CALL IT WHAT YOU MAY: OUTSOURCING, OFFSHORING OR THE NEWEST DESCRIPTIVE: GLOBAL SOURCING.

IT'S RAISING ISSUES - AND OFTEN BLOOD PRESSURE ESPECIALLY AS IT RELATES TO DOMESTIC JOBS, INTERNAL CONTROL AND NOW NATIONAL SECURITY. FINANCIAL EXECUTIVES RESEARCH FOUNDATION (FERF) SEEKS REASONS WHY THE STILL-EVOLVING PRACTICES HAVE BECOME THE WAY GLOBAL ORGANIZATIONS NOW DEFINE THEIR BUSINESSES.

View Image -

When The Washington Post reported on February 11 that Dubai Ports World (DP World) was poised to "take over significant operations" at six American ports, as part of a corporate sale, the national news networks churned into action - causing a political maelstrom and setting a new debate.

DP World - a company based in the United Arab Emirates - had purchased London-based Peninsular and Oriental Steam Navigation Co., the current operator of U.S. ports in New York, New Jersey, Philadelphia, Baltimore, Miami and New Orleans. DP World would effectively handle shipping arrivals, departures, unloading at the docks and many security-related functions (which it subsequently denied, saying it would not handle any security functions).

DP World said the deal had been approved by the Committee on Foreign Investment in the U.S., a 12-member board that includes White House officials and Cabinet members from the Departments of Treasury, Defense, Justice, Commerce, State and Homeland security. Within days, Senate and House leaders called on President George Bush to delay the takeover, threatening to introduce legislation if he did not act quickly.

Bush then told reporters, "I want those who are questioning it to step up and explain why all of a sudden a Middle Eastern company is held to a different standard than a [British] company."

The President's statement gets to the heart of global sourcing. What was once a debate about jobs has - in this instance - now become a debate about national security. Companies subject to Sarbanes-Oxley compliance also have to be concerned about internal control, both within their own company, as well as within those companies they align or partner with, whether the company is located in the U.S. or offshore. Yet, in spite of added layers of scrutiny, the pressures of competition will force companies to look for cost efficiencies wherever they can find them.

Last December, Unilever N.V. announced a seven-year contract to outsource significant parts of its financial transactional services to IBM Business Consulting Services (IBM). The agreement covers more than 20 European countries, and, according to Unilever's press release, "aims to streamline the organization in order to increase competitiveness in the marketplace and step up growth." The services will be delivered from IBM centers in Portugal, Poland and India, and Unilever expects annual cost savings of about 700 million euros (approximately $840 million).

What began decades ago as a way to find cheaper, faster, more effective ways for a company to eliminate noncore activities (outsourcing) moved certain jobs outside the U.S. borders (offshoring). In a global economy, the evolution to where a process is executed is smartly articulated as: "global sourcing."

Basically, notes Theo Forbath, chief strategist and practice leader with Wipro Technologies, this is "finding the best resources globally to address a company's development, operational and support requirements." Wipro is a provider of integrated business, technology and process solutions on a global delivery platform.

Forbath says "offshoring" is no longer the strategy that Wipro's clients are pursuing. Rather, he adds, "for almost all of our engagements, we use some combination of on-shore, near-shore and far-shore resources." While perhaps a subtle "nuance in terminology" for some, he says, it's an important distinction for his clients.

Based on some recent surveys, it appears that global sourcing (or outsourcing or offshoring) is here to stay, although it may always be an emotional and somewhat controversial issue.

FEI's Technology Survey

Financial Executives Research Foundation's (FERF) 2005 survey of Technology Issues for Financial Executives, released last June, reported that the outsourcing of a number of administrative functions was widespread.

Payroll, the most common function to be outsourced, was outsourced by 40 percent of the respondents, with another 10 percent planning to do so within the next year. Information technology (IT) followed, outsourced by 15 percent of the respondents, with another 15 percent planning to do so during the next year.

Other functions, such as human resources (HR), research and development (R&D) and even accounting were also outsourced, but to a much lesser extent.

Perhaps more importantly, these outsourcing initiatives were considered to be successful. Of those respondents that outsource functions, 40 percent said that their outsourcing was highly successful, and 45 percent said it was moderately successful. The primary reasons given for outsourcing a function was because it was not a core competency (45 percent) or because its in-house costs were too high (35 percent).

Global sourcing, however, was indicated to be a less-prevalent form of outsourcing. For example, offshore providers of IT were used by only 17 percent of the survey respondents, and 13 percent of the respondents off-shored 25 percent or less of their total IT operations. Also, global sourcing seems to be a recent phenomenon, with only 10 percent of the respondents reporting global sourcing of IT for two or more years. Nevertheless, the number one reason, by far, for going offshore for IT services - to reduce costs - was cited by 70 percent of the respondents.

