

## Outsourcing model redesign

*Unleash latent improvement potential by taking a fresh look at established partnerships*



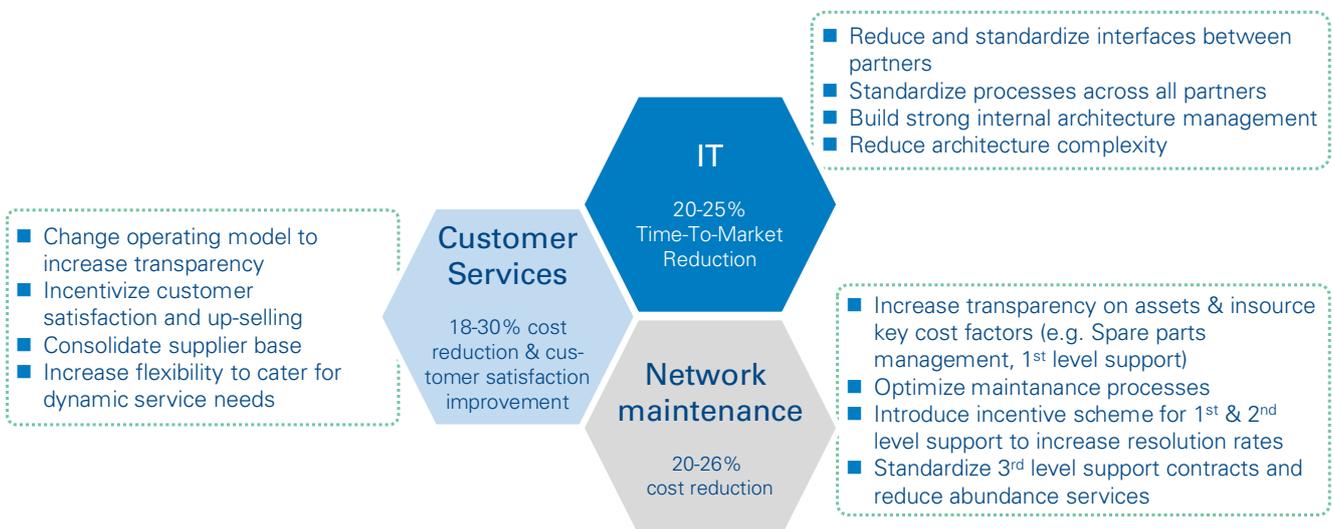
Outsourcing has been widely implemented in all industries. While some of these partnerships have failed miserably, others were perceived as successful. The aspired advantages, such as cost savings, flexibility and access to innovation, have often turned into dependency and inability to get the full value of the relationship. Taking a fresh look can provide the opportunity to transform the operational as well as the contractual set-up and to radically increase the value.

In the past decade, companies have outsourced services at the core of their value creation to external service providers. While support functions such as HR, finance and facility management are typically among the outsourced services, many services that are much closer to the core business, such as customer service, maintenance of core assets, IT and supply chain operations also have often been outsourced.

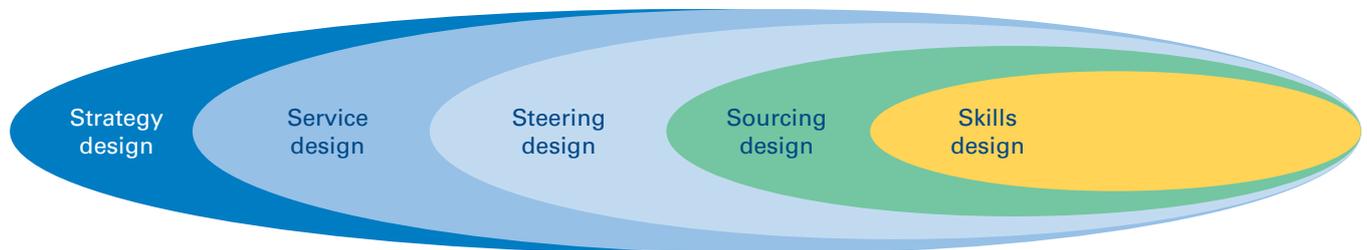
Companies enter into outsourcing agreements with either the goal of pure cost reduction, or of achieving greater flexibility,

access to innovation and the latest technology. Although the advantages of outsourcing have certainly been achieved – at least partially – many companies rethink this set-up. The common fear of dependency on outsourcing partners and difficulties in steering them has reduced anticipated benefits. Limited flexibility in adjusting services to changing demand, higher costs and dependency on the provider’s technology may have turned the situation around and caused companies to feel they are not getting the full value out of the partnership.

Improvement levers and benefits (from Arthur D. Little’s project experience) – Read the case studies for details



## Arthur D. Little's Outsourcing model redesign framework



In this situation it is necessary to take a fresh and holistic look at the set-up of the company's value creation. The goal is to find the right balance between efficiency, quality, access to innovation and technology, flexibility, and risk. In order to review and optimize the sourcing model, Arthur D. Little analyzes the design of strategy, services, steering, sourcing and skills. This holistic view of all dimensions of the sourcing model ensures not only that problems are covered on the surface, but also that the optimum set-up can be achieved.

### Strategy

Firstly, we need to analyze the strategic rationale, demand and operating model in a function. The required activities need to be fully transparent in order to allow understanding of the nature of the demand. This is necessary to establish an unbiased picture of the value question and avoid any compromises based on habits and existing structures.

### Service

Secondly, we take an in-depth look at the services and service levels that are required to sufficiently cover the demand, and how they need to be designed to provide the required flexibility. This detailed work often leads to elimination of many existing services that have been useful in the past, but which the dynamic changes inside the company or its environment have made obsolete. Furthermore, it allows redesigning of the function in a comprehensive way that radically increases the generated value.

