PART ONE

How to Plan, Lead, and Manage Outsourcing Initiatives

CHAPTER 1

Overview of the Outsourcing Process

> Outsourcing is not a threat to this nation's economy—it is an opportunity to raise American paychecks, productivity, and prosperity. It's an opportunity we will squander if we let the alarmists stampede us into boneheaded solutions.
>
> —John Castellani, president of The Business Roundtable to the Detroit Press Club, February 24, 2004

The purpose of this book is to establish guidelines, offer insight, and provide inspiration, so that you will be able to realistically identify, analyze, and maximize outsourcing opportunities. You'll learn how to:

1. Evaluate your business processes.
2. Identify outsourcing opportunities in processes.
3. Select vendors/suppliers/partners.
4. Negotiate successful contracts with vendors.
5. Establish successful working relationships with vendors.
6. Manage a multiple vendor environment.
7. Turn around a failing outsourcing relationship, or, when necessary, replace vendors.
8. Govern vendor relationships on a day-to-day basis.
9. Implement and track service level agreements (SLAs).
10. Anticipate, and avoid when possible, outsourcing problems; solve problems when they do arise.
11. Ensure success.

Outsourcing Terminology

It would be impossible to achieve the objectives just described without first ensuring that everyone reading this book understands the terminology of outsourcing as it is used here (see Chapter 3 and the Glossary). Therefore, we'll begin with two definitions:

Outsourcing. The act of obtaining services from an external source.

Business process outsourcing (BPO). Outsourcing as referred to in the corporate environment. BPO occurs when an organization turns over the management of a particular business process (such as accounting or payroll) to a third party that specializes in that process. The underlying theory is that the BPO firm can complete the process more efficiently, leaving the original firm free to concentrate on its core competency.

Outsourcing is essentially a basic redefinition of the corporation around core competencies and long-term outside relationships. These core competencies and outside relationships are identified with two objectives in mind: (1) to bring in the greatest value to the end customer and, (2) to ensure the highest level of productivity for the corporation itself. A number of BPO functions are listed in Table 1.1 on pages 22 and 23.

The benefits of corporate outsourcing are numerous. The following list is not intended to be comprehensive, but to stimulate your enthusiasm for this process:

- Increase sales opportunities.
- Improve corporate image and public relations.
- Prevent missed opportunities.
- Reduce annual costs almost immediately.
- Enable business to focus on core competencies.
- Reduce or eliminate customer complaints.
- Increase customer loyalty.
- Lower costs on projects and events.
- Beat competition.
- Make time and resources available.

Levels of Outsourcing

There are three levels of outsourcings: *tactical, strategic,* and *transformational.*

Tactical Outsourcing

On the first level, tactical, the reasons for outsourcing are usually tied to specific problems being experienced by the firm. Often the firm is already in trouble and outsourcing is seen as a direct way to address problems. Typical examples of "trouble" are: the lack of financial resources to make capital investments, inadequate internal managerial competence, an absence of talent, or a desire to reduce headcount. Not surprisingly, tactical outsourcing often accompanies large-scale corporate restructuring. Thus, many tactical relationships are forged to:

- Generate immediate cost savings.
- Eliminate the need for future investments.
- Realize a cash infusion from the sale of assets.
- Relieve the burden of staffing.

The focus of tactical outsourcing is the *contract,* specifically, constructing the right contract and, subsequently, holding the vendor to the contract. Traditionally, the expertise for making these arrangements came from the purchasing department. However, there is an emerging expectation that every manager involved in the supply chain process understand and be accountable for the aspects of outsourcing that affect their area of charge. Establishing and maintaining tactical outsourcing relationships, specifically functional or comprehensively, is the responsibility of the entire organizational team. Frequently, the contract was simply a fee for services, with much of the value stemming from the discipline of spending dollars externally. When managers formed successful tactical relationships, the value of using outside providers was clear: better service for less investment of capital and management time.

Strategic Outsourcing

Over time, as businesses sought greater value from outsourcing relationships, the goals of these relationships changed. Executives realized that, rather than losing control over the outsourced function, they gained broader control over all of the functions in their area of responsibility, hence, were freer to direct their attention to the more strategic aspects of their jobs. Facilities managers, for example, could focus more on infrastructure issues, instead of worrying about staffing janitorial positions. Technology executives could hand over running of the data center to a service provider and turn their attention to serving the needs of internal customers. This logic remains compelling.

