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The outsourcing decision for a globally integrated enterprise

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Introduction

For years CIOs and other IT executives have wrestled with mounting infrastructure cost and complexity. The decision to outsource was based on addressing these primary concerns, with vendor selection centered on the promise of cost reduction and improved IT performance. Now, as the economy shifts into recovery mode and companies return their attention to strategic growth, the outsourcing decision process—and the decision makers—are changing.

Today's CIOs are seen as part of the broader executive team. Still charged with running the technology show, they are increasingly being tapped to weigh in on strategic business decisions. At the same time, their C-level business colleagues are exercising greater influence over business-enabling IT investment decisions, like outsourcing.[1] These executives are keenly aware of the expanded value outsourcing can bring in helping the organization achieve its global business objectives—especially when cash and credit sources are tight. However, while outsourcing enables companies to continue moving forward, providing a lifeline to new technologies and expertise without incurring training, hiring and capital costs, company leaders are demanding higher rates of return from outsourcing arrangements, and they've shortened the runway for those returns. To be sure, they're looking for cost optimization over the short term, but they are expecting outsourcing to deliver tangible and transformative business results over the long term.

The global economy and rapid advances in technology have shifted the measure of success, driving companies to rethink how they acquire and deliver services. Business leaders are questioning the company's ability to do everything well and seeing the benefit of siphoning off some of their more costly core business functions—not just the transactional, back-office processes that characterize traditional outsourcing engagements. At the same time, they are recognizing that outsourcing has the potential to deliver extraordinary business value above and beyond simple cost savings and operational efficiencies. They are coming to the realization that outsourcing is less about labor arbitrage and more about accessing the myriad of global talent available to businesses today. Rather than limiting themselves to local resources, they are striking strategic relationships with business partners, suppliers and customers around the world to leverage the most optimal nodes of expertise in every area of the operation.

By connecting companies with new ideas, information and expertise, outsourcing spawns opportunities for collaborative innovation. It enables companies to take advantage of the global marketplace, to pick and choose the work they want to do and where they want to do it to drive the greatest profit. In that way, outsourcing is a fundamental enabler for the globally integrated enterprise: an organization that sees beyond traditional geographical limits and can leverage the world's best resources to drive the business forward. Forward-thinking companies such as this have mastered the challenges that go along with connecting and delivering services across organizational and geographic borders. They have made the necessary structural, operational and cultural transformation and have what it takes to compete successfully in the new world economy.

The changing nature of outsourcing

Today the vast majority of companies outsource some percentage of their organization's labor and processes, and that number is expected to rise. As the market has matured, outsourcing has become an integral part of enterprise business strategy, embedded in daily activities for most IT departments and increasingly leveraged for HR, finance and other business processes. Cloud computing models have helped to further this notion, encouraging diehard do-it-yourselfers to experiment with alternative delivery models to lower their costs, take advantage of new services in the global marketplace, and flex their innovative muscle.

While the economic downturn put many outsourcing initiatives on hold, they are being resurrected as world markets begin to stabilize and show signs of growth. Certainly, considerable pressure to cut operating costs and improve efficiency is still being felt up and down the supply chain, and outsourcing is expected to address these issues. But there are new expectations. Now more than ever, commodity benefits like better resource utilization and reduced downtime are merely the price of admission for new outsourcing initiatives; they are not driving the outsourcing decision.

These days, companies are making more informed decisions about outsourcing, and they want to unlock its greater value. Savvy executives view outsourcing's business and operational risks and the associated time and resource commitment as a necessary trade-off. They've reconciled the expected pains for potentially sizeable gains, and they are looking to realize substantially greater strategic and transformative outcomes from their outsourcing agreements. Moreover, in lieu of the traditional client-provider relationships, these companies are intent on establishing strategic partnerships to extend their opportunities for growth. They want to ensure that outsourcing's risks and rewards are shared and its value propositions are structured around their business objectives.

