BPO: What Went Wrong, And Why It Is Still Relevant

After many years of dominating headlines and up to double digit year-on-year growth, Business Process Outsourcing (BPO) as a topic has experienced an overall decline in corporate interest of late. However, BPO's main benefits, namely economies of scale, associated cost savings and the ability for organizations to focus on their core business are as much in demand as ever. So what went wrong? In this note, Ginkgo Management Consulting analyses the reasons for BPO's fall from grace in the recent past and why it continues to be a viable option for companies.

Introduction to BPO

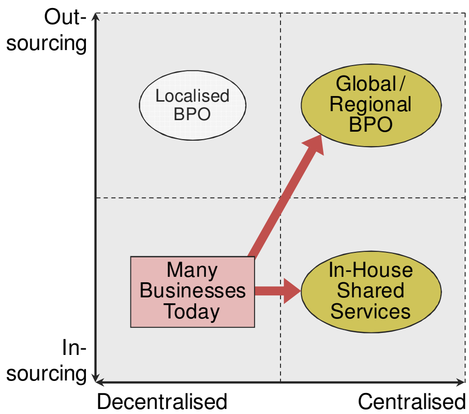
While the concept of outsourcing has been around for decades, outsourcing was only formally identified as a business strategy in 1989. In the subsequent years, many different forms of outsourcing were developed in the business world, with accompanying strategies and terminologies. As one of the key sub-categories of outsourcing, BPO rapidly gained recognition and experienced strong growth in the late 90s and into the first decade of the 21st century, with numbers of third party vendors sprouting and organizations embracing BPO models worldwide.

BPO is the delegation of operations and responsibilities of specific business processes or entire functions to a third party service provider. This can include back office services and functions, such as Finance & Accounting, HR, Procurement Transaction Centers, or IT & Software operations, or front office outsourcing, which focuses on customer-related services, such as Call Center operations. The provider in return owns, administers and manages the selected processes based on defined and measurable performance criteria. As buyers part-relinquish control of these elements, BPO usually focuses on non-core but critical business functions or processes.

BPO is not to be confused with Shared Services. Both concepts offer companies the opportunity to centralize processes or functions. However, in a Shared Services environment specific services, previously provided by multiple parts of the company, are provided to the business by a single, centralized source or group *within* the organization. Resourcing and funding of the service is usually shared and the department supplying the services effectively becomes an internal service provider, often operating from a specifically set up Shared Services Center (SSC). Beyond purely centralizing or consolidating services, Shared Services are often run like a business where the provision of the defined services comes at a cost, quality and efficiency competitive with external alternatives.

As BPO requires a substantial investment, both financial and organizational, it tends to be reserved for large outsourcing deals focusing on standardized commodities. Also, the higher its level of outsourcing maturity, the easier it is for a company to implement BPO. For companies not willing to take on such high stakes, seeking a more gradual approach to outsourcing, or looking for a quicker, less risky return on outsourcing investment, in-house Shared Services present an alternative opportunity.

Exhibit 1: Strategic Service Centralization Matrix



This article focuses on BPO, its benefits, reasons why it has not been meeting organizations' expectations, and how companies can mitigate risks involved in BPO relationships to implement a successful BPO strategy.

Benefits of BPO

Despite the considerable (and often unwarranted) negative press BPO has endured of late, the concept of outsourcing non-core business processes and functions to a third party specialist remains a very attractive proposition to organizations. When BPO processes are accurately defined and implemented and the relationship with the vendor properly managed, BPO provides a range of undeniable advantages.

- **Cost Reductions.** Companies can expect to see significant operational cost reductions when outsourcing internal tasks to a specialist that uses best-in-class methodologies. These savings occur in form of process improvements, process reengineering and optimization, and economies of scale. Reduction of operating costs is one of the main reasons for businesses to implement BPO.

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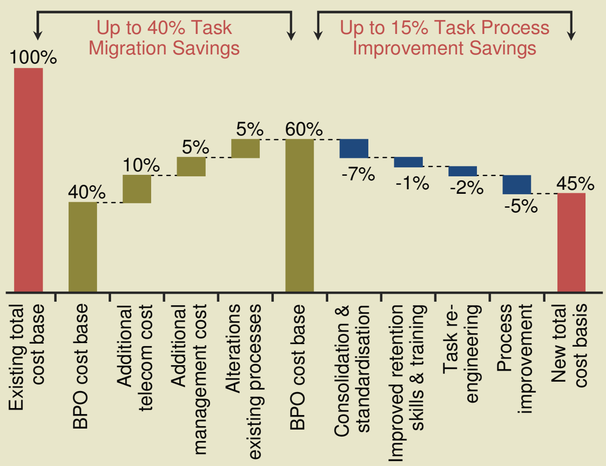
- **Increased Business Focus.** By outsourcing non-essential functions and processes, organizations free up resources, such as labor, investments or infrastructure, to focus on the core of the business. The expected result of this includes higher speed to market, quicker response times, and increased overall business agility.
- **Variable Cost Structure.** BPO allows a company to change its cost structure by transforming a portion of its fixed costs into variable costs. Not only does this have a positive effect on a company's operating leverage ratio, but also renders variable costs more predictable.
- **Improved Quality and Delivery Excellence.** Third party providers offer organizations access to a potentially larger and more specialized talent pool and optimized, homogeneous process structures. This allows for improved delivery of functions and processes through consistent, centralized quality levels based on uniform, pre-defined quality measures. Organizations can also benefit from an overall increase in transparency regarding support requirements and can react to changing needs more rapidly. This, in return, has a positive effect on the overall flexibility of the business.
- **Business Restructuring.** Especially for businesses with tired, crusty company structures and policies, BPO can offer the radical measure required to break down these constructs and provide the stepping stone towards organizational effectiveness and leaner, more modern business conduct.

