Gartner

Research

Publication Date: 15 November 2006 ID Number: G00143767

How to Create and Execute a Business Process Outsourcing Strategy

Lisa Stone

Before organizations can outsource a business process, they must assess internal services, decide what they want to achieve and determine how to get there. Executives in charge of the decision must follow a methodical approach and pay attention to the nuances that are critical when considering BPO.

ANALYSIS

Prospective buyers of business process outsourcing (BPO) services must follow Gartner's sourcing life cycle to create a BPO relationship that delivers enduring value. The steps of the life cycle are:

- Strategy
- Evaluation
- Contracting
- Management

This research covers each step and presents case studies on how prospective BPO clients went through the steps to arrive at their decisions.

Developing a BPO Strategy

Basically, the strategy phase includes three main activities.

- Measure the cost and quality of the current environment.
- Identify what is driving the organization to consider BPO, such as cost reduction, the need to replace an outdated environment, and the need to improve service levels or add a new product or service offering.
- Determine how the organization will approach BPO. There are two very different approaches to BPO. One is focused on transforming the environment as the first step, which is most often completed by the BPO provider, which then takes on responsibility for the transformed environment. The other approach is to turn control of the current environment over to the BPO provider and have the BPO provider transform the environment over time. (See "Distinguish Between Two Popular Approaches to BPO" for more information on the two approaches.)

Many organizations fail to take these steps before they evaluate BPO service providers (SPs). They simply speculate that a business process will be suitable for outsourcing, then begin discussions with BPO providers. Investing in the strategy phase will enable organizations to create an objective audit trail to track improvements, and it will help organizations to more quickly identify the BPO providers best positioned to help them achieve their goals using the approach that best fits their needs.

Case Study for the BPO Strategy Phase

Figure 1 shows how a major U.S. insurance company sought to add a line of insurance to its product base, in response to U.S. government pressure to sell the product, as well as a means to increase client retention.

Figure 1. BPO Strategy Case Study — Major North American Insurance Company

Source: Gartner (November 2006)

Previously, the U.S. government offered this product directly to the public, via an arrangement with a major IT SP. Because of this prior arrangement, the provider created significant intellectual property about the program, developed a system and was capable of operationally supporting all functions related to administering this line of insurance.

The insurance company — in this case, the service recipient (SR) — retained the provider for full program support, including educating its sales force about the product, full policy and claims administration, contact center support, finance and accounting (F&A), and regulatory reporting. There was no baseline because the company had not previously offered this product, but the SR could estimate what it would cost to develop its own capabilities in-house versus using a provider that already had intellectual property regarding the product and underlying technology. By entering into a BPO relationship, the SR greatly improved the time to market for the new product, drastically reduced capital investment and created a new revenue stream. In this instance, the buyer sought to offer a new service offering, not only to create an additional line of revenue, but to increase retention of existing streams of revenue. This significant opportunity was best suited (given time to market and capital investment vs. operating investments) for a BPO relationship.

Evaluating BPO Providers

Once an organization creates a BPO strategy and decides to evaluate what is available from external SPs, it must understand the SRs' value to the providers in the marketplace.

- If the organization is approaching BPO for tactical reasons (such as cost take out) and there is not a large scope of work involved, then the organization most likely will need to consider a standardized solution or an offshore solution. If the deal is tactical, but represents significant scale, then it will enable a larger degree of customization and could be a candidate for anchor client status. This status depends on whether SPs already have preferred platforms.

