Understanding Professional Services Outsourcing and Offshoring

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Abstract. Based on a series of semi-structured interviews with 10 supply management executives representing eight companies in a variety of industries, this research focuses on the topic of services outsourcing and offshoring. Findings from these interviews indicate that a number of firms that have been offshoring for some time believe that they have outsourced too much responsibility for certain services, thereby increasing their operating risks. They have developed new solutions to attempt to address these problems, as will be discussed in the presentation.

Summary. The topic of professional services offshore outsourcing has been very controversial from a political perspective. Further, the media reports mixed results in terms of cost savings and level of satisfaction (Corbett, 2005). Our findings support that in some cases, it is possible for a customer to rigorously specify, monitor and measure service level expectations, resulting in improved supplier performance as well as improved customer satisfaction. There is a complex balance that must be maintained between the cost savings associated with outsourcing professional services versus the level of risk incurred and the customer satisfaction.

Successful Cases. The organizations that experienced success in offshore outsourcing of services displayed a number of common characteristics in their successful outsourced relationships. They outsourced services that they:

- Understood very well
- Currently were performing at a satisfactory level, or they improved the process before outsourcing
- Could readily specify
- Could monitor performance
- Had either internal or external metrics to compare performance and cost competitiveness
- Could adapt the contract to meet their changing requirements
- Had sufficient volume to make it worth their time as well as the service provider’s time
- Had established processes for selecting and managing the offshore outsourced service providers
Did not offshore outsource services that they believed were critical differentiators of their performance.

An example of one such successful company was an organization we will call “Software”, a provider of commercial software for business and personal use. This company followed a pattern of doing all of its own “call center” services internally, providing all varieties of help to its customer base, from sales support to complex technical problem solving. It slowly began to outsource some of its capacity domestically, and then moved to offshore outsourcing. When discussing what had made its offshore outsourcing successful, it noted that there were several key factors, such as that it had a solid process for domestic outsourcing in place. It had a very methodical approach for screening suppliers so that only the most qualified would be considered. This meant that for years, offshore providers did not make the final cut despite the outstanding cost savings opportunities, because the offshore providers simply did not have the requisite quality. Rather than jump on the “bandwagon,” Software waited on the sidelines until it was confident in the offshore outsourced service providers.

In addition, Software developed a standardized template for its master service level agreement template, statement of work and common attachments such as privacy and security requirements, reimbursable items and amendments to the statement of work. This helped to ensure that no key issues were missed in the contracting process. It also builds contracts that provide performance incentives for superior performance, as well as disincentives for poor performance.

Offshore outsourcing problems and solutions. Even these successful companies experienced problems with their offshore outsourcing in a number of situations. Some of these problems, as well as the ways that organizations coped with the problems, are presented below.

Scope creep leads to gradually outsourcing too much. A large financial services firm began its outsourcing its IT support extremely carefully, with a clear scope of only outsourcing the most routine activities, such as maintenance and some very basic coding. It was quite satisfied with the performance one of its key offshore suppliers in this arena. At the same time, this supplier complained that it was having problems with employee turnover and job satisfaction because the employees were not challenged. According to the supplier, its employees were educated IT professionals who longed for some more challenging tasks, such as writing original code, or they would leave the company to find more challenging work. Because of the supplier’s good performance as well as very low prices, the financial services firm gave the supplier some basic coding work, which eventually evolved into complex work and the development of proprietary software.

After the financial services firm became very dependent on the supplier, the supplier started to raise prices, reduce its service level, and behave very opportunistically. The financial services firm had a difficult time changing suppliers, because the supplier had created some important software, the coding for which was only fully understood by the supplier. With considerable effort and expense, the financial services firm was eventually able to move away from the supplier, and resolved that it would not allow itself to become so dependent on a supplier again. Future contracts of a similar nature would either involve active hands-on management and participation by financial services employees, or such tasks would not be outsourced. The
lesson learned: manage contract scope so as to prevent inadvertent dependence on a supplier. If you do not understand what the supplier is doing, the supplier can gain power over you.

