THOUGHT LEADERSHIP

CHANGING LANDSCAPE OF OUTSOURCING PROVIDERS

Global sourcing has become a vital component of corporate strategy for organizations worldwide. Even as examples of successful outsourcing and offshore-outsourcing continue to emerge every new day, many such relationships continue to be plagued by issues surrounding a variety of factors – economic, political, cultural – including industry-specific dynamics. It has become very important for organizations to delve further into the key drivers of outsourcing, not just from their internal objectives involving cost savings, quality etc, but also from a perspective of providers and the markets they play in. This paper touches upon the key influencers in provider markets, and the manner in which this landscape is influencing outsourcing opportunities.

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Introduction

The term *Outsourcing* brings up some very interesting discussions amongst corporations all over the world. Topics of prime interest surround labor arbitrage opportunities, quality of work, ability to leverage a larger talent pool, consolidate and standardize operations, focusing on core competencies, reducing turnaround time to market et al. Such discussions have always been conducted from a perspective of buyers of outsourcing services. For more than a decade now, the industry evolved from a one-sided perspective driven by what organizations compelled to outsource their service portfolios, be it in soliciting support for their information technology needs, or for support with business processes.

The United States has and continues to lead the market with a large number of outsourcing relationships within the domestic marketplace. Large service organizations like ACS, EDS, CSC, Hewitt Associates etc have grown over the past two decades through various stages of entrenching themselves into their customer organizations through leveraging their stranglehold (more often than not) on various IT and business processes. Over time, customer organizations became intrinsically inter-linked to such provider organizations in a manner that eventually became counter-productive to their own business strengths. This is not gainsaying the fact that companies benefited from the competencies of such provider companies. However, companies encountered a fairly unachievable objective – that of making their internal organization more agile to their changing industry dynamics. With new products rolling out slower than usual and existing technologies increasingly becoming burdensome and expensive to maintain, a stalemate situation resulted wherein buyers and providers were intrinsically inter-woven into a fairly inextricable situation.

Provider organizations, with a more broad-band spectrum of capabilities, found it increasingly difficult to surmount challenges posed by such dependencies, thereby reducing their ability to add value to their existing customer relationships. Concurrently competitive pressures from changing consumer landscapes and fast-evolving technological innovations compelled most organizations to enhance their ability to adapt faster to such demands. While some organizations have been able to institutionalize their approach to such demands through proactive restructuring of their functions and product/ service lines, most organizations are still trailing behind.

The prime reason for such a gap can be attributed to the following factors:

> Traditional hierarchical corporate structures have, over time, resulted in decision inflexibilities and rigidities.
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> High domestic operational costs have left little leeway for improvements or innovations.
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> Existing outsourcing relationships with providers have taken away the ability to reengineer internal processes and align with internal product development teams, resulting thereby in a time-gap between new products, and availability of internal structures to support such products.
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> Strategic expansion plans outside of the domestic market have required for enabling flexibilities with systems, which didn't take place at the pace with which such market demands have changed, resulting in organizations having to deal with discrete, non-interfacing systems and localized processes.

All of this has put an increasing pressure on corporate CEOs to reduce costs. Concurrently, thanks to the dotcom bubble, capacities with international telecommunication lines had increased significantly, thereby driving overall costs of global telecommunications down. With availability of other international locations that could supply competent labor with requisite skills (at much cheaper costs), coupled with the ability to transmit data across borders and long distances, **organizational boundaries** and **national borders** became lesser and lesser an impediment to sourcing for capabilities.

While this phenomenon of globalization has immensely benefited organizations, primarily in the area of costs, focus has only rested in reducing or removing national borders. The factor – organizational boundaries – has continued to remain as it is. As a result, while global sourcing has taken off, creating a plethora of competent service providers, customer organizations are yet to encounter challenges surrounding their own boundaries.

This paper shall deal with how the global provider landscape has evolved with the fading of national borders, while aspects surrounding organizational boundaries shall be dealt with in a separate paper.

