Learnings from The 1999 Outsourcing World Summit: An Executive Briefing Paper

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The Use of Outsourcing Accelerates as Executives Search for Greater Value

Outsourcing Goes Global

The message of outsourcing's importance as a management tool is reaching an ever widening audience. Attendance at The 1999 Outsourcing World Summit topped 430 professionals, nearly twice the previous year. Dozens of industries were represented, including healthcare, manufacturing, retail, high technology, utilities, telecommunications, pharmaceuticals and business services. Government was also widely represented and at all levels -- federal, state and local -- as well as the military.

Outsourcing is crossing geographic borders as well. Executives from North America, South America, Central America, Australia, Asia Pacific-Rim, India, and Europe figured

At A Glance ~
Executive Summary from The 1999 Outsourcing World Summit

- The use of outsourcing continues to accelerate
- Outsourcing is increasingly seen as a tool for growth
- Outsourcing providers are becoming users of outsourcing services
- Firms are outsourcing to drive shareholder value and transform their businesses
- A focus on core competencies, flexibility, and innovation are key internal drivers of outsourcing decisions
- Tight labor markets and competition are key external drivers of outsourcing decisions
- Economic Value Added (EVA®) is a powerful tool for measuring outsourcing's impact
- Finding the right partner, winning top management support, and creating clear lines of communication are key to outsourcing success
- Top management support is won through demonstrated financial benefits, operational advantages, proven provider capabilities, and risk control strategies.
- Providers and buyers should pursue only mutually beneficial win-win relationships
- Performance measurement and scorecards are central to successfully managing outsourcing relationships.
- Executives must lead laterally by developing critical relationship management and communication skills
- Customer satisfaction is key to the long-term success of the outsourcing industry
- The future shape of business is being enabled through outsourcing

prominently among the attendees and presenters at the Summit. In fact, the growth of outsourcing internationally has spawned two additional Summits – The Asia Outsourcing Summit, October 11-13, 1999, Hong Kong, China and The Australian Outsourcing Summit October 6-7, 1999, Sydney, Australia. An additional Summit is in the early planning stages for Europe in 2000.

Outsourcing Transcends Company Size and Function

There is clear growth in the use of outsourcing across companies of all sizes and across all functional areas within the company. Outsourcing is now a widely used managerial tool for large, mid-size, and small companies alike. In fact, half of this year's summit attendees represented companies with under $500 million in sales.

Summit attendees exchanged views and directions in outsourcing across a wide range of business functions. Areas most commonly discussed were administrative services, customer support, distribution and logistics, facilities and operations, accounting and finance, human resources, information technology, manufacturing, marketing and sales, real estate management, and transportation.

Tom Dolan, keynote speaker and president of Xerox's North American Solutions Group, offered insights into the growth of outsourcing across both large and small firms. Dolan observed that, "Now, beyond improving the lot of larger companies, outsourcing services actually make new businesses possible. Small firms and start-ups are globalizing and unleashing growth opportunities by outsourcing entire pieces of their operations. They're building the virtual companies that we all hear so much about these days."

Frequently cited for smaller fast growing firms was the outsourcing of the supply chain -- logistics, warehousing, inventory, tracking, and shipping -- enabling high-growth, small to mid-size companies to compete with larger firms. As Dolan pointed out, companies in the headlines today, such as Amazon.com, wouldn't even exist without the ability to outsource. "One of the secrets of their success is that they know better than to go it alone. Amazon doesn't manage inventory, they partner with distributors to do their shipping," said Dolan.

During the Concur Technologies presentation they reinforced this point, noting that the Internet is exploding as a tool for delivering new outsourcing solutions to firms of all sizes. "Look at expense management," said a Concur Technologies product manager, "it's a process every firm does regardless of size, and it's an ideal candidate for outsourcing through the internet with automated software and a common browser interface."

Customers and Suppliers Becoming One

The traditional separation of buyer and seller is fast breaking down. Today, outsourcing providers are increasingly customers as well. Approximately one-third of the attendees at

Xerox as both Customer and Provider

Xerox Business Services, XBS, is a leading provider of document and knowledge management outsourcing services. At the same time, Xerox has many corporate outsourcing relationships, such as:

- EDS for information technology and management related services.
- Carlson Wagonlit Travel for travel and meeting services.
- Ryder Integrated Logistics for inbound, cross docking, and outbound distribution services.
- ARAMARK for multiple facilities operations services.

Tom Dolan, president of Xerox North American Solutions Group, explained the power of his company's outsourcing mindset, "Our Leesburg, Virginia training operation is a barometer of how far Xerox has gone in embracing outsourcing. For many years, this was a sacred cow of sorts. No one ever thought of having somebody else do our training. We were the best… or so we thought. But today, nearly our entire Leesburg learning center, which is one of the most advanced in the world, is outsourced. We've learned over time to stick to what we do best."

