

MANAGING OUTSOURCING FOR MAXIMUM VALUE

White Paper

ORBYS CONSULTING
www.orbys.com

with a foreword from Henley Management College

Copyright © ORBYS CONSULTING 2006. All rights reserved.
This White Paper is for information purposes only.
ORBYS CONSULTING makes no warranties, expressed or implied,
in this document.

MANAGING OUTSOURCING FOR MAXIMUM VALUE

INDEX

FOREWORD FROM HENLEY MANAGEMENT COLLEGE	4
MANAGEMENT SUMMARY	7
THE RESEARCH AND FINDINGS	9
RESEARCH PROCESS AND SAMPLE	9
THE EXPECTED BENEFITS	9
WHETHER INITIAL EXPECTATIONS WERE MET	12
PERFORMANCE REVIEW PROCESS	13
MANAGEMENT OF MULTI-CONTRACT SITUATIONS	15
MANAGEMENT OF RELATIONSHIPS	16
THE RETAINED ORGANISATION	18
RISK MANAGEMENT	21
THE PROBLEMS EXPERIENCED	22
CORRECTIVE ACTION	23
HOW EFFECTIVE WAS PAST ACTION	24
COMPANY PROFILES	26
BIOGRAPHIES	28

Foreword from Henley Management College

Outsourcing is an important feature of today's business landscape. According to estimates, the global revenues from IT & BPO outsourcing for 2005 were \$200 billion and \$133.7 billion respectively. A high-profile aspect of this growth is the move to offshore locations, estimated by the McKinsey Global Institute to involve 4.1 million service jobs by 2008, although not all of these will be outsourced.

But the changes are not just quantitative and outsourcing has come a long way from the initial focus on the traditional 'make-or-buy' decision. Perhaps most noticeable has been the migration towards outsourcing more complex activities, such as Knowledge Process Outsourcing (KPO) which may be non-routine and have a high knowledge content, such as research and development. The growing capability and maturity in outsourcing is underlined by the emergence of suppliers offering the complex services demanded in areas as diverse as contract manufacturing, third-party logistics and customer-service call centres.

Firms looking to outsource can also turn for advice and support to the specialised consultancies that have developed considerable expertise in this field. Despite these developments, past research has suggested that many outsourcing deals fall short of the benefits expected. One estimate, for example, suggested that four out of five BPO deals being signed today will need renegotiation within two years (Johnson, 2006) and whilst not all forecasts are as pessimistic, success in outsourcing is not a foregone conclusion. In addition, the growth in outsourcing has also attracted attention from a wider audience. Whilst it is offshoring that has grabbed the biggest headlines, outsourcing in both the private and public sector has often been a controversial topic – even when jobs do not migrate overseas.

Recently there has been much talk of "in-sourcing" as a solution to problem agreements and there have been several high profile examples in the press. What has been unclear is how much in-sourcing and other alternative actions have been used in practice and how successful each has been. This is one of the key areas of this research.

Dimensions of Outsourcing

There are three important dimensions to outsourcing. The first is the degree of strategic impact that outsourcing a particular activity is likely to have. This, in turn, is related to how close the activity is to the organisation's core business and whether it is a potential source of business advantage. A second important dimension is the commercial structure and governance used for the outsourced process. This can vary from arms-length, fee-for-service set-up, through more collaborative arrangements to partnerships, such as joint ventures and related management models. Choice of an appropriate structure will be linked, amongst other things, to the strategic impact of the activity. The third dimension concerns scope, in terms of both services and location. This includes, of course, the choice of locating offshore but it can also involve the decision about whether the outsourced service will be local, national, or international in scope.

Whatever choices are made in relation to the above dimensions, it is essential that both buyer and supplier have the skills and capabilities to manage the process if the value from outsourcing is to be maximised.

Benefits sought from Outsourcing

Clearly many companies seek cost reduction. This can include savings in operating costs, decreases in capital costs, and the shift in cost structure from fixed to variable. Such cost savings are possible as the result of the supplier's exploitation of economies of scale and scope, as well as superior expertise. In today's globalised outsourcing market, savings are also possible by relocating to low-cost countries, where labour and other costs can be significantly reduced. Aside from cost, many companies expect improvements in other areas of performance. Underpinning this is the idea that firms should focus on their core competencies. Thus companies that outsource may look for process know-how and technology that they lack themselves but which represent a core competence for the supplier. Real benefits should accrue from process re-evaluation and re-engineering, free of constraints imposed by legacy systems and ways of working. Outsourcers would also expect to gain both better service and reduced costs over the lifetime of the relationship by leveraging the capabilities of the supplier. In some cases, reputational benefits may accrue through association with a world-class supplier. Alternatively, where some form of joint venture is undertaken, there may be long-term revenue streams, or capital gains if the asset is sold.

These are some of the potential benefits of outsourcing but they remain only potential benefits unless they can be realised in practice. As already noted, not all outsourcing deals deliver the expected benefits. Any firm considering outsourcing needs to be aware of the possible risks. These can include a failure to achieve promised cost levels, for example should the supplier fail to realise the expected economies of scale. Supplier competitiveness may also deteriorate over time, particularly if there is poor governance of the on-going relationship and suppliers fail to innovate and improve. Similarly, service levels may reduce or expected improvements fail to materialise. Long-term deals in fields subject to rapid technological development may result in inappropriate contract arrangements to meet changing conditions. Outsourcing may also have a negative impact on internal staff morale, and in some cases a negative impact on corporate image, for example if there are a large number of employee redundancies.

Managing Outsourcing for Maximum Value

Effective management is therefore vital if outsourcing is to deliver its full value potential. Such management begins with taking a strategic approach to outsourcing. This includes being clear on the reasons for outsourcing and the value that the organisation expects to obtain from doing so. Taking a strategic approach also means understanding clearly what activities are, and are not, candidates for outsourcing. Here the idea of core competence can help organisations keep focus on what should be retained in-house, noting always that what is 'core' may change over time.

Only at this point is it possible to start the process of selecting the right supplier and negotiating the deal arrangement. However, whilst these steps will lay the essential foundations, successful outsourcing requires active management across the whole lifecycle. In particular, outsourcing organisations must have appropriate management and governance structures in place. This includes retaining, and in some cases acquiring, the necessary skills to manage the outsourcing deal post-contract – an area not fully recognised or adequately dealt with by many organisations. It also implies careful attention to the ongoing evaluation of the supplier's performance using suitable metrics and, where necessary, active intervention in the process.

It is these challenges of upfront planning and subsequent monitoring and governance of outsourcing that are the focus of the research presented here.

References

- FARRELL, D., LOBOISSIÈRE, M., PASCAL, R., ROSENFELD, J., DE SEGUNDO, C. & STÜRZE, S. (2005) *The Emerging Global Labour Market: Part 1 - The Demand for Offshore Talent in Services*. McKinsey Global Institute.
- JOHNSON, L. K. (2006) Successful Business Process Outsourcing. *MIT Sloan Management Review*, 5-6.
- MARSHALL, J. & HEFFES, E. M. (2005) *Gartner Expects Boom in BPO Contracting*. *Financial Executive*.
- WILLCOCKS, L. P., HINDLE, J., FEENY, D. F. & LACITY, M. C. (2004) IT and Business Process Outsourcing: The Knowledge Potential. *Information Systems Management*, 7-15.

Management Summary

Purpose and Focus of this White Paper

The outsourcing market is maturing. As the last white paper and Orbys' experience working in the industry shows, organisations are now far better at negotiating and implementing outsourcing agreements than they were. However, getting successfully to a signed agreement isn't the end of the story – do these deals then go on to deliver the value that was expected from them? If not, why not?

With much talk and high profile examples in the press of deals failing and being taken back in-house, what is the real picture and what are the lessons to be learnt to ensure outsourcing agreements deliver the value they should? This is the focus of this white paper.

The research on which this white paper is based covered 82 organisations predominantly large, many with turnover in excess of £1bn and the majority with 4 or more outsourcing deals in place. Although it covered three sectors; Financial Services, Manufacturing and Retail & Consumer businesses – the results do not vary by sector, or by size of business. These findings therefore hold relevance for all types of organisation.

Findings

Cost reduction and service improvement are of course the staple requirements from outsourcing for most organisations and most identified these upfront in their initial planning and approach to outsourcing. However, it is not the only key requirement and for many, other benefits such as continuous improvement and identification of new value adding opportunities, potential for transformation etc were also highly important. What is concerning is that many of the organisations entered outsourcing selection exercises without having properly identified these other requirements and therefore may have entered a process without properly considering what they wanted and how best to source it – hence they may have followed unsuitable sourcing approaches, without the most appropriate supplier shortlist.

