Outsourcing: Win-Win situation. How companies who outsource can mitigate risk.

Companies worldwide are always looking for the innovative ways to improve the performance. One of the ways is to reduce cost by outsourcing some of their business process to other companies in India, Brazil or China. But this result in companies exposed to risk. This article proposes a four stage model by which risk in the outsourcing process can be mitigated leading to win-win situation for both companies and vendors.

Outsourcing results in substantial savings, around 30 – 50% (NASSCOM & Mckinsey)

Outsourcing has become a key issue in both developed and developing countries. In developed countries like U. S and U.K it is being resisted, while at the same time developing countries welcome outsourcing. In India it has generated employment to a great extent. What started as a trickle in early nineties of last century has transformed into a storm today: from couple of companies shifting their back-end processing to India due to low cost to most of fortune 500 companies transferring their non-core activities to third party vendors in India.

Outsourcing involves providing range of IT and business services delivered to companies in developed countries by personnel based in developing countries. Primary reasons for outsourcing are cost advantage and technology. The cost advantage is generally in the range of 30 – 50% compared to the US, after additional costs of managing the offshore model is factored in. The underlying savings in the cost of personnel is higher and upto 70%. Technological advancements has reduced the communication cost to great extent making it possible to shift work where it can be done at reduced costs.

Outsourcing to India leads to significant cost savings, increase in productivity, and improvements in quality. India has abundant talent pool whose cost of employing is almost 70% less than that of a person employed in US. Moreover, India is a preferred destination for customers seeking outsourced services due to it ability to provide 24 X 7 service and reduction in turn around times by leveraging time zone differences. In certain remote services categories, Indian players have achieved high productivity levels with the emergence of BPO vendors with deep process skills and the ability to offer integrated outsourcing solutions.

Outsourcing is not without risks. Unlike the transfer of the work to the vendor, risk cannot be transferred. Some of the risks involved are: threat to security, availability and integrity of systems and resources, confidentiality of information, regulatory compliance, and cost and time over run of projects.

Even though risk can't be eliminated it can be reduced to a large extent. The process should start well before deciding whether the company should outsource their business needs. Company following the four step process can minimize the impact of risk involved in outsourcing

Outsource team formation: Once the top management decides that company should go for outsourcing some business processes, a team should be formed. This team will be responsible for all future outsourcing activities of the company. They will be responsible for identifying the activities that will be outsourced, selection of the vendors, and metrics for evaluating the outsourced activities, and evaluating the vendors for their performance.

Selecting business processes for outsourcing: Not all business process will be outsourced. Mainly business processes can be divided into strategic and non-strategic. Strategic business processes are unique to one organisation and provides competitive advantage over its competitors, hence not outsourced. Non-strategic processes are operational in nature and can be outsourced. So business processes that are non-strategic in nature should be selected for outsourcing.

Selecting vendors: Vendors should be evaluated on various parameters before awarding the contract to execute them. Vendor's capability in terms of infrastructure facilities, financial capabilities, and operational efficiency should be taken into consideration while evaluating the vendor. Long term contract Vs short term contract should be analysed thoroughly as each has its own advantages. While long term contract involves the risk of locking to the vendor, short term contract involves the risk of higher prices.

Evaluating the performance: Once the contract had been awarded it is essential to monitor closely the performance of the vendor in terms of services provided by him. So appropriate metrics should be designed that will capture the performance of the vendors.

Although these steps ensure that risk is mitigated to a large extent, it should be remembered that risk mitigation is a continuous process rather than a one-time affair.