

OUTSOURCING PRODUCTIVITY

Reimagine
Your
Outsourcing
to Drive
Productivity

ISG

Productivity is the ratio of inputs to outputs. Doing more for less is good. Higher productivity is important at a global level for the sustainable use of scarce resources; at a national level as a measure of economic growth, competitiveness and living standards (especially in Western countries with aging workforces); at a corporate level as a measure of the efficiency of production and the opportunity to enhance profit; and at an individual level as a measure of personal contribution and, ideally, to free up time for other pursuits.

Outsourcing has aspired to do more with less but has typically done what has been called “the same mess for less.” Buttoned-down, tightly controlled outsourcing contracts that have reduced risk and cost have also limited creativity and re-engineering that could lead to improved labor productivity. Even outsourcing that brings access to greater capability and capacity on demand is often directed toward staff augmentation instead of freeing up people to focus on value creation.



Outsourcing to save money is necessary but not sufficient to create value for the customers, staff and shareholders. We need to shift the focus to productivity and to doing more for less.

Margaret Wheatley, organizational consultant and researcher, once said “Even though worker capacity and motivation are destroyed when leaders choose power over productivity, it appears that bosses would rather be in control than have the organization work well.”¹ Outsourcing can bring this necessary control but sometimes at a price to individual capacity and motivation on the buyer side as well as on the supplier side. We run the risk of instituting the type of work that Wheatley calls “highly controlled mechanistic systems that only create robotic behaviors” and constraining productivity improvement.

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The starting point is a clear outsourcing objective and operating model. Since outsourcing is not a one-size-fits-all business solution, outsourcing objectives vary in their degree of control versus their freedom to innovate, their degree of certainty versus creativity, their access to capability and capacity and their cost structures.

¹Margaret Wheatley, *Finding Our Way: Leadership for an Uncertain Time*, Berrett-Koehler Publishers, Inc., 2005

²Market research firm, Vanson Bourne, recently questioned 650 business and IT leaders across Europe and found that 72 percent of the business leaders did not believe that IT could help them to hit their business targets. In the survey, executives cited improving customer service and engagement (70 percent), cutting costs (70 percent) and being more productive by “doing more with less” (67 percent) as their top priorities for 2012. The majority of business leaders (92 percent) said they would like to see business function improvements that would drive productivity, including improving employee productivity and empowerment (74 percent). *Computerworld*, 18 June, 2012



Organizations that begin by determining whether they want more for less and then designing the operating model that best facilitates this objective are more likely to increase productivity. Their focus will be on specialization of labor, economies of scale, labor arbitrage, agile development teams, demand management and cloud computing to reduce the cost of inputs, while at the same time focusing on increasing outputs through such means as process re-engineering, automation, virtualization and resource efficiency.

Establishing a baseline at the start is also helpful to track productivity improvement. Organizations that benchmark costs and service levels can better understand the input baseline and the performance gap compared to industry peers. A consumption management assessment is also important to understand the utilization of assets and how to do more with less, or at least identify which assets are underutilized and overcharged. Organizations that use a customer satisfaction survey and staff satisfaction survey also gain a view into what users and employees consider to be scope for improvement.

Such a baseline helps to define the end point as well as the starting point, with measures of output such as the number of ideas generated, the lines of code written per developer, the increased utilization of servers and/or reduced usage of storage. Measures of output also extend to business outcomes such as the number of new products brought to market or public service outcomes such as student participation rates and reduction in hospital waiting times. These measurements work to track the increase in outputs as well as to track the decrease in inputs. Defining the specific productivity objectives and creating a system to measure them will focus the appropriate attention on outputs as well as inputs.



"Self-interest and competition serve the development of the productive capacity and the welfare of everyone involved in economic activity." -- Adam Smith

The next step is to align the interests of the various demand-side and supply-side stakeholders so that they can see how increasing productivity benefits them. Outsourcing can be seen to reflect the fundamental tenets of a market economy, which are competition and self-interest.

