

WHITEPAPER

Modern approach towards Outsourcing

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Abstract: *Over the past decade, the term “Low Cost Country” (LCC) outsourcing known to be a slogan for North America and European companies. The key motive behind this was cost arbitrage. Other benefit is managing significant seasonal peaks and valleys. Global companies are under significant competitive pressure and need to increasingly focus on their core competences and capabilities.*

However today, “Low Cost Country” outsourcing no longer exists. Industries are now more focusing on quality, schedule, maturity, total ownership & value addition in the work and not only the cost benefit. The whole paradigm is now shifting towards “Best Value Country” (BVC) outsourcing.

This white paper looks at what BVC outsourcing means in today’s competitive world. It also discusses the parameters for deciding BVC supplier and the challenges while dealing with such emerging country suppliers. It also put forward the thoughts on Strategy for successful BVC outsourcing.

The concept is supported by a case study in the end to have a better understanding and to have deeper dive in the process for further enhancement in outsourcing approach considering both the customer as well as supplier to have a better and winning business deal.

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BACKGROUND

Outsourcing is the act of one company contracting with another company to provide services that might otherwise be performed by in-house employees. Often the tasks that are outsourced could be performed by the company itself, but in many cases there are financial advantages that come from outsourcing. In the nineteenth century railway companies relied on steel manufacturers, component manufacturers and tool makers to construct locomotives. The 20th century saw the emergence of large integrated and global corporations that controlled and owned their assets, requiring multiple divisions and departments with complex and multi-layered management structures. Over past decade or may be more, outsourcing has gained major acceptance in the area of design engineering, software development and related services.

There are many reasons that companies outsource various jobs, cost cutting is the main reason because companies are in constant pressure from top management to reduce the overall cost. Many of the companies that provide outsourcing services are able to do the work for considerably less money, as they don't have to provide benefits to their workers and have fewer overhead expenses to worry about. Outsourcing also allows companies to focus on other business issues while having the details taken care of by outside experts. The specialized company that handles the outsourced work is often streamlined, and often has world-class capabilities and access to new technology that a company couldn't afford to buy on their own. Plus, if a company is looking to expand, outsourcing is a cost-effective way to start building foundations in other countries. Outsourcing also provides access to alternate/backup sources of supply.

Outsourcing benefits can be consolidated in this way;

- Access to highly qualified workforce
- Low labor cost
- Quality improvement
- Shorter delivery times
- Companies can focus on core competency
- Localization of goods and services

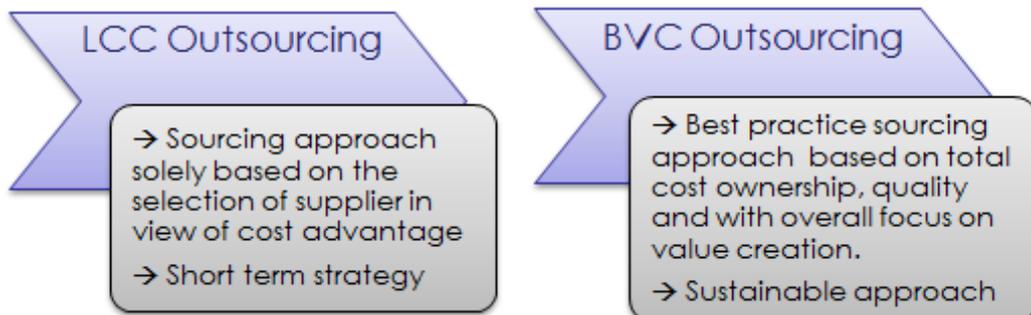
PARADIGM SHIFT: LCC → BVC

Global outsourcing always comes with uncertainty and challenges, primarily due to cross border culture, language difference, time difference, taxation issues and so on. These factors make outsourcing process more complex and sometimes ambiguous. In addition to this Low Cost Country (LCC) suppliers tend to mainly focusing on cost & tasks/activity, overlooked the accuracy in work which customer has to pay off in later stage with rework and schedule delay. LCC suppliers might not add any value in the given work having focus on short term strategy following do as directed approach. Under such scenarios, global companies tend to drop decision of outsourcing. Fortunately this has not completely stopped the outsourcing mainly due to benefit of cost. But now with more categorized and sophisticated strategies, global companies are increasingly shifting to what we call a Best Value Country (BVC) outsourcing approach and that is because the low cost country approach proven insufficient.

This new perspective is based on the insight that on one hand labor cost and quality are two major aspects. While, on the other hand value oriented topics like value creation through innovation and total solution gaining strategic importance. That doesn't mean that a LCC supplier automatically become a BVC supplier. Fierce global competition and continuous improvement in product design in turn need to reduce cost and raise performance, force the companies to re-conceptualize their view on outsourcing. This paradigm shift leads suppliers to think on value factors not only on cost factor. This shows that future of outsourcing is most appropriately described as Best Value Country Outsourcing approach.



“Time to make a move from conventional thoughts and practices”



FACTORS TO DECIDE RIGHT SUPPLIER

Following could be the key factors an OEM would consider while deciding the BVC supplier.

