Next Practice Outsourcing:
Orchestrated Outsourcing

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With inputs from C-level IT in selected Top200 companies
and heads of business units in the ITO/BPO field in KMD A/S

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Scope

The global ITO and BPO markets are simultaneously experiencing several transformative developments. Europe now comprises the largest share of the global outsourcing market: a 43% share according to Everest Group compared to 35% for the US market. The Philippines have surpassed India as the world's largest voice-based BPO outsourcing destination by volume. Growth in the outsourcing market is disproportionally higher among small to mid-sized buyers—companies typically lacking robust internal processes to manage outsourcing and offshoring. Mega deals are fewer. Moderate-sized deals are the order of the day. Outsourcing models are shifting convincingly away from one-stop-shopping to an actively managed portfolio involving multiple service locations and providers, each with complimentary, and often supplementary, strengths. Companies are blending outsourcing and offshoring rather than making it an all-or-nothing proposition. Cloud computing seems about to deliver on its long-coming promise of unprecedented scalability, enabling greater efficiencies while also re-shaping services.

These trends are challenging and transforming the outsourcing market in general and the ITO/BPO markets specifically. Opportunities exist for niche providers yet the demands for providers to increase the breadth of their service offerings are persistent. Near-shore and secondary outsourcing markets will boom at the same time that consolidation, standardization and scalability re-enforce the market share and presence of the current provider mastodons. The nascent and growing demand for analytics, particularly among high-end buyers, will force companies to think about and use data strategically; a skill-set that is not necessarily available internally at many organizations. Sourcing destinations themselves have become critical not only to access resource volume and talent but also to accessing, developing and serving new markets.

Hybrid models

The key trend which marks a fundamental shift from outsourcing and offshoring practices of the past is that companies are actively embracing a hybrid model that includes multi-sourcing, outsourcing, offshoring, near-shoring and on-shoring. As a Danish CIO at an international food company put it "I want to be able to choose best-of-breed and I want to be able to bundle it with other options in the way that works best for my company."

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This move to hybrid models comes for several reasons. First, IT organizations are making qualitative choices about where to put their internal resources' focus; the primary focus being those parts of the IT infrastructure and operation that are closest to the business. Second, the race for talent, particularly for 3rd level engineers, demands accessing talent despite their location or organizational relationship to the company. Third, there is a clear need to integrate volume and best practices both of which can often times be found outside of an organization. And fourth, in the public sector in particular, projects are put out to tender so by definition, the organization must work with multiple providers.

Delivering success and value in the multi-provider, multi-model landscape means that buying organizations need to be excellent at managing vendors, contracts, governance, and stakeholders not to mention technology.

Buying organizations actively stepping into the service integration role

With the rise of multi-sourcing, comes a pronounced need for quality service integration. Multiple buying organizations in our market have echoed the trend from North America in that they are taking back this role that in recent practice has been outsourced to a third party or perhaps to the largest vendor in the multi-vendor set-up.

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Senior IT executive
in the Danish banking industry

There appears to be both negative and positive drivers for the trend. This focus on in-house service integration comes as some buying organizations have sometimes experienced vendor-managed service integration as a challenge to their organization's sense of control. A senior IT executive in the Danish banking industry noted, "this comes about because we want things done in one certain way. We haven't been as willing to let the vendor do it their way. We might be better served to focus on the outcome instead but we're very focused on the process."

It's also clear that some of the drive to bring service integration back in-house is an attempt to infuse greater business logic while also enabling greater control and flexibility. For those organizations with visionary CIOs deeply integrated into the business itself while also supporting a deep bench of IT integration talent, this can be a viable option.

Security

From Edward Snowden to Se og Hør, the discussion about security has just hit warp speed. While security has always been an issue, the consequences for inadequate security have not always been quite so visible.

The critical issue is what individual organizations are doing to secure data, networks, intellectual property and resources. And while technology can be instrumental for delivering successfully on all of these areas, companies and public sector bodies need to make deliberate strategic decisions about how to secure, permission, and manage data as well as networks while monitoring and repelling intrusions. This means strategic leadership from the top regarding security management.

Critical competencies for mastering security include compliance, analytics, identity management, risk management, device security, encryption standards, and due diligence, just to name a few. All require specialized education and/or training and are typically a fair distance from many companies' core competencies.

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The hybrid models of sourcing and IT that are becoming more common bring with them much more complexity. Adding to this complexity and the challenge for security is that it often sits between two decision makers. For example, is it HR or IT that owns and manages resource vetting? Is it the CIO or the CEO that owns and decides the strategy for IP protection? Without a single point of responsibility, it is often too easy for these kinds of decisions to fall to the wayside. So what might appear to be only a technology problem is often an organizational problem as well.