The 1999 Outsourcing World Summit described themselves as both customers *and* suppliers. In fact, we are quickly approaching a time when most firms will be both a user and a provider of outsourcing services. Firms are leveraging their core competencies to bring outsourcing solutions to their customers while, at the same time, outsourcing non-core areas to improve their own operations.

Why Companies Outsource

Internal Drivers of Outsourcing: Core Competencies, Flexibility, and Innovation

There is new emphasis on outsourcing for long-term, value-enhancing, strategic reasons beyond the often-cited tactical rationale of cost reductions. The reasons for outsourcing are numerous, but the emphasis on shareholder value and transforming the company are receiving greater attention than ever before.

Using an audience response system sponsored by PricewaterhouseCoopers, Summit attendees were asked to profile their reasons for outsourcing. While last year's attendees stated that the top reason was "to reduce costs," in 1999 the most often cited reason -- although by a slim margin -- was "to focus on core competencies."

This is an important change with dramatic implications for the practice of outsourcing. Outsourcing's power as a strategic management tool for reshaping the business and driving it toward ever-higher levels of shareholder value is being more fully recognized. In fact, two-thirds of the executives attending the Summit now look to factors other than direct cost savings as the main reason for outsourcing.

Transforming Human Resources at BPAmoco

At their “Outsourcing in Action” breakout session at The 1999 Outsourcing World Summit, Howard Nelson, vice president corporate human resources, BPAmoco, and Alan Little, European partner-in-charge of HR outsourcing with PricewaterhouseCoopers described their initiative to transform how these services are delivered at BPAmoco.

As background, British Petroleum and Amoco recently completed the largest corporate merger in history. And did so in less than 30 days. The combined companies now have 100,000 employees in 120 operating units around the world. Bringing together both the corporate and national cultures was a significant challenge.

At the same time, human resources at BPAmoco needed to become both more strategic and more efficient, with a goal of trimming its overall resources by 40%. According to Nelson, “Administration drove the whole process within HR. What we needed was to change the skill set so HR could become the strategic partner it aspired to be.” There were significant obstacles in doing this to be overcome. These included improving the usefulness of the information the HR function provided to line managers and employees, overcoming fragmented policies and systems, and quantifying HR’s contribution to the overall business.

To accomplish its goals, BPAmoco forged a unique partnership with PricewaterhouseCoopers. “I thought it was important we find a partner who shared the vision, but who also had an appetite for having some true skin in the game. As a result, we moved rapidly from a traditional client-consultant relationship with PricewaterhouseCoopers to a partner relationship,” said Nelson.

BPAmoco and PwC began with a focus on processes and technologies. In so doing, they removed duplication, streamlined, and standardized the overall operations. Along the way, the traditional silos within HR, such as compensation and benefits, were eliminated with the entire operation restructured into separate transactional and strategic elements.

Under this new structure, the transactional work is performed by a new service delivery organization created in partnership with PwC. “We had to enhance the front-end so people could use HR -- individuals and line managers. We’ve eliminated work and we’ve given people direct access to the information they need,” said Nelson. At the same time, the strategic activities, such as acting as corporate change agent, continue as core within BPAmoco’s human resources function.

Alan Little of PwC observed, “We took a joint investment approach to an integrated process of change because you can’t just refine the processes. We actually had to address the roles of everybody in the service chain -- the very organizational structure of HR.”

With improved business focus and the introduction of process improvements becoming chief motivators for outsourcing, everything that flows from that decision itself changes – scope of services, contract structures, relationship management techniques, and, ultimately, judgements of outsourcing's success and failure.

As Tom Dolan observed, outsourcing partners add knowledge, and give back time that executives can use elsewhere. "Now management is more focused on what they do best, their core competencies," said Dolan.

Outsourcing also works with business activities that don't necessarily have a long history in the firm -- helping organizations expand flexibly with lower risk to their investors. "Take Dell for example, they don't make their monitors or handle shipping. They have established partnerships with Sony and Airborne Express. Dell has a sophisticated network that drives order information from the point of sale directly to its outsourcing partners. Sony ships the appropriate monitor to Airborne's distribution site where it's matched up with the PC by order number and they are shipped together," explained Dolan.

> On Innovation…
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> "We too have opened our eyes to innovation. I think sometimes you do tend to have more excitement on the front end in the sale process and on the operating process. You make sure you're hitting all your objectives, but you're not necessarily continuing to think outside the box.
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> But in this industry I think that we need to challenge ourselves. It's a very short lifecycle and the reason you're hired typically is for economic benefit. The reason you're renewed is for qualitative benefit. So you have to find a way to fit with that client to deliver both quantitative and qualitative value."
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> John Maher, group president, Trammell Crow Company

Outsourcing decisions also hinge on the question of innovation. The 1999 Strategic Outsourcing Study, sponsored by The Outsourcing Research Council and discussed during the main tent sessions, reported that innovation is increasingly the basis for outsourcing decisions. If internal operations can create the needed innovation, then executives will continue to source internally. But, where executives recognize the need for greater innovation than the internal operation can deliver, outsourcing becomes a powerful tool for harnessing the creativity of others. It enables organizations to leverage the experience, capabilities, and investments that others are making to help drive their company forward.