**Incomplete specifications lead to poor performance.** When firms first begin outsourcing, they may either not really know what they want, or may be unable to articulate it clearly. For example, one computer firm offshore outsourced its accounts payable operations because it was not its core competency. It believed that it was the core competency of the firm to which it granted the outsourced contract. However, there were some differences in its system versus the outsource service provider’s system that were not clearly articulated and allowed for. The result was a disaster, with the company insourcing the process at considerable expense and loss of goodwill from suppliers who had problems receiving timely and accurate payments. The lesson learned: don’t assume that a supplier who has performed successfully for one company can do the same for you. Make sure that the supplier has a very clear understanding of your requirements, and you of its capabilities, before you proceed. Run parallel processes until the outsourced system is stable.

**Lack of good performance measurement.** A recent study by CAPS Center for Strategic Purchasing Research indicated that only 38% of the 160 companies it surveyed said that they measure their offshore services suppliers’ performance. The 38% who measure offshore outsourced service supplier performance measure only 57% of their offshore service suppliers. While the eight companies studied here did generally measure their suppliers, they did not always monitor and measure the “right” behaviors to encourage the desired outcomes. The inability to determine whether your offshore services suppliers are doing what you contracted with them to do invites opportunistic behaviors.

For example, one of the companies studied routed certain in-bound calls to both an owned call-center and an offshore outsourced call center. The company had a system that routed calls to the agent with the longest idle times. The offshore outsourced supplier hired more agents, to increase the idle time so that it would receive the majority of calls. Because of the way the measurement and payment scheme were structured, the opportunistic supplier benefited greatly from this arrangement. This was not the way the system was designed to work; the buyer only found out after it investigated why this supplier was getting an inordinate number of calls. As a result, it improved its specifications to include delivery related issues that might undermine the efficiency or effectiveness of the process. Other companies studied also discovered that they were measuring the wrong things, i.e. call completion when problem resolution was really what was relevant. This company learned from the experience, and improved its performance metrics over time. The lesson learned: suppliers will focus their performance to achieve the results that you measure. Make sure that you are measuring the right things to achieve the results that you desire in terms of cost, effectiveness, efficiency, service and other relevant measures.

**Wishful thinking does not create results.** The companies studied here had experiences with suppliers who made many more promises than they could deliver. While this is not something that is specific to offshore suppliers, it seems to be more prevalent. There is such a strong growth of the entrepreneurial spirit in many Eastern cultures right now, that some suppliers have a tendency to say, “Yes, we can do that,” when they have never done it before and are just hoping that they can perform. This was experienced by a large computer company that
offshore outsourced its accounts payable operations, as mentioned above. Yes, the supplier that they chose had some experience in accounts payable, but never of the volume level of nature that the computer company had. The results were a huge disaster, with the computer company insourcing its accounts payable, taking over a year to “clean up the mess” of this failed offshore outsourcing venture. The lesson learned: unless you are an extreme risk-taker, select offshore outsourced services providers that already have successful direct experience in doing what you need. If you cannot find such a supplier, transition the work so that you can test the supplier before you commit fully.

Summary. Learn from your experiences. One of the primary drivers of offshore outsourcing is still cost reduction. Yet studies indicate that many firms do not get the savings they had anticipated. A recent survey show that when companies outsource, 42% of companies experience a 10-25% loss in contract value versus expectations, and 21% experience a loss of over 25% of contract value. This is simply not acceptable in the long run. To improve performance and create an outcome more in line with expectations, companies need to learn from their unsatisfactory experiences, and not repeat them. The companies in this study indicated that they had learned a great deal from their mistakes. They did not blame the offshore outsource suppliers for the shortcomings. They recognized that as the buyer of services, they needed to put together better analysis, clearer expectations, more meaningful contracts and performance measures, and not behave in such a naïve fashion. These companies have not been discouraged from offshore outsourcing; they see it as an area that will continue to grow. As such, they need to learn to improve their supplier selection, management, and execution of offshore outsourced contracts. Incorporating the lessons learned provided above is an important first step in improving the outcomes of offshore outsourced supplier relationships.

References

