The Death of Outsourcing

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There is a revolution taking shape in the business services industry, one that disregards the traditional shared services and outsourcing paradigms and centers the design of support services on the needs and priorities of the enterprise as a whole.

Since the information technology outsourcing mega-deals of the 1990's and through the expansion of offshoring and business process outsourcing in the 2000's, companies have consistently sought ways to use sourcing strategies to reduce the cost of back office services.

When part of a comprehensive strategy, outsourcing has proven to be a transformation catalyst that has helped companies implement new processes and technologies, reduce costs, access a global talent pool, and change their overall business through the use of partners.

But today, the average deal size is smaller, performance expectations are higher and many providers are delivering more complex services with greater industry knowledge and business acumen. While cost is still key, success in a mature relationship is more often determined by its contribution to the business than by cost savings alone.

Shared services has also steadily evolved from the days of simple accounts payable and data entry processing. In many companies it has moved up the value chain to provide a wider range of more complex services and, as a result, established an internal brand. Indeed, multi-functional captive delivery centers are an example of the success of the global shared services concept. Many organizations have monetized the asset and sold off their captives to become commercial service providers with specialties in an industry and function.

Labor arbitrage, India, and the new customer

In the past five years, a number of significant changes have begun to transform the traditional underpinnings of business service delivery in the Western world. For example, cloud technology and social media are ubiquitous. They are changing not only how we connect with family members or store music, but also how we do business, collect data and deliver technology. These are more than new technologies; they represent a change in behavior in how the customer and business agree to interact, share information and conduct trade.

Perhaps as significant a change is who the customer is. The traditional low cost arbitrage markets have been India, China and other parts of Asia. However, the success of outsourcing and global manufacturing has spawned a rapidly growing middle class in these regions, which is both increasing the cost of labor and broadening the potential customer base for many companies. As this success causes the benefits of labor arbitrage to disappear, how do organizations effectively serve new markets, and where is the next level of back office savings?

As most companies would opt for a few hundred million new consumers over 20 percent additional savings on information technology (IT) and finance and accounting, the competitive advantage will go to those that can both connect with new customers and do business effectively in these new markets with lower costs, better data and market insights, and operational flexibility.

A change in business services models

When thinking about sales, general and administrative functions—human resources, IT, purchasing, accounting, etc.—some organizations view these support services as a tactical necessity, while others consider them a strategic weapon. Some see cost center, and others a competitive advantage. The reality is, none of these are mutually exclusive. In fact, they demonstrate the degree of contrast KPMG sees in the strategies and objectives of new business services models. But in a market ripe for and requiring change, a services delivery model that focuses on the holistic requirements and priorities of the enterprise gives companies the ability to enter new markets easier, integrate acquisitions faster, adopt new processes more rapidly, and access and analyze a wider range of data that, most importantly, serves their customer better.

While many of these new business services organizations have different objectives, most share common traits. They are centrally managed, and usually have an integrated portfolio of capabilities – typically a combination of external service providers, internal specialists and internal shared services. Most of these organizations are enabled by common technologies and governed by common processes.

These companies have the characteristic of a delivery concept KPMG calls the Extended Global Enterprise—or "EGE." The EGE is not a specific model or set delivery structure, but rather a paradigm for delivering business services based on the concepts of end-to-end processes, internal and outsourced service providers, high value services and strong central governance. Instead of relying on resources within the four walls of the enterprise, the EGE leverages a global pool of internal and outsourced resources to deliver a service that is nimble, aligned to the business, and connected with customers, employees and suppliers.

The EGE concept has four key attributes:

- First, its overall goal is to increase value to the business, and help achieve competitive advantage. Beyond meeting service levels and cost benchmarks, it also enables flexibility and the ability to quickly adopt new processes, assemble talent, deliver new technology and centrally collect and analyze relevant data.
- Second, its design is influenced more by customer need and business strategy than by the traditional organizational structure.
- Third, it consists of a balanced portfolio of services and processes that spans across functions, and deploys the most appropriate capabilities whether they are internal, globally sourced or technology enabled.
- Fourth, it is governed by an empowered organization that has a charter to support the business, manage the delivery model and is measured by the value it creates.

Through alignment of global capabilities, processes and governance, implementation of an EGE-oriented model enables delivery of services in a way that not only supports the business but also advances it. It's about using the knowledge and capabilities of service providers – both internal and external – to make the enterprise more successful.

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Does this approach always work? Not for everyone. But the results from recent KPMG surveys demonstrate that companies with services delivery designed on similar concepts have reported cost savings of 10-15 percent to 20 percent above and beyond the traditional shared services and outsourcing or decentralized models. They're reducing facilities costs by 10 to 15 percent, for example. And due to improved processes, they're getting 8 to 13 percent savings on indirect goods and services.

Overcoming inertia

While the business impact is positive to the bottom line and the objectives of the business, adopting this paradigm represents a disruptive change that is almost always met with resistance. For example, because end-to-end processes are blind to organizational structure, this model impacts the traditional concept of functional empowerment. That's a hard change management discussion.

Other companies face inertia -- ironically -- because of their initial success. Some functional managers may have used outsourcing and shared services to reduce support costs by up to 30 percent and, justifiably, they shined within the enterprise. So when asking these people to revisit their model and take it to the next level, there is naturally some resistance.

To overcome these challenges, organizations will be best served by picking the areas in which they want to improve, based on finances, culture and appetite for risk. They may focus on developing a commercial orientation, while going slower on the relocation of some services. Or they may put their efforts into governance and improving customer value.

Following are some steps a company can take to move an EGE-oriented initiative forward:

- First, objectively review where the organization is and consider where it wants to go with support services
- From there, take a look at current outsourcing relationships and shared services capabilities
- Next, consider service delivery. What kind of strategy is in place? Is it aligning services with corporate objectives?
- Consider geography. Are all current markets being served? Is the organization prepared for expansion into future markets?
- Look at technology. Consider whether existing platforms support the integration of processes and providers.
- Don't forget culture. Will it support a governance structure that provides comprehensive oversight of services, including performance metrics?

By answering these kinds of questions, an organization can identify gaps and opportunities and then develop a roadmap for improvement. The EGE is a concrete, "true north" compass to guide the redesign of the back office and prepare for an increasingly successful future.

To learn more, visit the Shared Services and Outsourcing Institute at http://www.kpmginstitutes.com/shared-services-outsourcing-institute/

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