External Drivers of Outsourcing: Tight Labor Markets and Competitors

The tight labor markets, especially for skill and knowledge workers, will continue to be a concern for all corporations and, as a result, a key external driver of outsourcing for the foreseeable future. Serge Uccetta, senior vice president SPS Payment Systems, cited the scarcity of talent as a driving force for adopting outsourcing. “A recent survey published in CFO magazine, shows that people in finance were the most in demand in 1998. As you might surmise, the demand for people with the financial experience, training and savvy to contend with the scope of change is only growing. As these skills have become increasingly valuable resources within organizations, so have outsourcing partners,” said Uccetta.

Increasingly, the fast-paced, global marketplace of highly focused and innovative competitors is a powerful external driver of outsourcing. When one firm in an industry uses outsourcing to create a competitive advantage – as Chrysler did with its supplier network or Southwest Airlines with aircraft ownership and maintenance – it forces others to follow.

Europe is yet another example of external competitive forces driving outsourcing across a large segment of the economy. Claude Hartridge, partner,

How America’s Most Leading Companies Use Outsourcing ~
A Report by The Outsourcing Research Council

How do America’s best-run companies use outsourcing to enable and drive their business strategy? This is the central question examined by a study reported at the Summit.

The firms studied and reported on were “America’s Most Admired Companies” as published in the March 2nd, 1998 issue of FORTUNE Magazine. These firms represent a cross-section of American businesses and industries. Some (Microsoft and Southwest Airlines) are relative newcomers, still managed by their founders, who have achieved unusual success in their markets. All are icons of American business. Multiple industries are represented, including: technology (Microsoft, Intel, Hewlett Packard); pharmaceuticals (Johnson & Johnson, Merck); consumer products (Coca-Cola); entertainment (Disney); diversified firms (GE, Berkshire Hathaway), and; transportation (Southwest Airlines).

Three major findings were reported. First, the strategic use of outside resources permeates the thinking at these leading firms. Second, this so-called “boundaryless behavior” creates an environment of intense goal-directed behavior and customer focus. These firms create environments where the old notions of organizational structure are challenged, and internal sourcing, outsourcing, strategic alliances, and joint ventures are equally valid options for solving business problems.

Third, outsourcing is used by these firms in direct support of specific business strategies. Outsourcing allows these firms to do what they already do well, even better. It enables leading firms to reinvent themselves structurally and drive strategies of innovation, speed to market, globalization and focus.

PricewaterhouseCoopers in Europe, noted that the barriers are all starting to break down thanks to the Economic Union and the Euro. “So over the next couple of years I see a tremendous trend toward outsourcing and shared services structures in the delivery of multi-national back office support,” said Hartridge.

Success with Outsourcing -- Defining It

Shareholder Value

There is a new drive to define successful outsourcing in terms of the value delivered to the client’s end customers and ultimately the client’s shareholders. As a result, the working relationship between providers and their clients becomes the real engine of value creation. Jag Dalal, partner, PricewaterhouseCoopers Business Process Outsourcing, offered a powerful and succinct test of outsourcing’s success in creating shareholder value. “You ask yourself: does outsourcing make me more flexible? More nimble? More competitive in the marketplace? If yes, then you can say your shareholder value has been increased.”

Stakeholder Value

Defining success in the commercial sector is one thing, defining success in the government sector is something quite different. For government at all levels success is

Outsourcing and Privatization Hits its Stride in the Public Sector.

At The 1999 Outsourcing World Summit, Mayor Steven Goldsmith, Indianapolis, shared many of the principles that guide his efforts to privatize city functions. Under Goldsmith’s leadership outsourcing has become part of a fundamental transformation of his city’s government.

The first part of this transformation was to change the very way costs were tracked, moving from a traditional governmental accounting system to an activity-based costing system. “I run 200 businesses yet I didn’t know how much it cost me to fill a pot-hole, clean a mile of sewers, or trim a tree,” said Goldsmith. The second part was changing a mindset that certain things were inherently governmental. “There are some things that the public wouldn’t support outsourcing or privatizing, but generally, the lines between public and private are artificial. The question is whether I can make it or buy it more effectively for my citizens,” he added.

One example the Mayor offered was the operations of the city’s wastewater treatment facilities. In this case, the city council brought in an accounting firm to look at the city’s costs. “They said, congratulations Mayor, you run the most efficient waste water treatment system in the country. And if you really manage it better you can save 5%. I said, let's try this differently. Let's just ask everybody in the world who’s in this business to bid on the right to run our waste water treatment plants.” Indianapolis received bids from all over the world. The winning bidder, a combination of a French company and an Indianapolis company, won the bid and reduced cost not by 5%, but by 40%. “Now remember, we're the most efficient government run waste water treatment operation in the country. Which means that when government benchmarks itself against other government monopolies, it's an irrelevant exercise,” concluded Goldsmith.

ultimately in the eyes of constituents. This places a special burden on officials to communicate the benefits achievable through outsourcing to the public being served. For example, if a service provider guarantees a $30 million savings, “we turn to the public and say, as long as the quality is maintained, do you want to give up this $30 million?” said Stephen Goldsmith, Mayor of Indianapolis. In the end, outsourcing success becomes tangible to the voters when it means avoiding a rate increase or eliminating the need for a bond issue to capitalize infrastructure improvements.

