

The outsourcing decision for a globally integrated enterprise: from commodity outsourcing to value creation.



Contents

2	<i>Introduction</i>
3	<i>The changing nature of outsourcing</i>
5	<i>Outsourcing and the globally integrated enterprise</i>
11	<i>Outsourcing—the fundamental enabler</i>
12	<i>Outsourcing considerations for the global enterprise</i>
14	<i>Conclusion</i>

Introduction

For years CIOs and other IT executives have wrestled with mounting infrastructure cost and complexity. The decision to outsource was based on addressing these primary concerns, with vendor selection centered on the promise of cost reduction and improved IT performance. Now, as companies aspire to a more global business model and CIOs move from the data center to the executive table, the decision process for outsourcing is changing. CIOs are being asked to take on a more strategic role in order to drive innovation and competitive advantage.¹ More than any member of the executive team, CIOs are keenly aware of the role outsourcing can play in helping the organization achieve these transformational objectives. Clearly, the stakes for outsourcing have never been higher.

A new brand of outsourcing is essential for organizations intent on leading in today's global economy. Globalization and rapid advances in technology have shifted the measure of success, driving companies to rethink how they acquire and deliver services. Business leaders are questioning the company's ability to do everything well and seeing the benefit of siphoning off some of their more costly core business functions. At the same time, they are recognizing that outsourcing has the potential to deliver extraordinary business value above and beyond simple cost savings and operational efficiencies. They are coming to the realization that outsourcing is less about labor arbitrage and more about accessing the myriad of global talent available to businesses today. Rather than limiting themselves to local resources, they are striking strategic relationships with business partners, suppliers and customers around the world to leverage the most optimal nodes of expertise in every area of the operation.

Highlights

Outsourcing enables companies to leverage the global marketplace, to choose the work they want to do and where they want to do it to drive the greatest profit.

Outsourcing is helping companies meet current cost savings objectives and resulting in substantial efficiency improvements.

By connecting companies with new ideas, information and expertise, outsourcing spawns opportunities for collaborative innovation. It enables companies to take advantage of the global marketplace, to pick and choose the work they want to do and where they want to do it to drive the greatest profit. In that way, outsourcing is a fundamental enabler for the globally integrated enterprise: an organization that sees beyond traditional geographical limits and can leverage the world's best resources to drive the business forward. Forward-thinking companies such as this have mastered the challenges that go along with connecting and delivering services across global borders. They have made the necessary structural, operational and cultural transformation and have what it takes to compete successfully on the world stage.

The changing nature of outsourcing

Today the vast majority of companies outsource some percentage of their organization's IT labor. What's more, outsourcing is on the rise as pressure to lower long-term operating costs and improve efficiency continues to be felt up and down the supply chain.

A recent study by Forrester Research and outsourcing advisory firm TPI found that "a whopping 70 percent of IT decision-makers are focusing on ways to 'curtail their IT spending' in 2007 and many of these decision-makers will use outsourcing to achieve cost savings goals." The reason? The study found that "the few dozen TPI clients analyzed have unlocked at least \$3.3 billion of total contract value. Firms at the high and low ends of the deal sizes saved closer to 12 percent, while firms in the middle of the bell curve saved more than 17 percent."²

Highlights

Today's executives want to unlock outsourcing's greater business and transformative value.

Outsourcing can free up investment capital to fund new revenue opportunities and long-term growth strategies.

In other research, companies are seeing substantial efficiency improvements, including better resource utilization, less downtime and more rapid reporting. But commodity benefits such as these are merely the price of admission for an outsourcing engagement; they are not driving the outsourcing decision.

These days, companies are making more informed decisions about outsourcing, and they want to unlock its greater value. Savvy executives view outsourcing's business and operational risks and the associated time and resource commitment as a necessary trade-off. They've reconciled the expected pains for potentially sizeable gains, and they are looking to derive substantially greater business and transformative value from their outsourcing agreements. Moreover, in lieu of the traditional client-provider relationships, these companies are intent on establishing strategic partnerships to extend their opportunities for growth. They want to ensure that outsourcing's risks and rewards are shared and its value propositions are structured around their business objectives.

In this era of globalization, where customers determine business survival and firms that are virtual unknowns one day can be fierce competitors the next, the need for uncompromised efficiency and service delivery has never been stronger. Companies entering into outsourcing agreements expect to improve their business-critical IT processes and provide more predictable performance, but they aren't limiting outsourcing to IT. They expect to take advantage of market-ready skills at a lower cost for key business processes like procurement, human resources and finance. But they also expect outsourcing to free up the investment capital needed to help them pursue new revenue opportunities and focus on long-term growth strategies.

