The Issue: How to Design and Optimize Global Service Delivery Models

by Cliff Justice, Managing Director – Globalization
Stan Lepeak, Managing Director – Research

The business and information technology services markets are becoming increasingly globalized. The majority of F2000 companies, for example, are now using services delivered out of India or other remote, low-cost “offshore” markets. Concurrently, leading multinational service providers are rapidly expanding delivery capabilities in India and other lower-cost markets, while Indian-based services firms are building capacity in Western countries as well as other offshore locations. The key issue for outsourcing buyers today, therefore, is how to develop a service delivery model that can fully exploit global sourcing opportunities and is supportive of overall corporate strategies, goals and principles. This goes far beyond determining where to get the lowest price for a particular service. It involves developing a set of integrated capabilities and processes to source, deploy and manage a global service delivery resource network that will likely include captive operations as well as third-party information technology and business process outsourcing services (ITO/BPO).

The Details

The business and information technology (IT) services industry is rapidly globalizing, as are many other industries, such as financial services, manufacturing, consumer product goods and pharmaceuticals. BPO and ITO as well as related consulting and systems integration services are now delivered to Western buyers through a network of local, regional and remote/low-cost locations. These services are delivered both via buyers’ own global service centers and captive operations as well as via multinational and offshore-based service providers. Buyers today experience the mixed blessings of a plethora of third-party services and service delivery options from which to choose, coupled with the challenges of assessing, prioritizing and executing on these options. For an increasing number of buyers, this means their global service delivery model will include a mix of local, regional and offshore services coupled with captive local and remote shared services centers.

Reinforcing these trends, the following statistics highlight the global services market’s pervasiveness and diversification:

- A 2006 Offshoring Research Network (ORN) survey (led by Duke University and supported by Archstone Consulting and Booz Allen Hamilton) of 537 buyers in the U.S. and EMEA, 70 percent of which were F1000 and larger firms, found that over 50 percent of respondent firms have now undertaken offshore outsourcing.
- The same study found that while ITO remains the leading offshore functional area, product development, general and administration, and call center/help desk have also been outsourced offshore by 25 percent or more of the survey respondents. Procurement, a functional area less frequently outsourced to date, is one of the leading areas targeted going forward.
- EquaTerra estimates the knowledge process outsourcing (KPO) market will approach $10 billion in revenue by 2010. KPO encompasses a diverse set of value-added and strategic activities like equity analyst research, research and development (R&D), legal and patent work. This work, again, historically has been viewed as too critical and sensitive to outsource, much less offshore; though, until recently, the offshore option for the most part did not exist due to a lack of qualified service providers.
- EquaTerra research finds growing demand in the pharmaceutical and life sciences industries for offshore outsourcing to support drug development and clinical trials work, processes historically viewed as too critical to outsource at all, much less outsource offshore.
An Economist Intelligence Unit survey of 300 executives worldwide found that when asked what country would be the best overall location for their firms’ R&D work, outside of their home country, India was the country most frequently cited, followed by the U.S. and China.

Organizations also continue to tap into offshore resources via the captive route. EquaTerra counts over 300 major captive operations of Western firms in India alone. Use of captive operations are sometimes transitional, as over time, the parents of the captives (for example, General Electric, British Airways and Citigroup) opt to spin them off to not only make a profit but also to rid themselves of the challenges and operating overhead.

While there has been much negative market press surrounding “outsourcing” and “offshoring,” there also are proponents of globalization, influencing many to consider the political and economic benefits to the world in a global economy. EquaTerra and other research consistently finds that buyers are continuing to aggressively move forward with global sourcing efforts. As one EquaTerra advisor noted, “The mainstream idea of ‘outsourcing’ is now intertwined with sensitive political issues surrounding globalization, which clouds the discussions of the most sound global business strategies.”

Organizations considering outsourcing offshore to global service markets – e.g., India, China, Philippines, Central/Eastern Europe, Central/South America and Russia – face challenges far above and beyond those faced by traditional outsourcing buyers. These include language, culture, work ethics, infrastructure and legal system maturity, economic transparency and familiarity, geopolitical risk and services sector immaturity. These are in addition to the practical issues of geographic distance and time zone differences. While global service markets are typically lower-cost alternatives to local markets, they are not always the preferred alternative, at least for certain types of services and/or for less sophisticated buyers. What buyers need is a globalized service delivery model that addresses the where, what and how of service delivery.