Although overall satisfaction levels with outsourcing are high, 55% are quite satisfied and a further 27% are very satisfied, there is significant level of failure of deals to meet expectations, with 43% saying that the supplier failed to perform as expected and 35% that the deal failed to meet the client's needs.

The lack of upfront planning is clearly a factor in this failure to meet client expectations, other explanations can be found in the way deals are managed.

While formal management of hard factors such as performance against SLAs (Service Level Agreements) and pricing against contracted levels was generally good, only 57% of respondents were formally monitoring and managing performance against the market and even less managing the relationship with the supplier on a formal basis.

Although business customers of the outsource service were involved in the deal in terms of change management support and ensuring they understood their obligations, there was lesser coverage (65%) of respondents in terms of their involvement in governance and in client satisfaction surveys. 38% of organisations had failed to define the retained organisation design during the strategy and planning stage.

Although operational and data security risks were being actively managed by most, softer factors such as supplier risk, regulatory risk etc were surprisingly less likely to be actively managed.

Despite the overall satisfaction levels there was a high incidence of problems during the life of the deal, most common being; declining or static service levels, loss of pricing competitiveness and supplier inertia. Each experienced to an appreciable/significant extent by about 40% of respondents.

There were high levels of corrective action taken to resolve these problems, 71% having implemented remedial programmes with the supplier, 59% having renegotiated the contract and 23% even having brought the services back in-house. This corrective action was in fact only partially effective, with only 29% finding the remedial programmes highly effective and 38% finding the same for renegotiation.

Conclusions

There were clear statistical correlations between high satisfaction that the deal met expectations and respondents adopting good practice in the following areas:

- Planning for and designing the retained organisation at the strategy and planning stage
- Adoption of formal comprehensive review processes

The failure to meet expectations therefore appears to be due in large part to weaknesses in the initial strategy and planning – in particular in not understanding market capability and available options, in not designing the retained function at this stage, and in the quality of subsequent performance management which was often limited in scope and end user involvement.

The fact that overall satisfaction is relatively high despite the failure to meet expectations, the high incidence of problems and only partially effective corrective action, suggests a surprising level of acceptance and complacency with this standard of underperformance.

It is Orbys' contention that organisations should focus more on effective prevention – via effective strategy and planning and regular pro-active and comprehensive management rather than have to resort to only partially effective, costly and time consuming corrective action programmes. It is in both clients' and suppliers' interests to support this process and this improved management (with regular assessment against market performance and best practice) will ensure that expectations are better defined, managed against and delivered. Organisations should not have to accept less than good performance from their outsourcing arrangements.

The Research and Findings

Research Process and Sample

Independent research organisation, Benchmark Research, undertook a detailed study into the UK outsourcing market on behalf of Orbys. 82 private sector organisations with a turnover in excess of £100 million either within the UK or globally were interviewed, the majority (55%) of respondent organisations having a turnover in excess of £1bn p.a. All had at least one outsourcing deal with a value of at least £5m p.a. In fact, the majority had 4 or more such current deals and nearly 40% had over six such deals, illustrating both the growth of outsourcing and the increasing importance of supplier and deal management.

26% of the deals discussed represented pure IT contracts, the balance being BPO/ facilities management etc. 37% were international in scope and although the majority (55%) were with a UK based supplier, 22% were specifically offshore deals.

Three sectors were covered; Financial Services, Manufacturing plus Retail & Consumer businesses. The differences in opinion by sector were not statistically significant for any of these sectors to the overall results discussed in this white paper. Hence the findings and conclusions expressed here are relevant across all three sectors.

All respondents held senior management positions and were responsible for one or more of establishing the initial strategy, implementation, or for ongoing management of at least one of the existing outsourcing deals.

This survey is therefore a good indicator of the private sector's current outsourcing performance, approaches and success in managing outsourcing agreements.

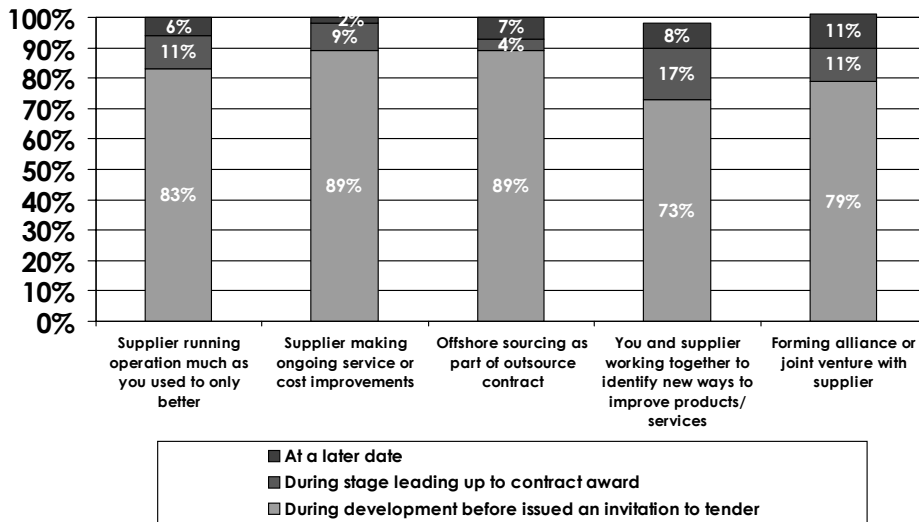
The Expected Benefits and When and How they were Identified

Unsurprisingly (and consistently with most other research), one of the most important factors respondents looked for when initially setting up outsourcing deals was commitment to ongoing cost reduction and/or service improvement (93% of respondents). Interestingly, equally important was the ability to work with the supplier during the deal to identify new ways to improve products or services – i.e. continuous improvement and added value (identified as important by 96% of respondents).

While nearly all (89%) of the respondents had identified the importance of cost/ service improvement at the internal strategy and planning stage (i.e. ahead of going to market for the services), the opportunity and potential importance of working with the supplier to identify new ways to improve products or services or of forming more innovative commercial alliances were not identified until later on, as part of the process of working with and contracting with suppliers or during delivery, by 25% and 22% respectively of relevant respondents.

Many respondents had also not recognised the opportunity for other important benefits such as potential for transformational change and the benefits of relationship with a strong supplier brand until these later stages in the outsourcing process.

When did you really start to consider these ways of creating value through outsourcing?



Source: www.orbys.com

These findings suggest a combination of factors:

1. Clients did not put enough effort or focus into the upfront strategy and planning process
2. Clients were not aware of the full range of potential benefits at the time they were developing their market strategy
3. Additional added value benefits were then identified in discussion with suppliers (once they were involved in the process)

This confirms two key learning points for clients at the strategy and planning stage:

Firstly, outsourcing deals are usually long term and significant in impact, consideration of options and potential opportunities should therefore be wide-ranging and strategic. Transformational type changes in particular need strategic alignment, with suitable assessment and design which needs to at least be started by the business itself ahead of going to market. Only then, once the appropriate opportunities, risks and benefits have been identified should an approach to market and selection of suitable suppliers be made to meet these requirements. This analysis and consideration of options should be informed by market capability and not unduly influenced or shaped by discussions with a limited number of suppliers.