Table 1.1
Elements of Business Outsourcing

Human Resources Services	*Knowledge and Decision Services*	*Operations Support Services*	*Marketing Services*
Benefits administration	Content solutions	Architecture and engineering	Marketing programs
Employment process outsourcing	E-Learning and education solutions	Re-engineering	Printing
Hiring	Point solutions	Facilities management	Fulfillment
Recruitment	Procurement and purchasing	Global delivery and sourcing	Advertising
HR/Personnel management	Project management	Healthcare and medical services	Sales and sales management
Payroll	Supply chain management	Manufacturing	Strategic planning
Professional employer organization	Systems integration and consulting	Office solutions	Fund raising and foundation management services
Recruitment process outsourcing	Transformational outsourcing	Document management	Business communications
Staffing services	Decision support systems	Pharmaceuticals	Public relations
Talent and human capital outsourcing	Data analytics	Research	Web development
Training and staff development	Data mining	Real estate management	
Workforce consulting and management	Data warehousing	Retail	
		Scientific and engineering	
		Telecommunications	
		Telephony	
		Venture capital outsourcing solutions	
		Transportation administration	
		Logistics	
		Dispatch services	

Customer Interaction Services	*Back Office Transaction Processing*	*Information Technology and Software*	*Operations Finance and Accounting Services*
Call centers	Administrative and management support services	Applications development	General accounting
Collections	Back office processing	Applications maintenance and re-engineering	Audit
CRM	Banking/checking/ATM/transaction processing	Application service providers	Accounts payable
Customer contact services	Payment processing	Cybersecurity and infrastructure support	Banking
Government sourcing	Business support systems	Data base management	Financial services solutions
Customer services voice and email	Document management and processing	Data center management	Credit services
Telesales	Forms management	Design and multimedia	Insurance processing
Order processing	Payroll and benefits processing	Requirements engineering	Tax services
Customer support	General transaction processing	Packaged application outsourcing	Billing systems
Technical support	Tuition and scholarship services	Implementation services	Accounts payable
Warranty administration	Collections	Enterprise storage solutions	Accounts receivable
Customer feedback	Accounts receivables processing	ERP implementation	Collections and credit
Stakeholder feedback	Billing services	Comprehensive IT services	Compliance
Client satisfaction surveying	Direct and indirect procurement	Flexibility	Management reporting
		IT strategy and planning	
		Decision support	
		Systems development	

To meet the requirement of earning greater value from outsourcing, how it was used and where it was applied had to change. The scope of outsourcing relationships grew significantly, as did the service provider's involvement. By virtue of the increasing dollar value of the relationships, the integrated scope of services, and the length of the new relationships, outsourcing was no longer a tactical tool but a strategic tool. Most important, the managerial mind-set regarding the nature of these relationships matured, from one between buyer and supplier to one between *business partners.*

Strategic outsourcing relationships are about building long-term value. Instead of working with a large number of vendors to get the job done, in a strategic model, corporations work with a smaller number of best-in-class integrated service providers. These relationships thus evolve from vendor-supplier arrangements (which are often adversarial) to long-term partnerships between equals, with the emphasis on *mutual* benefit.

Transformational Outsourcing

Transformational outsourcing is third-generation outsourcing (Table 1.2). The first stage of outsourcing involved doing the work under the existing rules; the second stage used outsourcing as part of the process of redefining the corporation. This, the third stage, uses outsourcing for the

Table 1.2
Transformational vs. Traditional Outsourcing

Transformational Outsourcing	*Traditional Outsourcing*
Business focus	Operational focus
Centered on creating value	Centered on cutting costs
Assists in managing uncertainty	Assists in establishing controls
Aligns with the business processes that revolutionize in harmonization with your strategic goals	Aligns with basically unchanged business processes
Based on fashioning a network of partnerships in the new connected global economy	Based on external (primarily IT) specialists realizing higher performance for the client than internal nonspecialist resources
Business cost and re-engineering facilitate perpetual value creation	Removes noncore functions from the business to provide a one-time discharge of capital