Evolution of Outsourcing Providers

In the late 90s large US telecommunication providers laid a significant amount of copper and fiber-optic bandwidth to cater to the increasingly growing demand for the internet, owing to benefits corporations could accrue by leveraging this wonderful technology that transcends borders. The dot com bubble happened as fledgling companies resting on shaky unproven business and revenue models jumped on the internet bandwagon. With the bust of this bubble, billions of investment and venture capital dollars got eroded, leading to prices of telecommunications dropping significantly.

Simultaneously, the Y2K problem required large numbers of technically competent mainframe engineers who had to resolve this issue within a limited timeframe. The only place where such large numbers of engineers were available was India. The entire evolution, which is a continuum rather a discrete set of events, can be described in three waves.

WAVE 1 – START POINT OF SERVICES GLOBALIZATION

The ability to cater to demands placed by the Y2K issue was the start-point for Indian engineers, and subsequently IT companies to leverage cheap global networks and their experience working in the US and Europe on the Y2K issue. Many returned and commenced outfits in India providing remote IT services. This particular entrepreneurial spirit translated into what is today a large services export market (in excess of $20 billion in IT services alone). These companies, more commonly known as offshore providers became the savior of businesses especially in the US and UK for technological expertise and IT service capabilities. During the late 90s and early 2000, companies like Infosys, TCS, Wipro, and Satyam proved that similar quality of IT services can be successfully provided out of a cheaper country like India. This led to more and more companies adopting offshore outsourcing as a model to reduce current burdens relating to operational costs, and production inefficiencies.

What has been interesting with offshore outsourcing companies is that they represented two distinct facets.

> One, an ability to take on discrete service portfolios (in full or in part) and deliver them efficiently, at much cheaper costs.
> Two, an inability to cater to more critical business processes of application development needs.

The first facet allowed corporations to adopt offshore outsourcing in a discrete manner, and explore multiple options of working with vendors, both global and offshore, while still retaining much of the control and business knowledge. These fee-based relationships didn't add much value to the providers themselves, except giving them the ability to run a successful service business.

The second facet however, represented a more complex set of options. The absence of knowledge of specific industries restricted offshore providers from being able to take on and service larger end-to-end portfolios. This continued to remain the forte of the large global outsourcing majors like IBM, Accenture, EDS etc. However, customer organizations now had a leverage factor by which they could potentially reduce their overt dependence on these global providers, while simultaneously enhancing their ability to sustain competition. Price was the first point that drove offshore providers to win more deals, thereby enabling them to compete directly with the global majors. Quality, flexibility and process improvements subsequently added weight to an offshore provider's ability to win deals against heavy competition from the global players.

WAVE 2 – CONVERGENCE OF DELIVERY MODELS

The first wave forced the global majors to look at leveraging offshore capabilities, so as to retain their customer base and revenue streams in a way that wasn't thought possible. Large offshore players with their inherent flexibility, no-past-baggage business models brought to the customer organizations not just price competitiveness, but business agility, process innovation and a collaborative mindset. Global majors realized that the only manner in which they could compete successfully was to replicate the benefits that offshore providers were able to pass on to customer organizations. This strategic direction, fuelled by an ability to invest significantly, helped the global majors quickly scale up their offshore capabilities, both in terms of competitive prices, and qualitative benefits. The playing field was on its way to getting leveled after all.

It is interesting to note that the second wave disproved the prime expectation – offshore providers would be able to compete across a much wider spectrum of services. Large deals continued to elude offshore providers, for the single most pertinent reason - lack of knowledge and experience with customer organizations' industries. This forced most offshore providers to restructure their businesses, resulting in creation of industry focused business units.

Not only did this agility provide offshore providers with much needed impetus to grow into a customer's business through offering end-to-end service capabilities, but enabled customer organizations to look at incorporating much needed flexibility into their businesses through reduced dependence on providers. The resultant effect was felt in 2002 and onwards, when single billion dollar deals (hitherto serviced by global majors) started breaking up into smaller deals, wherein some smaller component deals were awarded to offshore providers.

Essentially, this wave reflected enhanced agilities across both offshore providers and global majors. Collaboration between these two types became inevitable, while also throwing up significant challenges around vendor management, process quality and program management. Delivery locations spread across continents, creating the need for standardizing the entire process of delivery. Quality of delivery and demand for process discipline resulted in adoption of stringent (flattening) principles like CMM, CMMi, COPC, CIAC, ITIL, BS7799 etc. While convergence of delivery processes commenced, it was still a few years of infancy before such an approach bore fruit.