In this era of globalization, where customers determine business survival and firms that are virtual unknowns one day can be fierce competitors the next, the need for uncompromised efficiency and service delivery has never been stronger. Companies entering into outsourcing agreements expect to improve their business-critical IT processes and provide more predictable performance, but they aren't limiting outsourcing to IT. They expect to take advantage of market-ready skills at a lower cost for key business processes including procurement, accounting and customer service. But they also expect outsourcing to free up the investment capital needed to help them pursue new revenue opportunities and focus on long-term growth strategies.

In 2010, IBM Research reported the results of a multiyear study aimed at understanding the business impact of IT, business and application outsourcing on 244 publicly traded companies. The analysis, which compared each company's financial performance for five quarters before and twelve quarters after outsourcing, revealed that companies engaged in large-scale outsourcing projects made significant financial gains. As soon as one year after the outsourcing engagements began, participating companies realized lower Selling, General and Administrative (SG&A) expenses and higher earnings before taxes (EBT) growth. Moreover, these companies consistently outperformed their non-outsourcing industry sector peers in SG&A, EBT, operating income and return on assets.[2] The implications for members of the C-suite are clear. Outsourcing can energize business performance and profitability while increasing the availability of funds needed for more strategic growth initiatives, such as innovation, agility and business process transformation.

The importance of innovation and business transformation

In the new global business arena, companies can no longer count on local and niche markets as their safe haven. Every market and every customer is up for grabs as companies vie for their piece of the global pie.

With market dynamics constantly changing and new entrants making inroads daily, the most vigilant and successful companies are continually striving to outdo competitors by differentiating themselves in ways that their competitors can't or won't. They are developing new competencies and alliances, and deploying innovative, new business models that enable them to preempt competitive threats while boosting market share.

Redefining business value through outsourcing

Eager to grow its customer base but challenged by an increasingly fragmented and redundant IT infrastructure, an Indian telecommunications provider knew that outsourcing was the only answer. In a bold move, the company shed its entire network operation and back-office business processes so it could focus on improving the customer experience. The payoff was big.

Cost savings from IT and business process consolidation facilitated the deployment of numerous differentiating systems, enabling customer-centric relationship management, self-service and behavior prediction capabilities. In three years, the company quadrupled its subscriber base and achieved one of the highest customer satisfaction ratings in the industry.

IBM's Global CEO Study 2006 first affirmed the importance of business model innovation to financial growth. Companies that implemented new or changed business models saw significant operating margin growth over a five-year period when compared with their peers.[3] IBM's next two CEO studies in 2008 and 2010 reiterated these findings, amplifying the association between business model innovation, competitive advantage and profitability.[4,5] In an increasingly volatile and uncertain economic climate, top-performing companies continue to be more committed to business model reinvention than their less successful peers. Their willingness to experiment with new concepts and overturn proven methods is building the kind of agility needed to respond effectively to competitive threats and shifts in consumer expectations. And these companies are seeing better financial results as a consequence.

Outsourcing factors heavily into innovation initiatives by breathing new ideas, fresh perspectives and flexibility into the organization. It makes new skills and partners accessible, facilitating collaboration and increasing opportunities for innovation and business transformation. Further, the savings generated through such outsourcing arrangements can, in turn, provide the venture capital to fund future innovation programs.[6]

Outsourcing and the globally integrated enterprise

Globalization and advances in technology have changed the way business gets done. Core business processes are no longer viewed unilaterally as proprietary. Large and small firms alike are seeing both core and noncore business functions as dispensable components that they can retain internally or offload to external partners, according to company need and strategic objectives. With worldwide access to what has become a global tapestry of talent and resources, business leaders are empowered to choose the tasks they want to do and where they want them done. Not only are they rethinking their current practices for everything from manufacturing to marketing, they are questioning whether those jobs could be done better and cheaper outside the organization. They are seeing the necessity of workforce alternatives like outsourcing and offshoring, and they are acting on it. IBM's 2010 CHRO Study found HR executives intent on extending the traditional workforce beyond current physical and functional boundaries in order to improve efficiency and promote growth.[7]

This more open-minded approach to getting work done enables companies to manage their operations, expertise and resources more fluidly, without the usual enterprise constraints. Moreover, it allows them to focus on service quality and delivering greater value to their customers, employees and business partners.