If this approach of strategic evaluation of benefits isn't properly adopted, then a number of problems can arise:

- Downstream service integration/supplier rationalisation issues as a result of failing to clearly adopt a comprehensive approach to developing your strategy and planning its execution based upon future business changes and potential requirements
- Flawed selection exercise because the suppliers weren't originally short listed based on the final requirements and hence weren't the best from which to select the services and capability which were ultimately required
- Cultural, operational or commercial failure due to lack of upfront planning, design and selection linked to desired business outcomes. For example, failure to identify the requirements for, and therefore to incorporate, suitable incentivisation for joint working between client and supplier(s) to develop new opportunities and encourage continuous improvement

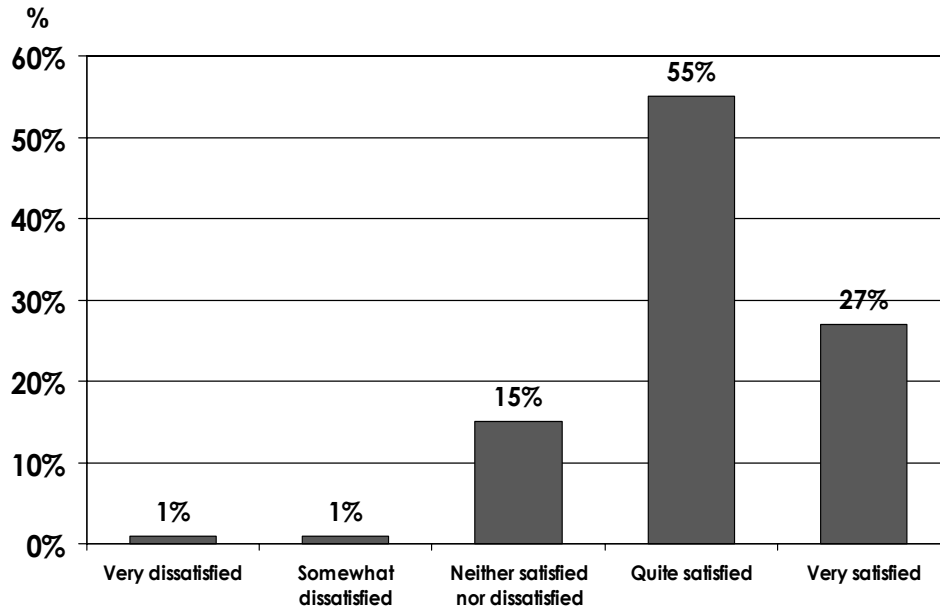
Secondly, good suppliers do add value to client propositions. Clearly, as discussed above, clients need to first understand their own strategic requirements and what opportunities and market capability are available and are the best fit to their needs and carry out selection from a shortlist of suppliers based on this comprehensive view of requirements. However, once suppliers are involved in the process they should be able to contribute to the design of the solution. The challenge for clients is to design and run selection exercises that allow individual supplier input. Some of the key lessons Orbys has learnt in practice are:

- The importance of defining required outcomes, not how they are to be delivered - unless there are compliance/control/risk issues – leave the “how” to the supplier as far as possible
- Allow time in the process for refinement of requirements – don't get caught negotiating against a deadline
- Provide suppliers with adequate briefing sessions/Q&A opportunities, to understand requirements and what they mean
- Consider allowing joint working sessions for suppliers to “test their ideas and approaches” for suitability ahead of formal bid submission (but don't let these become informal negotiation/selling sessions)
- Consider options such as “compliant and non compliant bids (with guidelines on what is and isn't acceptable)” and/or a selection process which involves a second “Best and Final Offers (BAFO) stage” once requirements are clear – but don't let any expectation of a BAFO round undermine the importance of the initial proposal stage (there must be some de-selection at this point and/or no commitment to follow a formal BAFO process with all bidders)

Whether initial expectations were met

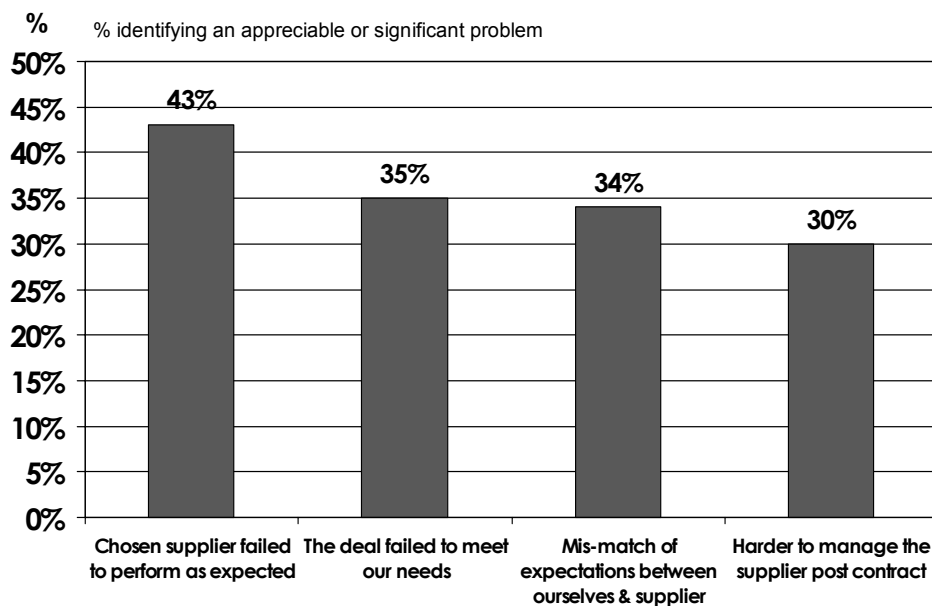
The sample was asked about how well their initial outsourcing expectations and requirements had subsequently been met. Although over half (55%) of respondents were “quite satisfied” and a further (27%) were “very satisfied” with the overall value they obtained from their outsourcing agreements, a number of problem areas were identified by a significant proportion of the sample:

How satisfied are you with the value you derive from your outsourcing contract(s)?



Source: www.orbys.com

Where were initial expectations not met?



Source: www.orbys.com

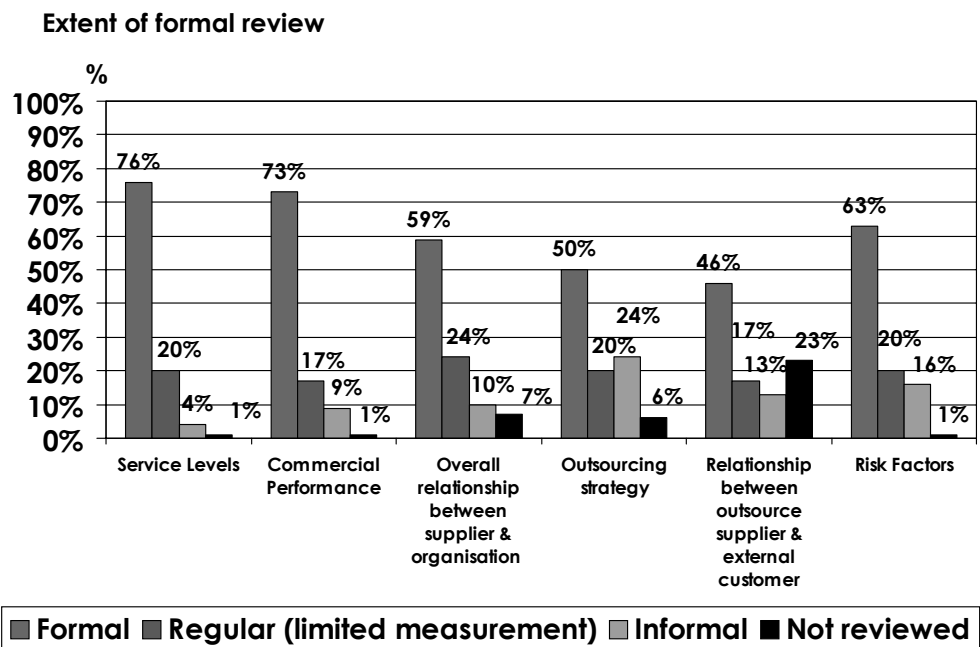
What is surprising is the contrast between the relatively high levels of satisfaction and the level of failure of arrangements to meet expectations. This suggests one or more of:

- Unrealistic/unachievable expectations – due to the impact of inadequate upfront research and planning leading to flawed design, selection and implementation (as previously discussed)
- A lack of, or ineffective, performance management
- A level of complacency/acceptance with underperformance against expectations

The following questions address how benefits delivery was managed and identify additional reasons why some of these issues may exist. The question of complacency will be revisited later, in the light of these findings.