WAVE 3 – EMERGENCE OF THE GLOBAL DELIVERY MODEL

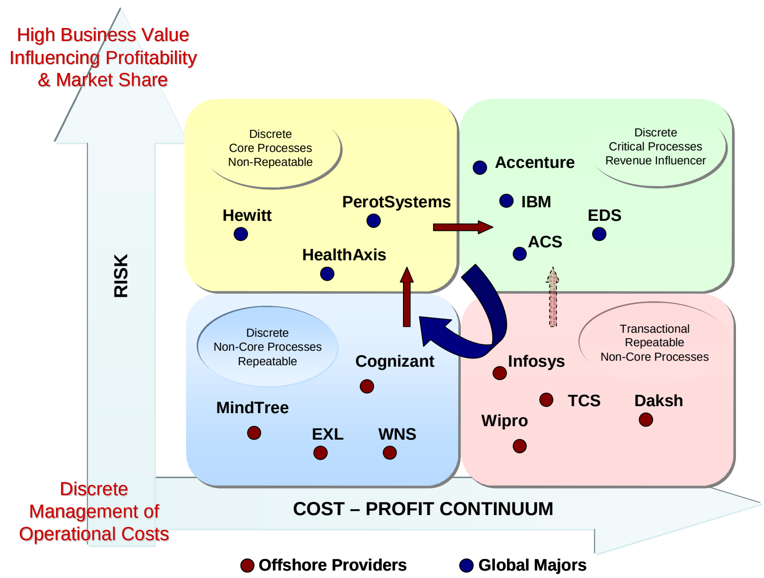
Customer organizations, in their adoption of outsourcing more aggressively, focus for continuance of such relationships moved away from procurement teams to the Boards. With this change came a renewed vigor and additional challenges. Risk became a more pertinent aspect influencing decisions surrounding outsourcing and offshore outsourcing. Organizations transformed their expectations from mere cost savings and quality to management and diversification of risk. Economic factors surrounding regional stability, sustenance of talent pool, longevity of business sustenance, proximity to industry et al, drove corporations to demand a more broadband approach from provider organizations.

Offshore outsourcing providers with a much smaller market base were forced to now compete with the global providers on a different plane – global presence – which has always been a forte of the latter. Catering to services across an entire value chain of a product line or industry is one thing. Addressing such needs through deployment of competencies from across different geographies required a completely different approach altogether. Offshore providers had to now re-look at their revenue models. Earlier driven by volumes and economies of scale, value propositions, reengineering and innovation became prime drivers to winning deals against competition from global majors.

The global majors have always been able to sustain their leverage on customer organizations primarily because of their entrenched knowledge of industries, gained over decades of providing consulting services.

While global majors were working towards integrating backwards in the value chain (and thereby getting their implementation and service delivery capabilities competitive), offshore providers are being forced to integrate forwards in the value chain. The start point for this move for offshore providers has been to build standard, replicable delivery models that could be sustained from any location.

As reflected in the picture below, the landscape of providers has matured from being discrete bottom-line focused business models, to top-line driven partnership entities.



Consolidation of Capabilities

While outsourcing and global sourcing is still an infant and growing industry, what is important to note is the pace at which change is being adopted in line with dynamics of core industries. Most mature providers (whichever quadrant of the continuum they currently belong to) are looking at consolidating their capabilities such that they drive their business models towards intrinsically entrenching themselves with their customer organizations' core businesses. Gone are those days when employment of specialized agencies or companies was a norm driven by need for costs' rationalization or reducing time to market.

Today we are seeing a purposeful move by many providers towards enhancing their internal structures and capabilities in a manner such that they could directly influence top-lines of various business entities. Would this then call for customer organizations to look at their own structures and question their veracity or benefits? Yes, this is becoming more and more of an imperative. The inquiry that follows next is whether organizations are ready to question their own business models. The answer may be a resounding No at this point in time. However, talk to any competent provider today, and this is what they are keen on driving their customer organizations to seriously look at.

Matryzel Consulting is an independent strategic consulting, services sourcing and advisory firm specializing in practices that have a direct influence on the services globalization industry.

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