

Trend # 7 – Outsourcing becomes a way of life

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This month we discuss one of our favorite topics and one that is in the hotbed of discussion and debate around the world – outsourcing. This was a little-mentioned and heard-of word a decade ago, and has changed and re-shaped, to an extent, the way we work, and has ordained the direction of the global economy. There are generally two mega-families of outsourcing – services and manufacturing. Within manufacturing, the work is varied-assembly, sub-components, turn-key, full-line manufacturing, and parts. On the service side, there are many shapes, sizes, colors, and nuances to outsourcing. The various forms of outsourcing can add as little or as much value as you would like, can be as pervasive or invasive as you like, can perform whatever functions you like, and can be located wherever you like, using a plethora of business models, from cost-plus basis, a revenue share basis, a risk basis, or a fixed-fee basis. There are numerous factors to consider before taking on an outsourcing initiative, both tactical and strategic. We will begin to explore the services component of outsourcing in this column and in some articles later this year.

The Bottom Line

Process-oriented repeatable work (e.g. Accounts Payable, Account Receivable, Call Centers, etc.) is already being outsourced to different countries across the world. We expect that value added services in supply chains are next. We, as Equus Group, LLC, are already taking on clients to perform core analytics work, as well as piloting doing demand planning (non-promoted sales forecasting) and supply planning (inventory policy development, production and distribution tactics development, and sourcing network modeling) work for some clients. We expect demand planning (e.g. baseline statistical models) to be the next wave of outsourcing, in conjunction with model development for sophisticated pricing optimization, revenue management, promotions modeling, and other advanced applications to be packaged and possibly sent overseas. Outsourcing moves to different locations around the world and becomes more time-zone friendly (e.g. Brazil instead of India, for US clients) as clients tradeoff price for convenience. Outsourcing becomes another functional management responsibility for supply chain leaders – e.g. *Director of SC Outsourced Services*. While outsourcing has already been given a head-start, a second possible wave of outsourcing becomes what we call '2G outsourcing' – where outsourcing companies need some content expertise, and the employees who might have been displaced due to the original move towards outsourcing are back in demand because of the valuable 'business insight' that they provided, which outsourcing companies will probably never have. These 'ex-employees' know the products, the market, and the customers, which outsourcing companies do not, and frankly, shouldn't – as this is not their core strength.

The Different Shapes, Sizes, Colors of Outsourcing

We are all familiar with the most common form of outsourcing – call centers. When you call British Airways, American Express, Citibank, Linksys, Dell, or a host of other service or product oriented companies, they are staffed in different regions of the world such as Malaysia, Indonesia, India, Ireland, and Scotland. What else exists? Over time, outsourced capabilities started becoming more specific and more specialized. Companies like consumer products giant in the personal care and foods are, Unilever, started internally outsourcing much of their exploratory research to India, where the labor markets work in their favor, and can significantly accelerate their ability to innovate through dedicating more bodies to a particular function. With abundant, qualified individuals, this was an example of success in 'productizing' research and development of new products into an internally outsourced model. Other intellectual property and service oriented companies such as GE, Microsoft, SAP, and others, have also farmed out their development and programming activities to countries such as India and China, where round-the-clock work is possible, encouraged, and relied upon to keep up with accelerated timeline promises to consumers

and wall-street for new releases of software and services. Another 'wave' of outsourcing came some years ago with Accenture and IBM aggressively selling traditional 'back-office' operations such as general ledger (GL), accounts payable / receivable (AP/AR), order-to-cash processes, and order management, and shipment receipt reconciliation, to name a few. As companies try and focus on their core competencies, in their ever-increasing desire to increase their level of competitiveness, they are happy to send their back-office processes to third party players, who can excel in these processes and take cost out at every step. With increasing competition, we find that the varieties of outsourcing explode, from general services and manufacturing to highly-specialized information-based services.