***Redefining business value
through outsourcing***

Eager to grow its customer base but challenged by an increasingly fragmented and redundant IT infrastructure, one Indian telecommunications provider knew that outsourcing was the only answer. In a bold move, the company shed its entire network operation and back-office business processes so it could focus on improving the customer experience. The payoff was big. Cost savings from IT and business process consolidation facilitated the deployment of numerous differentiating systems, enabling customer-centric relationship management, self-service and behavior prediction capabilities. In three years, the company quadrupled its subscriber base and achieved one of the highest customer satisfaction ratings in the industry.

Scientists at the IBM T.J. Watson Research Center measured the business impact of infrastructure outsourcing on 56 public companies over a five-year period. Their analysis revealed that companies engaged in major IT outsourcing deals achieved better long-term improvements in business performance than their peers. These companies realized lower selling, general and administrative (SG&A) expenses, higher return on assets (ROA) and higher growth in earnings before interest and taxes (EBIT).³ The implication for business leaders is clear. Outsourcing can improve financial performance and increase the availability of funds needed for more strategic growth initiatives, such as innovation and business process transformation.

The importance of innovation and business transformation

In the new global business arena, companies can no longer count on local and niche markets as their safe haven. Every market and every customer is up for grabs as companies vie for their piece of the global pie.

With market dynamics constantly changing and new entrants making inroads daily, the most vigilant and successful companies are continually striving to outdo competitors by differentiating themselves in ways that their competitors can't or won't. They are developing new competencies and alliances, and deploying innovative, new business models that enable them to preempt competitive threats while boosting market share. IBM's Global CEO Study 2006 affirmed the importance of business model innovation to financial growth. Companies that implemented new or changed business models saw significant operating margin growth over a five-year period when compared with their peers.⁴ Innovation drove competitive advantage and profitability.

Highlights

Company leaders are taking a more objective, strategic look at both core and non-core business functions and determining which are best offloaded to external partners.

Outsourcing factors heavily into innovation efforts by breathing new ideas, fresh perspectives and flexibility into the organization. It makes new skills and partners accessible, enabling collaboration and increasing opportunities for innovation and business transformation. Further, the savings generated through such outsourcing efforts can, in turn, provide the venture capital to feed future innovation programs.

Outsourcing and the globally integrated enterprise

Globalization and advances in technology have changed the way business gets done. Core business processes are no longer viewed unilaterally as proprietary. Large and small firms alike are seeing both core and non-core business functions as dispensable components that they can retain internally or offload to external partners, according to company need and strategic objectives. With worldwide access to what has become a global tapestry of talent and resources, business leaders are empowered to choose the tasks they want to do and where they want them done. They are rethinking their current processes for production and distribution, and questioning whether they could be done better and cheaper. This more open-minded approach to outsourcing is enabling companies to manage their operations, expertise and resources more fluidly. Moreover, it is allowing them to focus on how they provide service and deliver value to their customers, employees and business partners.

Such globally-minded organizations aren't looking to optimize the business within traditional boundaries. They aren't constrained by geographical borders, time zones or language. They are targeting the worldwide market to cut their costs and tap into new sources of skill and knowledge. Conducting business in this manner, choosing where and how work gets done in order to maximize business value, is the essence of the globally integrated enterprise.⁵

Highlights

Globally integrated enterprises target the worldwide market to find opportunities by tapping into new sources of skill and knowledge.

Globally integrated enterprises reach far beyond developing nations like China and India to find cost efficiency and growth opportunities.

Defining the globally integrated enterprise

A company that fashions its strategy, management and operations in pursuit of the worldwide integration of production and value. A globally integrated enterprise seeks to use the best resources from the best locations at the optimum time to gain a competitive advantage.

Globally integrated enterprises have the ability to enter new markets and seize new business opportunities wherever they happen to arise. They have restructured the organization and eliminated process redundancy. They have replaced their autonomous country-led operations with a more seamless enterprise offering centers of industry and technical expertise scattered around the world. Rather than leveraging only local resources and partners, globally integrated enterprises position themselves to take advantage of resources and partners around the world. They thrive in a global economy by:

- *Securing specialized skills from a broad network of providers*
- *Leveraging infrastructures, applications, personnel and other assets wherever they reside globally for the best, most economical results*
- *Enabling systems and platforms for an open, collaborative work environment and embracing opportunities for external collaboration*
- *Adopting the global values, skills and processes needed to operate seamlessly across organizational, cultural and geographic boundaries*
- *Managing the risks associated with doing business in an open ecosystem*

Highlights

The focus on value creation has significantly changed the decision criteria for outsourcing.

