

Avoiding the Seven Deadly Sins of Outsourcing Relationships

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About the Author

James Champy is the chairman of consulting at Dell Services and is a leading authority worldwide on the management issues surrounding business reengineering, organizational change, and corporate renewal. He consults extensively with senior-level executives of multinational companies seeking to improve business performance. In addition to authoring **X-Engineering the Corporation: Reinventing Your Business in the Digital Age**, Jim is co-author of **Reengineering the Corporation**, a landmark business transformation book that sold more than two million copies and appeared on the *New York Times* bestseller list for more than a year.

His follow-up book, **Reengineering Management**, is also a best-seller and was recognized by *Business Week* as one of the best books of 1995. His next book, co-authored with Harvard Business School professor Nitin Nohria, was **The Arc of Ambition**. Mr. Champy also collaborated with Professor Nohria for the book **Fast Forward**, which is a compilation of significant *Harvard Business Review* articles on change that was published in March 1996.

Building successful outsourcing strategies that deliver maximum value

In 2008, Mr. Champy's book **Outsmart! How to Do What Your Competitors Can't**, was published. His latest book, **Inspire! Why Customers Come Back**, includes eight short case studies that look at how businesses become successful by "inspiring" their customers to be loyal for the long-term.

Although outsourcing has gotten a lot of press recently, it's hardly a new phenomenon. More than a century ago, industrialization gave rise to specialization and the practice of companies working for each other. The trend abated briefly when Alfred Sloan developed the famed vertically integrated organization of General Motors, but by the 1950s, competitive pressures had again driven companies to send work beyond their walls.

Given the relentless demand by customers for getting more for less, it's certain that work will increasingly be outsourced to partners around the corner and around the world. As various studies and decades of actual experience have shown, the value added through outsourcing not only benefits the outsourcing provider and customer, but the economy as a whole. Global sourcing is not a zero-sum game.

But as smart a business move as outsourcing usually is, effectively managing the workflow is tricky, since a company's knowledge accompanies its work—often to another shore. Executives need to avoid common pitfalls to ensure that their outsourcing relationships deliver maximum value. I call them the Seven Deadly Sins of Outsourcing Relationships.

1 Launching an outsourcing relationship without deeply understanding your core competencies versus the work that can most effectively be outsourced.

A key benefit of outsourcing is that it enables a company to focus on the work that is core to its value proposition. Obviously, it is vital to know exactly what that is. That might sound elementary, but the truth is that many companies have only a superficial knowledge of how they truly create value for their customers. If you're a pharmaceutical company, is your success based on the quality of your research, on your sales and distribution network, on your unique manufacturing capabilities, or on something different altogether?

Don't be surprised if you find yourself considering outsourcing one of your operational strengths. Although you may be good at something tactically, it still may not be core, and someone else may do it better and at a lower cost.

2 Underestimating the importance of process standardization.

Every company begins with the belief that the work it is outsourcing is unique and must be managed uniquely. The company expects its outsourcing service provider to maintain the complexity rather than to simplify and standardize the work processes. Processes and people are moved to the provider in their existing state and are independently managed next to countless similar processes of other companies. Consequently, the cost and service benefits of standardization and simplification are lost.

The reality is that most basic processes are similar from company to company, and service providers must embrace process standardization if they are to help their customers achieve true operational excellence. Twenty years ago, companies argued that their payroll processes were unique, and they spent millions building custom payroll applications and processes. Today, no rational company would consider running its own payroll system—they simply use the standard processes offered by service providers, realizing not only greater efficiency, but also higher quality as a result.

3 Not driving for true transparency with your outsourcing provider

Certain kinds of work involve fairly stable processes, like order fulfillment. But others change over time. Companies may have new application needs in an IT outsourcing relationship or new transactional protocols in a business process outsourcing relationship. In such cases, full transparency between the customer's company and its service provider is a must.

Managed well, an outsourcing relationship will affect how each company works as it learns from the other. Work should move seamlessly across corporate boundaries, with breakdowns quickly identified and fixed. This happens only when operational transparency is hard-wired into the relationship from the outset.

4 Casting your outsourcing relationship in stone.

No business stands still today. The breakneck pace of change demands flexibility on the part of companies and their service providers. But outsourcing agreements, too often focused solely on cost control, can lock in behaviors that inhibit the nimbleness a customer company needs to maintain true operational excellence over time.

A relentless focus on costs will continue to be part of doing business for the foreseeable future, but the scope of outsourcing agreements should be subject to change as the customer's needs evolve. At the same time, a provider has to have minimum commitments to be able to invest in the work of its customers.

5 Being too one-sided in your view of the relationship.

The most successful outsourcing relationships—those that lead to long-term value creation for both parties—never lose sight of the fact that the relationship is a bilateral one. Just as the customer's company seeks to save money, reduce risk, and/or enhance the quality of its operations, the service provider seeks to earn a profit, build on its service capabilities, and leverage its growing expertise for the future.

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Fortunately, these goals are complementary. An insurance company, for instance, can not only gain efficiency and quality by allowing a provider to take on much of its back-office policy administration functions, but the added work volume may enable the service provider to accelerate release of the next advancement in the intellectual property it has brought to the relationship—a win-win scenario.

6 Not building in sufficient mechanisms to resolve issues.

Outsourcing relationships, like all business relationships, are about people and personalities—and the marriage will inevitably hit a rough patch. This may stem from a management mistake by the customer's company, a service delivery hiccup by the provider, or some combination of both. Savvy companies, however, anticipate these episodes at the outset and build in mechanisms to guide their behavior when dealing with these issues.

These may include ad hoc councils, defined escalation ladders to take issues up the management rungs, or creative guidelines for issue resolution. But notice the emphasis on "guidelines," not "laws." While it's smart to plan issue resolution approaches early on, they should not be cast in stone, lest they themselves become issues. More important than the specific mechanism is the mutual commitment to resolve issues quickly and amicably.

7 Tending the trust-based relationship carefully over time.

Don't think of your outsourced service provider as a "vendor." A vendor sells widgets; an outsourced service provider brings you knowledge and skills. Or it may be your knowledge and skills that you transfer and invest in the service provider to take advantage of their superior execution. No matter the specifics of the relationship, it demands a high degree of trust as well as a willingness to look continuously at the work with fresh eyes.

Many business alliances fail either because the parties don't share the same business values or because there isn't enough in the deal for everyone. When outsourcing relationships work, however, they can deliver value beyond expectations. So ask some hard questions of your service provider before consummating the deal: How does it treat its people? Its customers? What does it believe about service quality, innovation, and ethics? And how does it handle the inevitable bumps in the road?

Then structure a relationship where all parties enjoy financial benefits, growth opportunities, and the chance to contribute meaningfully. In business alliances, it's important to keep good companies strong. With that common ethic, trust will grow as the relationship flourishes.

If executed properly, outsourcing is a win-win situation. The enterprise receives the benefits of best practices expertise and the service provider earns new business opportunities. Taking the time to implement the tactics discussed in this paper will make outsourcing relationships more successful by mutually increasing understanding, transparency, flexibility, communication, and trust.

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