Business Process Offshoring

Making the Right Decision
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Offshoring business processes can offer companies across a range of industries the opportunity to lower costs by 40% or more. Still, offshoring is not for every firm—and certainly not for every business process. As senior managers look beyond the back office for functions to offshore, they need to determine first whether it makes economic sense to offshore them and then how to do it efficiently and effectively. Our work with clients that are offshoring to captive and third-party vendors—plus recent in-depth interviews with 10 offshoring vendors in India specializing in banking, insurance, telecommunications, and media—furnishes some unique and useful insights into this growing phenomenon.

Though hardly a new concept, offshoring activity has escalated recently as telecommunications and cross-border barriers have dissolved worldwide. Estimates of the overall business process outsourcing (BPO) market range from $200 billion to $500 billion, and a quarter of that work is now going offshore. Indeed, the offshoring of business processes is growing at double-digit rates in the United States and Europe.

Such blue-chip companies as GE Capital, American Express, HSBC, Standard Chartered, British Airways, Bechtel, General Motors, Ericsson, Toshiba, MetLife, and Prudential have outsourced business processes to captive or third-party offshore service providers in the past few years. The functions sent offshore run the gamut from routine IT transactions to increasingly higher end, knowledge-based business processes.

Examples are customer service, finance and accounting, human resources, and even product development and advanced analytics.

In many cases, companies are taking advantage of the opportunity offshoring presents to reengineer operations, source new product ideas, and serve customer segments they could not afford to serve before.

**Benefits: It’s Not Just About Cost**

Though outsourcing is largely a scale game, offshoring is driven by the dramatic wage-cost differential between Western “onshore” economies and the economies of South and Southeast Asia and Eastern Europe (see Exhibit 1). Labor savings alone—depending on the nature of the work and the skill level required—range from 40 to 70%.

**Exhibit 1**

*Outsourcing is a Scale Game; Offshoring is Driven by Labor Savings*

Source: Booz Allen Hamilton
Exhibit 2
Breaking Down the Offshoring Savings Opportunities

Exhibit 2 breaks down the 50+% cost savings opportunity that companies can capture from offshoring business processes to India. Our research indicates that these savings are roughly equivalent to those available in the Philippines and higher than those available in Eastern Europe. Remarkably, clients can expect to save even more from offshoring to China, despite the significant language and trade barriers that still exist there.

Of course, such labor savings do come at a price. The additional technology, telecommunications, and management overhead required to relocate and supervise operations overseas typically reduce the savings captured by 10 to 12%.

However, lower labor costs are not the only persuasive factor recommending offshoring. Our work suggests three other key factors:

1. **People.** Offshore BPO workers are invariably college educated, and many—more than 40%—have an advanced degree (e.g., MBA, PhD). Treated as white collar, salaried employees (in stark contrast to the hourly workers performing the same function in the United States), these individuals are in the 75th percentile with regard to pay for their age group (early- to mid-20s). Proud to work for an international company and motivated by targets and incentives, offshore workers tend to be more productive and proactive in enhancing processes than their onshore counterparts.

2. **Market discipline.** Even captive offshore subsidiary processes are profit centers, which differentiates them from their domestic back-office counterparts. They compete in an open marketplace for business, so there is a strong focus on continuous improvement and customer service. Offshore service providers often refer to their operations areas as the “shop floor,” and top performers have already established Six Sigma, ISO 9001, or COPC certification programs.

3. **Access to technology and resources.** Simply put, offshore operations can afford to “throw more brainpower at a problem” to meet their performance goals. Technology know-how is a relatively cheap commodity in ample supply in offshore economies. Dedicating the equivalent technology and personnel to a problem would be cost prohibitive in the United States or Western Europe.

Risks: Offshoring Is Not for Everyone

Despite ample evidence supporting the decision to offshore, our experience indicates that it does not work for everyone. In fact, our research shows that most of the companies that have tried to set up instant offshore operations in India over the past 2 years have failed.

That failure rate stems from several factors. For one, not every process is a good candidate for offshoring. Processes that are core to the business, require significant personal interaction, change frequently, or involve high levels of customization will not transfer well to an offshore environment. Our research and experience show that these factors rule out up to 30% of a typical client’s processes. Of the remaining processes, only about one-half are feasible for offshoring (see Exhibit 3).