Our case study on transforming the customer service function (see below) shows the extent to which a function can be optimized.

### Steering

The service portfolio needs to be managed and steered towards achieving the company's value objectives. A governance

structure with clear guidelines for transparency, KPIs and target levels needs to be established. Responsibilities within the firm need to be defined to ensure the organization supports the newly defined service model. A mechanism for reporting and monitoring needs to be set up. It is necessary to distinguish between KPIs that are used for steering a particular service and other data that is reported for other reasons. To keep a steering mechanism pragmatic, no more than five to 10 variables should be used.

### Sourcing

To make a decision on the sourcing model, to insource, or to partially or fully outsource the situation on the supplier market as well as the strategic relevance, transaction cost and risk of dependency are the key factors that need to be assessed. It also allows organizations to define whether to aim for a partnership approach, or whether the company has the ability to leverage its market power to maximize its own benefit.

Furthermore, the analysis can provide indication of how many suppliers a service needs to be sourced from. The actual outsourcing model needs to be implemented through robust contracts. In our experience, many existing outsourcing contracts are driven by the vendors. For a company choosing to outsource, it is essential to define the structure, pricing and steering mechanisms and the terms and conditions in all outsourcing contracts.

### Skills

Finally, the company needs to reassess the capabilities required to support the changed set-up. In our experience, gaps in internal capabilities for steering providers are key reasons why companies lose control over vendors. Furthermore, the outsourcing partner also needs skilled people to manage and optimize the relationship.

## Case study: IT outsourcing optimization

Arthur D. Little assisted a telecom operator in optimizing its IT functions, which were mostly outsourced (applications development and maintenance – ADM – testing and operations). The function was suffering from high time to market, low quality of applications, and high cost of application development and maintenance. The root cause of these issues was traced to the existing IT operations sourcing model, which was characterized by fragmented responsibilities and accountabilities across vendors, lack of standardization of processes and limited control over the partners' activities. A very rigid KPI and SLA framework that had been established at the beginning of the outsourcing relationships prohibited the companies from optimizing the partnerships.

As competitive pressure in the client's market increased, it was necessary to redefine the IT function:

- Radically improving the business focus of the IT function
- Instilling flexibility in development planning to allow adjustment to dynamic market conditions
- Improving time to market for application development

ADL assisted the client in developing a sourcing model that would reduce the dependency, increase flexibility and radically improve time to market. ADL reviewed and enhanced the application development process, IT operations governance set-up involving different stakeholders, performance management mechanisms, and organizational set-up of IT-related roles and responsibilities to complement the sourcing model.

The new sourcing model is expected to generate 15–20% higher output while ensuring higher agility and control, and will be a significant factor in helping increase the operator's competitiveness.

## Case study: Transforming customer service

For a client in the service industry we were able to transform the customer service function and radically increase the value generated from it. Initially the function had a purely transactional role – e.g. answering the customer's calls and written requests. However, due to intensifying competition, knowledge and management of the customer became a

strategic asset. The supplier portfolio showed the typical signs of a historically grown customer service function. It included approximately 15 different vendors for specific services and different languages.

Customer service functions are typically outsourced because of high expected cost savings. In our analysis, however, we found that economies of scale are minimal once a contact center exceeds 100 agents. Moreover, service levels and service quality cannot be measured easily due to the often very vague nature of the interaction (biased customer satisfaction, first-call resolution, classification of call types). The most important factor, however, is call volume. It drives cost, but also customer satisfaction. An outsourcing provider rarely has incentive or the means to reduce call volume. Hence, we recommended partially insourcing the customer service function to increase the company's understanding of the customers and the reasons they called. This was also aimed at providing credible benchmark data on service levels and customer reactions to external effects such as new product launches or service disruptions.

Furthermore, we transformed the nature of the customer service function significantly. Customer segments were redefined based on current customer value and cross-/upsell potential. For each customer segment, specific service levels were defined that minimized service costs and maximized customer satisfaction. The large low-value customer segments were shifted entirely to online- and self-care channels. Calls such as inquiries, complaints or cancellations from high-value and high-potential segments were serviced through the new in-house contact center. The remaining volume (still by far the greater part of customer interactions) were outsourced to four specialized service providers. The service-level framework was redesigned to ensure that the new vendors would support the new direction. The vendors were incentivized through an improved pricing and bonus-penalty framework that also fostered the partnership between the company and the outsourcing firms.

Furthermore, a demand reduction program was set up to evaluate and eliminate the root causes for clients to call.

The effect of the improvements led to cost reduction of almost 30%, radically improved customer satisfaction (net promoter score) and generated significant new revenue from cross- and upselling.

## Case study: Network maintenance and operations transformation

Our client had relied heavily on network equipment providers for the operations and maintenance of the network. Even though a large pool of network engineers were available in-house, more than 55% of network OPEX was attributable to outsourced services and support contracts. The company had lost internal technical skills, which had put our client into a lock-in situation with his outsourcing providers.

The resulting transformation program consisted of three key measures:

1. Reducing the number of suppliers and adopting a standardized and simplified contract framework with revisited service-level agreements
2. Improvement of supplier management capabilities by redesigning and automating the relevant processes
3. Insourcing parts of the services by improving internal technical capabilities, including a revamp of the operating model

The changes were planned to be implemented over a period of 18 months, and yielded identified savings of 10–15% on annual network OPEX, as well as increased customer experience by reduced incident resolution times.

## Conclusion

Transforming the outsourcing model of a company happens at the core of the operation. By taking a fresh look at the operating model, radical improvements in terms of costs, quality, innovation and flexibility can be achieved. The key steps that need to be made are defining the right services, transparent management of the services, a clear sourcing decision and building the required capabilities.

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## Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. Arthur D. Little is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations

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