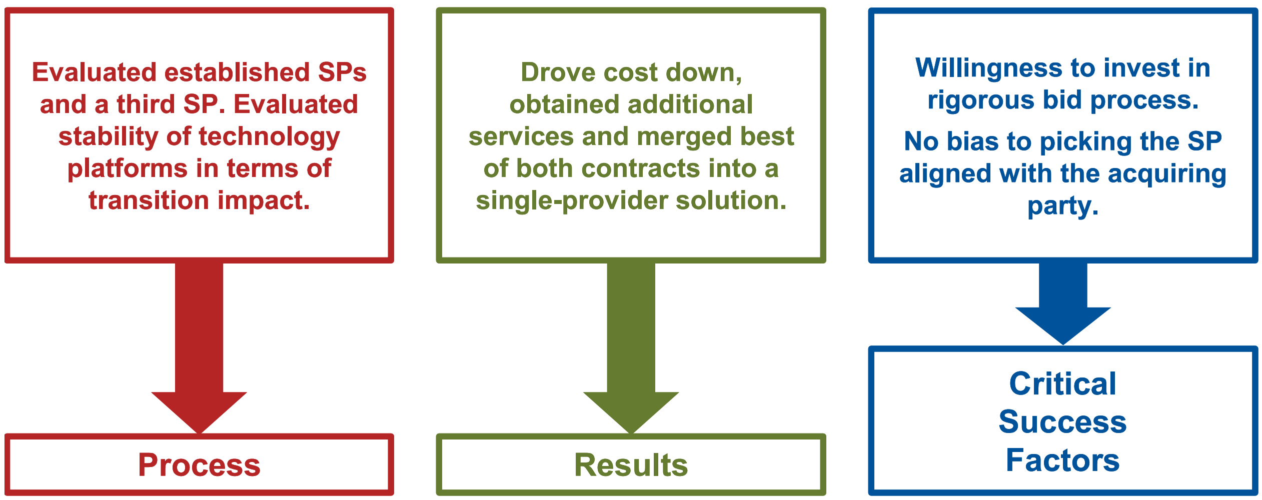
- If this is more of a strategic move (the organization needs to upgrade service quality and wants to use a BPO provider's established solution), then the organization likely is a candidate for the transform-and-support approach. With enough scale, the organization may be able to help drive the vendor's solution over time.

- If the organization has assets to unload, then it should look for BPO providers that need those assets as part of their go-to-market strategies.
- Organizations should evaluate whether the services they need support for are part of the BPO provider's strategic vision. This will affect the BPO provider's commitment to and investment in continuous improvement for its solution.
- When considering comprehensive or multidomain BPO, organizations need to evaluate the overall solutions in terms of their various parts, which are likely to be at varying degrees of maturity.

Case Study for the BPO Evaluating Phase

Figure 2 outlines a case study for selecting BPO providers. In this case study, two major insurance companies merge when one acquires the other. They both have established BPO providers for the same suite of services.

Figure 2. BPO Provider Evaluation Case Study



Source: Gartner (November 2006)

Rather than simply selecting the provider that was serving the company that acquired the other company, the companies took a disciplined approach to selecting the provider best positioned to help the newly combined entity.

Not only did the newly formed organization evaluate both established BPO providers, they also evaluated a third BPO provider. The evaluation included an analysis of the stability of the solutions and the impact of making the transition to these solutions. One of the established providers was selected, but with new contract terms and conditions that reflected the best aspects of the prior two arrangements under a single contract with one provider. The buyers' investment in a rigorous competitive bid process, coupled with a lack of bias toward any one provider, yielded the best result.

Contracting for BPO Services

Contracting for BPO services is all about business operations on an ongoing basis, because that will be the majority of the cost to the buyer. Although the initial phase of the contract may involve system implementation work, and will always involve a transition of some sort, the long-term success of the arrangement depends primarily on the success of the day-to-day operational performance of the BPO provider. Typically, BPO contracts include:

- Some level of per-use costing
- Process-based service-level agreements (SLAs) with associated penalties and incentives
- A scope of the process support that the BPO provider is responsible for completing
- A scope of the process support that will remain within the buying organization

BPO contracts typically do not include (although they can be contracted for separately):