The question for buyers today, therefore, is not whether global service delivery models are needed – but rather, when and how to efficiently and effectively exploit them. Buyers must understand their global options and opportunities for a broad range of functions and process areas, not just transactional back-office work traditionally outsourced. Buyers must assess these needs in addition to addressing other dimensions of outsourcing, such as what benefits to seek (e.g., cost savings, process improvement, or both), which service providers to add to the short list, how to prepare a retained organizational model to govern the effort, how to undertake outsourcing and still support various regulatory compliance mandates, etc.

How are Buyers Responding?

Buyers that are successfully exploiting global service opportunities are increasingly those that view global service delivery as a part of the shared services continuum. Different business functions and processes have different needs and requirements and require different service delivery models. This can range from traditional distributed service delivery to shared services centers, offshore captive centers, single process and multi-process outsourcing. What works best for a given business activity will change over time, just as the best location from which to source services will change. Leading buyers deploy processes and dedicated teams to oversee and modify as needed service delivery model choices.

Leading organizations are also beginning to better manage their business and IT outsourcing efforts as an integrated portfolio just as much as they strive to holistically view and manage their supply and service chains. This is an evolution from the historically more siloed approach to managing outsourcing efforts (e.g., the IT group manages ITO, HR manages HRO, etc.) on a business unit and regional basis. This requires changes to the operating models of buyers’ retained organizations as well as outsourcing management and governance groups. It also typically requires greater investments in governance resources, processes, policies and procedures, and supporting software systems and tools.

Ultimately, the buyers that are best able to capitalize on global sourcing opportunities are those making services sourcing and management a “core competency.” Just as competitive differentiation in product design and development or operational and execution excellence defines market leaders, so too will the ability to efficiently and effectively source services globally.
The following are some key decisions buyers must make in a global outsourcing effort, above and beyond what they may have addressed in more traditional efforts:

- Outsourcing, captive, joint venture?
- Source of services, market penetration springboard or both?
- Local partner or go solo?
- Local service provider, multi-national or regionally-based?
- Market support for transactional services versus interactive versus high touch?
- Leverage prior outsourcing/offshoring experiences, but account for differences in:
  - Legal systems
  - IP laws, regulatory environments
  - Services’ market maturity
  - Economic market models, characteristics and maturity
  - Political models and environments
  - IT standards
  - Export/import regulations
  - Currency restrictions
  - Language, culture, proximity, etc.

How are Outsourcing Service Providers Responding?

The business and IT service provider market has become much more global over the past 10 years and hence more competitive and diverse. This is good for buyers but adds to the complexity of the sourcing process. There are three main camps of providers from a global service perspective:

- Multinational service providers rooted in the West but rapidly building out their non-western delivery footprint.
- Indian-based providers with roots in application development and management (ADM) offerings that are expanding both in terms of service offerings (e.g., BPO and other areas of ITO) and geographic delivery footprint.
- Regional, tier-two and lower providers with narrower or limited service line and geographic focus.

All outsourcing service providers that hope to serve G2000 organizations are rapidly expanding their global service capabilities in India and in virtually all other lower-cost geographic regions. Leading multinationals and Indian-based firms have the greatest diversity of delivery capabilities and also the most experience in remotely delivering service that was traditionally delivered on-site or locally. This is important because it is relatively easier to add global resources and service centers, especially in markets like China and India, than it is to figure out how to integrate and leverage those resources into a seamless global delivery model.

From a differentiation standpoint, the multinational service providers are still generally stronger in terms of local brand, vertical industry and horizontal business process experience, and they have the resources needed to deliver the services that require local implementation (e.g., BPO transition and transformation services). Indian providers remain adept at managing rapid growth and delivery process efficiency, as well as the ability to deliver remotely services historically provided locally. Indian firms are being pressured, however, to evolve and adapt their business models as they expand their service offerings. This includes building out BPO capabilities that can require more on-site delivery resources, replicating their models in other non-Indian markets like China or South America, and keeping investors used to strong growth and competitively higher profit margins happy. Both multinationals and Indian-based providers face continued challenges to manage global expansion and maintain and improve service delivery quality – especially in terms of delivery innovation and transformational outsourcing – while also driving more standardization, specifically in BPO.

