



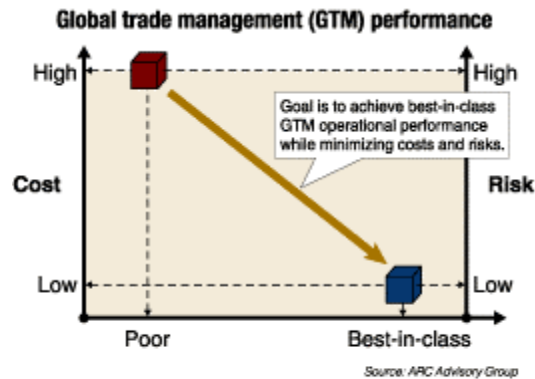
Outsourcing separates winners and losers

Farming out non-core processes pays dividends for those who do it right

By Scott Bury

Here's something you may not know about business process outsourcing, or BPO: roughly half the time it fails to deliver the anticipated benefits.

That fact, uncovered in a study conducted last year by New York-based **McKinsey & Co.**, raises the question of why outsourcing remains a popular business strategy, with analyst groups like Stamford, Conn.-based **Gartner** expecting companies to spend more than \$133 billion on it this year alone.



In a report on outsourcing global trade management, a primary goal of outsourcing is achieving best-in-class performance while minimizing risks and costs.

The simple answer is that when outsourcing is done properly, the benefits are substantial. For instance, **Forrester Research**, Cambridge, Mass., estimates that most large and medium-size companies can lower the cost of supporting their IT infrastructure 20 percent to 40 percent by outsourcing that function.

"Better service at a lower cost is the main benefit of outsourcing any business process," says Andrew Kris, advisory board chairman for the Shared Services and Business Process Outsourcing Association (SBPOA), an independent, not-for-profit organization offering information and advice to companies that either want to outsource business processes, or establish a shared-service program in their own organizations. SBPOA's growth over the past seven years—from zero to more than 7,800 members—attests to outsourcing's popularity.

"In a typical business today, 40 percent of employees are in administrative positions such as human resources, accounting, legal services, supply chain management, or logistics," says Kris. "None of these are core competencies—the activities that actually generate revenue." That, in Kris's view, makes these functions good candidates for outsourcing.

In the manufacturing sector, this sentiment permeates the high-tech and electronics industries, where companies have come to view the design and marketing of new products as their core competencies. Other functions—including the actual making of the product—are turned over to

subcontractors, many of which make popular products such as computers and cell phones on behalf of a number of customers.

Outsourcing's appeal

Solectron, Milpitas, Calif., has built an \$11-billion annual business by functioning as the manufacturing arm for such well-known companies as **Cisco**, **Lucent**, and **Nortel**.

Manufacturers are turning to outside contractors like Solectron more often these days for many of the same reasons that companies in other industries—such as insurance carriers that farm out claims processing—are attracted to the outsourcing model.

An outside contractor typically can lower the cost of performing a specific function because doing the work of multiple companies in a single location offers the benefits that come from economies of scale—such as the ability to purchase large volumes of parts for a lower overall price. The subcontractor also will normally have an easier time adjusting to demand fluctuations because its workforce—and its production capacity—can be spread out among its various customers' projects.

Having the outside contractor take responsibility for capital equipment can be an especially attractive benefit to CFOs and CEOs, who sometimes see the purchase of new equipment as bothersome overhead.

"We allow our customers to turn fixed assets into variable assets," explains Dave Cooper, VP of global program management and supply chain solutions at Solectron. "You have to ask whether it makes more sense to build another factory or to outsource that manufacturing to someone who already has economies of scale."

Ideally, BPO should mean that every participant in the supply chain is performing its own core competency, and the entire chain is operating at optimal efficiency. For instance, a global manufacturer with customers that demand spare parts be available within two hours after any existing part fails—anywhere in the world—would find the cost of providing that service on its own astronomical. But that same service probably could be performed much cheaper—and much more efficiently—by a company that specializes in global logistics or supply chain management.

This concept of each supply chain member excelling at a small set of dedicated functions is practiced regularly in the high-tech electronics arena.

"Today, electronics is an industry of specialists," says Peter West, VP of marketing for **RiverOne**, a supplier of software and services for managing supply chains, including relationships with outsourcers. "Computer companies are either world-class component manufacturers, or they are brand owners—not both. To be competitive, you have to pick a point in the supply chain and excel at it."

Solectron actually has a set of core competencies, but they all revolve around manufacturing and delivering products that are designed by Solectron's customers. "A customer can have an idea and nothing else, and we can build a prototype, a production model, and ramp up production to deliver it quite quickly," says Cooper. "Or, the customer may have a tested product ready to go into production, and we can manufacture it in the geographical areas that would make it most efficient for delivering the product to its various markets."

Why outsourcing fails

The existence of partners like Solectron offering such wide-ranging services begs the question of why nearly half of all outsourcing initiatives fail. An SBPOA survey of companies that had bad outsourcing experiences found a lack of support from executive management to be a major cause of failure. Also on the list was the tendency for companies to view outsourcing as a means of simply centralizing a process that had been performed in multiple locations rather than taking the opportunity to actually improve the process. Some survey respondents blamed the failure on "uncompetitive third-party suppliers."