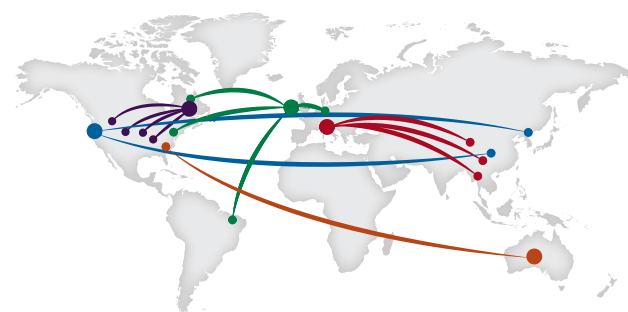
Companies with this mindset aren't looking to optimize the business within traditional limits. They aren't hampered by geographical borders, time zones or language. They are targeting the worldwide market to cut their costs and tap into new sources of skill and knowledge. Conducting business in this manner, choosing where and how work gets done in order to maximize business value, is the essence of the globally integrated enterprise.[8]

Globally integrated enterprise: A company that fashions its strategy, management and operations in pursuit of the worldwide integration of production and value. A company that seeks to use the best resources from the best locations at the optimum time to gain a competitive advantage.

Globally integrated enterprises have the ability to enter new markets and seize new business opportunities wherever they happen to arise. They have restructured the organization and eliminated process redundancy. They have replaced their autonomous country-led operations with a more seamless enterprise that leverages centers of industry and technical expertise scattered around the world. Rather than use only local resources and partners, globally integrated enterprises position themselves to take advantage of resources and partners around the world. They thrive in a global economy by:

- Securing specialized skills from a broad network of providers
- Leveraging infrastructures, applications, personnel and other assets wherever they reside globally for the best, most economical results
- Enabling systems and platforms for an open, collaborative work environment and embracing opportunities for external collaboration
- Adopting the global values, skills and processes needed to operate seamlessly across organizational, cultural and geographic boundaries
- Managing the risks associated with doing business in an open ecosystem.

Perhaps globally integrated enterprises have had their most visible impact in China and India, where manufacturing plants, service centers, and R&D facilities have sprung up by the thousands. But globally integrated enterprises reach far beyond emerging markets to find cost efficiency and growth opportunities. As these companies turn their attention outward to pursue the most cost-effective, highest quality providers, processes and places for production and delivery, they are also finding answers in the world's most progressive nations (Figure 1). Asian chipmakers are tapping engineers in the U.S. to improve their manufacturing technologies. Global investment banks are turning over their back-office derivatives processing operations to Dublin financial services firms specializing in these services. U.S. pharmaceutical firms are developing research and manufacturing facilities in Singapore. Favorable business and legislative conditions as well as technology-driven reductions in the cost of transportation and communications will continue to fuel such arrangements.



- Asian chipmakers tap U.S. engineers for expertise
- Customer service centers in Nova Scotia handle warranty inquiries for U.S. shoppers
- Global investment banks send derivatives processing to Dublin
- Asian clothing manufacturers outsource design work to Italy
- U.S. radiologists send x-rays to Australia for analysis

Figure 1: Leveraging the best hubs of skills and knowledge. Undaunted by the geographic differences in distance and time, globally integrated enterprises seek out partners that can help them deliver the highest quality service at a cost-effective price.

Changing how outsourcing decisions are made

Understandably, companies that are or aspire to be globally integrated enterprises have a new outsourcing agenda. These companies are more willing to hand over work they had previously performed in-house. But their decisions are not simply a matter of finding cheap labor. Cost takeout pressures aside, these companies are focused on value creation and the potential for new sources of revenue that outsourcing can deliver, especially as the economy recovers. Instead of outsourcing to cover short-term staffing and skills gaps, they see outsourcing as a means to drive the productivity gains that fund collaborative innovation and business transformation, while enabling them to emerge from the downturn leaner and more agile. They look to secure strategic relationships with partners who can take their business to the next level by ramping up their capabilities and providing them with the technology, infrastructure and analytics-based insights needed to differentiate their business model and trade in global markets. This focus on value creation represents a significant shift in how outsourcing decisions are made.