Success with Outsourcing -- Measuring It

Value can Best be Measured with Economic Value Added

One of the most enduring questions with outsourcing is exactly how to define and measure the value proposition. Increasingly, executives are reporting that the answer is to move beyond straight dollar comparisons of costs to look at the total value added to the firm. Reevaluating the economic tools we use to measure outsourcing has become a top priority. Companies need to be able to fully and accurately capture and report the value of outsourcing.

Using the audience response system sponsored by PricewaterhouseCoopers, attendees at The 1999 Outsourcing World Summit were asked to identify which financial analysis technique was most commonly used within their organization to support outsourcing decisions. Thirty-eight percent of the attendees reported that the primary means of analysis was a straight budget comparison. At the bottom of the list was value creation measures such as Economic Value Added, EVA®, and TBR, Total Business Return.

> On Economic Value Added…
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> “A financial analysis performed by a Fortune 1000 company identified a number of benefits that compel and justify outsourcing of the accounts receivable function. Those reasons included: a dramatic reduction in DSO - day sales outstanding; a reduction in the cash conversion cycle, thereby, generating cash much faster for the company; a substantial reduction in accounts receivable, freeing up capital and improving leverage, and, as a result; a significant increase in EVA.
>
> Now, it will take organizations a while, some longer than others, to explore, adopt, and adjust to strategic outsourcing. Inevitably, we’ll see an evolution, but the forces driving that evolution are just not going to disappear. If there are compelling reasons to develop the kinds of strategic outsourcing relationships that define the virtual corporation today, there is no reason to believe that the drive to: increase shareholder value, operate flatter more flexible organizations, contend with rapid technological change, and focus on core competencies will be any less as we move into the 21st century.”
>
> Serge Uccetta, senior vice president SPS Payment Systems

In his presentation, Simeon Hyman, vice president, Stern Stewart, made an important and illustrative link between this and another audience response question finding. With almost a third of organizations looking for cost reductions from outsourcing and few organizations using EVA as their primary financial analysis tool, Hyman observed that, "If you're just focused on those savings, you're really limiting the world of outsourcing opportunities."

Hyman contends that as more organizations adopt EVA's value creation mindset, and look for ways to add value beyond cost reductions, the opportunities for outsourcing will multiply and companies will recognize a wider array of more strategically oriented outsourcing opportunities.

> What is EVA®?
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> EVA is simply:
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> | | |
> |---|---|
> | | Revenues |
> | - | Operating Costs |
> | - | Taxes |
> | = | Net Operating Profit After Tax (NOPAT) |
> | - | Capital Charge |
> | = | EVA |
>
> "What separates EVA from traditional financial models for making the outsourcing decision is that EVA is the only periodic measure of performance that captures the trade-off between earnings *and* the capital employed to derive the earnings."
> Simeon Hyman, vice president, Stern Stewart

Success with Outsourcing -- Achieving It

Four Keys to Successful Outsourcing

Tom Dolan of Xerox identified four keys to successful outsourcing.

First, firms need to seek a good strategic fit with a prospective partner. An outsourcing partner needs to have the right knowledge set, share the client company's business philosophy and values, and fit with its culture. The decision can't hinge on contract price alone. "You wouldn't hire an important manager based on the lowest bidder. Finding the right fit will make for a smoother integration process and clearly offers the best prospect for long term success," said Dolan.

Second, it takes a total commitment from the top down. Outsourcing isn't always a welcome change in organizations and there will be some resistance. To build internal cooperation, management must demonstrate that it is committed to its employees. At the same time, service providers must be very sensitive to managing the relationship in ways that minimize the tensions that might be there.

Third, create clear communication paths for knowledge sharing. All available communication channels should be used, including information networks. Networks can be used to create bulletin boards to facilitate communications, schedule progress meetings, and share overall information.

Fourth, do the legwork to identify mutual objectives and define service expectations. “Moving forward, listen carefully to concerns, share issues openly, and monitor progress regularly,” Dolan recommends.

Home Depot Uses Outsourcing to Get Content under Control

Gene Hodges, director of advertising at Home Depot, shared with attendees at The 1999 Outsourcing World Summit his experiences with a major outsourcing initiative -- Home Depot’s Pro Book. Home Depot, founded in 1978, opened 137 new stores in 1998 alone. The company plans to be operating 1300 stores nationwide by the end of 2001.

Home Depot’s Pro Book is hundreds of pages long and contains 40,000 to 50,000 building, home improvement, and lawn and garden products. Hodges’s and Home Depot’s experiences with this book underscore how intellectual assets have become increasingly valuable in our new economy. These experiences also underscore how this value is diminished when those intellectual assets -- that content -- can’t be delivered where and when the customers use it. At Home Depot this content management challenge was met through a strategic outsourcing partnership with Banta Corporation.

