

## Adapting Offshoring to Your Business

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November 2007



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Frequently, companies that are considering offshoring find themselves conforming their sourcing strategies to existing alternatives offered by service providers rather than constructing alternatives more suited to their unique requirements. While the evolution of sourcing has certainly led to an expansion of available options, a lot more can be done to reach the full potential of sourcing alternatives.

The traditional choice between creating an offshore captive and outsourcing to a third party leaves a company to select between alternatives with starkly different risks and benefits. Creating a captive can offer the promise of control, labor cost savings through disintermediation, elimination of exit risks, protection of competitively sensitive information, and preservation of company culture and brand. However, in comparison to outsourcing, the captive approach requires greater investment and local country expertise, may forfeit leverage and flexibility, and takes longer to realize savings. The importance of these factors in a company's choice depends on the attributes of the function being offshored and the goals and attributes of the company itself. The attributes that have to be considered include the competitive sensitivity or strategic importance of the function, the domain-specific knowledge required, and the size and scale of the operation being outsourced. The relevant goals and attributes of the company can include factors such as organizational readiness to make a long-term commitment, the need for process improvement, time sensitivity, available skills in creating and managing an offshore enterprise, and the relative strength of the company's brand in drawing labor resources in the local market. Very often, the combination of these attributes and goals do not match up neatly with either the captive or the outsourcing option. If the mismatch is significant, the results can be disappointing. For example, a company may wish to create a captive to house a competitively sensitive or strategic function but have insufficient scale or local country expertise to realize the savings potential.

There are some well-established alternatives, such as joint ventures and build-operate-transfer (BOT), which, by combining features of both captives and outsourcing arrangements, can address some of the limitations of the traditional choices. But these alternatives come with their own drawbacks. Joint ventures offer companies the promise of greater control and visibility to costs, but they are complex structures that require extensive planning and documentation to address governance issues, capital contributions, dilution of interests, exit

rights, and competition restrictions. BOT arrangements offer the advantages of outsourcing with the downstream prospect of ownership, but experience has shown that BOTs are often nothing more than outsourcing deals stripped of the usual customer protections and with no realistic likelihood of any transfer. This outcome is generally the result of insufficient customer planning and a strong service provider incentive to keep the outsourcing arrangement going.

Companies are finding ways to combine traditional choices in hybrid arrangements to give them the flexibility to adjust their outsourcing strategies as they go. These arrangements typically leverage a third party supplier's skills and experience while retaining greater control and more options for the company. For example, a company could use a third-party outsourcer as a vehicle for rapidly establishing an offshore service center while planning to migrate the outsourced function to its own captive center at a future date, thus giving the company time to construct its own center and wait for the offshored services to be stabilized. This arrangement also allows the company to begin realizing labor arbitrage savings immediately. In this model, the transfer of functions to a captive center need not be inevitable. It may very well happen that the company will discover that for some functions, or parts of functions, continuing the outsourcing arrangement is preferable to transferring them to a captive center. Hence, the real strength of hybrid arrangements is that they can be constructed to give the company the flexibility to adapt its offshoring approach over time.

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Another option is to construct hybrid-like arrangements within the contractual outsourcing by varying the degree of the company's control over such factors as employee selection and hiring, the sharing of space and infrastructure, technology

requirements, third-party contracts, and how services are delivered. By adjusting these factors, the company can exert captive-like control over the outsourcing services provider with or without the option to migrate services to a captive center. For instance, a company that is concerned about sensitive information could require that an exclusive work force be housed in a dedicated portion of the service provider's facility, operating on an entirely separate data processing and telecommunications infrastructure.

Of course, more control comes at a higher cost, so finding the right balance is essential to preserving the cost advantages of using a third party. In addition, it is important to give sufficient control to the service provider to make it accountable for the services and to give it sufficient incentive to properly manage them. For instance, the company's control should not be so thorough as to absolve the service provider of its responsibility for achieving service levels and operating within cost parameters. After all, the reason for using a service provider in the first place is to leverage its expertise and obtain the cost advantages of having it provide the services.

While not necessarily complex, because these hybrid arrangements are neither standard nor common, advance planning is essential to a successful outsourcing. As anyone who regularly negotiates contracts knows, straying from precedent can be challenging, if for no other reason than it takes people outside of their comfort zone. Consequently, to employ a hybrid arrangement, a customer must be deliberate and explicit in its requests for proposals, rather than treating these arrangements as an afterthought or attempting to retrofit them onto existing deals. Success also relies heavily on developing a pricing strategy that counteracts the innate tendency of service providers to extend the term of their revenue generating services. One such strategy is to build in success fees that reward the service provider for achieving the customer objectives, such as transferring the function to customer operations.

Offshoring is an embedded part of most major companies' sourcing strategies, but the structures being used for offshoring are continuing to evolve as companies seek to adapt offshore alternatives to their businesses, goals, and strategies. The well-worn paths of traditional outsourcing and captives, and even alternatives of joint ventures and BOTs, sometimes do not lead to optimal results. However, by exploring the creative and challenging options afforded by hybrid arrangements, companies can design offshoring arrangements that more closely match their needs. ♦

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