White paper

Business Process Outsourcing

- the future is clear

SOLUTIONS THAT MATTER

Business Process Outsourcing

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Positioning statement

Recent hype describes Business Process Outsourcing (BPO) as an emerging solution all organisations should consider. This generates many varying opinions of how this market will develop, all claiming a degree of foresight supported by various options and scenarios.

However the future direction of BPO can be accurately predicted.

We will show how an outsourcing market, very similar to BPO, has been developing over the last twenty years, and how this example can be used to demonstrate the likely progression of the BPO market, and what this will mean to both BPO service providers and users alike.

Introduction

When referring to business processes in this paper we mean the essential back office services common to most organisations which typically include finance, human resources and payroll. Whilst critical to the operation of the organisation, such functions are usually unmeasured, disparate and rarely optimised.

We will compare the recent shift to BPO with the mature third party logistics (3PL) market, which has been providing outsourced process driven services for over twenty years. The correlation between the two markets is extremely strong, as they both:

- grew out of a need to focus on cost reduction and service improvement
- concentrate on essential processes not traditionally regarded as core
- allow specialists in these processes to release the economies of scale
- collate operations together for maximum efficiency
- allow the organisation to focus on primary activity
- enable better measurement of the process
- provide opportunity for reductions in headcount and cost base
- act as a focus and catalyst for improving the supporting IT systems used
- demonstrate to investors the determination to improve.

The only significant difference between these two markets is that 3PL outsourcing has been active and developing for about 15 years longer than BPO.

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Evolution of the 3PL market

Figure one summarises the development cycle of the 3PL market, from customer driven need, through strong growth to consolidation and the need to broaden the offering and benefits.

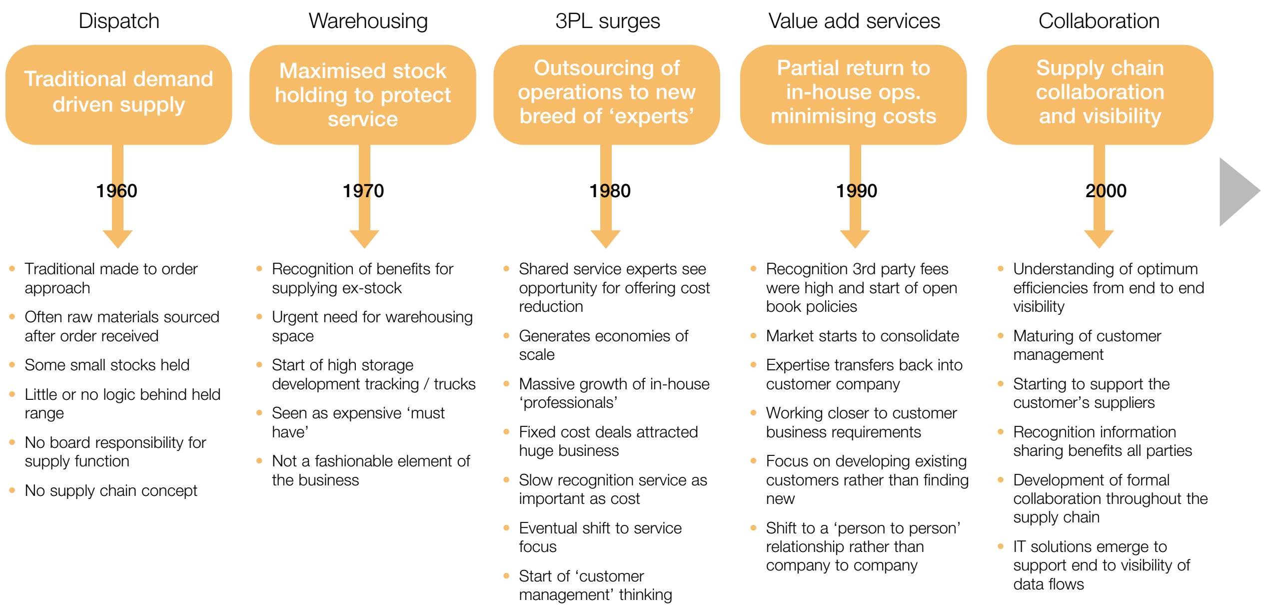

Figure 1: Summarised timeline of 3PL market development

Similar to the BPO market, initial need for 3PL was driven by a requirement to enhance service levels and reduce costs. This was followed by a period of rapid growth, when shifting to 3PL was the fashionable thing to do. More recently customers have been demanding a broader collaborated service, integrating several business needs into one solution.

The logistics specific elements of this comparison are irrelevant to the BPO environment, but the overall pattern to date shows a strong correlation.

So what does this mean to users of BPO?

Potential and existing users and providers of BPO can take powerful insights from the experiences of 3PL. The core lessons can be grouped into three categories:

1. Supplier/customer relationship structure

- Initial over-focus on the commercial arrangements is likely to breed mistrust before a single transaction has taken place

- The installation of a single "person to person" point of contact for each party personalises the relationship
- These individuals should be able to rise above contractual issues and work together to find middle ground
- Careful selection of individuals with diplomatic as well as technical skills will elongate the commercial relationship.