- Level of accuracy
- Value creation
- Competency & Domain knowledge
- Cost
- Timeline
- Protection of intellectual property
- Display of better governance and internal processes

Global companies are more focusing on total solution so to target their core activities like New Product Development (NPD), product improvement etc. Total solution in the area of; bench marking, reverse engineering, design, detailing, FEAnalysis, data management, parts localization, onsite support and so on.

Sometimes companies find cost effective suppliers much easily but when it comes to value creation, domain knowledge, maturity, product & process understanding these suppliers fall behind. This indeed reflects in quality, delivery promptness & confidence. Some of the service areas like; design engineering, bench marking seeks years of study & maturity. Lacking to which one cannot provide effective and optimum solution. So, choose your supplier carefully. It plays a critical role for successful outsourcing.

CHALLENGES WITH EMERGING COUNTRY SUPPLIERS

There is no consensus on the definition of emerging markets or the countries with emerging economics. In loose term, an emerging market is defined as an economy with low-to-middle per capita income that is in transition to a more developed economy, characterized by stable and sustained economic growth and high standard of living. A fresh approach came up in late 2010 by BBVA Research to identify all emerging economies. These are emerging and growth-leading economies (EAGLEs) who expected to lead global growth in the next 10 years, and to provide important opportunities for investors.

Emerging countries like India, China, Brazil, and Indonesia come up as a favorite destination for outsourcing. However we cannot overlook the challenges associated like;

- Cultural & Geographical differences
- Language
- Time zone
- Government regulations
- Custom & Tariffs
- Complexity of transport & logistics



An essential problem with sourcing in today's climate over numerous time zones and across language and cultural barriers is how one identifies suppliers that are in fact at risk and may disappear before any particular order is shipped. An ability to monitor one's vendors is an integral part of Best Value Country outsourcing.

Associated risk with the incorrectly selected suppliers may be;

- Unreliability of quality
- Unreliability of delivery
- Compromised efficiency
- Intellectual property protection

In this current environment it is necessary to 'look under the hood' and to develop strong relationships with your suppliers

FIVE BEST PRACTICE FOR BVC OUTSOURCING

I. Develop long term relationship with your supplier

Many a times it happens that buyers with buying mentality only targeting the price benefit. Approach to the BVC outsourcing should be with the vision of long term benefits which may not be churned out overnight. Targeting value chain, companies should change their mindset from price to value, product to solution and from inputs to outcomes.

II. Explore new value frontiers

Targeting overall business outcome, company should focus on exploring new value frontiers. An assessment is necessary to check potential of supplier to create long term value for your organization.

III. Consider supplier as your extended team

Do as directed bring out the required output but again with limited focus suppliers cannot open themselves to give beyond expectation. Companies should look supplier as their extended team and should bring them in the process of decision making and change initiatives.

IV. Build strategy to nurture your supplier

Companies mostly get significant benefit working with BVC suppliers with a condition that they must have proper strategy and funding to develop them. A good example is when companies bare part of the expenses of the supplier's employee who is visiting company site to learn and understand the product/processes.

V. Pursue best value country suppliers

It is not always worthwhile for a company to develop skills and expertise on its own. The company should look outside for the right supplier. Companies must be prepared to leap hurdles imposed by borders and geographic differences, language and cultural barriers.

CASE STUDY

Cost reduction and Localization of drive of an Agricultural machine:

The Project:

In present scenario, customer buys drive assembly from one Italy based supplier. Customer is planning to enter into emerging country market like India. The landed cost of drive in India is almost 11% of total price of whole machine. So, cost reduction is the prime focus in top of all. Following activities are defined by customer in order to achieve the cost target;

- Tear down
- Measurement on CMM
- Material testing
- De-featuring
- Alternate Sourcing

L&T's Approach:

- Total project cost ownership
- Technical leadership team
- Defined Project plan
- Followed VAVE approach
- Product Benchmarking (Competition, function, similar application)
- Robust review and feedback mechanism
- Customer delight, team satisfaction

Value Addition:

- *Standard Operating Procedure*
- *Alternative drive concepts, Patent disclosure is in discussion*
- *Preliminary report of localized supplier recommendations*
- *Accelerated product development, reducing "time to market"*

Companies can realize tangible results with BVC suppliers. Effectively managing their potential with proper handholding and freedom are the key elements.

CONCLUSION

The low cost approach that has prevailed for years is losing its significance and moving instead towards the BVC outsourcing approach. Accuracy, timeline, value creation, cost, IP protection are the major drivers behind this development. They influence the decisions for or against outsourcing outside the home region, as well as the choice of target suppliers. Because of global competition, companies entering into emerging market. This appears as a new trend which also favors for BVC outsourcing.

Relationship with the supplier just for cost benefit proved insufficient. For sustainable growth company have to build a good relationship with supplier. Treating as an extended team, supplier should be given proper guidance & liberty so they can also involve in the process of decision making & design changes.

Emerging countries are the growth engines for worldwide economies. Global collaboration is the key for growth and sustenance.

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Individual thoughts & experience shared by L&T Project Managers

THE BLACK BOOK OF OUTSOURCING: How to manage the changes, challenges and Opportunities

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