Performance Review Process

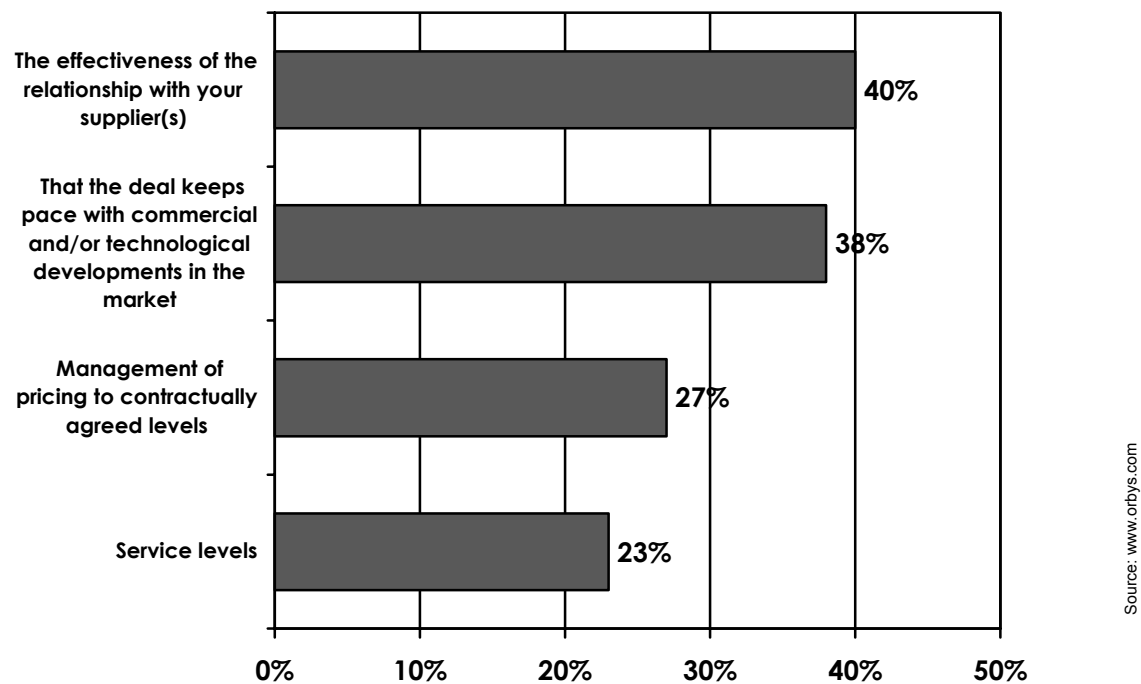
The majority of respondents had formal regular review processes in place with comprehensive measurement of both service delivery performance (76%) and commercial performance (73%), with a further 20% and 17% respectively, still having regular reviews but with more limited formal measurement. There was, however, comparatively reduced coverage of softer factors such as the supplier relationship, the overall sourcing strategy, the relationship and risks.



Source: www.orbys.com

Even among those respondents implementing formal review processes to manage performance against the contract, the scope covered tended to be traditional management of pricing to contractual levels and service performance to service levels (over 90% for both). Factors such as the deal keeping pace with commercial and technological developments in the market and the effectiveness of the supplier relationship were lower with circa 40% of respondents not formally managing these two facets at all.

Aspects of Contractual and commercial performance management that are NOT subject to ANY formal reviews.



Taken together, this means that out of our sample of 82 respondents, only 57% had regular formal reviews of contractual performance that the deal was keeping pace with commercial/technological developments in the market and only 55% had such reviews covering effectiveness of the relationship with the supplier.

These findings are unfortunately in line with Orbys' experience that softer performance factors are often not given adequate recognition and focus, which provides further explanation for the failure to achieve expectations.

This conclusion is supported by the statistical correlation between the review approach and client satisfaction, which showed that there was a significant relationship between having formal regular reviews of key factors such as service delivery performance, commercial performance and risk with having greater overall satisfaction with the value and performance of the contracts.

Hopefully these findings will provide a case for action for those clients who have not implemented formal review and measurement processes – the vast majority of whom, from this research, had not done so due to either not considering it at all, or believing it unnecessary.

There are again some lessons here for both clients and suppliers, which are backed up by experience:

- Successful management and control of value from outsourcing depends on effective ongoing review and measurement
- Clients can't know they are getting a fair deal (and therefore be sure they are satisfied) unless they have the evidence to demonstrate it to themselves and the internal customers of the outsourced service. This means active comparison to the market in terms of commercial performance and technological developments and provides an objective basis on which to compare expectations
- Without a combination of measurement against the market and active management failure to achieve expectations is highly likely

This is a key area where forward thinking suppliers can demonstrate value and improve client satisfaction and therefore retention by encouraging, supporting and contributing to effective performance measurement.

Management of Multi-Contract Situations

Additional complexity and challenge is added to businesses where they have outsourcing agreements with more than one service provider in terms of integration of the overall service to the end user and in co-ordinating and managing business changes which impact or require support from more than one supplier.

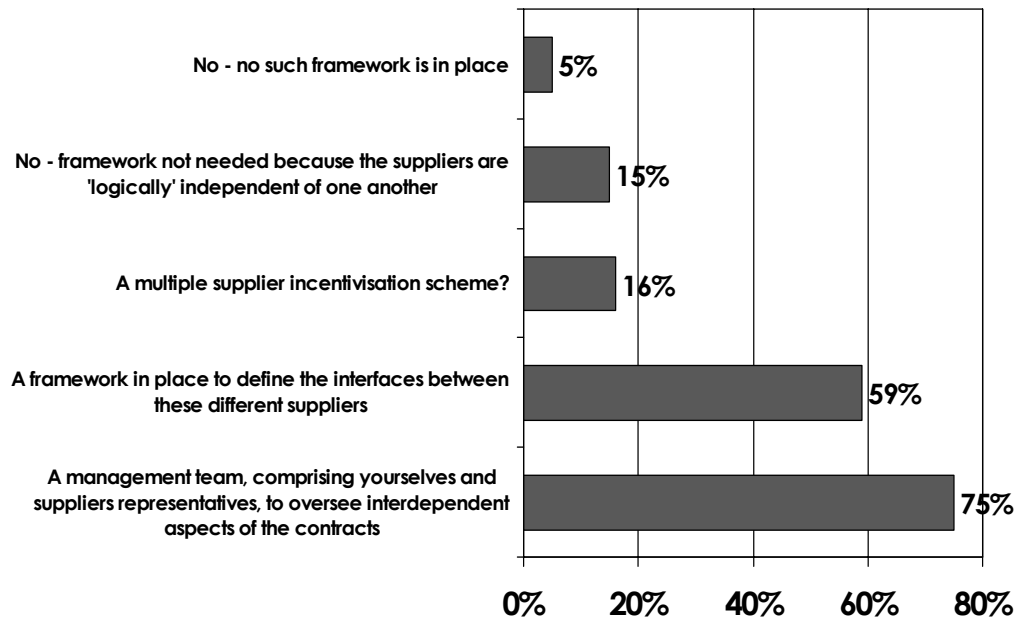
Of those organisations with more than one significant outsourcing contract, 75% of respondents utilised a mixed management team comprising client staff and supplier representatives to oversee and co-ordinate interdependent aspects of the contracts. More disappointingly, only 59% utilised a formal framework to define the interfaces between the different suppliers.

While some clients did not utilise a mixed management model or integration framework because of the services being logically distinct, this was not a justification for all, and even in this situation, experience suggests that many organisations see value in establishing common approaches and shared best practice in supplier and contract management. Ideally Orbys would expect such a framework to cover:

- Defined interface points between suppliers and clients
- Common processes and controls that link the retained organisation and its multiple suppliers
- Incentivisation/penalty mechanisms to ensure collaboration across suppliers rather than blame passing on services that cut across or handover between more than one supplier
- Multi-party governance covering maintenance/changes to the sourcing model, including supplier participants, and related decision rights. For example, a clear ground rule that one supplier will not encroach on another supplier's existing scope of work

A small number (16%) were utilising multiple supplier incentivisation models. While this survey did not allow the opportunity to investigate this approach further – this can be highly successful, but is challenging to negotiate and successfully maintain as a formal contractual model unless introduced at the time of simultaneous contract renewal/renegotiation across the suppliers involved. This is yet a further example that illustrates the need for proper strategy and planning.

How are multi-contract situations managed?