Even if appropriate and feasible, offshoring significant business processes is a major organizational undertaking—one that is likely to provoke considerable resistance, not only from employees whose jobs are relocated, but also from communities and government bodies concerned about declining domestic employment. Companies considering offshoring must weigh the likelihood of unfavorable legislation, lawsuits, and negative publicity.

Exhibit 3
Making the Decision: What to Offshore?
Besides the cultural and political risks that must be surmounted at home, there are also risks a company will encounter at the offshoring receive site. Country-specific risks range from weak legal systems to inadequate infrastructure to foreign exchange fluctuations. Social and political resistance, regulatory restrictions, and trade issues need to be resolved. Data security, privacy, and intellectual property rights are all of concern.

There is more. Though attractive, the returns on an offshoring investment typically take 2 years to start rolling in. Those companies that choose to set up captive operations offshore can expect to wait 2.5 years or more to break even. And whether one offshores to a captive subsidiary or to an outsourcer, an intense 18-month effort will be needed to transfer and stabilize the first processes.

Companies must explicitly consider all these risks in transitioning business processes to an offshore location. More important, they must develop an exit strategy or effective fallback plan in case the offshoring initiative ultimately proves unsuccessful.

Building an Offshoring Business Model: Many Options
To ensure long-term value creation, offshoring should be considered in the context of a portfolio of sourcing, process improvement, and complexity reduction decisions. Each company’s decision to offshore rests on a unique set of factors, but our experience has yielded some general guidelines:

1. To offshore or not. Companies need to carefully consider and resolve three key questions:
   - **Where?** Significant differences in risk, reward, and capabilities exist among India, China, the Philippines, and Eastern Europe. Once a country is chosen, city differences need to be evaluated. For example, Chennai is better for finance and accounting, but Delhi has better call center capabilities.
   - **How?** Should a captive operation be built or should you outsource to a third-party vendor? Although captive offshoring provides the greatest rewards and control, it is more difficult to manage and will become increasingly so as the market matures. Outsourcing to an established offshore vendor is the easier option, though less profitable. However, several vendors now offer build-operate-transfer models that reduce the initial investment risk and assure companies some degree of long-term control.
   - **Who?** Many offshore service providers are now in the market—from international companies to local facilities. Track record, scale, and expertise in

2. Pick the processes. Offshoring starts with simple, standardized, measurable, and manual processes that can generate early and significant wins. The technology to support offshored processes should be stable and accessible through a wide area network. To minimize the disruption to the existing organization and ease the change management process, companies should start with processes that are already outsourced and that can be incrementally improved by offshoring.

3. Manage the migration. The key to successful offshoring is the smoothness and discipline of the migration process. Best practice companies migrate the first process in 3 to 4 months, and after going through the exercise a couple of dozen times, can offshore a process in 4 to 6 weeks. The migration process comprises the following basic steps:
   - Form a transition team, including “send site” and “receive site” staff.
   - Baseline the process being offshored.
   - Design the migration, including document process flows, technology requirements, people needs,
compliance standards, financial analysis, and disaster recovery.
- Execute in a staged, redundant manner.
- Keep 15 to 20% of the onshore team on-site to ensure a smooth transition.

4. **Manage the relationship.** Will the offshore service provider serve as an off-site “process factory” or a partner? Though either option is viable (depending on the processes being offshored), expectations and pricing for the options will differ significantly. Each firm needs to understand its individual responsibility for keeping the relationship productive over time. On a more tactical level, companies need to establish governance structures to ensure that the right metrics are being measured and tracked and that appropriate steering and escalation mechanisms are established on both sides.

5. **Anticipate the change.** The most common refrain heard from offshoring executives is that they should have started managing the change earlier. More time should have been dedicated to fostering buy-in at the beginning of the process through physical site visits, internal communications, labor relations (as necessary), and legal and regulatory preemptive moves.

**Proceed…with Caution**
The savings that can be realized by offshoring the right business processes are simply too compelling to ignore, particularly in a competitive global marketplace. If companies consider carefully what processes to offshore, exercise appropriate due diligence in selecting a site, and dedicate sufficient forethought and resources to the transition itself, they can realize step-change improvements in operating efficiency and productivity. The right approach to business process offshoring is a measured one that weighs the benefits and risks to the enterprise and focuses on long-term value creation.
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