

Transformation Execution StrategiesSM

Insights to empower you to transform enterprise performance

Conventional Vs. Transformational Outsourcing

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Context:

First Kernel polling among senior executives in global corporations, and among leading outsourcers in some industries like manufacturing, is revealing that growth centered transformation is replacing cost centered optimization as the basis for strategic outsourcing relationships.

With the global economy showing sustained strength and enterprises feeling comfortable using third parties for IT and Business functions, there is a growing consensus among a number of business strategists that the current models used for outsourcing, deliver at best, competitive parity in non-value-add capabilities. The emerging view is that outsourcing relationships must drive more dynamic business-models and capability structures. Some vendors like IBM have, in our view, already understood this and have responded, with IBM stepping out with its vision and message around a Component Business Model (CBM), supported by its global resource prowess.

While not yet the headlines, the shift to transformational emphasis has already commenced, and more substance and sound will be heard about this in the coming 12-18 months. This week, we will look at the fundamental differences between Conventional Outsourcing as it is preached and practiced today, and its morphed successor, Transformational Outsourcing.

Analysis:

We have organized key differences between Conventional Outsourcing and Transformational Outsourcing around the following aspects:

1. Approach
2. Incentives
3. Success Measures
4. Governance
5. Benefits

Approach:

Conventional Outsourcing is anchored around elaborate contracts, reminiscent of the way the government organizes buyer /seller relationships. The current baseline is extrapolated into the future, with rudimentary future factors usually limited to basic growth, inflation, and productivity. The contract is driven by metrics, mostly technical, already locked in for 3-7 years!

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Transformational Outsourcing is anchored around a program jointly developed between the outsourcer and the enterprise to integrate change, capability, resources and business structures . around shared accountability. The contract is driven by business outcomes, and accommodates re-alignment based on future realities. The relationship is structured for portability in the event either party needs to disengage.

Incentives:

Conventional Outsourcing is designed, in the words of an executive, %to provide you the ability to win while your partner loses+. The contract often punishes the supplier for investments in new technologies, tools, automation.

Transformational Outsourcing is designed to maximize incentives for both parties. It accepts that each party has specific capabilities and constraints; the relationship offers incentives to both parties to win (or lose) together.

Success Measures:

Conventional Outsourcing relies on cost reduction as a major success measure. It often outlines specific operational outcomes to be generated by the supplier in tactical terms, such as cost per transaction, cycle-time, and number of calls per agent.

Transformational Outsourcing relies on what the supplier and the client can generate in strategic terms, such as Earnings Growth, Market Share Gain, Employee Productivity and Industry Leading Customer Experience. Innovation and market dominance form the underlying premise.

Governance:

Elaborate penalties, credits and earn-backs are the mechanisms used for governing Conventional Outsourcing agreements. Straying from the contracted path is tantamount to suicide for the supplier. Governance models are designed to keep the supplier in check at all times.

Verifiable trust, two-way information transparency, integration of workflows and executive commitment in both parties to the success of the partnership are the mechanisms used for governing Transformational Outsourcing agreements.

Benefits:

While not advertised as such, the most that a Conventional Outsourcing agreement can deliver is competitive parity in non-value-add capabilities. When it is successful, your non-differentiating SG&A capabilities are the same as your competitor.

Transformational Outsourcing aspires to provide you product leadership, customer intimacy or operational excellence, as applicable. It aligns with your desire to dominate your chosen markets.

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Take Away:

Transformational Outsourcing is an approach whose time is here. You ignore it at your own peril. Several structural moving parts for establishing and operating sustainable transformational arrangements have yet to be perfected . but not reason enough to sit on the sidelines. Its benefits, compared to risks, are substantial. The approach offers better margins for the supplier and better profits for the enterprise client.

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Mentioned in this Research Update:

Individuals:	None
Organizations:	IBM Corporation
Websites:	None
Publications:	

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