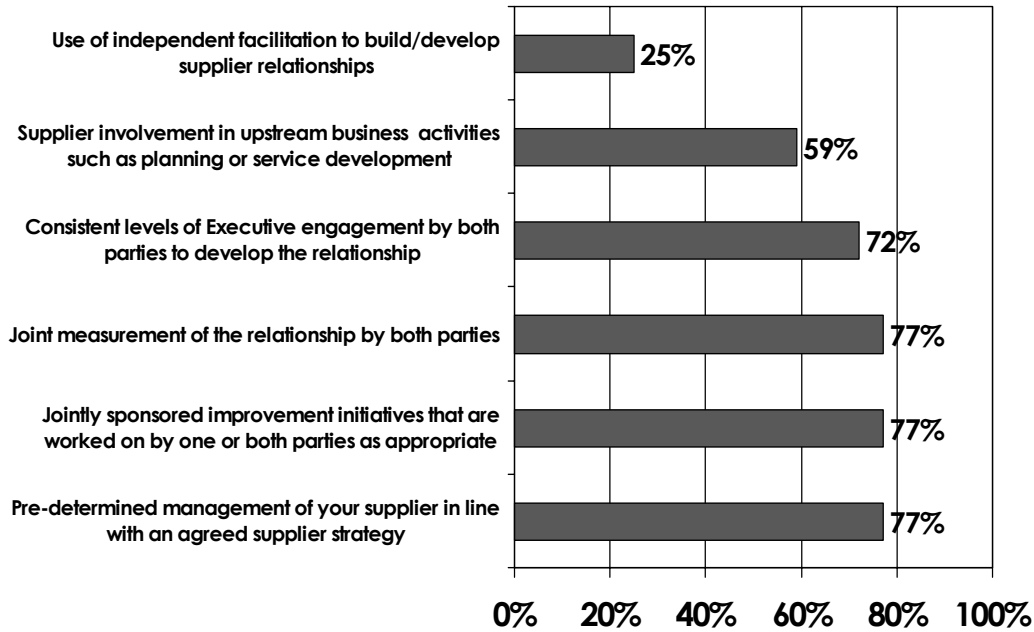
Source: www.orbys.com

Management of Supplier and Internal Customer Relationships

The sample was surveyed on elements of their approach to managing supplier relationships. The majority of respondents were adopting all the good practice approaches discussed, with the exception of independent facilitation to support client-supplier relationship issues and development. This independent facilitation, which involves using a third party independent of the client and supplier to act as an “honest broker” to assess client and supplier perspectives and help create action plans for improvement (ideally utilising knowledge of market best practice), was adopted by 25% of respondents.

There was a positive correlation, albeit based on a small sample of 19 respondents, between those using independent facilitation and higher satisfaction that the deal met their expectations.

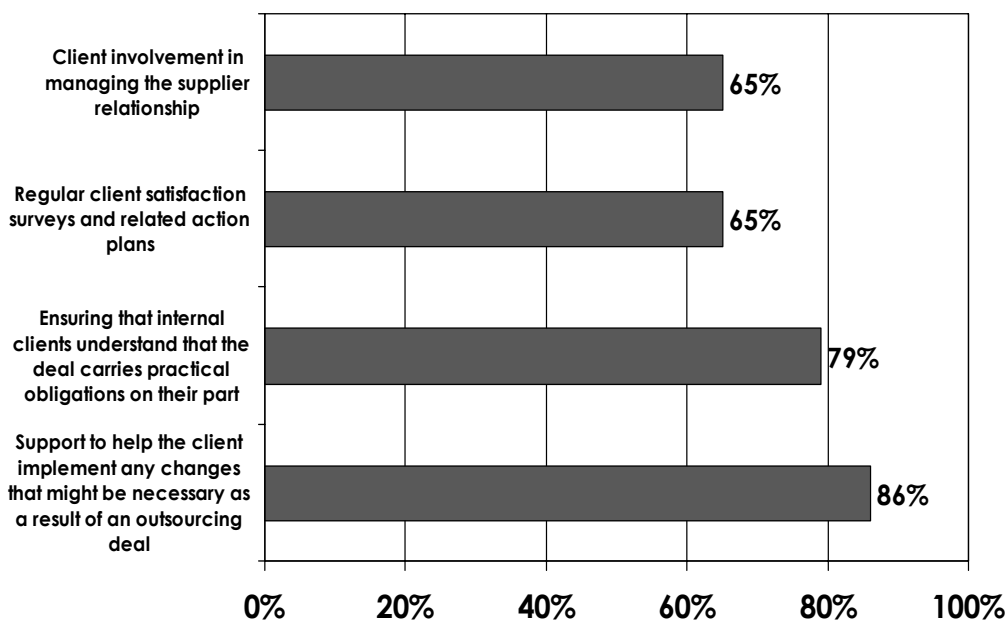
How are supplier-customer relationships managed?



Source: www.orbys.com

Involvement of business customers in the outsourcing agreement was well adopted in terms of change management support and ensuring that they understood their obligations, although softer factors such as client satisfaction surveys and involvement of these customers in the governance of the agreement were less widely adopted.

How is the relationship with the internal business areas managed?



Source: www.orbys.com

Again, the adoption of good practice measures in contract management had a high correlation with overall user satisfaction with their outsourcing agreements.

Hopefully these findings will help improve the role and involvement of end users of an outsourced service in its management and in direct feedback on its performance.

The Retained Organisation

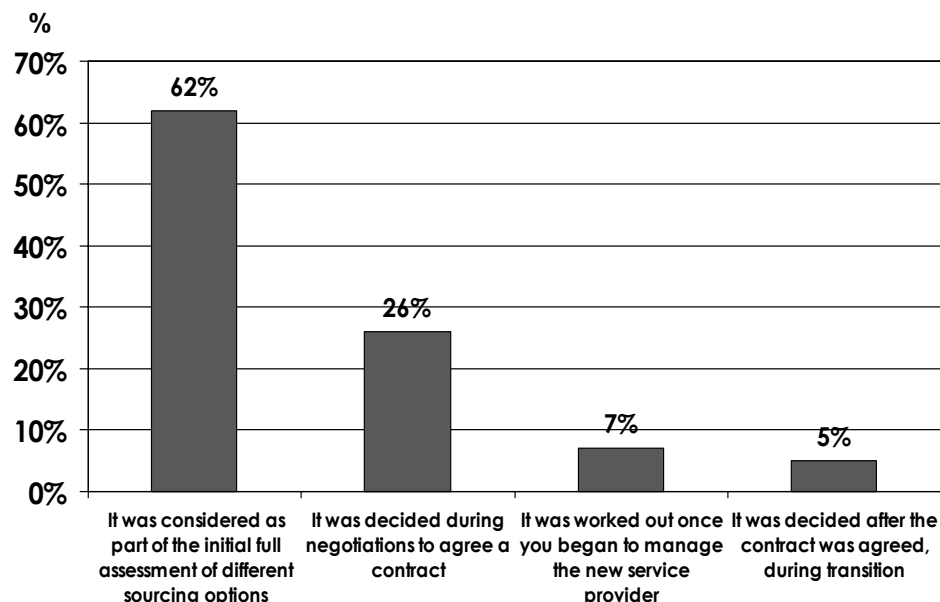
The retained organisation (the functions/activities that are not outsourced and are responsible for managing the outsourced contract(s)), clearly plays a key role in ensuring successful delivery of benefits from outsourcing. The respondents were asked a number of questions in relation to the retained function.

When the Retained Organisation Design was Developed

A significant number of organisations (38%) had not established the design at the strategy and planning stage, the majority of these completing this work during the period after engagement with suppliers, prior to the start of service delivery.

12% of the sample had not defined the retained organisation design until the contract was agreed – during transition or service delivery. There was a clear correlation between failure to plan for the retained organisation upfront and dissatisfaction with the subsequent value of the outsourcing contract.

When was the design of the retained organisation decided?



Source: www.orbys.com

Designing and populating a retained organisation is a long lead time item that can often result in the need to run an internal change programme in parallel with pursuing an outsourced agenda.

In practice, much of the requirements for the retained organisation, such as demand management, service and supply management etc and the related skill sets can and should be identified early on as part of the strategy and planning stage. It is however consistent with the findings that some organisations had not fully identified their business requirements upfront, that the retained organisation design had also not been completed at this stage.

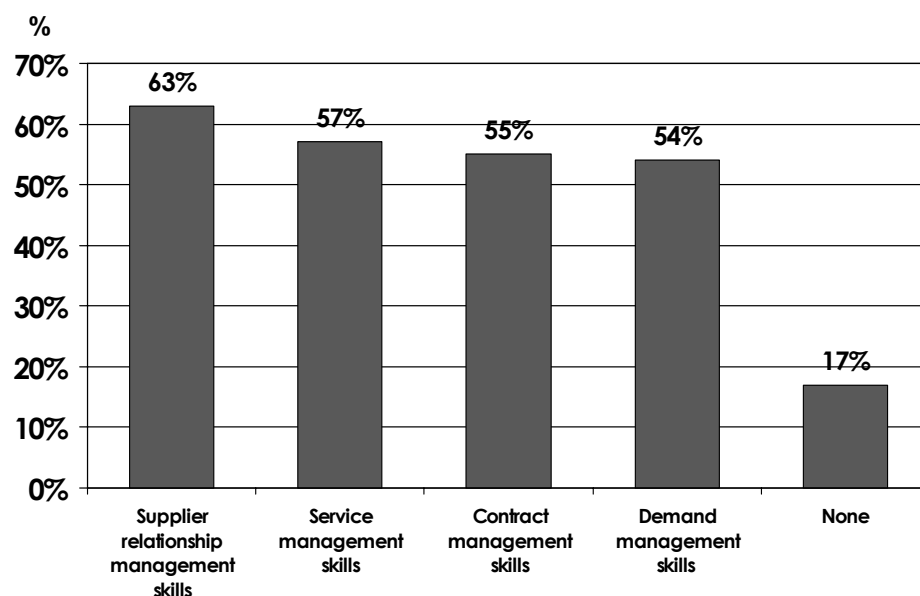
Ideally, Orbys would encourage clients to:

- Ensure the service and commercial management team is in place pre-contract award and that preferably they are involved in contract negotiations
- Have a transition management project team and funding established to discharge their transition phase obligations and full retained organisation set up post contract award
- By the end of transition clients have embedded and established all necessary controls and processes across the organisational/supplier divide including governance so that a robust basis exists for managing the deal

The Skills Required

The majority of respondents had found that they needed new or enhanced skills to manage their outsourced deals as shown below:

What new or enhanced skills did you find that your company needed, to manage your outsourced deals?