But the use of offshore IT providers is expected to increase in coming years, and all respondents currently using offshore providers indicated that they have plans to increase their use of offshore providers.

When the results of the 2006 survey of Technology Issues for Financial Executives are published later in April, we will have additional information on whether these responses are indicative of a longer-term trend.

Duke University Survey

The FEI results are amplified in a recent study by the Center for International Business Education and

Research (CIBER) at Duke University. The second Duke University CIBER/Archstone Consulting study, released in December, found that many companies now view offshoring of business processes, IT engineering and R&D activities as a means to drive business growth, not just to reduce costs.

Of the companies surveyed:

\* 73 percent responded that offshoring is an important part of their overall growth strategy;

\* Key offshoring initiatives cited were product innovation and design, research and development, and engineering services; and

\* Access to qualified personnel was cited by 71 percent as a major reason for considering offshoring.

The surveyed companies were not all huge multinational corporations. Although 24 percent of the 96 companies responding were Fortune 100 companies, 41 percent were not large enough to be included in the Fortune 1000, and one-third were privately held.

The 96 responding companies reported 377 offshore functional implementations. Of this total, only 42 percent were provided by third-party service providers (the "outsource model"), with 58 percent of the implementations run as a captive center (the "captive model"), owned and operated by the company itself.

However, one of the more important findings of this study was that "growth strategy" was more often associated with product development functions than with administrative functions. For example, "growth strategy" was given as the reason for offshoring 81 percent of the implementations of R&D, product design and engineering, compared to only 67 percent of the implementations of accounting, HR and other back-office functions.

View Image - Juergen Reiners,Vice President of Business Process Outsourcing Delivery, Hewlett-Packard Co.

Nevertheless, there are perceived risks to offshoring. The number one perceived risk, by just a slim margin, was service quality, cited by 59 percent of the respondents, which just edged out cultural fit, cited by 58 percent. Data security was number three (54 percent), and loss of control was cited by 46 percent.

Companies that use the outsource model perceive greater risks, on average, than companies that use the captive model (49 percent compared to 41 percent). Risks associated with the outsource model are particularly higher in terms of service quality, data security, loss of control and corporate culture buy-in.

Deloitte Global Financial Services Offshoring Survey

Deloitte Touche Tohmatsu's (DTT) third annual study of offshoring practices in the financial services industry (Scaling the Heights) examines the industry's overall offshore trends. One of the key findings is that "relentless margin pressure and intense competition have made offshoring a competitive necessity for most financial services companies." Although low-cost IT outsourcing has been the predominant offshore activity, the trend is toward multiple functions, with a shift toward captive operations.

Another key finding is that the industry as a whole could triple its cost savings from offshore operations. These savings will be a function of two factors. First, as offshore headcount increases from an average of 3.5 percent of total headcount to current best practice of 6.7 percent, average cost savings will increase from 38 percent to 60 percent. second, efficiencies can be gained by expanding offshore operations to "full service," by relocating some middle and front office activities offshore, in addition to back offices.

DTT recommends four key elements for success, the four "Cs:"

1. Managing and minimizing complexity;

2. Ensuring compliance with regulations;

3. Creating a culture that helps both onshore and offshore workers perform their best; and

4. Balancing near-term cost savings with long-term strategic investment.

DTT argues that offshore operations that aggressively expand their scope and scale will deliver much higher returns. And, their message is clear: Don't dabble - stay home if you are not committed.

The Future of Global Sourcing

Juergen Reiners, vice president of Business Process Outsourcing Delivery for Hewlett-Packard Co. (HP) offers some historical perspective. "Global sourcing is not a new thing. It is just a continuation of a story."

Reiners says that when he joined HP years ago, "HP had metal shops and owned even some trucks for shipping to customers. Today, no large company would even consider having those activities in-house... and tomorrow it will be the same for administrative services. They will be provided to customers via the Internet. Technology makes this possible."

At HP, business process outsourcing (BPO) is a strategic imperative, with its go-to-market strategy focusing on segments where HP can add superior value for its clients. HP's current BPO capabilities primarily focus on an extensive range of services that span all core finance & administration (F&A) processes. HP optimizes infrastructure, applications and business processes as part of its BPO F&A capabilities and is positioned to be an endto-end BPO service provider offering global business solutions across a range of processes.

Reiners offers a vision for the future. He is convinced that global sourcing will become much more widespread. "Today, horizontal solutions are sourced, such as data centers and individual business processes. Tomorrow, vertical solutions will be sourced, such as global human resource solutions." He believes that the most successful providers will be those that can provide complete administrative solutions to customers.

"Ideally, the provider should be able to plug their solution into the customer's ERP (enterprise resource planning) system." As processes become more automated, with less reentering of data, quality goes up, and costs come down. "You become volume-independent," says Reiners. "Customers will be able to invest the savings in their core businesses."

References

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