

We see suppliers having to get used to silencing supply networks, which may well become the norm in large-scale outsourcing deals. As multi-sourcing dominates suppliers will have to get used to more customers in lower value deals, though some will continue to seek semi-exclusive multi-tower deals with their major customers. There will be constant downward pressure on costs fuelled by optimisation of labour arbitrage, cheap locations and streamlined use of technology and processes. Customers are likely to manage relationships more as strategic assets, and will expect suppliers to become more entrenched in the client’s business.

And as they outsource more, so clients are going to have to take the bullet on investing in outsourcing management. On our horizon, based on over 400 outsourcing deals, between eight and ten percent of contract value needs to be invested in building a high performing in house capability to run outsourcing governance, elect and deliver on business requirements, ensure technical capability, and manage leverage external supply. Too often clients discover this the hard way three or four years into a deal littered with problems, cost escalation and fire-fighting. In such cases it is all too easy to blame the supplier. We find time and again it rests at least 40/40 with the client. For the client on the learning curve here is one sure-fire way of moving in the right direction.

Leslie Willcocks is Professor and Director of the newly established Outsourcing Unit at London School of Economics and Political Science.

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**The Sourcing Learning Curve**

- **Phase 1:** Hyper and Fear
  - Focus on costs
  - Easy adopters

- **Phase 2:** Market Maturing
  - Ratchet practice emerge
  - Focus on cost

- **Phase 3:** Institutionalised
  - Focus on clients

- **Phase 4:** Transformation
  - Focus on learning

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**Key global BPO destinations**

- Offshore
- BPO
- IT Outsourcing
- Internationalised
- Focus on clients

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**LSE Information Systems**

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***Image information***

- Page dimensions: 595.0x842.0
- Illustration: "The Sourcing Learning Curve" graph
- Notes: Vertical alignment, use of contrasting colors, and clear segmentation.