Perhaps globally integrated enterprises have had their most visible impact in China and India, where manufacturing plants, service centers, and R&D facilities have sprung up by the thousands. But globally integrated enterprises reach far beyond developing countries to find cost efficiency and growth opportunities. As these companies turn their attention outward to pursue the most cost-effective, highest quality provider, process and place for production and delivery, they are also finding answers in the world's most progressive nations (Figure 1). Asian chipmakers like Tokyo Electron are tapping engineers in the U.S. to improve their manufacturing technologies. Global investment banks are turning over their back-office derivatives processing operations to Dublin financial services firms specializing in these services. Merck, Lonza and other pharmaceutical firms are developing research and manufacturing facilities in Singapore. Favorable business conditions and technology-driven reductions in the cost of transportation and communications will continue to fuel such arrangements.

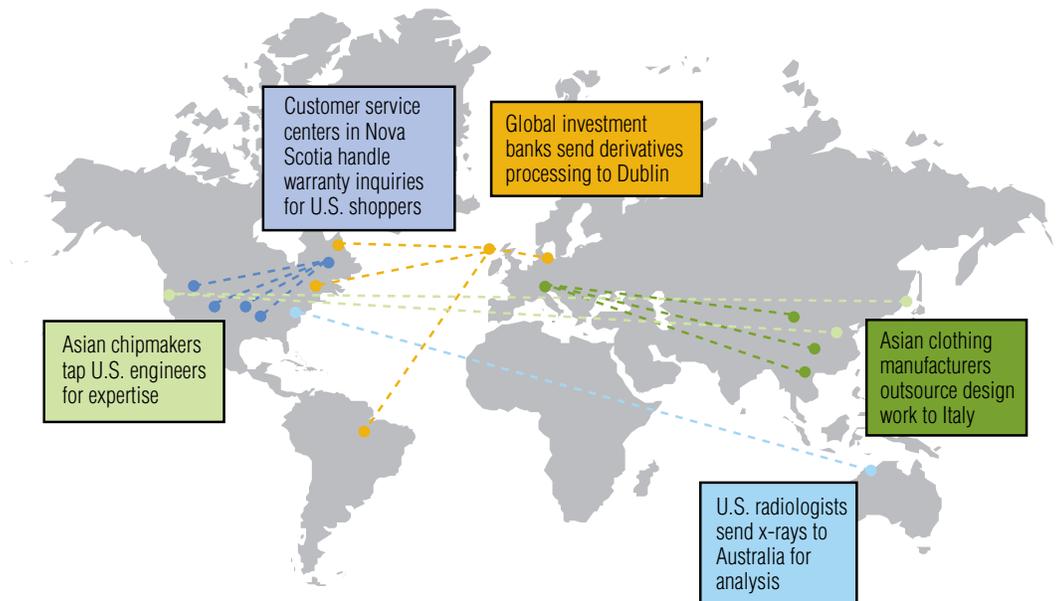


Figure 1: The globally integrated enterprise in action, tapping the best hubs of skill and knowledge.

Highlights

While cost savings are still a priority in most outsourcing decisions, globally-minded companies are increasingly giving credence to the value and revenue opportunities that outsourcing can create.

Changing how outsourcing decisions are made

Understandably, companies that are or aspire to be globally integrated enterprises have a new outsourcing agenda. These companies are more willing to hand over work they had previously performed in-house. But their decisions are not simply a matter of finding cheap labor. Cost take-out pressures aside, these companies are focused on value creation and the revenue opportunities that outsourcing can deliver. They see outsourcing as a means to drive the productivity gains that fund collaborative innovation and business transformation. They look to secure strategic relationships with partners who can take their business to the next level by enabling them to trade in global markets and providing them with the technology, infrastructure and know-how needed to deploy a differentiating business model. This focus on value creation represents a significant shift in how outsourcing decisions are made.