2. Realising the benefit

- All benefits should be tangible and ideally visible on the bottom line
- Clear measurable performance targets should be identified
- The relationship is strongest when supplier reward is driven by performance.

3. Growing the benefit

- Initial, easily obtained, cost savings should be considered as the start of the benefit stream, rather than the complete position
- Effort should be made to understand the additional benefit the solution can provide, beyond that initially agreed, thus maximising the long term benefit
- Flexibility should exist to expand or contract the service in accordance with user activity
- The identification of additional value add services will fuel a robust relationship and ensure all possible benefits are extracted
- Service levels must be viewed equally to costs, one without the other will stagnate the potential life of the contract.

Avoiding the pitfalls

New users of BPO solutions can avoid the pitfalls associated with a shift to outsourcing by identifying the core drivers required by both parties and basing commercial agreements on these openly. The relationship between the service provider and the user should be viewed as a partnership rather than that of a supplier and customer. As with any strong partnership, mutual benefit and understanding should be at the heart of all decisions.

Understanding these issues can also minimise the gestation period from initial interest to benefit realisation, thus minimising the cost of transition. The whole process of selecting an outsourcing partner and establishing the service can be daunting and extremely elongated. Whilst the premise of caveat emptor will always prevail, there are specific actions the user can take to smooth the process:

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Prepare your requirements thoroughly
All too often the user is professionally courted by the service provider from a very early stage and underestimates the effectiveness of this practice at their peril.

Users should conduct their own research into existing solutions, operational designs and processes and should be focussing on finding out what tangible benefits can be achieved. It is rare for potential users to investigate similar solutions in other industry sectors, yet this approach can be fruitful and represents a tiny proportion of the overall cost.

The findings from this research should then be used to springboard assessment and definition of their own requirements, including what is not required. This proactive approach will readdress the balance of the user/provider relationship from the outset.

Define your required benefits - and stick to them
The most impressive BPO function is worthless if it doesn't deliver the benefits the user needs. Define the benefits sought before engagement with the potential service providers. These should remain at the heart of all discussions and form the crux of the final agreement.

Define the financial engineering you require from the deal
Users should avoid being blinded by the solution itself; don't forget you are still the buyer and have that leverage. The agreement can be engineered to address any business issue faced, for example immediate cost savings, margin increase, balance sheet adjustment or staffing changes.

Shared risk and reward deals have been a common theme of 3PL contracts, however this has only been seen recently. Users of BPO should look to this learning and take the benefits available. The market is generally receptive to such suggestion, especially with the larger outsourcing operations required to enhance service providers portfolios.

Research the players - size doesn't matter
No matter how impressive the service provider, they cannot deliver the benefits unless the operational service level and flexibility meet the user's needs. Many niche providers have a strong service offering and may place a higher value on the user's custom, meaning the most appropriate provider may not always be the big safe obvious choice.

So what does this mean to providers of BPO?

Business Process Outsourcing providers have generally reacted positively to the recent surge in market interest. Many providers are actively developing facilities with varying geographic options. The projected development of this maturity curve can be shown by looking at the development of the 3PL outsourcing market. The mistakes made and the lessons learned by providers in that environment over the last twenty years can be summarised as:

Lessons of the emerging 3PL market

- Too many smaller players who didn't have the critical mass or demonstrable credibility sought by customers
- Overly optimistic plans for market entry
- Lack of focus on the true quality of service required to land the sale
- Sales campaign was overly focused on the "new trend" element rather than the tangible benefits available to users
- Many were "jumping on the bandwagon" rather than carefully determining a strategic route to market and the differentiation offered.

Lessons of the established 3PL market

- Over-promised and under-delivered
- Failure to investigate the full breadth of customer benefits available, instead basing the sale on classic features, advantages and benefits
- Established "company to company" relationships rather than "person to person" relationships
- Allowed the service provided to stagnate rather than actively seeking ongoing improvement
- Concentrated primarily on their income stream, however, with a robust contract, focusing on improving the customer service levels would have protected the income stream and strengthened the relationship.

Lessons of the mature 3PL market

- Forgetting to enhance the service provision for the benefit of the customer
- Failure to identify new value add services that can be delivered from the existing resource
- Lack of preparation for the natural shift to a commodity market, where differentiation in the service offered is rare and the choice of providers reduces.

Whilst the history of 3PL doesn't provide a flawless crystal ball, it does provide a very relevant insight into what is most likely to happen and what actions can be taken to avoid many of the traps along the way. Taking heed of these lessons will allow BPO service providers to steal a march on the competition, and position themselves strongly for the likely phases of market development.

