August 30, 2006

Inside Outsourcing™

BRIDGING BUSINESS AND TECHNOLOGY

Inside with: Jeff Bruckner,

Founder and Chief Architect, Rational Decisions

Larry Janis' interview with:

Jeff Bruckner
Rational Decisions

From the Editor.

Welcome to our current issue!

Inside Outsourcing's goal is to provide you with articles of interest and with a forum for the exchange of information in this rapidly evolving industry.

Rational Decisions was founded to provide tools, technologies and services to optimize internal business relationships. Our approach to relationships connects internal support processes to the underlying value chain, allowing service providers, such as IT, HR, Finance and Administration, to deliver maximum value.

We believe that ineffective relationships are the single biggest obstacle to business performance - an obstacle that will loom larger as the digital economy matures. The impact of poor relationships is already being felt - half of all outsourcing deals ultimately fail, the vast majority (over 80%) because of relationship failure.

LJ: What is your view on the current state of outsourcing?

JB: Outsourcing is a maturing industry, especially IT outsourcing (ITO). Business process outsourcing (BPO) is on a similar path, though it started later and is maturing more quickly. To illustrate the pace of change, let's take a look at how terminology has evolved. ITO has come to mean infrastructure, operations, and coding, while developing and deploying applications – which used to be considered an IT function – is now called BPO. Accordingly, business now generally owns the BPO process, while IT continues to own the ITO process. The long-term battle between IT and business over applications development is rapidly becoming irrelevant – the marketplace is stepping in a providing a better solution.

Let me describe how ITO is maturing. Probably the biggest factor is the convergence towards best practices, as outsourcers begin to offer similar services and performance guarantees. Less differentiation means more competition as outsourcers are forced to compete on price. Buyers are learning to leverage their purchasing power by forcing outsourcers to compete in their areas of specialization, leading to more multi-source deals.

Accelerating this trend is the poor success record of sole-sourced deals – more than half of them fail. Buyers have moved to reduce the risk of failure by sourcing across multiple suppliers, limiting the impact of a deal failure with an individual supplier. This has the unfortunate – and unintended – effect of actually increasing risk, since managing multiple suppliers is much more difficult, and often not a core competence for the buyer. ITO will become a commodity (some argue that it already is), leading to further consolidation in the industry. Eventually, ITO won't look like outsourcing, but more like commodity procurements, like purchasing cars for the fleet, real estate, or food services. Purchasing departments are already becoming more active participants in the outsourcing purchasing cycle, their role will continue to increase. (continues on next page)

Inside with: Jeff Bruckner,

Founder and Chief Architect, Rational Decisions

BPO is currently a smaller market, but is expected to grow more rapidly than ITO. Right now, its growth is constrained by the buyer's perceived risks: large and difficult to manage. The primary risk driver is BPO's close proximity to the businesses value chain, which carries a higher – and more directly measurable – business impact than ITO. Close behind is the disruption of adopting BPO processes, which often requiring a retooling of business methods, roles and responsibilities. These risks will decrease – and already have – as BPO best practices become more ubiquitous, and buyers begin to adopt the lessons learned by the pioneers.

One more thought – outsourcers have become quite good at what they do, the tricky part is keeping them in their sweet spot. A buyer can still easily move an outsourcer out of their sweet spot by the promise of more revenue, a chance to develop a new capability that can subsequently be marketed to other buyers, or a chance to score a win against their competitor. It's difficult, but vitally important, to make sure your outsourcer can teach you, not the other way around. Unless, of course, you're looking for a joint venture, in which case that's how the deal should be structured.

LJ: Why do outsourcing deals fail?

JB: Excellent question. Recent surveys reveal that more than 50% of ITO deals fail, and estimates of BPO failure rates range as high as 60%. Furthermore, 80% of these failures are due to some sort of relationship failure; service delivery failures were responsible for less than 10% of deal failures. Many deals do have service delivery issues, especially during the transition phase of the deal; witness the many anecdotes and press coverage of war stories. But delivery issues don't cause the deal to fail, since they are usually fixed quickly, with buyer and outsourcer joining together, and contributing resources, to solve the problem. Cooperation comes almost naturally, as service delivery problems are generally well defined and have well-known solutions. Both parties have experience in diagnosing these kinds of problems, developing an action plan, and in executing it.

Rational Decisions
Technology for Business Relationships

Relationships are much more of an unknown. Not only can they manifest themselves in different ways, such as unclear expectations, poor communications, misaligned interests over time, and poor governance, but rarely does either party have a well developed expertise in relationship management. Consequently, relationship problems tend to go unheeded, festering until they reach the point of no return. Usually, one party decides to abandon the deal and reassigns vital resources, dooming the relationship. Vendors cut back to the minimum and invest in other customers, while buyers start moving responsibility – either back in-house or to another supplier.

LJ: What are the keys to a productive relationship with an outsourcing provider?

JB: Successful relationships have two critical success factors: structure and skill. Relationship structure relates to the numerous individual interactions that constitute a relationship, while skill relates to the talent, experience, and wisdom that individuals bring to each interaction. Structure serves to direct skill.

Poor structure – which is often the case – causes the skill and energy of the stakeholders to be undirected and chaotic. It also consumes much of the energy and focus of the stakeholders – even highly talented ones – as they struggle to overcome its deficiencies and work to create the necessary structure. Poor structure makes even skilled individuals perform poorly. And replacing them with new individuals with equivalent or even better skills makes little difference.