Business and IT executives still want outsourcing to produce the kind of predictable business results that shareholders demand (albeit without the rigid service levels), but they also want their outsourcing contracts to be flexible enough to allow for competitive adaptation in response to changing market forces.

In general, that means contract terms must be shorter and subject to renegotiation. And they must offer opportunities for variable pricing and pricing based on business outcomes. Almost two-thirds of the CEOs participating in IBM's 2010 CEO Study expect to infuse a greater proportion of variable versus fixed costs into their operating models. Outsourcing is likely to be a primary means to accomplish this because it allows companies to address market fluctuations without carrying excess operational and human overhead. IBM's CHRO Study confirmed this point, with 56 percent of HR executives expecting to do more outsourcing over the next three years to achieve greater workforce flexibility. They recognize that outsourcing will enable them to allocate the type and quantity of resources needed to support changes in demand, without paying for those resources when they are not in use.

Service delivery also factors into the outsourcing decision in a big way. Because globally integrated enterprises see outsourcing as a way to penetrate new markets, they want capabilities, skills and infrastructure delivered from wherever they perceive productivity gains and cost savings to be the greatest. As such, they are willing to form outsourcing partnerships with multiple specialized providers.

Primary driver	**Cost reduction driven by economies of scale**	**Cost reduction driven by value creation**
Measures of success	**Performance results, predictability, service level agreements (SLAs)**	**Business transformation, innovation**
Client-provider relationship	**Technology-based relationship**	**Business-based strategic partnership**
Risk/reward model	**Risks predominantly borne by client; rewards shared by client and provider**	**Risks and rewards shared by client and provider**
Service delivery model	**Local resources and partners**	**Globally diverse resources and partners**
Outsourced processes	**Noncore, back-office and support functions**	**Core and noncore business functions**
Skill access	**Access to a broad array of skills and services from a single or few providers**	**Access to specialized skills and services from multiple providers**
Contract	**Long duration; rigid terms**	**Shorter duration; flexible terms with option to renegotiate**
Pricing	**Fixed cost structures tied to IT performance**	**Variable cost structures aligned to business outcomes**

Table 1: Outsourcing decision criteria comparison

Outsourcing—the fundamental enabler

There is no doubt that companies are entering into outsourcing agreements to increase their ability to compete at a global level. After all, large outsourcing providers, in particular, bring significant global expertise and reach to the table. Moreover, outsourcing often opens the door to the kinds of collaborative projects, innovation partnerships, and communications and networking technologies that can facilitate global business. Towards that end, outsourcing is a fundamental enabler for the globally integrated enterprise.

Outsourcing increases the spread of shared technologies and open business standards that are driving global integration and enabling the free exchange of information. It can provide the tools and technologies to enable a government agency in one country to share intelligence with agencies in others. It can help commercial enterprises integrate their supply chains, overcome trade barriers, and establish business ecosystems and open-source communities. Outsourcing enables businesses to exploit the latest technologies, shifts in economics, and worldwide availability of expertise that are required for a globally integrated enterprise.

What are the implications for small business?

Small business is benefiting from the globally integrated marketplace. In the past, smaller companies were unable to tap into global resources because the cost of entry was too great. Now that more vendors are providing services globally and delivering services via technology clouds, the cost has come down considerably. Small firms can access the very same infrastructures, support services and other assets once only affordable to larger organizations.

Outsourcing enables companies to find global partners who are already in the business they want to be in. It allows them to fill a gap in their suite of services and take specific services to market. Instead of waiting for mergers and acquisitions to help them make these gains, companies are turning to outsourcing to reshape themselves, shedding the processes and operations that no longer distinguish them competitively and tapping into other providers' hubs of expertise for the skills and services they need. IBM, for example, sold its PC hardware business to Chinese PC-maker Lenovo and now outsources its PC procurement services to Lenovo. At the same time, Lenovo outsources marketing and sales support to IBM.