Solectron's Cooper says there are many potential pitfalls in the outsourcing model, which is why it's important that both parties in these arrangements are committed to working as true business partners. Just dealing with questions such as which partner will hold inventory at various stages of the product development and delivery cycle can have a huge impact on the overall success or failure of an outsourcing program, he says.

So, how can manufacturers avoid outsourcing's pitfalls? The first step is to take a hard look at your company and identify your important activities—your own core competencies. Anything not on that list could be a candidate for outsourcing.

For a manufacturer, making the product might be a core competency, but if you examine the business closely, you might find your core competencies are limited to product research & development. "Nike would never want to outsource its research or design functions," says William Martorelli, an analyst with Forrester Research, "but it doesn't actually manufacture anything itself. All the production and the logistics are outsourced."

Once you have identified core processes, don't just assume everything else should be outsourced. "Just because it's not core doesn't mean it's not strategic," warns Jason Gilroy, VP of outsourcing services for **ICG Commerce**, an outsourced procurement services provider based in King of Prussia, Pa.

"[The decision to] outsource involves a number of variables, including the makeup of the organization: its size, age, history, how distributed it is geographically, and the structure of its competition," says Kris of the SBPOA. Often, new companies find it easier to outsource processes than established companies, which may have to "unravel" a process that's deeply integrated into several divisions of the enterprise. This may partially explain why outsourcing is so popular in the high-tech electronics space, an industry populated by a large number of relatively young companies.

"Some companies are continually in-sourcing, then outsourcing processes like logistics," says Stephanie Williams, an executive with New York-based **Choice Logistics**.

Efficiencies in processes typically result from achieving a certain volume. A manufacturer with one production location may find it most efficient to hire one person to manage all logistics; as it starts exporting overseas, it may benefit from a relationship with an export specialist; as it grows and logistics become more complex, a closer relationship with a logistics or supply chain outsourcer may be more efficient; then again, when it grows larger, hiring an internal logistics or supply chain management staff may be the most efficient choice.

Martorelli, the Forrester analyst, recommends benchmarking the efficiency of your processes. Look at real costs and other financial drivers, and find the return each process delivers.

Find real partners

The search for outsourcing partners should focus on companies whose core competency is performing the process that needs to be outsourced. You also want to make sure the outsourcer's corporate personality matches your own.

Experts say a successful outsourcing relationship requires that the outside contractor be more than just a supplier; they must be a true business partner, in effect an extension of the organization.

"A lot of the work we do is in designing the supply chain and proving that we can supply what the customer wants in the time and the way that they want it," says Solectron's Cooper.

Much of this happens by setting clear goals for the outsourcing relationship. A statement of work detailing expectations should be drafted. A list of performance metrics also should be created, along with a formal process—supported by IT when possible—for tracking how well the contractor performs against those metrics.

Enterasys, an Andover, Mass.-based supplier of IT networking infrastructure components, has mastered these techniques. Enterasys provides and installs all the components an enterprise needs to run a secure IT network, although it does not manufacture any of those components. Instead it designs them and relies on outside contractors to build the actual product. "That's the [outside contractor's] core competency," explains Tom Bunce, VP of field service at Enterasys.

Enterasys began outsourcing all its manufacturing in the 1990s, and it constantly looks at all its processes to determine whether others should be outsourced. A year ago, the company outsourced its supply chain management to **Baxter Planning Systems**, Austin, Texas, which also sells supply chain management software. Baxter manages Enterasys' parts-inventory depots around the world, and oversees all the supply chain functions, including the software that controls it.

"Baxter has enabled us to cut the number of inventory stocking locations around the world by about 30 percent, without reducing our fulfillment level," says Bunce. In fact, the customer fulfillment level actually has gone up to 99 percent—that is, 99 times out of 100, customers' requests for delivery are accomplished on time and on budget.

"Maintaining two-hour delivery times around the clock—and around the world—requires a very complex system of inventory depots and logistics so that they have inventory very close to the market. That could lead to huge costs," explains Greg Baxter, founder and CEO of Baxter Planning Systems.

Enterasys continues to examine all its business processes to determine if others should be outsourced, including finance and accounting, logistics, human resources administration, and even customer service. Bunce anticipates having a list of candidates ready by the beginning of 2006.

"'We've always done it this way' doesn't stand in our company," he says. That's a good motto for creating a successful outsourcing strategy.

Why business process outsourcing?	
Benefits	Issues
<ul style="list-style-type: none">● Some services can be provided more effectively by others● Allows the company's departments to spend more time focused on core and strategic activities● Often available 24 hours a day● Sophisticated reporting and data capabilities● Have a standard, integrated platform● Sometimes cheaper through economies of scale	<ul style="list-style-type: none">● Outsourcing provider may not understand company culture and processes● Quality of service can be an issue● Outsourcing provider may not be as invested in company's success● Getting processes to an "outsourcable" state● Initial resistance to change

Source: SIBPCA

Outsourcing can be rewarding for companies that learn to avoid its pitfalls.