The goal was to centralize, manage, better utilize and then deliver product information. As a result, Home Depot’s relationship with Banta extends well beyond the complexities of producing a specific professional marketing catalogue. In fact, Hodges found that everyone needed the same content. “The stores need information to answer customer questions, merchandizing needs it to make decisions about product purchases, and advertising needs the information to design flyers and mount campaigns,” said Hodges. Advertising alone produces 60 million retail catalogues a month.

Going outside for solutions is key to Home Depot’s success. “If we don’t look at what everybody else is doing out there we’ll become complacent, we’ll become less innovative,” added Hodges. In the end, “The issue is managing the content. We had images on eight different servers. Material coming in from manufacturers on an on-going basis -- new photographs, new product information. It was a disaster just to keep up with it.” And, with 120,000 employees and 750 stores to manage, Hodges observed that in solving these types of challenges, “We don’t want to overextend ourselves on the support side.”

The larger solution that Banta addressed for Home Depot was about the creation, maintenance, and distribution of intellectual assets. The growing use of the Internet to deliver product information is driving the issues of flexibility and speed. “The main aspect of this is really getting the thing out there faster, not cheaper, today. Although down the road, I’ll give Banta a hard time about costs. Right now we have a book we can get out there in a 90-day timeframe as opposed to what was more than a year at one time. And, we’re using photography not line art. We never believed we could do this,” said Hodges.

"Outsourcing is right if there are focus and core competency questions, as with Home Depot. There may also be concerns about making internal investments in people and equipment to do the job," observed Dennis Meyer, vice president, Banta Corporation.

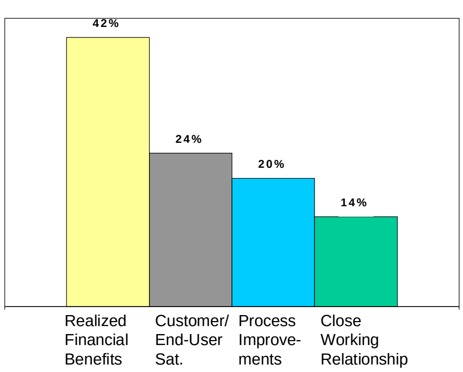
Meyer suggested that companies ask themselves seven questions to test how well they manage content and whether it should be outsourced:

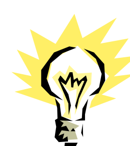
- Will lower information distribution costs significantly improve your margins?
- Will quicker time to market offer your company a competitive advantage?
- Does the ability to locate content cause frustration and production delays?
- Do you need to protect content through instant access to property rights?
- Do you need more speed to take advantage of alternative distribution channels like the Internet?
- Do you want to customize and personalize content for target audiences?
- Do you need to improve content distribution to make collaboration easier?

Securing Top Management Buy-In

Andrew Cvitanov, senior vice president, external enterprise management at American Express offered valuable insights into how to successfully implement major outsourcing initiatives in large organizations. At the Summit, Cvitanov described how he approaches executive management at American Express with outsourcing opportunities. His experiences offered lessons applicable to any organization.

What is the single most important factor driving executive satisfaction with outsourcing?





The interesting finding is that non-financial factors are the most important factor in more than half the cases

Source: 1999 Outsourcing World Summit Survey System
~ Sponsored by PricewaterhouseCoopers LLP

In early1999 Cvitanov presented sixteen outsourcing initiatives to the policy and planning committee at American Express, the firm's top executives. Twelve outsourcing initiatives were approved for further consideratio

n. Four were taken off the table by the committee. “Those are the white elephants I can’t touch,” Cvitanov said.

The twelve approved initiatives then went immediately into an assessment phase. In the assessment phase Cvitanov’s staff and external consultants gather preliminary information but they purposely do not talk to the staff within the business units. “Whether or not it’s core, you can never touch it if you don’t understand the process. But if you talk to the business units too soon you encounter resistance,” said Cvitanov.

If the preliminary assessment is favorable, Cvitanov’s team then engages the responsible executive to sponsor a full analysis. Each and every initiative has to pass muster with the sponsoring executive before it can proceed further. “These are people who are used to looking at expense numbers in the $500 million to a billion dollar range. So if I’m trying to talk to them about saving a million dollars I’m not going to get much attention. But if I can talk about a direct expense savings of $10 million and I can talk about an indirect expense savings of $100 million then I start to get their attention.”

When and if executive sponsorship is secured, the business unit personnel are then involved with the full analysis. Each outsourcing opportunity is ultimately decided on four questions -- its financial impact, the quality and availability of external providers, the operating advantages, and the risk management and control techniques. About fifty percent of the projects that make it to this point are eventually implemented at American Express.