As businesses expand into global markets, outsourcing offers access to instant capacity, not just in computing infrastructure but in processes that are globally scalable. Whether this involves supply chain, call center support or integration processes, outsourcing enables global businesses to acquire the just-in-time capacity they need.

Important considerations for globally integrated enterprises

Globally integrated enterprises have to be willing to partner on a variety of levels to acquire desired skills and services, offload costly operations and market services that are profitable. In all cases, it's about finding partners that offer the optimal mix of expertise, services and infrastructure in locations that offer the most attractive tax benefits and transport conditions (Table 2).

To accommodate these globally integrated enterprises, outsourcing providers must have a level of global maturity that is consistent with their clients' aspirations. In other words, they must have the expertise to deliver services on a global scale, not just as outsourcers but as commercial enterprises. They need to understand the speed and efficiency that a global economy demands and have the requisite agility to respond quickly to changing business dynamics transparently and without disruption. Whether clients require procurement, manufacturing, research, sales or other specialized services, providers need to have the technology depth and the local experience, practices and personnel to facilitate global transactions. It's not just about having a presence in a desired country; it's about having a commitment there in the form of facilities, employees and day-to-day business exchange.

Global governance is also vital. Organizations that conduct business globally cross multiple geo-political domains and engage with customers, business partners and employees belonging to different cultures and governments. A global governance structure ensures clients' outsourced operations are deployed and managed consistently around the world. Even though an outsourcing provider may employ different suppliers in each country, they need to look like one supplier from the client's perspective. In addition, a global governance framework ensures that the outsourced operations are in compliance with legal and taxation rulings, and conform to local requirements for health, security, employee welfare, funds distribution and the environment.

Finally, outsourcing providers must invest in staying current. Change is continuous and constantly accelerating. Today's hubs of technical and industry expertise may not be tomorrow's. As such, providers should continually be looking for the next China or India and evaluating alternative destinations based on scale, quality of workforce, financial infrastructure, risk and quality of life. They should be open to new possibilities, particularly as companies look to reduce their carbon footprint and the pendulum swings from centralized outsourcing strategies (in Asia) to more balanced and socially conscious regional strategies that put production closer to end markets and limit fuel-intensive modes of transport .[9]

Provider profile for the globally integrated enterprise
✓ Global maturity, expertise and resources aligned to clients' aspirations
✓ Global governance structure to ensure consistent quality of service worldwide and ability to work within local laws, regulations and politics
✓ Global delivery model capable of adapting to local differences, changing business conditions and market dynamics
✓ Shared technologies and business standards to facilitate worldwide communication and collaboration
✓ Proven ability to help clients manage the complexity of the globalized world

Table 2: Criteria for outsourcing provider selection

Conclusion

The outsourcing decision-making process has changed. The traditional view of outsourcing as a tactical, cost takeout solution can spell failure in today's globally competitive, dynamic business climate, but particularly as the economic recovery unfolds. Companies that want to compete on the global stage need to take an enterprise-level view and make strategic judgments about which business operations they want to keep and which they think are best suited to external partners.

For these companies, outsourcing is not simply about labor arbitrage; it's about leveraging the global tapestry of talent and moving work to its best, most profitable location around the world. Such a boundless view of outsourcing is essential to leading in the world economy and becoming a globally integrated enterprise. Companies that are prepared to take advantage of this business model can dramatically increase their opportunities for collaborative innovation, operational efficiency and cost savings. Leading organizations will create an array of strategic partnerships to optimize the production and delivery of services and, in the process, drive substantially greater business and transformational value.

For more information

To learn more about outsourcing for the globally integrated enterprise, please contact your IBM marketing representative or IBM Business Partner, or visit the following website: **ibm.com**/cio

Notes

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