Business and IT executives still want outsourcing to produce the kind of predictable business results that shareholders demand (albeit without the rigid service levels), but they also want their outsourcing contracts to be flexible enough to allow for competitive adaptation in response to changing market forces. In general, that means contract terms must be shorter and subject to renegotiation. And they must offer opportunities for variable pricing and pricing based on business outcomes.

Highlights

Companies are realizing that forming outsourcing partnerships with multiple specialized providers can enable them to make the greatest gains.

Service delivery also factors into the outsourcing decision in a big way. Because globally integrated enterprises see outsourcing as a way to penetrate new markets, they want capabilities, skills and infrastructure delivered from wherever they perceive productivity gains and cost savings to be the greatest. As such, they are willing to form outsourcing partnerships with multiple specialized providers.

Decision criteria	For traditional outsourcing	For the globally integrated enterprise
Primary driver	Cost reduction driven by economies of scale	Cost reduction driven by value creation
Measures of success	Performance results, predictability, service level agreements (SLAs)	Business transformation, innovation
Client-provider relationship	Technology-based relationship	Business-based strategic partnership
Risk/reward model	Risks predominantly borne by client; rewards shared by client and provider	Risks and rewards shared by client and provider
Service delivery model	Local resources and partners	Globally diverse resources and partners
Outsourced processes	Non-core, back-office and customer support functions	Core and non-core business functions
Skill access	Access to a broad array of skills and services from a single or few providers	Access to specialized skills and services from multiple providers
Contract	Long duration; rigid terms	Shorter duration; flexible terms with option to renegotiate
Pricing	Fixed cost structures tied to IT performance	Variable cost structures aligned to business outcomes

Table 1: Outsourcing decision criteria comparison.

Highlights

Outsourcing—the fundamental enabler

There is no doubt that companies are entering into outsourcing agreements to increase their ability to compete at a global level. After all, large outsourcing providers in particular bring significant global expertise and reach to the table. Moreover, outsourcing often opens the door to the kinds of collaborative projects, innovation partnerships, and communications and networking technologies that can facilitate global business. Towards that end, outsourcing is a fundamental enabler for the globally integrated enterprise.

Outsourcing increases the spread of shared technologies and open business standards that are driving global integration and enabling the free exchange of information. It can provide the tools and technologies to enable a government agency in one country to share intelligence with agencies in others. It can help commercial enterprises integrate their supply chains, overcome trade barriers, and establish business ecosystems and open-source communities. Outsourcing enables businesses to exploit the latest technologies, shifts in economics and worldwide availability of expertise that are required for a globally integrated enterprise.

Outsourcing enables companies to find global partners who are already in the business they want to be in. It allows them to fill a gap in their suite of services and take specific services to market. Instead of waiting for mergers and acquisitions to help them make these gains, companies are turning to outsourcing to reshape themselves, shedding the processes and operations that no longer distinguish them competitively and tapping into other providers' hubs of expertise for the skills and services they need. IBM, for example, sold its PC hardware business to Chinese PC-maker Lenovo in 2004 and now outsources its PC procurement services to Lenovo. At the same time, Lenovo outsources marketing and sales support to IBM.

***With outsourcing as an option,
companies no longer have to rely
upon mergers and acquisitions to
enhance their suite of services.***

***What are the implications for
small business?***

Small business is benefiting from the globally integrated marketplace. In the past, smaller companies were unable to tap into global resources because the cost of entry was too great. Now that more vendors are providing services globally, the cost has come down considerably. Small firms can access the very same infrastructures, support services and other assets once only affordable to larger organizations.

As the business expands into global markets, outsourcing offers access to instant capacity, not just in computing infrastructure but in processes that are globally scalable. Whether this involves supply chain, call center support or integration processes, outsourcing enables global businesses to acquire the just-in-time capacity they need.

Outsourcing considerations for the global enterprise

Globally integrated enterprises have to be willing to partner on a variety of levels to acquire desired skills and services, offload costly operations and market services that are profitable. In all cases, it's about finding partners that offer the optimal mix of expertise, services and infrastructure in locations that offer the most attractive tax and transport conditions (Table 2).

To accommodate this new business model, outsourcing providers must have a level of global maturity that is in alignment with their clients' aspirations. In other words, they must have expertise at delivering services on a global scale, not just as outsourcers but as commercial enterprises. They need to understand the speed and efficiency a global economy demands and have the requisite agility to respond quickly to changing business dynamics transparently and without disruption. Whether clients require procurement, manufacturing, research, sales or other specialized services, providers need to have the technology depth and the local experience, practices and personnel to facilitate global transactions. It's not just about having a presence in a desired country; it's about having a commitment there in the form of facilities and employees.