Managing the Relationship

At one time, the management of the relationship simply meant structuring the contract. Today it means much more. Speakers at the Summit consistently pointed to defining and working toward mutually agreed to goals and creating a strong working relationship between the firms as keys to successful outsourcing relationships. The bottom line – both parties must maintain a win-win approach.

According to Dr. Wendell Jones, vice president, Compaq Computer Corporation, creating this win-win relationship is far more important for long-term success than is driving down the provider’s margin. In fact, that approach can actually take away from the provider’s ability to invest in the relationship. “Unfortunately,” Jones added, “one of the things I am observing is customer companies who haven’t yet had much experience with outsourcing don’t really understand this point too well.”

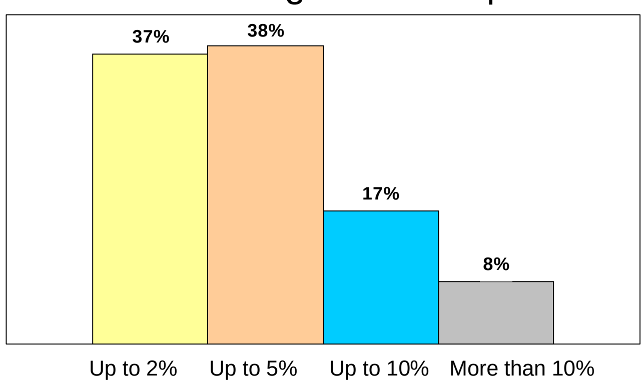
In addition to maintaining a win-win approach, establishing clear lines of communication and accountability are key. Bill Meyers, director of information technology at Hughes Electronics oversees his company’s billion-dollar-plus contract originally signed in 1994. To help make this relationship work, Meyers created an Executive Management Committee. In this way he was able to keep the business executives engaged from the beginning of the process and throughout the life of the relationship. Observes Meyers, “You can’t abdicate responsibility or accountability.”

In addition to communications and accountability, another element of relationship management frequently discussed at the Summit was setting standards, building a measurement system, and then rewarding appropriately. Wendell Jones observed that he has seen a marked change in attitude on this point even over the last year and a half. “I think smart providers today are recognizing that it’s much better if you can put in place a relationship management process that is based on real scorecards, real benchmarks, and all the rest, so that the provider can be evaluated based on reality rather than feelings and that sort of thing,” said Jones.

Benchmarking Outsourcing Management Costs

Another question often asked at the Summit was, ”How much do companies spend managing outsourcing relationships?” On average, Summit attendees reported that they spend 4% of the contract’s annual dollar value on managing the relationship.

On a percent of contract dollar basis, how much does your company spend managing an outsourcing relationship?



Source: 1999 Outsourcing World Summit ~ Survey System Sponsored by PricewaterhouseCoopers LLP

Wendell Jones, recalling his work at McDonnell Douglas, offered a different rule of thumb. In Dr. Jones’ experience, “you need about one full time person for every $200 million in relationship value. And, so for a $3 billion dollar deal we had a permanent staff of about 15 people at McDonnell Douglas to manage the relationship. If you've got a smaller deal, it's a fraction of a person.”

Andrew Cvitanov from American Express also addressed the question of the resources needed to manage outsourcing relationships. Cvitanov pointed out that initially American Express underestimated the infrastructure requirements. “Relationship management costs run 5% to 10% of contract value,” said Cvitanov. Over the years, American Express has made significant investments in benchmarking and streamlining the management of the outsourcing interface.

Success with Outsourcing -- Leading It

Leading Across Boundaries

Leading laterally, that is across organizational borders, requires a new set of skills that is very different from traditional executive leadership skills. Bill Meyers observed that when outsourcing "you don't have that opportunity to rally the troops because you have to get things done through somebody else and it takes a totally different set of skills to do that." As Peter Bendor-Samuel, editor-in-chief of the Outsourcing Journal and the president of InfoServer put it, "another important element is having relationship managers with the requisite skills—including communication, negotiations, team-building, and business skills."

Professor Michael Useem of the Wharton School has researched these new executive leadership skills. Once outsourced, the idea is "to move laterally, work with ambiguous authority, and get people to do things when you can't tell them to do anything any more," said Useem. The task is hard and "the companies that can work those concepts from the idea stage into the actual behavior of the people that you work with

> The 1999 Outsourcing World Achievement Award
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> The Outsourcing World Achievement Award, presented annually by PricewaterhouseCoopers LLP and Michael F. Corbett & Associates, Ltd., honors individuals for extraordinary achievement in advancing the theory and practice of outsourcing as a powerful management tool.
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> For 1999 the award was presented in two categories - corporate executive and academic. An independent panel of judges comprised of corporate executives, academia, and analysts selected the finalists and winners.
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> Finalists for 1999 in the academic category were:
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> Rudy Hirschheim, professor, University of Houston
> Robert Klepper, professor, Southern Illinois University
> James Brian Quinn, professor emeritus, The Amos Tuck School
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> Finalists for 1999 in the executive category were:
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> Kevin Campbell, global managing partner, Andersen Consulting
> Jeff Hayes, vice president, VHA, Inc.
> Vaughn Hovey, senior project executive, IBM Global Services
> Van Honeycutt, president & CEO, Computer Science Corp.
> Ellen Kitzis, vice president, Compaq Computer Corporation
> Dennis McGuire, president, Technology Partners Inc.
> Rick Roscitt, president & CEO, AT&T Solutions
>
> The winners were:
>
> James Brian Quinn, professor emeritus, The Amos Tuck School
> *and*
> Rick Roscitt, president & CEO, AT&T Solutions

and really create leadership in the ranks, are going to be the ones that can make outsourcing work," he concluded.