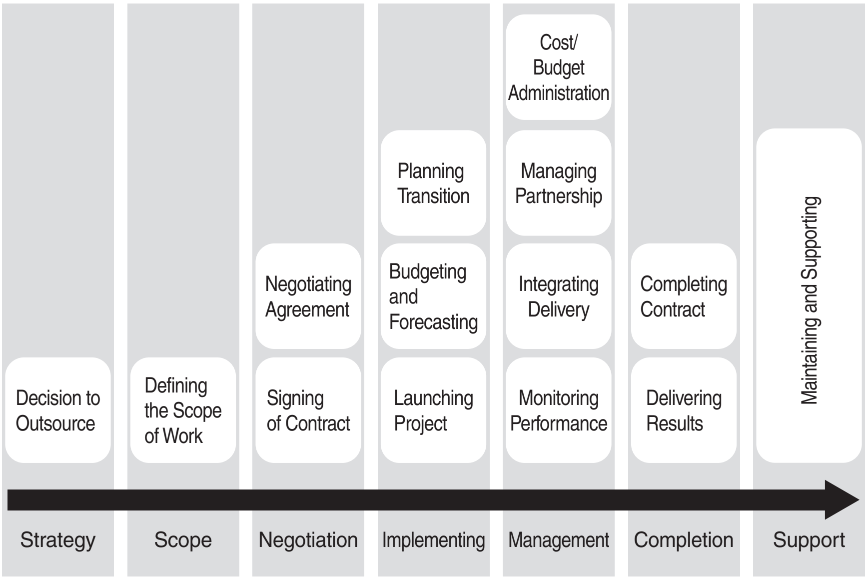
purpose of redefining the *business.* To survive economically today, organizations must transform themselves and their markets in an ever more daunting challenge to redefine the business world before it redefines them. To that end, outsourcing has emerged as the single most powerful tool available to executives seeking this level of business change. Those who take advantage of transformational outsourcing recognize that the real power of this tool lies in the innovations that outside specialists bring to their customers' businesses. No longer are outsourcing service providers viewed only as tools for becoming more efficient or better focused; rather, they are seen as powerful forces for change—allies in the battle for market and mind share.

Phases of the Outsourcing Process

The phases illustrated in Figure 1.1 are part of any outsourcing process:

1. *Strategy phase.* You define the objectives and scope of the outsourcing concept and determine the feasibility of outsourcing before making the decision to proceed. Also, you plan the total effort in terms of time, budget, and necessary resources.
2. *Scope phase.* You establish baselines and specify the service levels required of vendors. You clarify relationships between the function(s) to be outsourced and those functions that remain in house, to include proper interfaces. You develop the request for proposal (RFP); collect and analyze responses from vendors; and, finally, choose a vendor.
3. *Negotiation phase.* Negotiations proceed with the chosen vendor until a contract is drawn up and, ultimately, signed by both parties.
4. *Implementation phase.* This phase marks the transition from in-house provision of services to outsourcing.
5. *Management phase.* Throughout this phase, you manage the outsourcing relationship with the vendor. It includes the negotiation and implementation of any changes in the outsourcing relationship seen as necessary to ensure a successful outcome.
6. *Completion or termination phase.* At the end of the contract period, you make the decision either to negotiate another contract with the same vendor or to terminate that relationship and align with a new vendor; and the cycle begins again. Alternatively, a decision is made to bring the function back inside the organization.

Figure 1.1
Black Book Model of Successful Outsourcing



There will always be some aspects of the outsourcing arrangement that will be unpredictable and thus will evolve over the life of the contract. However, there are key deliverables and activities for a sound BPO relationship each step of the way. These include the prerequest for proposals phase and postcontract governance. Without these, you and your colleagues may find yourselves saying, "Outsourcing didn't work for us." To ensure you do not become one of the failure statistics, use the time wisely *before* you sign a contract, to integrate your own best practices into the terms of your outsourcing deal.

Remember, outsourcing providers are *partners* to whom you give significant managerial discretion as to how to deliver the service they offer; it is they who will manage the day-to-day delivery of that service. To generate the value you define, it is essential that these partnerships become long-term relationships. You want your partners to understand your business in depth, so that they can meet your requirements today and develop better ways to service your firm in the future. In sum, managing the outsourcing relationship is one of the most important tasks undertaken by executives today.

Monitoring the Evolving Outsourcing Environment

As the outsourcing environment evolves, not surprisingly, conflicting information surfaces as to how to make an effective decision about the process. This decision is complicated by the growth of the outsourcing market and the wide range of services now available. To evaluate their options accurately, companies must first be able to identify their reasons for outsourcing and then specify costs and benefits of the process. Managers must also be able to match their specific needs with both the correct service and the correct service supplier. Let's examine the possibilities:

- *Outsourcing versus supplier relationships.* As previously defined, the term *outsourcing* applies to an activity formerly done by an organization internally. Outsourcing relationships replace or substitute the services of an external provider for current internal capabilities.
- *Outsourcing versus consulting.* Many companies concurrently position themselves as offering both consulting and outsourcing services. Unfortunately, they don't clearly distinguish between the two, and in the process confound the situation. The difference would seem to be clear-cut: Consultants advise companies on how to do something; outsourcing providers "just do it." However, sometimes a consultant will also deliver a business service or product, hence acting like a provider; other times, an outsourcing provider will advise, hence acting like a consultant. Generally, the distinction is easy to make. Most professional services firms fall into one of three categories: consultants, providers, or some combination of the two.
- *Outsourcing versus out-tasking.* Outsourcing relationships are high value-add, robust, and ongoing—that is, they are not a one-time only deal. In contrast, out-tasking refers to turning over a narrowly defined segment of business to another business, typically on an annual contract, or sometimes a shorter one. This usually involves continued direct or indirect management and decision making by the client of the out-tasking business. Out-tasking is an emerging concept. Out-tasking defines the boundaries necessary to explain to a workforce that it is being evaluated for possible outsourcing. With the uncertainty of today's business climate, facility managers are reluctant to discuss an outsourcing possibility until the benefits are certain. At that time, the concept of out-tasking seems to make the explanation easier and is restrictive enough to help employees understand the overall and final

effects of out-tasking. For example, hiring an outsourcing vendor to set up your new human resources technology, a manufacturer to handle production when demand exceeds capacity, or an overnight delivery service to deliver urgent packages. As explained in the preceding discussion on phases, outsourcing relationships are high-level, contractual relationships for a fixed period of time, usually measured in years, and they are assumed to be continuous. Provider and user often work to define the service delivered; there is frequent interaction and communication between user and provider. The outsourcing service is customized to the needs of the user.

Outsourcing versus Worldwide Sourcing

Business officials leading a new coalition to combat efforts to prevent companies from moving some operations overseas know they have a public relations problem, and they are preparing to act. Although the tone of outsourcing is softening, outsourcing has become a dirty word. Corporate leaders are working hard to try to strike outsourcing from the lexicon.

Business coalitions are rallying around worldwide sourcing as a less provocative term for the movement of jobs around the globe. The change is part of a new strategy to try to impart the business community's view that preventing firms from relocating outside the country to reduce costs will restrict competitiveness and ultimately cost jobs.

Leaders of one business alliance, the Coalition for Economic Growth and American Jobs, have also lobbied officials at the White House, the Commerce Department, and the Office of the U.S. Trade Representative to brief them on the new message of worldwide sourcing.

Business Roundtable President John Castellani told *CongressDaily* the new outsourcing public relations campaign stemmed directly from the torrent of attacks on outsourcing in the Democratic campaign. "Our concern was that if we didn't respond, we ran the risk of having a reversal of those kinds of policies that promote economic growth and job creation," he said. Castellani and others in the coalition referred to their opponents as "isolationists."

Castellani said worldwide sourcing was a more appropriate term because outsourcing has for decades referred to efforts by companies to more efficiently manage their costs by contracting with other domestic producers. With worldwide sourcing, "you participate in worldwide markets, you do the things in those markets appropriate to products and services and do things in the United States that we're best at—design and innovation," Castellani said.

Governmental administration officials appear undecided on whether they will adopt the term worldwide sourcing instead of outsourcing. With the disastrous exception of Council of Economic Advisors Chairman Gregory Mankiw, Bush aides already studiously avoid using the term outsourcing.

The administration also has avoided using the term *outsourcing* to describe its efforts to subject hundreds of thousands of federal jobs to competition from private firms. Administration officials say the term *competitive sourcing* is more accurate, because when agency teams win the competitions, the jobs are not outsourced.

Facing the Challenges of Outsourcing

No powerful tool is without its challenges, and outsourcing is no different. The three most common outsourcing challenges you'll face are:

1. Choosing the right partner(s).
2. Establishing effective governance for the relationship.
3. Managing employee transitions with sensitivity.

These may seem obvious, but there is one other challenge that can catch managers by surprise: *accidental transformation.* What does that mean? Simply, that companies may outsource without realizing that the profile or style of the outsourced function makes a difference in its success. An incompatibility of styles can cause unanticipated changes, sometimes positive and sometimes negative, so it's important to be alert to such activity.

Managers can also fall prey to another cause of failure for the new outsourcer relationship: ignoring the "real work," which begins *after* the deal is signed. To avoid this pitfall, outsourcing must be approached as a project, one with a clearly established life cycle that needs to be managed every step of the way.

Changes wrought by outsourcing require both organizations and individuals to develop new success skills. For instance, an executive who operates on business-process management principles will likely be rewarded for having fewer staff and running a lean operation. Also favored will be those who leverage third-party relationships that don't tie up capital and consume resources. Business professionals will be working with a skeletal operating model with few fixed but many variable costs. At any given time, a competitive company will likely have a number of business functions that it is considering for cost savings and value improvement.