The changing landscape of IT decision-making and mandates

It's clear that the confluence of digital technology, technology's proximity to customers, Big Data, risks and potential for transformation via technology means that CIOs and IT need to play a much bigger role in the business itself, that is "to come out of the engine room" according to a senior IT executive in the banking industry. Areas traditionally at a distance from the CIO role, e.g. business processes, transportation and logistics, are now unequivocally run on IT platforms and integrated into the business.

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Yet along with this shift and burgeoning pressure, other decision-makers with both mandate and budget are coming onto the IT playing field. Process-specific applications can be relatively easy to acquisition and deploy; BYOD pretty much guarantees that IT isn't the prime decision-maker when it comes to devices; and customer-facing platform delivery means that business units are often the decision-maker. Add to that, many Cloud solutions are found outside the company's firewall. As a Danish CIO of an international food company put it "Cloud technology makes business units more independent from IT, not less."

Seen from a different light, a Danish senior IT executive in a global logistics company noted "This issue of the changing role of the CIO seems to come up every three years or so. On one side: " Companies want to " gain agility and lower time-to-market in deliveries by moving IT into the business. On the other side this model too often results in insufficient quality (availability, scalability and response times)." At this point, IT centralizes again in an organization holding a higher level of IT skills and IT maturity. "The drivers are time-to-market and flexibility" but they seem to come at a cost of quality.

This changing landscape means that the successful organization has a CIO who can set flexible and secure frameworks that allow specific decisions. It also means that the CIO needs to lead an organization that can add value, that is leverage the domain specific knowledge that adds value to the growing plethora of options available to business units. As a senior IT executive in the banking industry put it "companies need a technology visionary who understands business objectives." A senior IT executive at a large Danish financial institute noted, "Our organization re-organized recently and brought the IT organization from the CFO and to a position that reports to the CEO."

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Big Data

As one interviewee said, "Our situation with Big Data is like a classified ad; Have—massive amounts of data: Want—understanding." Collectively across the group of professionals interviewed for this article, the question was "what do organizations want to DO with the data?" There is robust agreement that companies such as Amazon and Facebook are doing interesting things with data but there was thin agreement that Danish companies are doing interesting things with data. One of the interviewees said that he had recently been on a banking web site that recommended student loans to him; This was somewhat irrelevant as he's closer to retirement than school and was on the site looking for mortgage options.

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Interviewee

The challenges for many organizations wishing to exploit opportunities in Big Data is that although they might have volumes of data, little of it is shared across platforms. A senior IT executive in the banking industry said, "each project or product creates its own separate database. There are so many different places where data is stored and little of it interacts with other applications." A good example noted one interviewee, are CRM systems; "Many these day are Cloud-based solutions with data sets predominantly focused on sales and account management but are often not integrated with the billing system.

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Senior IT executive

The biggest challenge with Big Data, as expressed by a senior IT executive is that the decisions about what to do and where to start are leadership questions and not necessarily technology questions. "The business has to develop a strategy about what they want to do with this space. We are definitely here to participate in that discussion but the business has to identify strategic goals for Big Data before we set about solving how to do it."

Growing BPO markets… Coming soon (?) to Denmark

Within BPO, estimates are that traditional BPO, that is front and middle office BPO services, will grow at roughly 6% annually between 2012 and 2017. Cloud based BPO services are pegged to grow at 19% (HFS Research).

However in Denmark, BPO has barely gotten started. Although payroll outsourcing is standard, there is little other BPO outside of finance areas. For example, there is little procurement or customer service BPO in Denmark. Yet. Preferred business processing models for Danish companies are heavily weighted towards shared services centers typically focused on specific functions, as opposed to integrated global business services. Organizations seem somewhat skeptical of external providers' abilities to deliver so most buying organizations are insisting on developing captive centers as a perceived means of maintaining control.

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There is considerable interest in exploring the opportunities in BPO both to gain access to appropriate resources and competencies but the main focus is on securing cost savings and process efficiencies.
The biggest challenges facing Danish organizations wishing to do more with BPO is the significant "install base" of non-standard processes and lack of documentation.

The financial crisis and its affect on outsourcing

The ITO and BPO markets have both been severely affected by the financial crisis. Budgets have clearly been constrained and focus has been almost exclusively on cost and pure reduction of CAPEX. Gartner estimates that continued negative financial conditions will lop three full percentage points off potential growth through next year.

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Yet, there are glimmers of change from merely surviving to actually moving forward. Other advantages of outsourcing and offshoring have become more apparent. Some of the most persuasive are agility and access to markets. Agility is an integral characteristic of a modern, proactive organization that seeks to be responsive to market trends while also mitigating risk; something that outsourcing and offshoring can be directly leveraged to address. Equally critical and fundamentally connected to future growth is that the mere presence of sourcing activities in non-domestic markets can open doors to new markets and thereby enable growth. The focus, in some instances, changes from not just reducing costs but to leveraging external value chains in ways that are directly visible on the bottom line.