Constraints likely to be faced by the developing BPO market

As the 3PL market developed, a series of constraints were experienced. These were of varying magnitude, but all would have been less troublesome if they had been accurately predicted. The BPO market is likely to face similar hurdles, however an accurate forecast is available:

Unpredicted rapid surge in market growth

Such activity can often lead to a rush of new entrants. Many of these organisations have limited or no existing capability. This “must get a customer at all costs” approach is most likely to increase risk and generate an unstable commercial situation. Looking into the future, to the mature phases of market development where the consolidation starts, only those with a solid foundation of capability will survive. Hence it is imperative that service providers strategically plan the capability required in order to correctly service the needs of the target market.

Shortfall in truly capable operations management

As with any newly emerging market, lack of management experience is a limiting factor. This is amplified in such operational environments as BPO where the “accuracy of routine” and requirement to continuously improve service is a specialist skill in itself. When determining capability, BPO service providers should carefully review the senior and middle management skill base they have. Sufficient skill will make a contract, insufficient skill will definitely break it.

The threat of the in-house providers

Potential users of BPO services can create their own facility and look to increase transaction volumes by opening this up to other users. Often the business model is based purely on covering their own costs. This can provide a significant threat to BPO service providers, usually on the grounds of demonstrable capacity and cost. When this was experienced by the 3PL market, the most effective defence was a combination of expertise and scale. The high number of specialists and scale of operations was offered as a more secure alternative, which, when considering the importance of finance, payroll and HR transactions, should be equally applicable with BPO.

Reducing margins driven by a shift to a commodity style market

After the initial surge of 3PL market interest, a natural plateau was reached, where the services offered were common, differentiation was difficult to generate, and cost became the main decision factor for users. At this point a price war developed and margins were squeezed. This triggered a period of consolidation, where those with the most robust operations (although not necessarily the largest) were usually in prime position. BPO service providers need to be watchful for the signs of this stage; having built a solid foundation of capability they need to be acting as the hunter rather than becoming the hunted.

Lack of creative differentiation and a frustrated customer base

Of all the constraints faced by 3PL operators, perhaps the most destructive and yet most avoidable was the failure to create differentiation in their service offering. It may initially appear managing trucks and sheds is enough. The short sighted operators thought so and lost. The provision of any essential support service, irrespective of nature, should be merely the base from which additional business benefit is triggered. If the existing service is only replicated, any resultant cost saving will soon become “the norm”. The challenge facing the BPO service provider is to constantly refresh the benefit.

Outsource everything and then manage the brand?

Recent BPO commentary has focused on the attraction of outsourcing all possible non core processes, leaving the organisation free to manage the brand. It is easy to see the apparent attraction in this business model, however yet again the 3PL market provides valuable insight suggesting this approach is flawed.

Those organisations who relinquished all interest in their logistics operation, relying instead on the 3PL service provider, missed out on the opportunity to dovetail this essential element of their business into core activity. The resultant fragmentation led to restricted growth and increased costs, highlighting there is a fine balance between profitable partnerships and loss of flexibility.

Most organisations do not have the brand strength to justify this model. For organisations with household brand names the reputation of the brand is everything. For the rest, the service and competitiveness provided by the brand is far more important, thus relinquishing control of all else is a high risk strategy.

Investor relations can also be dented by this approach. The apparent “eggs in one basket” approach of outsourcing all except brand management, can lead to concern over lack of control and business continuity risk.

The reality is different to the hype. Outsourcing all except brand management may be sold as the easy way out, but like many ideas that appear too good to be true, it is.

Turning a necessary evil into a fresh product offering

Earlier we mentioned the 3PL service users who would offer their facility to others in the market in order to cover their costs and the associated issues surrounding this approach. One interesting development of this, without the associated risks, is the potential for the user to actively market their outsourced service as an additional “badged” product for sale. The facility would still be provided by the BPO organisation, but fronted and marketed by the user. This approach is particularly effective when the user’s normal product offering is enhanced by a BPO service.

An example of this is a major clothing retailer (company A) who utilised their own transport function to manage and deliver imported products on behalf of their competitors. Initially this appears to be a commercial own goal as surely it assists the competition. However the detail of the operation presents a different slant:

- the competition would have imported this product anyway using another means of distribution
- the economies of scale presented by combining the transactions of multiple retailers presented economic benefits, the bulk of which were absorbed by company A
- significant intelligence could be obtained on competition volumes
- cost benefits were enjoyed by the competition also providing a stable win-win position.

The net result for company A was their own import logistics costs were significantly lower, allowing for an increased margin and shareholder satisfaction. Benefit to the competition was only a fraction of this.

In this situation the potential market is greatly increased and provides another example of how creative, mutually beneficial broadening of the service offered can enhance the earning potential of the BPO solution.

Conclusion

The strong correlation between the development of the emerging BPO market and that of 3PL over the last twenty years means we can confidently predict the future direction of the BPO market. The two services offered may initially appear disparate, however they both provide identical transition from in-house support service to outsourced. The market stimulants are the same and they both concentrate on essential processes not traditionally regarded as core.

BPO users and service providers alike should take valuable insight from the 3PL example and make the most of the opportunity to learn the lessons and avoid the pitfalls experienced in the 3PL market.

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