Background Information

Hidden BPO Cost Drivers and Benefits

Arguably the largest attraction of BPO is its ability to provide organizations with significant cost savings over conventional business models. When developing a BPO model, companies have to be aware of a number of hidden cost drivers that form part of BPO set-up and management. These include additional costs for networks, staff training, and communication, to name but a few. On the other hand, when quantifying the benefits of a BPO model, efficiency gains from consolidation, standardization and task re-engineering have to be incorporated, as well. In Ginkgo's experience, BPO can potentially provide organizations with up to 55% cost reductions over conventional business models, and regularly delivers 30-40% savings.



Source: Ginkgo Analysis

BPO: Not Meeting Expectations?

Despite its significant benefits and having enjoyed a considerable amount of attention over the years, one has to raise the question why BPO has fallen from grace of late. After being at the forefront of organizational efficiency developments and dominating headlines with up to double digit year-on-year growth and positive industry forecasts, BPO has experienced a downturn in public recognition while business leaders are displaying cooler attitudes towards the topic than before. The main reason for this is that BPO has, in a number of well-publicized instances, not delivered the desired results and has fallen short of expectations. As a result, businesses are shying away from the concept and are wary of implementing BPO.

The reasons why BPO has failed to meet expectations, however, is regularly due to businesses' mismanagement of the BPO process and the relationship with the service provider, as well as a poorly defined contract with unclear goals and targets, rather than a shortcoming of the concept itself. In Ginkgo's experience, the following are the main reasons why businesses fail to extract maximum value from BPO models.

- **Complete Outsourcing of Competence.** The number one reason why organizations fail in their BPO ventures is due to the fact that they tend to completely contract out their competence and intelligence in the relevant areas to the third party providers. This is highly dangerous and can have disastrous consequences as the organization loses all capabilities regarding the processes or functions in question. As a result, the organization is not in a position to actively manage the third party provider anymore and loses control of the relationship. As such, many organizations find themselves at their supplier's mercy and are unable to effect required process alterations, such as scaling up or down, integrating new processes to established ones, or taking part of the services back in-house. Functions and process can become disaggregated, 'band-aid' approaches are used to support requests and service delivery becomes sub-standard, inevitably falling short of expectations.

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- **Inadequate Process Definition.** BPO requires *considerable* pre-go-live efforts. Unlike processes that are managed in-house, where alterations can be discussed, ad-hoc agreements made and temporary workarounds defined, once the processes are outsourced, this is no longer possible. It is only with sizeable efforts and costs that modifications can be made, and until these are realized the process is ineffective and does not deliver. Therefore, it is vital to rigorously define the interfaces to secure continued operations from the portion of the business to be outsourced before it is handed to the provider, and clear alignment with processes that are to remain in-house must be ensured. For this, a very detailed definition of specifications is required, to outline clear procedures and execution paths for the third party. It is important to remember that BPO is not a pragmatic problem solver, but a reactive business support instrument. Execution within BPO is inherently 'dumb' and simply follows pre-defined steps. If these steps are not fully provided, the process breaks down.
- **Excessive Cost Focus.** At first glance, there seems to be little that distinguishes many third party BPO suppliers – which in some cases can be true. Organizations often perceive them to be of similar size, provide similar services, have similar geographic coverage, and provide similar approaches using similar technologies. With seemingly little to set providers apart, pricing can become a main differentiator. As such, businesses' primary focus is often on cost as they select the vendor with the lowest price. This can be detrimental in two ways. First, many providers have specific strengths that play towards particular client requirements, be it a specific industry focus or tailored technology and applications. Without sufficient due diligence, organizations will not recognize these benefits and won't take advantage of them. Secondly, while focusing on the lowest offer, businesses frequently don't understand the total cost of ownership. Often providers quote only the basic fees and don't scope in additional charges, such as additional services or change orders. Not only does this mean that a company may not have chosen the lowest cost provider at all, but it can also lead to a piecemeal, 'muddled' approach to the BPO process. This frustration can be avoided if businesses are familiar with overall BPO requirements, including pricing elements, their impact and importance, and are thus in a position to drive the supplier and pre-define the offer content and structure.
- **Lack of Local Process Integration.** Within the BPO process, an organization is required not only to de-fine an exact process map for the provider, but must also ensure that internal stakeholders are satisfied. This means that internal business continuity has to be ensured for every process of the business units with touch-points to the supplier. Often, organizations do not have a clear overview and full understanding of local processes and practices. Therefore, some processes are unintentionally dropped in the transformation from in-house to out-sourced service provision and, as a result, internal users find themselves confronted with incomplete, fragmented delivery of services. This leads to a slowdown or even disruption of operations which can require detailed re-working to be resolved.
- **Complete Reliance on Vendor.** A surprisingly frequent reason why BPO ventures fail is the unreasonable expectation some companies have that once the third party provider has been appointed they will provide an 'all-inclusive, worry-free package', a one-stop shop to managing the entire engagement, while the buyer can take a back seat. Needless to say, this naïve approach is a recipe for disaster and leads to certain failure.