Highlights

Providers with a global governance framework are better able to deploy and manage clients' outsourced operations consistently around the world.

Global governance is also vital. Organizations that conduct business globally cross multiple geo-political domains and engage with customers, business partners and employees belonging to different cultures and governments. A global governance structure ensures clients' outsourced operations are deployed and managed consistently around the world. Even though an outsourcing provider may employ different suppliers in each country, they need to look like one supplier from the client's perspective. In addition, a global governance framework helps ensure that the outsourced operations are in compliance with legal and taxation issues, and conform to local requirements for health, security, employee welfare, funds distribution and the environment.

Finally, outsourcing providers must invest in staying current. Change is continuous and constantly accelerating. Today's hubs of technical and industry expertise may not be tomorrow's. As such, providers should continually be looking for the next China or India and evaluating alternative destinations based on scale, quality of workforce, financial infrastructure, risk and quality of life. They should be open to new possibilities, particularly as companies look to reduce their carbon footprint and the pendulum swings from centralized outsourcing strategies (in Asia) to more balanced regional strategies that put production closer to end markets and limit resource-intensive modes of transport.

Highlights	Provider profile for the globally integrated enterprise
	✓ Global maturity, expertise and resources aligned to clients' aspirations
	✓ Global governance structure to help ensure consistent quality of service worldwide and the ability to work within local laws, regulations and politics
	✓ Global delivery model capable of adapting to local differences, changing business conditions and market dynamics
	✓ Shared technologies and business standards to facilitate worldwide communication and collaboration
	✓ Proven ability to help clients manage the complexity of the global world

Table 2: Criteria for outsourcing provider selection.

Conclusion

The outsourcing decision-making process has changed. The traditional view of outsourcing as a tactical, cost takeout solution can spell failure in today's intensely competitive, dynamic business climate. Companies that want to compete on the global stage need to take an enterprise-level view and make strategic judgments about which business operations they want to keep and which they think are best suited to external partners.

A boundless view of outsourcing is essential to leading in the global economy and becoming a globally integrated enterprise.

For these companies, outsourcing is not simply about labor arbitrage; it's about leveraging the global tapestry of talent and moving work to its best, most profitable location around the world. Such a boundless view of outsourcing is essential to leading in the global economy and becoming a globally integrated enterprise. Companies that are prepared to take advantage of this emerging business model can dramatically increase their opportunities for collaborative innovation, operational efficiency and cost

savings. Leading organizations will create an array of strategic partnerships to optimize the production and delivery of services and, in the process, drive substantially greater business and transformational value.

For more information

For more information on outsourcing for the globally integrated enterprise, please call your IBM representative or IBM Business Partner, or visit:

ibm.com/cio

¹ Center for CIO Leadership, The CIO profession: driving innovation and competitive advantage, October 2007. http://www-935.ibm.com/services/us/cio/pdf/2007_cio_leadership_survey_white_paper.pdf

² Paul Roehrig, "Outsourcing Clients Can Expect 12% To 17% Savings," Forrester Research, Inc., August 30, 2007.

³ IBM, Business Impact of Outsourcing – a fact-based analysis, IBM T.J. Watson Research Lab, September 2005. http://www-304.ibm.com/jct03004c/businesscenter/smb/us/en/content-template/!!/gcl_xmlid=42484/

⁴ IBM, Expanding the Innovation Horizon: The Global CEO Study 2006, IBM, March 2006. http://www-306.ibm.com/innovation/us/pointofview/enterprise/mar27/ceo_study.html?re=study2004

⁵ Samuel J. Palmisano, "The Globally Integrated Enterprise," Foreign Affairs magazine, May/June 2006. http://www.ibm.com/ibm/ideas-fromibm/us/integration/010607/images/leaf1/The_Globally_Integrated_Enterprise.pdf?sa_campaign=message/ideas/landingpage/section1/1/newglobal



© Copyright IBM Corporation 2008

IBM Corporation
New Orchard Road
Armonk, NY 10504
U.S.A.

Produced in the United States of America
01-08
All Rights Reserved

IBM, the IBM logo and Component Business Model are trademarks or registered trademarks of International Business Machines Corporation in the United States, other countries, or both.

Other company, product and service names may be trademarks or service marks of others.

References in this publication to IBM products and services do not imply that IBM intends to make them available in all countries in which IBM operates.