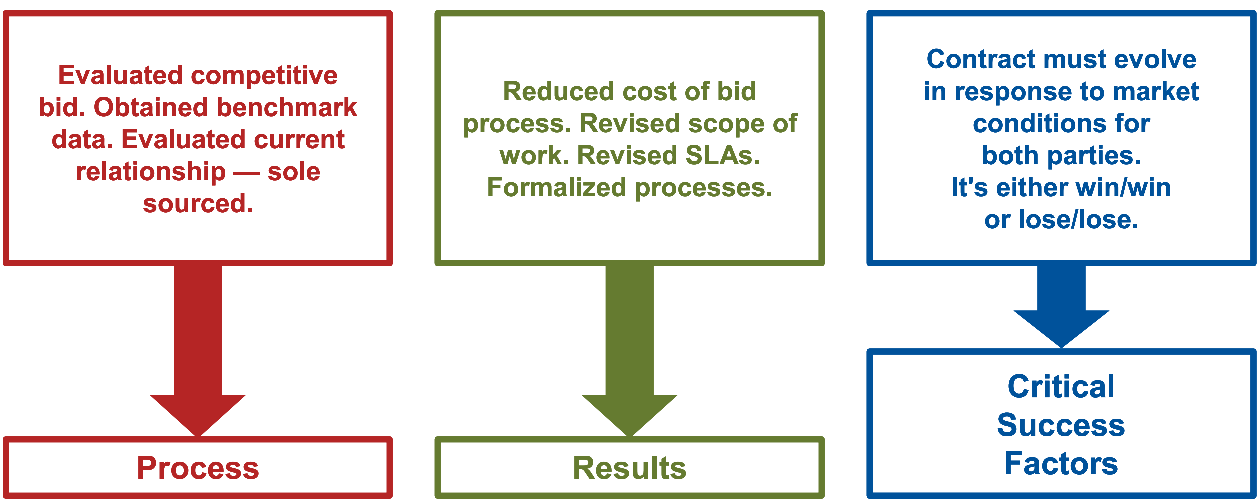
- Ongoing innovation
- Support for ongoing process enhancements
- Ongoing consultative service

BPO contracts can never shift (nor should they) the responsibility for the success of the business process to the BPO provider. This is what enables a buyer to influence and control the outcome of specific business processes to their client base. The sourcing strategy will be affected by domain-specific considerations (see "How to Create Service Levels for Finance and Accounting BPO" and "Answers to Key Questions for Crafting Successful Service-Level Agreements in HR Outsourcing Deals").

Case Study for BPO Contracting

Figure 3 outlines a case study for BPO contracting.

Figure 3. BPO Contracting Case Study — BT and Accenture for Comprehensive HR



Source: Gartner (November 2006)

In 2000, Accenture and BT Group created a joint venture: ePeopleServe. BT wanted to leverage its HR shared service center to other clients and decided it would best accomplish its goals by working with a consulting partner. In February 2002, BT sold back its share to Accenture, and Accenture continued to provide HR BPO services to BT. When the contract was nearing expiration, BT conducted an in-depth analysis of its options: bring the work back in-house, competitively bid the work or sole source the work to Accenture.

After obtaining benchmark data (which indicated that BT had a relatively high-value contract in place), reviewing the success of its relationship (performance was good to date) and evaluating what else was available in the marketplace, BT approached Accenture with its revised scope of work and pricing requirements. Through negotiation, BT and Accenture reached mutually agreeable terms and created a new 10-year contract. BT used the renegotiation process to refine many aspects of its original agreement — for example, it obtained ownership of the HR technology platform, refined many of its SLAs, formalized governance processes and change management controls, and improved visibility in its costs on an ongoing basis.

Managing a BPO Relationship

Companies must anticipate the creation of robust internal management structures to ensure success when entering a BPO relationship. Gartner case studies have shown that buyers and providers equally indicate this as one of the critical success factors in their engagements. Because BPO encompasses several layers of service, there must be comparable layers of management structures, interfaces and communication processes in place. Although day-to-day operations will be monitored through operational, delivery and technical counterparts by the company and the provider, periodic interaction at higher levels must also occur to ensure continual alignment with business strategies.

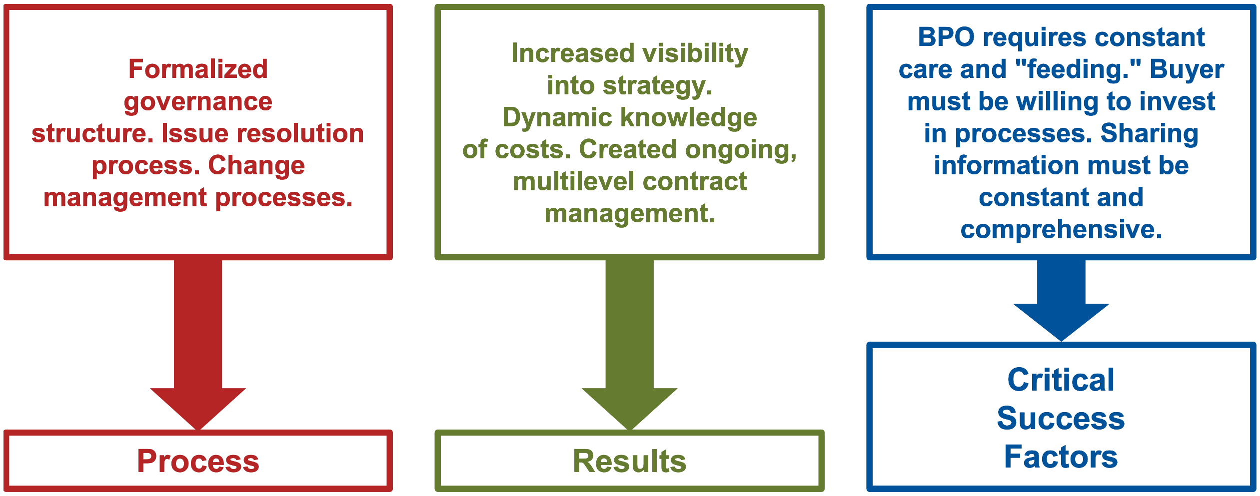
Committees are a critical IT governance mechanism. With regard to BPO, Gartner recommends that companies operate with at least three committees:

- *Business strategy committee:* Communicates any changes in the overall corporate business strategy and discusses the likely effects on specific business processes.
- *Business process strategy committee:* Analyzes the effect of business strategy changes on business process operations and is responsible for prioritizing specific initiatives needed as a result of those changes.
- *Business process operations committee:* Decides specifics (technology- and operations-related) in terms of required technical and business process change management efforts. Communicates those specifics to the business process strategy committee in terms of costs and scheduling effects.

At each level, the preceding level is responsible for communicating the changes in business strategy and how those changes affect business process strategies. The day-to-day management personnel and business process operations staff can translate that into how day-to-day operations will be effected, and feed that information back up the management chain.

Figure 4 outlines a case study in BPO management from the BT/Accenture relationship.

Figure 4. BPO Management Case Study — BT and Accenture for Comprehensive HR



Source: Gartner (November 2006)

In discussions with BT, the company said that many critical success factors are necessary for a BPO relationship that will be successful throughout a lengthy contract term. Several critical success factors that BT mentioned included retaining sufficient in-house expertise in all areas that are being supported by the BPO provider so that, in a comprehensive relationship such as this, someone internal continually manages the specific components. BT indicated that a joint focus on ongoing improvement was also critical, as well as being open to new ideas.

BT felt that sharing information with Accenture enabled Accenture to develop better suggestions for ongoing improvement. The companies manage the relationship through multiple forums that meet regularly to discuss strategy, change management, pricing, performance and proposed major initiatives. Additionally, a highly visible, dynamic view of costs is critical in terms of being able to achieve continuous improvement.

Recommendations for Organizations Considering BPO

- Because the BPO market is dynamic, follow a structured sourcing process.
- Develop, gain consensus on and document a BPO sourcing strategy (baselines, drivers and approach) before evaluating specific BPO providers.
- Evaluate providers in terms of experience in required competencies, the fit of their solutions and their willingness to contract for proper allocation of risk.
- Create a contract that not only solves immediate issues, but also anticipates ongoing business changes and enables flexibility for both parties to create net worth.
- BPO is a multilayered service arrangement. Create a robust management structure, with associated processes, that fosters multilevel, ongoing communications.

RECOMMENDED READING

"Take BPO-Specific Factors Into Account When Evaluating Outsourcing Relationships"

REGIONAL HEADQUARTERS

Corporate Headquarters
56 Top Gallant Road
Stamford, CT 06902-7700
U.S.A.
+1 203 964 0096

European Headquarters
Tamesis
The Glanty
Egham
Surrey, TW20 9AW
UNITED KINGDOM
+44 1784 431611

Asia/Pacific Headquarters
Gartner Australasia Pty. Ltd.
Level 9, 141 Walker Street
North Sydney
New South Wales 2060
AUSTRALIA
+61 2 9459 4600

Japan Headquarters
Gartner Japan Ltd.
Aobadai Hills, 6F
7-7, Aobadai, 4-chome
Meguro-ku, Tokyo 153-0042
JAPAN
+81 3 3481 3670

Latin America Headquarters
Gartner do Brazil
Av. das Nações Unidas, 12551
9° andar—World Trade Center
04578-903—São Paulo SP
BRAZIL
+55 11 3443 1509