Sourcing locations and the shift to a portfolio model

The mastodons of outsourcing destinations continue to be China, India and The Philippines. Mexico, Brazil, Costa Rica and Poland are considered to be mature locations. Emerging sourcing locations include Malaysia, Romania, Slovakia, Hungary, Czech Republic, Colombia, Chile, Argentina and Uruguay. Nipping at their heels are Bulgaria, the Baltic States, Egypt, Morocco, South Africa, Ecuador and Peru. While Asia Pacific continues to lead with the overall number of new outsourcing center set-ups, Central and Eastern Europe, Ireland and Latin America have witnessed significant sourcing growth in the past three years.

Overall growth numbers certainly reveal general trends, but it's equally important to understand the ways in which functional specialization specifically impacts the sourcing activity patterns. For example, the Ireland/Central and Eastern European group is seeing a mix of IT, BPO and engineering services. Latin America is seeing bilingual voice and non-voice BPO services. Asia Pacific is seeing a prominent functional spike in engineering services and R&D.

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The interesting story is not only the convincing growth that is happening on the next level of outsourcing destinations in Asia, Eastern Europe and Latin America but the clear development of a portfolio model of outsourcing amongst buying organizations. This means that the choice is no longer India vs. destination X or China vs. destination Y but rather, how a buying organization will develop its portfolio of needs across a varied set of destinations, including near-shore and domestic destinations, to meet complex and changing business needs.

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The potential benefits are high as are the demands and risks for buying organizations venturing into the future of outsourcing. The skills and competencies to be able to actively orchestrate this varied field of providers, locations, technologies, and business drivers are not necessarily the skills that organizational development has been focused on to date.

To succeed in Next Practice Outsourcing, it won't be enough to be a skilled technician.

To succeed in Next Practice Outsourcing, it won't be enough to be a skilled technician. IT professionals and decision-makers will need to be able to abstract from technology itself to not only understand practical process consequences in a matrixed environment; they will also need to be able to digest, translate and articulate the constant development of new technologies and platforms so that businesses are actually able to leverage the value of technology to deliver on business strategies.

"IT, BPO, outsourcing, offshoring….they are all tools to support the business achieving its goals," notes a senior IT executive. Yet the reality is that "sometimes IT organizations make good IT for IT people and not for the customer," according to a senior IT executive at a large bank with headquarters in Denmark. He went on to say, "We're not spending time understanding the customers' needs because we're spending all our time focused on building an IT enterprise to support the organization." Supporting the organization's business goals and strategies means that the CIO must help to facilitate a dialog with those who have direct customer-facing responsibility.

The most important element of Next Practice Outsourcing is that the organization puts time and care into developing a strategy for where it wants to go. "It's not about just getting in the car and starting to drive. Companies must have a destination in mind otherwise, they'll never get there," noted one interviewee.

Conclusion

IT today isn't IT of 10 or 20 years ago. The burden is on a single organization to master multiple areas of complexities at a very high level. For many organizations, this state is simply not achievable in-house and with the skills available in a single market. The critical success factor then is to orchestrate the results and outcomes using multiple sources.

Organizations need to choose strategic differentiators upon which they will focus their internal organization while outsourcing more, particularly non-differentiating processes. The successful business model of the future is not a vertically integrated behemoth but a strategically well-networked organization that can leverage external resources, technologies and standardized processes in order to deliver on its business strategy.

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There are opportunities for new players, new models, new policies and growth. This doesn't mean that the market will be re-inventing the wheel with each successive generation but rather that moving from volume, undifferentiated processing, and labor arbitrage—hallmarks of the early incarnations of outsourcing to an even larger overall outsourcing market characterized by functional specialization based on standardization, technology, analytics, customer service, and a greater focus on value will provide opportunities and a clear competitive advantage for those who can deliver on these parameters.

Market estimates

Gartner pegs the ITO market growth to 2018 at 5.9%. Cloud infrastructure services represent more than a third of the spending growth predicted by Gartner. The European BPO and ITO markets' total spend meanwhile is estimated to be a total of $301 billion of which $97 billion is BPO and $204 billion is ITO (HFS Research).

Of the global BPO market which is growing at a rate of 5.1% over 2012, North America and Europe generate the majority of the business. Finance and accounting (F&A) and HR are the main drivers of growth in both markets at 7.8% and 5.6% respectively (HFS Research). Industries leading the growth of BPO are the financial services and health care industries, followed closely by the public sector as efforts are made to increase efficiencies and reduce government deficits.

The ITO market in Europe will continue to post growth rates that although not even close to booming show that there is life in the market. Gartner predicts stronger rates of growth in the US ITO market, 8%, which will be higher than both European and global rates of growth. Professional services have suffered in Europe over the past few years but estimates seem to see a leveling off of the worst declines. Positive signs for growth are also spotted in IT infrastructure management and ADM which at 5.6% CAGR is expected to grow faster than the average rate within ITO (HFS Research).

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