Lateral leaders will need to think strategically, take risks and then manage those risks. According to Useem thinking strategically means "looking ahead, anticipating risks, going beyond their immediate job function, beyond their immediate division, to really ask themselves: what is this doing for the shareholder, or if it's a public agency: what is this doing for the public?"

Success with Outsourcing -- Keeping It

Satisfying Customers

In 1999 the importance of customer satisfaction firmly entered the dialogue of the outsourcing industry. The outsourcing provider's brand name is becoming increasingly important as the marketplace matures, and quality is a central part of that brand image. Providers reported that the ultimate purpose of any customer satisfaction program is customer retention and internal process improvement. It's difficult and expensive to make new customer relationships. It's far more effective to build and expand upon existing relationships.

In a research program conducted by Michael F. Corbett & Associates, called The Global Outsourcing Quality Report, 88% of firms reported overall satisfaction with their outsourcing providers and 80% of firms reported that they would renew their existing contracts without going out to competitive bid. The participants in the program were customers of three outsourcing service providers: Trammell Crow Company, The Haas Corporation, and Johnson Controls.

Key Determinants of Outsourcing Customer Satisfaction

- Relationship Management
- Responsiveness
- Integrity
- Technical Competence
- Flexibility
- Personal Service
- Value
- Productivity
- Communication
- Innovation

The Global Outsourcing Quality Report as presented at The 1999 Outsourcing World Summit

Consistent strengths in the relationships studied were relationship management, responsiveness, and technical competence. The scores were lower, which is not unique to these companies but reflective of an emerging trend in the industry as a whole, in the areas of communications and innovation. It is the consistency of the information provided to the customer, by all of the individuals responsible for the relationship and at all levels, that is central to improved communications. Innovation, which is increasingly driving decisions to outsource, can be lost when the provider becomes too operationally focused over the life of the relationship. Innovation is often at the core of the relationship when it was created and it then must be infused on an ongoing basis.

Customer satisfaction information can be a useful tool for making internal changes. "It was a valuable tool for us. It helped us organize our thinking. When you look at this and you say, gee, we scored real well here. Let's pat ourselves on the back. But, wait a minute, we didn't do quite as well in that category. How come? What are we looking for? What might the problems be? So in our strategic planning this helped push a lot of our thinking about how we're going to approach new bidding and how is past performance impacting our business," said Mark Wagner of Johnson Controls. .

In talking to his company's results, Thad Fortin, president of the Haas Corporation noted the importance of staying close to two critical but essentially different parts of his customers' organization: the client executives – those responsible for the contracting decisions – and the end customers – the ultimate recipient of his firm's services. "The difference between a client and a customer is clear in our situation. A company like General Motors has a corporate staff that we're involved with. They're our client. Our customer is the actual facility or plant that we're working in. What our client wants us to do and what our customer wants to do in a lot of cases are two different things," said Fortin.

The Future of Outsourcing: The Next Year and Beyond

The Search for Change Through a Network of Knowledge Partners

Using outsourcing to create knowledge partners was a key theme for those looking into the future of outsourcing. Jag Dalal, partner, PricewaterhouseCoopers, quoting futurist author Ian Morrison, spoke of the *first* and *second curve* of value creation within the corporation. "Capital, corporate control, and portfolio management were the mantras of the first curve. The emphasis was on the corporation. Collective knowledge and relationships are the stuff of the second curve. The emphasis is on the network."

Through that network, firms pursue the lasting ability to share knowledge across their entire enterprise. Knowledge sharing is the next step for organizations that have exhausted the benefits available through quality and reengineering -- for these organizations outsourcing is the next step. Dalal believes that successful companies of the future will be those that not only embrace change but relish in it -- seek it out. "Companies now don't have time to react to changes in the marketplace, they have to be the driving force behind the change. You need to be in control of changing that playing field," he concluded.

The Search for Flexibility

Andrew Cvitanov told Summit attendees, "I think in the long term there's almost going to be a disintegration of the corporation. You'll see a combination of internally provided processes and externally provided activities, and a greater reliance on external roles. It will give companies, such as American Express, enormous flexibility in the marketplace to change direction."

The result will be organizations that are able to rapidly connect their solutions to customers in today's and tomorrow's fast-paced, global economy. Internal flexibility, enabled through strategic outside relationships, will become increasingly central to success and value creation.