Source: www.orbys.com

Only 17% of respondents had not identified any need for additional or enhanced skills. These findings clearly reflect the fact that outsourcing management requires a different and specialist skill set to that existing within most organisations – other than perhaps where there is capability and capacity within an in-house team already managing other outsourcing deals.

Source of New/Enhanced Skills

Most (85%) respondents were able to provide these new/enhanced skills by developing existing staff and 39% used external recruitment, these options were not exclusive, and some respondents therefore clearly used a combination of both.

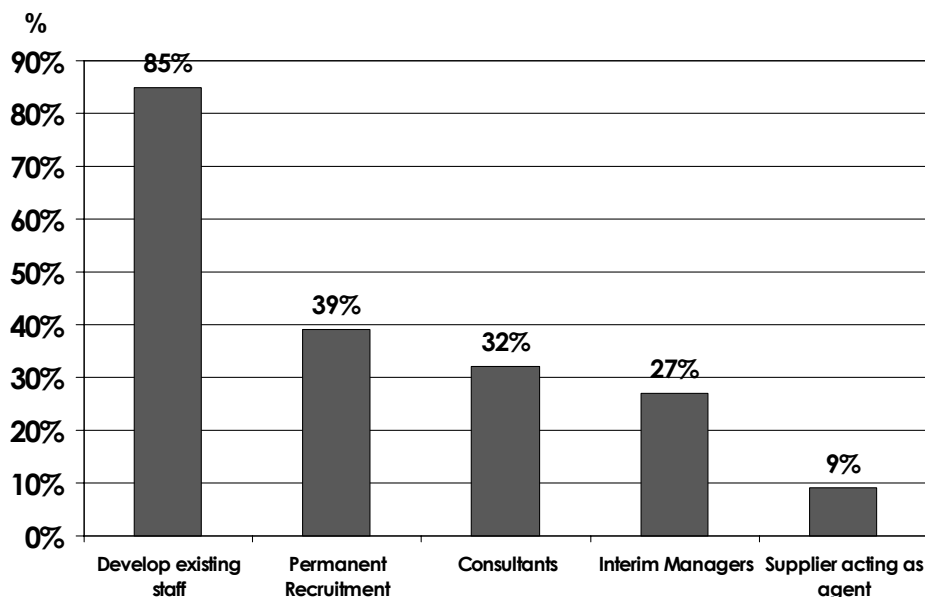
Although 56% (presumably those best able to utilise available internal resource) had been able to bring these resources into place during the contract negotiation period – which is ideal timing to involve these staff in the process, the remainder had taken longer to source these staff – leaving in some cases, a short term skills gap.

These shorter term skills gaps (and support to training and development of in-house resources) were covered by a combination of interim managers (27%) and/or consultancy support (32%). In total 48% of the organisations sampled had used either interim or consultancy support and 11% had used both.

A small number (only 9%) used one of the suppliers to help them manage the others – presumably through a prime contracting arrangement.

These findings show recognition of the need to use specialist support to cover short term skills requirements while sourcing permanent roles internally/externally and to provide training and handover to permanent resource.

Means used to ensure you had the right skills



Source: www.orbys.com

It is typical in Orbys' experience that the retained organisation is either an afterthought or considered a low priority issue, when in fact establishing the right structure, skills and processes is essential to long term success. Sourcing the required skills often has a long lead time and should therefore be planned for early on and considered as part of the retained organisation design. This is particularly important in multi-sourcing situations where consideration of 'integrator' model options and whether or not to perform this role internally or via a supplier become critically important.

Risk Management

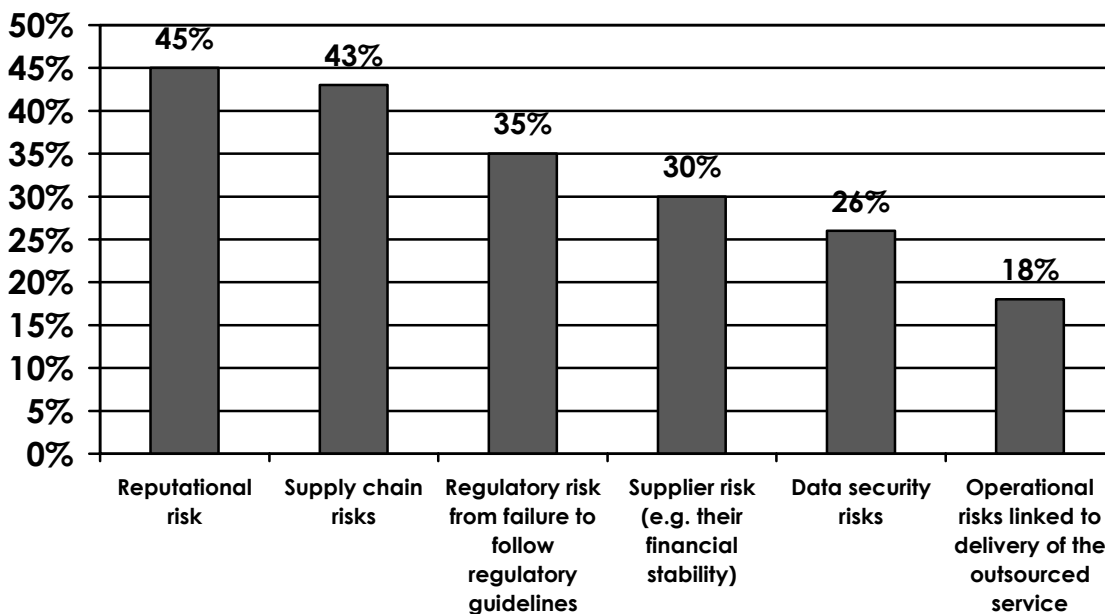
Most respondents are proactively managing risk. Although the most significant areas were in management of operational risks (92%), closely followed by data security (84%), surprisingly, at least one third of respondents are not actively managing the following potential key risks:

- Supply chain risks (e.g. how well subcontractors are managed)
- Regulatory risk
- Reputational risk

This is consistent with Orbys' experience that the most actively managed risks are usually the most frequently occurring and most visible/obvious risks, not always the lower frequency/probability, harder to identify, but potentially critical impact risks. This suggests that a large number of organisations may have scope for improvement in the process of risk identification, risk assessment and risk management.

Clearly best practice is for proactive, regular and comprehensive risk identification, assessment and management.

Risks associated with outsourcing contracts that are **NOT** being actively managed.