LOU DOBBS: TRUE CRUSADER AGAINST "EXPORTING AMERICA"

In March 2004, James Glassman pointed out in *Tech Central Station* that CNN pundit Lou Dobbs, possibly the reddest face of the anti-outsourcing position, was praising companies like Boeing and Washington Mutual as worthy stocks in his eponymous investment letter . . . even though he was bashing these very same companies for offshore outsourcing on his CNN show, *Lou Dobbs Tonight.*

In June 2004, Zachary Roth at *CJR's Campaign Desk* followed up on this tendency of Dobbs to say one thing to his viewers and another thing to readers of his investment letter:

> Unlike most investment advisors, Dobbs goes beyond talking up the earning potential of these companies. He typically goes out of his way to praise them as good corporate citizens. The newsletter keeps a running tally of the companies profiled, under the heading, "The following companies have been featured in the 'Lou Dobbs Money Letter' as those doing good business with good people." The appeal is alluring: You're not just buying a smart investment choice, you're buying a piece of good citizenship.

Dobbs devoted a column in his March ($398 annual paid subscription investment newsletter) issue touting the prospects of the Minnesota-based Toro Company, which makes outdoor landscaping-maintenance equipment. He told subscribers that Toro was a "long-term wealth-builder," and praised Toro's "formal code of ethics, something I think is sorely needed at more of America's companies," and its ". . . exemplary corporate governance structure, which aligns the interests of shareholders, employees, and customers." He concluded his interview with Toro CEO Kendrick Melrose by frankly telling him, "I like the way you treat your shareholders, employees, and customers."

One wonders whether Dobbs' admiration extends to Toro's 2002 decision to move 15 percent of its workforce—about 800 jobs—to Juarez, Mexico. Indeed, CEO Kendrick Melrose might be interested to know that Toro appears on Dobbs' own list of companies that are "exporting America." And Toro is not alone. Of the 14 companies Dobbs has highlighted for investors since starting his newsletter last year, eight appear on his CNN web site as companies that outsource jobs.

Conclusion

It's tough to argue that productivity is very important. Productivity means doing more for less. Productivity means lower costs to consumers, which, in turn, frees consumers to spend the money they save on new products and services. That leads to economic growth.

In 1900, 40 percent of U.S. employees worked on farms. Today, less then 2 percent of the American population generates all the food the entire United States needs, which is a much more significant quantity that it was 100 years ago. At the same time, grocery shopping requires a far smaller percentage of our paychecks than it cost our great grandparents at the turn of the past century. We then use our excess money to build bigger houses, buy computers, new cars, iPods, big screen TVs, and take vacations.

Follow this closely: Indirectly, our food cost savings has paid for the creation of a vast array of new products and services introduced since 1900, as well as jobs for the people who work to create and sell those products and services.

Politicians, kings, ministers and priests, and public service workers have attempted to resolve the problems of world poverty for decades. The only opportunity that the poverty-stricken billions of world residents who live on very little have of someday living lifestyles like those of us in the United States . . . lies in economic growth. And economic growth is driven by increases in productivity.

In 2005, the one clear path to productivity is positioned in outsourcing. In shifting jobs offshore that can be done by cheaper and, in some cases, less skilled, workers to foreign locations, productivity escalates.

As a result, of outsourcing, prices fall, Americans and Europeans have more money left after they buy what they need and can then spend it on new products and services, creating new industries and new jobs, particularly in the United States, United Kingdom, and other developed countries.

The drama and political mudslinging created through the 2004 U.S. presidential election have clearly backed off from outsourcing. Outsourcing is being recognized in its rightful place as the most important business shift of the new century.

Up to this point in business history, it's been easier to think of outsourcing as a concept in the abstract. Recognizing it is ultimately for the common good, sooner or later, all business leaders will either voluntarily or involuntarily become required to manage outsourcing changes. In the *Black Book of Outsourcing* we take the concept out of the theoretical and abstract and into concrete actionable steps for you.

The dark future forecast by some outsourcing pundits doesn't have to be so grim if you take action now. The advice in this book is intended to lead many of you to acquire skills that extended your education and experiential value and preserved your job, particularly if you transition into outsourcing.

We are going to have to live with the realities of a global economy and the relentless demands for greater productivity and outsourcing for the rest of our lives. And our children are going to have to live with the same realities. Some will suffer while others will prosper as we negotiate the changes that outsourcing is presenting. This book is a great start toward ensuring that you position yourself appropriately as well as in advising new college graduates and outsourced job seekers.