The Advisor Perspective – Critical Points to Consider

As outsourcing buyers become more sophisticated and aggressive in their use of global business services, they must refine the sourcing process relative to mapping local capabilities to industry or process-specific needs. Organizations must determine when, if and how selection criteria changes based on what is being outsourced (e.g., human resources, finance and accounting, IT) and in which vertical industry the buyer organization operates. These enhanced needs highlight that while understanding local capabilities and service provider skills has always been an important element in sourcing outsourcing services, it is imperative and becomes more complicated as outsourcing becomes global.
Organizations buying global outsourcing services must develop – ideally before they undertake an outsourcing effort – the capabilities to address the following needs:

- A process to determine which business and/or IT processes and functions are suitable for and should be outsourced beyond local providers and boundaries.
- Who the key decision makers and stakeholders are in the sourcing process for a particular process area.
- What the business case is – including expected benefits – and how to measure achievements for a specific outsourcing scenario.
- A risk profile to identify and assess the additional potential risks involved (e.g., financial, personnel, regulatory, compliance, data privacy, IP, negative PR) from undertaking an offshore outsourcing effort.
- Processes to identify, vet, assess and select candidate service providers and service locations and geographies.
- A retained organization and outsourcing management and governance model and process capable of supporting global sourcing efforts.

This collective strategy and set of processes is manifested in an organizations’ Service Delivery Model (SDM), illustrated in Figure 1. Key to an SDM in today’s globalized service market is the “Who” that impacts the “Where” that impacts the “How.” This obviously becomes increasingly complicated as more and varied source markets for services are targeted.

The SDM is also impacted by the experience and sophistication of the buying organization. A buyer with limited global services experience is likely not suited to launch its first effort with a local service provider from an emerging services country. Similarly, moving from transactional to more collaborative outsourcing also has a learning curve relative to global service providers and locations that are involved.

**Designing a Global Service Governance Model**

Organizations must also develop a different and more enhanced retained organization, as well as outsourcing management and governance models and processes, as their outsourcing efforts become more globalized. Leading organizations are moving toward managing and governing their outsourcing efforts – local or global – more as an integrated portfolio than as a set of discrete transactions and relationships. This is necessary not only because of the growing pervasiveness of outsourcing in support of and enabling core business and IT activities, but also because of the complexities of support with a global service footprint.

One aspect of this global service management model is that it often operates more on a regional than a home office/external delivery location model, as was more common with earlier offshore outsourcing efforts. A buyer organization, for example, might develop a global governance model and team with centralized and standardized financial management and contract administration capabilities. This centralized group would be responsible for strategic/executive-level client and service provider-facing responsibilities. It would also interface with a variety of captive centers that would exist on a regional level based on where the organization operates (e.g., Europe, the Americas, Asia-Pacific).

These centers would own three primary activities:

- Perform some amount of internally maintained buyer operations in a shared services fashion.
- Act as the primary interface in those regions back to the global governance group.
- Interface to and manage any third-party service providers in those regions. It would also interface with a variety of captive centers that would exist on a regional level based on where the organization operates (e.g., Europe, the Americas, Asia-Pacific).

Operating under this regional model would also provide the outsourcing buyer greater consistency, economies of scale, and more efficient management operations than managing each relationship with each remote location and service provider from the “home office.” Strong regional centers can also help protect buyer organizations against geopolitical, economic and natural risks that can have a greater impact on the country or sub-country versus the regional level.
Conclusion

The business process and IT outsourcing markets have become globalized in the past 10 years. Just as BPO and ITO have become common and accepted tools that buyers should at least consider to enable process improvement and cost reductions, the global sourcing of BPO and ITO is becoming an option that merits consideration. Buyers must develop service delivery and governance models that reflect the needs and requirements of global sourcing. These models must account for the dynamic and changing nature of the global service provider landscape, while also recognizing that for certain buyers’ and services’ needs, shared services centers and global captive operations may provide a preferable alternative to outsourcing. Key to success in global sourcing is addressing service delivery in a continuum, akin to an organization’s supply or service chain, in which the sourcing and governance of external services is managed as an integrated portfolio. Ultimately, leading firms become those that institutionalize programs to make the global sourcing of business and IT services a strategic core competency.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. With an average of more than 20 years of experience in over 600 global transformation and outsourcing projects, our advisors offer unmatched industry expertise. EquaTerra has in-depth functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes with advisors throughout North America, Europe and Asia Pacific. Our people are passionate about providing objective, conflict-free advice to our clients, which has fueled our exponential growth over the past four years. We help clients achieve significant cost savings and process improvements with outsourcing, internal transformation and shared services solutions. It is all we do.

If you have questions about this report or would like to learn more about how EquaTerra can help your organization address the points and opportunities discussed, please contact Cliff Justice, at Cliff.Justice@EquaTerra.com or +1 925 918 0142.

For additional information on EquaTerra, please contact Lee Ann Moore at LeeAnn.Moore@EquaTerra.com or +1 713 669 9292.

For more information on EquaTerra’s research efforts, contact Stan Lepeak at Stan.Lepeak@EquaTerra.com or +1 203 458 0677.