Source: www.orbys.com

The Problems Experienced

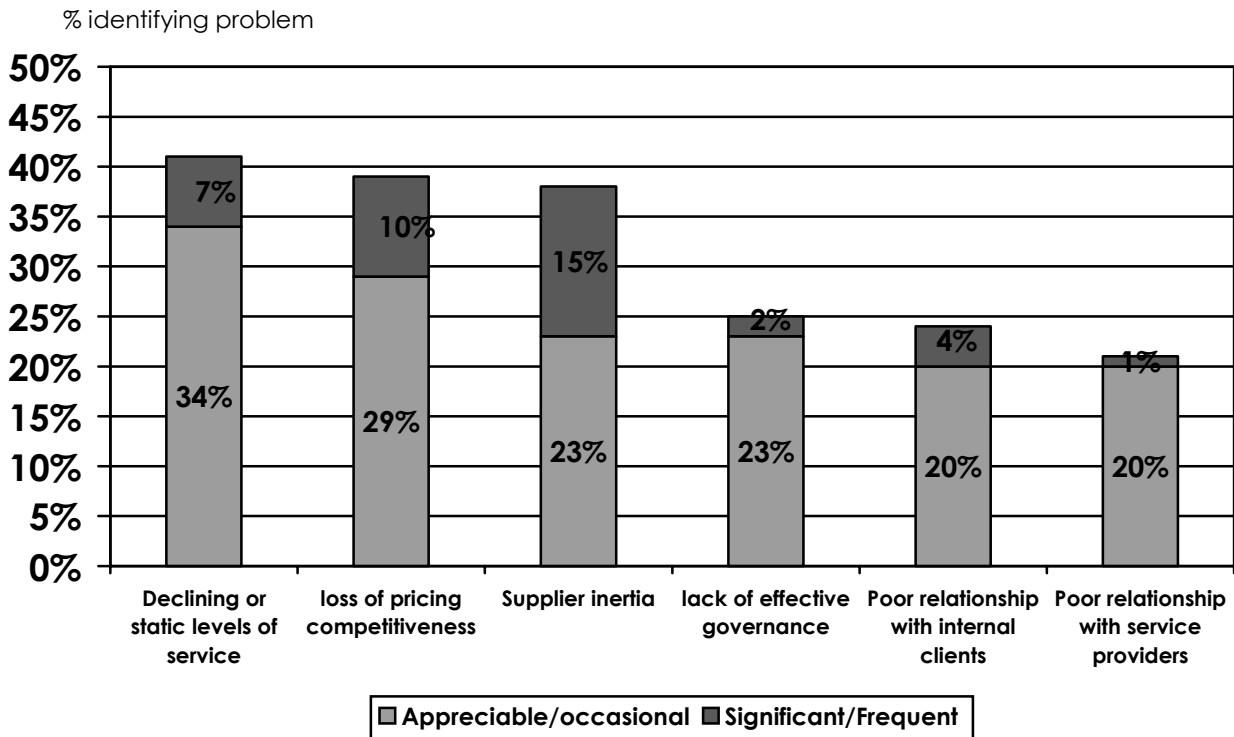
The survey questioned the extent to which a number of types of problem had been experienced.

The most common problems experienced were:

- Loss of pricing competitiveness
- Declining or static service levels
- Supplier inertia

Each of the above was an appreciable/significant problem for about 40% of the sample. Of these the most rated as a significant/frequent issue (15% of respondents) was “supplier inertia” (a post contract lack of pro activity or focus on continuous improvement by the supplier – a perception by clients that suppliers are merely “turning the handle”). The next issue most highly rated as significant/frequent issue (10% of respondents) was loss of pricing competitiveness.

Problems experienced over the life of an outsourcing deal



Source: www.orbys.com

In fact these three areas are clearly related – with supplier inertia and lack of proactive effort at continuous improvement being a strong explanation (and a reason Orbys often sees in practice) for a gradual erosion of price competitiveness and static (or worsening) service performance. The loss of pricing competitiveness in particular also being driven by the number of respondents who do not actively measure and manage supplier performance against the market

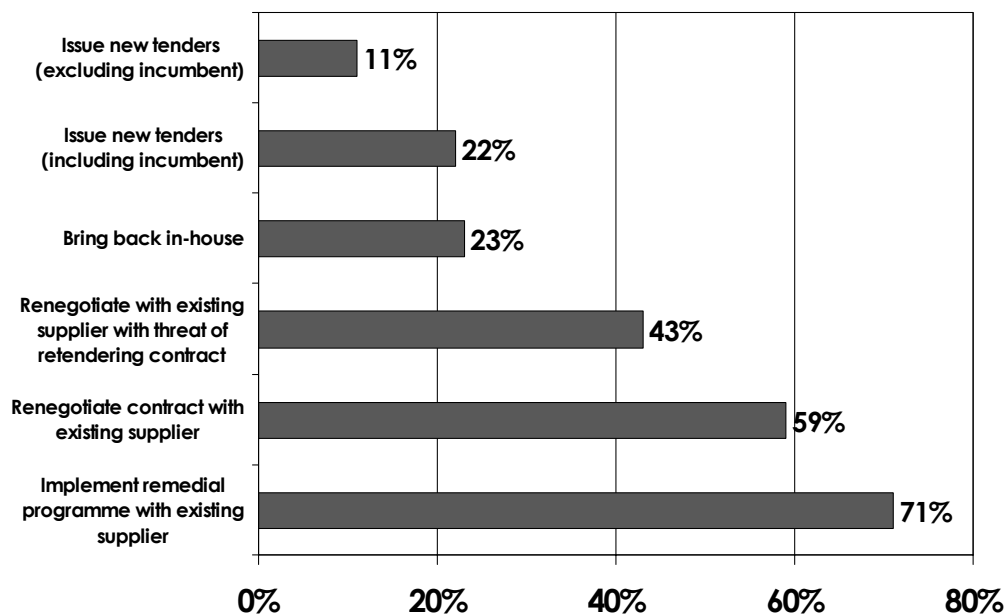
These results make a stark contrast with the benefits clients identified as most important at the start of the outsourcing process which were ongoing cost reduction/ service improvement and working together to identify new areas for improvement. Clearly these discrepancies contribute to clients’ perceptions of the failure to achieve expectations.

Corrective Action and its Success/Failure

What has been done previously?

When questioned what action they had taken within the last five years to address outsourcing performance issues, the actions taken were as shown below:

What remedial action has been taken in the last five years?



Clearly the most common approach had been to follow up the easiest routes first, that is to implement a corrective action plan with the existing supplier and then to escalate to renegotiation/tender later.

At a general level, what is surprising is the high amount of corrective action taken, from remedial action plans through to renegotiation and re-tendering. 23% had even gone as far as to bring services back in house.

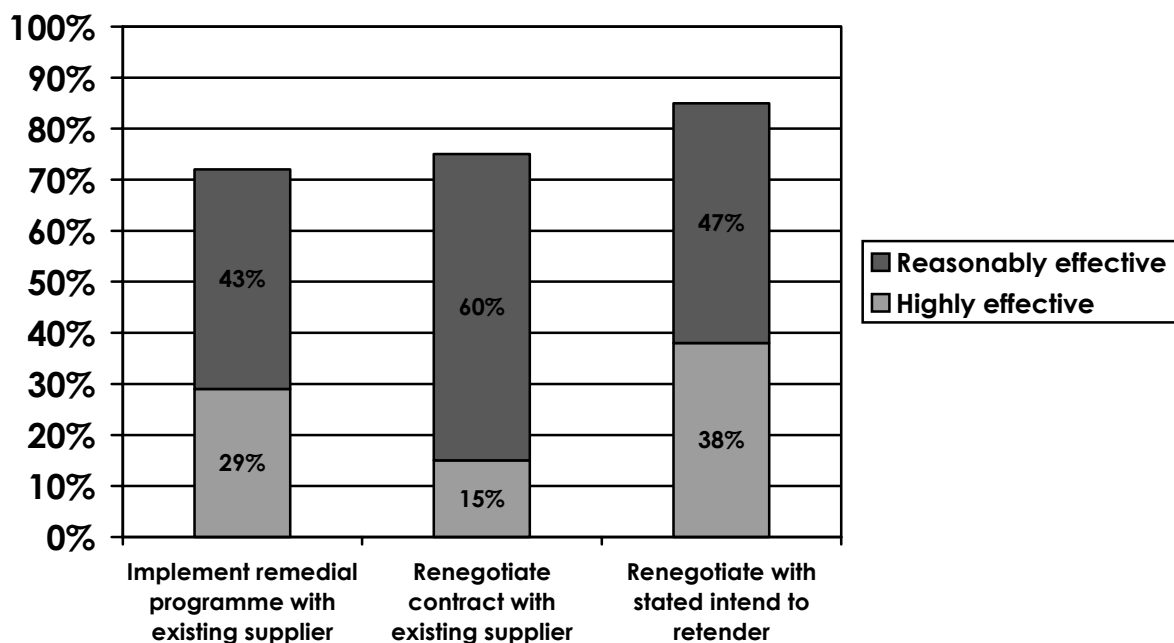
When questioned about what action they would take again in the future the responses showed that clients expected to follow the same actions in the future.

How Effective was Past Action

Of the actions taken, hardly any respondents found it to be largely ineffective, nearly all actions were at least partially effective. Of those options with a statistically meaningful response size, the most successful was renegotiating against the threat of re-tender, in fact effectiveness was largely the reverse of frequency – the more extreme actions bringing the best outcome (from a client perspective at least!).