The Search for the Future Shape of Business

Businesses in the future will have a smaller core operation managing relationships with an ever-changing network of outside providers. They will be faster to market, more flexible and better able to make the most of opportunities. Companies will constantly innovate to stay ahead of the competition. They will use knowledge to create the future. At the forefront will be organizations that create a marketplace presence by conveying quality, and who themselves make use of best-in-class providers to support their primary mission.

The future shape of business will be driven by the knowledge capital owned by the company. "A core that is surrounded by competent service providers whose expertise in those areas comes together, is brought together, is held together, by a common vision for that company," predicted Jag Dalal.

In summary, Summit attendees reported that in the coming year the dialogue is truly going to be around using outsourcing for business transformation. Leveraging skill, knowledge, and capabilities in ways that transform the company, its relationships with its customers and, in so doing create competitive advantages that truly make the competition's strengths irrelevant. This is the vision of today's leaders and it is a summit reachable through outsourcing.

Microsoft Corporation and Arthur Andersen Manage Outsourcing Risks

Working with an outsourcing provider on a long-term basis means ensuring that their services continue to fit with the customer's needs and that the provider, itself, grows as a reliable source for those services. These risks of working with an outside provider can, through careful planning, be mediated. Managing the risks of an outsourcing relationship is the purpose of a major project by Microsoft and Arthur Andersen. The goal is to map out these risks and develop a system to address them.

As background, Microsoft works with approximately forty outsourcing providers worldwide. The providers serve four major functional areas: 1) Packaged products – the assembly and distribution of software; 2) Licensing – the management of the licenses issued to corporations; 3) End-user fulfillment programs including on-demand printing, and; 4) Product release services.

“Microsoft currently outsources all of our functions from an operating perspective, with the exception of 60% of our CD manufacturing and our credit and collections,” said Mike Negrin, general manager, operations development, Microsoft. “As Bill Gates said to me, way back in the early 1990’s, if I can hire three more developers instead of five more operations people, I’ll hire the developers,” recalled Negrin.

Jointly, Arthur Andersen and Microsoft identified a number of circumstances that could jeopardize a provider’s ability to deliver their service over the long-term. Many of these risks have to do with the business risks that the outsourcing provider faces and how they deal with them. The purpose was to develop an evaluation system Microsoft could use as an early warning system to pro-actively manage relationships with providers. With their previous management processes, Microsoft recognized a problem only when key performance indicators dipped, which was often too late. “In other words, we had outsource suppliers around that world that were changing business strategies, changing personnel, changing investment strategies, and we were not aware of that because we were evaluating them on KPI,” said Negrin.

Microsoft wanted an evaluation program it could employ proactively. The result is Microsoft CORE, for Comprehensive Outsourcing Risk Evaluation. It takes into account many aspects of the provider’s business and the risks they face – including financial risks, such as, cash flow. The process also looks at the provider’s process for measuring customer satisfaction and incorporating that feedback into their processes. Additionally, Microsoft looks at each provider’s procedures for managing their own business interruptions. All of these factors and others are used to assess the long-term viability of the provider to determine if they are doing well enough to be able to invest in the relationship with Microsoft. “We look at: do they invest in their core competencies, train their people, hire the best and brightest to supply us with world class service,” said Negrin.

In order to both make the system work and achieve buy-in, it was developed in a bottom-up approach with the 30 or so vendor account managers and a team from Arthur Andersen. Now, Microsoft’s vendor account managers have responsibility for assessing the risk that an outside provider’s performance will deteriorate over the mid- and long-term thereby impacting Microsoft’s customers. “Our VAMs were very stagnant, we were using them in a purely tactical way ensuring that the contract was being met. We have a whole risk department at Microsoft and that wasn’t integrated, same with credit and collection, and procurement. Using customer satisfaction surveys and KPIs was a view of the past, what had happened in the past. That worked well but it didn’t formulate a long-term understanding of the risks that we would have with our outsourcing suppliers. What we needed to be able to do was project what will happen in the future, the mid to long term with any particular vendor,” explained Negrin.

This standardized approach to risk assessment offers Microsoft the ability to compare providers across locations and to one another. The system is just as helpful when considering a new provider. “This is important as we look for new outsource suppliers. We are using our risk family and risk criteria to understand how our suppliers can help us in the future. Should we elect to use a new supplier it is part of the criteria," observed Negrin.

The point of this forward looking approach is that "we want to make sure that we anticipate and prevent risks from the outsourcers from becoming your risks," says Rick Julien, partner, Arthur Andersen. "There are three things to be achieved. One, ensure that the provider is building quality. Two, ensure that today's performance is being measured. And, three ensure that this measurement is done and revised on a regular basis."

More than 400 professionals from around the world participated in The 1999 Outsourcing World Summit. The next Outsourcing World Summit will take place February 21-23, 2000 at Disney's Yacht & Beach Club Resorts, Lake Buena Vista, FL. International Summits are being held October 6-7, 1999 in Sydney, Australia and October 11-13, 1999 in Hong Kong, China.

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