Case Study

Design and Creation of a Regional BPO Model

A global Fortune 50 manufacturer engaged Ginkgo Management Consulting to optimize its operations in APAC. It supported 13 separate local entities with largely heterogeneous process landscapes and varying service levels per function. After an initial analysis, Ginkgo suggested to create a regionalized BPO model, focusing initially on Finance and IT Operations. Ginkgo planned, designed and set up the model, including the outsourcing and centralization strategy, detailed service catalogue design of the services to be outsourced, market and vendor analyses, and vendor selection via RFP. Ginkgo defined the required SLAs and supervised the migration of the services to the third party vendor, managing the transition and tweaking the service model as required. As a result, the manufacturer successfully transferred its services from geographically disparate entities to a centralized, tightly managed BPO model, achieving up to 50% cost reductions in some markets.

Risk Mitigation of BPO Relationships

Besides the aforementioned preventable reasons why BPO has failed to meet expectations, businesses can take steps to mitigate the risks inherent to BPO models. Managing short and long term risk in a BPO relationship is at least as important as seeking short term cost advantages from them, and can be achieved through careful analysis, precise planning and clearly defined agreements.

- **Mapping of Delivery.** While legal contracts are necessary in a BPO model, they should not be the key driver of risk mitigation. The primary way to mitigate risk is better preparation and mapping of ser-vice delivery. Businesses need to recognize the vendor's strengths and play to them. This may well mean that customer will not get 'their way' but consult the provider about the most effective delivery model. Marrying the provider's best practices and internal requirements in this way will more of-ten result in optimized service delivery.
- **Attrition of Supplier Employees.** An area which is often neglected when choosing a supplier is staff retention. As the BPO market grows, the fight among providers for qualified talent increases, leading to high levels of attrition and risk of loss of company-specific process knowledge. Buyers should make sure that potential suppliers take a partnering approach to BPO through a demonstrated interest in key staff retention. This can be achieved by looking at attrition levels, retention policies and even conducting site visits.
- **Security Planning.** The threat and potential impact of security breaches is a key element in the consideration of any BPO agreement. So much so that some companies appoint a dedicated security manager to larger BPO deals to handle physical and systems security. Companies must ensure that any BPO contract clearly outlines the processes involved for safeguarding their assets, spanning systems, data, IT, physical security, staffing and disaster recovery, and includes periodic security audits.
- **Future Planning.** It is important that organizations plan beyond the immediately targeted BPO model and consider potential future developments of their own. Companies must ensure that the solution and technology offered is able to scale to changes in scope and is not overly customized. This also makes it easier to change supplier if needed. Furthermore, it is important to have an addendum in the contract that provides the organization with options at the end of the life of the contract and shows an exit plan, be it to simply extend the existing agreement or even take the services back in-house.

Summary

Much of the negative press and attention BPO has experienced of late is unjustified. In fact, most of it stems from a lack of rigor and mismanagement of the BPO relationship mainly on behalf of the buyer, and could have been avoided through tighter supervision and more clearly defined contract agreements. Organizations should use these failures as case studies and lessons learnt.

As the BPO market continues to grow and evolve, so does its makeup and focus. While the BPO landscape continues to be dominated by the large end-to-end providers, such as Accenture or IBM – and this area is beginning to see industry consolidation – there is a discernible growth in smaller companies focusing on key business process areas trying to build a niche for themselves. Similarly, new, promising areas of BPO and offshoots are developing, such as Knowledge Process Outsourcing (KPO), the outsourcing of supply chain functions and the noticeable increase in multi-shoring.

Overall, BPO is here to stay. The benefits provided by BPO models are too attractive for organizations to ignore. In addition, as the BPO market becomes increasingly sophisticated and diverse, power is shifting away from the vendors to the buyers who are in a position to dictate their requirements and have a large amount of single or multi-vendors to choose from. As long as organizations apply the required rigor and follow established BPO best-practices, they will continue to reap the benefits of such models. Subsequently, if their BPO attempts fall short of expectations, they have no-one to blame other than themselves.

About Ginkgo Management Consulting

Ginkgo Management Consulting specializes in strategy development and execution with a distinct focus on business technology. Our clients include leading global corporations in the automotive, manufacturing, telecommunication, logistics and financial sectors.

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