The Next Wave of Outsourcing

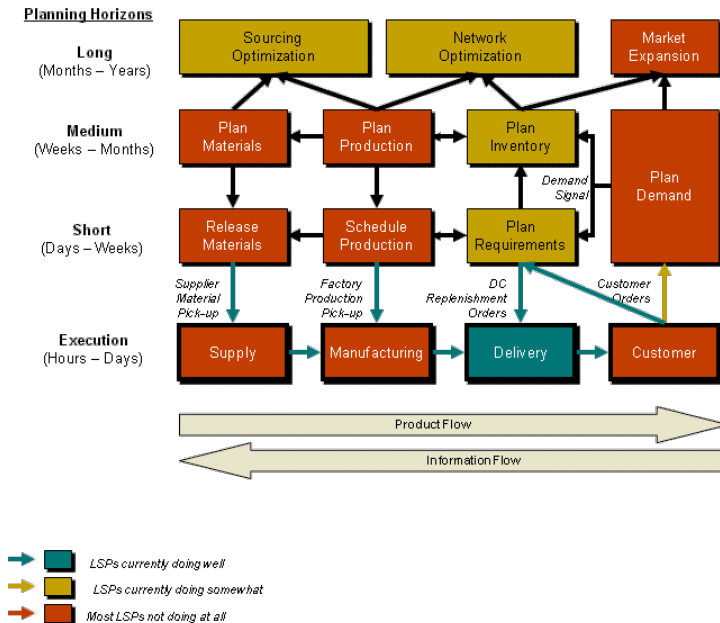
We are seeing some emerging trends which indicate to us that there is a new wave of outsourcing underway – in specialized services. Such services, relevant for those of us in the Logistics and Supply Chain industry, could include things such as business analytics, shipment tracking and monitoring, problem resolution, and distribution forecasting. In some senses, freight forwarding is ahead of its time, and in some ways, too ahead of its time – clients have never realized the true value in this service. The fact that an LSP can take the entire process of shipping, customs clearance, carrier selection, payment and invoicing, and other steps out of the process is a significant savings. However, due to inadequate packaging and marketing of these services as value-added, forwarders have made their industry commoditized. Now, there emerges another chance for LSPs and forwarders to expand their service portfolio, re-brand, re-bundle their service portfolios, and re-launch their services under a new solution offering of time-sensitive, results-oriented, risk-shared, revenue-based services. Imagine, an LSP is managing the movement of a load that a shipper like Proctor and Gamble is importing from China for a big promotion at Walmart. The LSP could up the game by bidding on the basis of their ability to deliver it on time and under / within a stretch budget, thereby helping gain margin for the brand and the company (a holy grail), in some form of commission. This is a new way to re-inject value into LSP services.

Distribution forecasting is another hot area. We know of companies who have invested in new positions such as 'Logistics Operations Managers', who actually manage the distribution and logistics function as if it were a manufacturing function. These are specialized people who review the weekly and monthly trends in distribution and inventory management, freight movement, and pick/pack logic, and develop a multi-constraint based distribution and warehousing plan, which the LSP staff can execute. Another exciting new service that's emerging is around Demand Forecasting. This function can be complex, with highly specialized skills required. Why are positions like this being created and why are services becoming more common? The value of this work is being recognized in the light of the fact that all competitors have the basics, and they need something else to stand out and turn their supply chains into competitive weapons.

LSPs Can Leverage Outsourcing as a Competitive Advantage

Logistics Service Providers (LSP) can use outsourcing as a competitive weapon as well as shippers. They can be both 'consumers' of outsourcing services as well as 'suppliers'. On the 'consumer' side, LSPs can outsource the traditionally outsourced services such as Accounting and Human Resource management. This helps the LSPs to reduce their cost base and bring on more professional staffing in terms of these essential functions. On the 'supplier' side, one of the most requested services from LSP clients is to support problem resolution and develop more insights for the longer term. LSPs are already doing a lot in terms of giving clients visibility into the freight status and location, but this reminds me of the proximity sensor on my car, which warns me that I'm about to hit the vehicle behind me as I'm backing into a parking spot, but does nothing to actually stop me from doing it. Similarly, your LSP will tell you with full confidence where your shipment is, how far it is away from you than it should be, and how late it's going to be arriving

compared to the promised date, but doesn't really help you do anything about bringing it either back on schedule or developing alternate plans! Performing the problem resolution (vs. problem identification) can be a significant. Other services LSPs can provide shippers are those which are more upstream in the supply chain. As we had presented in a previous article, Figure 1 shows the areas where LSPs can provide additional outsourced services to their clients, the shippers.



LSPs are poised to offer services in the production and materials planning space, since they are the 'go-between' between the manufacturer and retailer, and can control this through effective inventory and replenishment planning, some of which they are already doing. Further downstream, the area of Demand Planning, as we mentioned earlier, is a hot-spot for shippers, who are ever-seeking to improve their sales forecast accuracy and speed to market.

Rationale for Outsourcing

We find today that companies are getting caught up in the wave of outsourcing. Many companies get into it without understanding the longer term impacts of it, or without considering the total costs involved. Most outsourcing is being done in terms of tactical cost-reduction. Companies need to re-evaluate their business strategies and integrate areas of outsourcing into their strategies, and foster and develop them as necessary to grow their businesses. Companies need to consider outsourcing for the following primary reasons:

- Non-core functional cost-efficiencies
- Specialized functions that they do not wish to have or cannot sustain
- Temporary or seasonal staffing support
- Strategic functional support and business continuity

Different Types of Deals for Outsourcing

There are some key considerations for outsourcing. Depending on what is the rationale for outsourcing deal, the company considering outsourcing should be looking for specific types of contracts. For non-core functional cost-efficiencies, such as equipment maintenance and servicing, it is best to consider a fixed cost deal, or a per-piece deal. For specialized functions that are being considered for outsourcing (such as Demand Planning and Forecasting), it may be worthwhile to consider a result-linked fee-basis, where the upside can be shared by both the company and the outsourcing party. Else, it can be based on a variable fee based on specific skills required. For seasonal staffing, a scope-restricted deal may work best. For strategic functional support (for instance a customer-support call-center deal or contract manufacturing), perhaps a cost-plus type deal or captured-staff deal works best, where the costs can be restricted and business continuity can be maintained.

In closing, outsourcing is here to stay, and the more we progress forward in globalization, the more prevalent it will become.

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