Conversely, high quality structure encourages proper behavior and allows the stakeholders to focus on business impact, making them better performers. But good structure can never compensate for individual skill. It can constrain poor behavior and provide incentives for improvement. More importantly, good structure shines a bright light on individual performance, stripping away all excuses for poor performance. (continues on next page)

Inside with: Jeff Bruckner,

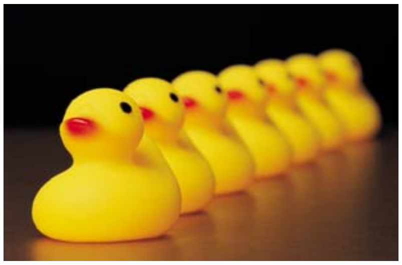
Founder and Chief Architect, Rational Decisions

Relationship structure can be designed, quantified and managed independently of the participating stakeholders. At the most fundamental level, structure has four elements: roles, information, participation and accountability. A useful analogy is to think of the interactions that constitute a relationship as discussions being held around a conference table. Effective interactions require that the stakeholders at the table represent the appropriate interests at the appropriate level of responsibility for both the outsourcer and the buyer. Secondly, the participants must have information – the key relevant facts about performance, cost, risk, and so on. Thirdly, the stakeholders must participate in the interaction in a manner consistent with their role. And finally, there must be individual accountability for results.

These four elements can be used to quantify relationship structure, providing an independent, objective metric that both parties can use to build strong relationships. Rather than relying on the force of personality or a prefabricated governance structure, relationships can be built that connect the outsourced services to the underlying business processes that they support. Periodic measurements of relationship effectiveness can ensure that the relationship stays on track – and will provide early warning if circumstances change, or if changing personnel impact the structure of the relationship.

LJ: When should a buyer of outsourcing initiate the plans on how to effectively manage a provider?

At the very beginning of the procurement lifecycle. Relationships should be thought of in the same was as the services being outsourced – they should have requirements and performance service levels. Each party should seek to understand how the other designs, builds, measures and manages relationships. If one party doesn't know, that should serve as a warning signal to the other. The discrepancy can then be addressed during the proposal and evaluation stages of the relationship. The due diligence phase or a deal is too late, because the findings, especially if they are sufficiently problematic, will get lost in the rush to close the deal – only to reemerge later, when the personalities that drove the deal move on to the next one.



The initiation stage is the time to build the structure, based on the previously agreed requirements. Many outsourcing relationships begin to fail at this point, when the parties start to realize that they have incompatible structures or no structure at all.

A word about dysfunctional relationships. When outsourcing deals begin to sour (but before one party walks away), a window of opportunity opens– briefly – that provides the parties common ground to rebuild their relationship. In this case, the parties should go back and execute the steps they skipped at the beginning of the procurement cycle.

LJ: What are the biggest issues with outsourcing today?

There are several, some of which have been with us for some time. In no particular order:

Outsourcing deals are often front loaded to give the buyer an immediate benefit (usually financial), while the outsourcer takes the benefit at the end of the deal. No problem if both parties understand what they're getting. But often the buyer has a short-term bias (especially public companies with quarterly financial reporting), which tempts them into taking the up-front benefit and leaving the back-end problem to someone else.

Outsourcers face intense competition and will agree to take on services and performance levels that they have little or no experience with. And buyers let them, thinking that the 'outsourcer is the expert'. Buyers must find the areas of core competence for their vendors and stay within them.

An over-reliance on service levels, to the exclusion of relationship management. Relationships need to be managed the same way that service delivery is managed today: with clearly defined requirements and performance levels. There is one key difference, however: both parties should be held to relationship service levels, not just the outsourcer (one-sided relationships aren't very effective).

Integrated Search Solutions Group

We are a fourteen-year-old retainer based executive search firm that has successfully attracted top talent in the areas of Outsourcing (IT, BPO and BPM), Consulting (Strategy & Technology) and traditional IT functions (CIO, CTO, etc). We have worked effectively with major corporations as well as effectively with venture capitalized start-ups. Executive recruiters typically pride themselves in their ability to recruit top executives, irrespective of the industry. Leaders in outsourcing tell us a different story; outsourcers value what we do because we understand their business. Executive search in outsourcing is what we do.

Office Locations:

New York	Phone: 516-767-3030
Florida	email: janis@issg.net
London	www.issg.net
Belgium	Members of: HROA, SBPOA, BPOAdvisory Board

Inside with: Jeff Bruckner,

Founder and Chief Architect, Rational Decisions

Buyers' belief that they're unique and therefore require services tailored to their needs. Sometimes manifested as the belief that the customer doesn't to do the work – the outsourcer should handle everything – they're the one getting paid. The approach is backwards – buyers should be looking for the areas in which they can use best practices and then outsource them. Unique requirements should be kept in-house, or reengineered if they don't add any competitive advantage.

Buyer's belief that outsourcing confers a competitive advantage. Actually, buyers get similar services as other customers. More often than not, the services are commodities. Any competitive advantage comes from managing the relationship so that commodity services are connected to business processes in a unique way.

LJ: How can buyers get maximum value from their outsourcers?

Again, in no particular order:

1. Stay within your outsourcer's core competence.
2. Spend as much time managing relationships as you do managing service levels.
3. Pick service levels that matter to the business.
4. Design your processes to leverage your outsourcer's expertise
5. Don't export problems. Solve them before you outsource, or expect to pay the outsourcer for fixing them.

Involve the business at each impact point. Don't surprise them.

"Innovation distinguishes between a leader and a follower."

Steve Jobs