However, even for this most successful action, it was considered highly effective by only 38% of the sample and for the most common corrective action (a remedial programme with the supplier) the proportion who found it highly effective was only 29%.

How Effective was past action?



Source: www.orbys.com

Perhaps this disappointing level of effectiveness of corrective action explains both the large amount of corrective action undertaken and the remaining failure to meet expectations.

In terms of causes, Orbys suggests the following:

- 1) Weaknesses in upfront planning and strategy – setting off in the wrong direction, with the wrong supplier, or just with poorly defined expectations based on lack of market knowledge, it will be much harder to get back on track and meet your original expectations
- 2) Lack of comprehensive and proactive management against hard and soft factors and against what is happening in the external market – these methods need to be established upfront and embedded into the design and running of the retained organisation and its workings with the supplier. Expectations which are formalised and managed against on an ongoing basis are clearer to both parties and problems/issues are better resolved while they are small than before they require remedial programmes or worse

Finally, in terms of the discrepancy between relatively high satisfaction and failure to meet expectations, it seems that this inability to achieve effective change has driven an acceptance of failure to meet expectations. Hopefully the lessons of better upfront planning and effective performance management can help address these problems of failed expectations and reduce the need for clients to accept less than good performance from their outsourcing agreements.

Company Profiles

About Orbys Consulting

Orbys was established in 1993 and provides sourcing advisory services that enable organisations to evaluate and implement the most appropriate sourcing options for their business.

Orbys specialises in best practice sourcing solutions, providing end-to-end advice and support on onshore and offshore sourcing initiatives across Information Technology, Business Process and Shared Service Centres.

The organisation works with its customers to evaluate which sourcing option is most suitable for their business, and can support or undertake the entire sourcing process from sourcing strategy to supplier selection and through to contract negotiation and post contract sourcing management solutions.

In addition, Orbys offers an Interim Management service that supplies its customers with high quality interims across a variety of business disciplines. This primarily, but not exclusively, focuses on the supply of interims who have relevant sourcing experience (e.g. service managers and/or programme/project managers).

The consultants at Orbys have all held senior positions with end users, sourcing consultancies or suppliers and this is backed up by a proven, structured approach and methodology. Orbys provides objective advice, independent market input and practical solutions to drive maximum value out of new and existing third party relationships and deliver quantifiable and tangible returns to our clients.

The Orbys team has worked with over 700 clients globally. Key customer names include BNFL, British Airways, BP, Clarks, Deutsche Bank, Barclays Bank, Orange, Royal & Sun Alliance, Signet, Standard Chartered Bank, Boots, Laura Ashley, Magnet, Rubicon, Sainsbury's, Spirit Group and Thomas Cook.

About Henley Management College

Henley was founded in 1945 as a place for the development of senior managers in British industry, and as such was the first business school in the UK.

Our service to industry and commerce has grown and developed over the years both in the UK and overseas, and we are now working extensively with many international companies and with companies headquartered in several countries worldwide.

Henley has developed extensive expertise as a provider of the MBA degree. The College was one of the first to provide the MBA degree through distance learning in 1984, after ten years of previous experience in masters' level provision. From the start of our MBA programme, we have stressed the importance of combining learning at a distance with learning face-to-face with tutors and fellow participants.

We now deliver the MBA in four different modes - Full Time (one year), Executive Modular (over two years), Executive Evening (in the City of London), and Distance Learning. In all of these we blend face-to-face learning with the use of our course materials available either over the internet, on CD ROM or as texts.

Henley has also been a pioneer in the delivery of the MBA to companies, tailoring the learning mode and application of the ideas to company needs. There are currently close to 7,000 people worldwide working on the Henley MBA degree.

Henley has also pioneered the DBA degree, and now has one of the largest and most respected professional doctoral programmes in the world.

About Benchmark Research

Benchmark was established in 1985 to provide specialist market information to meet the needs of UK manufacturers and providers of IT solutions. Today we remain strong in these sectors, but we have also acquired an impressive track record in researching the Training, Public sector, construction and the trade and exhibition sectors.

Benchmark designs and implements market research solutions, tailor made to the needs of each client. As research consultants, we offer a full service from designing research solutions which address specific marketing problems, to implementing the research and delivering survey findings which facilitate action and change. Above all, Benchmark is a market research partner you can trust.

Every project is based on five core values:

- Clarity and understanding of the research problem
- Creativity of research design
- Applying the right technical capabilities and resources
- Accuracy and objectivity in collecting and analysing data
- Analysis and recommendations which provide direction and facilitate change

At Benchmark, we don't apply standard solutions, because every project is unique. Our approach to research is based upon a spirit of close partnership with our clients, and an emphasis on effective project management. We are committed to providing information that empowers our clients to take clear strategic actions with confidence.

As a full service agency, we have an in-house Computer Aided Telephone Interviewing (CATI) unit and offer Computer Aided Web Interviewing (CAWI). Benchmark is a quality assured company, complying with MRQSA/BS7911 and IIP. Benchmark also offers a 'bureau service' designed to provide third party access to high quality data collection or reporting services, on a modular basis.

Biographies

Mark Sukiennik, Director, Orbys Consulting

Mark Sukiennik has worked in a variety of senior commercial and sourcing roles for over 20 years. He has in depth experience of working in the Financial Services Sector and has also worked in the Engineering/Manufacturing, Food, Gases and Chemicals sectors.

In the recent past, Mark has worked at Executive level within Financial Services leading one of the largest enterprise wide IT & BP outsourcing programmes in the UK covering an annual spend base in excess of £1bn. This involved the full lifecycle of outsource activity from the development and review of enterprise level strategic sourcing options through to deal implementation, transition and post contract management.

Mark has performed/led a number of client assignments for Orbys including Barclays, Deutsche Bank, Boots and Somerfield spanning both strategy development and post contract management/re-compete work.

Mark also has extensive experience of leading change programmes, helping businesses to better manage outsource arrangements, and realise value. Most recently he was accountable for restructuring sourcing and supply management capabilities across a major UK plc to better manage third party dependencies and implementing a number of 'best practice' relationship management activities.

Simon Lindley, Consultant, Orbys Consulting

Simon Lindley has over 15 years experience working on outsourcing and major business change/transformation projects. He has experience in all stages of the change process from analysis of requirements, assessment of current operations, identification and evaluation of options through to project management, contract development and negotiation. This has included onshore and offshore outsourcing, internal Shared Service Centre feasibility and design.

Projects have covered the areas of finance and accounting, HR, payroll, distribution, industry specific back office processes and all aspects of IT.

As well as helping clients make and implement sourcing decisions he also helps them improve existing arrangements through performance review, "health checks" and implementation of balanced scorecard measurement performance management.

Simon is a Chartered Accountant (ACA) and MBA. He has also completed APM (Association of Project Management) accredited training and is a member of the British Computer Society (MBCS).

Prof. David W. Birchall, Director of the School of Management Knowledge and Learning and Director of Henley Learning Advisory Services, Henley Management College

Professor Birchall is a regular speaker on innovation, knowledge project management, IT and learning and new forms of organisation and has designed management development programmes at all levels.

His latest book *Capabilities for strategic advantage: Leading Through Technological Innovation* – co-authored with George Tovstiga – was published by Palgrave in May 2005.

Nigel Spinks, Fellow, School of Projects, Processes and Systems, Henley Management College

Professional Expertise

Before joining Henley, Nigel spent 10 years in a variety of technical and export sales and marketing management roles in a start-up division within a multi-national company based in Germany. Prior to embarking upon a civilian career, Nigel served as an Army Officer for 10 years, including tours in Germany, Gibraltar, Belize and the Gulf.

He holds a degree in history from Fitzwilliam College, Cambridge. He gained his MBA from Henley, completing a dissertation on strategic innovation in the financial services industry.

Research

Nigel's research interests include innovation and the sociology of skill. He has most recently been involved in research projects for the Royal Academy of Engineering, the Engineering Employers' Federation and the Henley Incubator. In addition to conducting his own research, Nigel teaches research methods including training in computer-assisted qualitative data analysis software.

Notes




www.benchmark-research.co.uk



1 Northumberland Avenue
Trafalgar Square
London WC2N 5BW
United Kingdom

Tel: +44 (0) 20 7872 5525
Fax: +44 (0) 20 7753 2893
Email: orbys@orbys.com

www.orbys.com