This is consistent with the works of Adam Smith, the so-called father of economics³, and the "Global Economic Ethic," which notes that "self-interest and competition serve the development of the productive capacity and the welfare of everyone involved in economic activity."⁴ Successful organizations understand that they must create value for their customers, their employees, and their shareholders and that sustainable value cannot be created for one group unless it is created for all of them. However, sometimes these different interests can appear to be in conflict.

³Adam Smith, *An Inquiry into the Nature & Causes of the Wealth of Nations, The Theory of Moral Sentiments*

⁴*Manifesto, Global Economic Ethic - Consequences for Global Businesses*, www.globaleconomicethic.org



Contracts that include incentives and service levels will help to align behaviors, share the benefits for customers, employees and shareholders and maintain their attention on continuous improvement.

It is important to identify the self-interests of the stakeholders and deal with any areas of potential conflict between the client and the service provider in terms of who profits from greater productivity. Doing more for less often means greater output for the client, but less revenue for the service provider.

But should the client also expect the full saving on the input costs to flow to them, or should they allow the service provider to retain more profit as an incentive and an offset for reduced revenue? Contracts that include incentives and service levels will help to align behaviors, share the benefits for customers, employees and shareholders and maintain their attention on continuous improvement.

While increased labor productivity can come from the application of capital and automation or from removing unnecessary work through process re-engineering, the right behaviors remain a key ingredient. Improved productivity comes from selecting, augmenting, empowering and motivating the right employees to work hard and to work smart. Used narrowly, clearly defined outsourcing contracts, statements of work and service levels can create the situation that Meg Wheatley fears: “highly controlled mechanistic systems that only create robotic behaviors” on the part of individuals as well as organizations. Used more broadly, outsourcing contracts can allow scope to foster collaboration, innovation, continuous improvement, personal productivity, dignity and purpose.

Wheatley sees a “simpler, finer way to organize human endeavor...This simpler way is demonstrated to us in daily life, not the life we see on the news with its unending stories of human grief and horror, but what we feel when we experience a sense of life’s deep harmony, beauty, and power, of how we feel when we see people helping each other, when we feel creative, when we know we’re making a difference, when life feels purposeful.”⁵ Eliminating the “hero culture,” in which resolution of Severity 1 incidents is the *raison d’etre*, will help build a culture of purposeful and sustained improvement. It requires courage and commitment for the productivity goal to create value for the service delivery employee, motivate them to innovate and collaborate and, thereby, create value for the customer and the shareholders. Value for employees includes being treated respectfully and being involved in decision-making. Employees also value meaningful work, competitive performance-based compensation opportunities and continued training and development.

⁵Margaret Wheatley, *Finding Our Way: Leadership For an Uncertain Time*, Berrett-Koehler Publishers, Inc., 2005



After getting clear on the sourcing objectives and appropriate operating model, creating the productivity measures and the baselines, and aligning and incenting the behaviors of the stakeholders, the final step is to establish good contract governance. Managing the contract effectively helps to reduce value leakage from such basic compliance areas as errors in service levels or invoices, deliverables that are not met, issues that escalate into disputes, etc. ISG findings show that these errors can have a cumulative cost to the client of 10-20% of the annual contract value⁶ (as well as a cost to the service provider). These compliance activities are necessary and save time, money and stress. Beyond compliance, good governance focuses on the relationship with the external service provider and with the internal customer to manage by exception, hold each other accountable and explore areas of process improvement.

In *The Wealth of Nations*, Adam Smith argues that greater prosperity and productivity stem from exercising a light touch rather than heavy-handed governance, stating that “little else is requisite to carry a state to the highest level of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice, all the rest being brought about by the natural course of things.”⁷ The job of governance, therefore, is to create an environment of peace (through active relationship management), easy taxes and tolerable administration (through systematic contract, financial and performance management), and individuals who are free to look beyond mere compliance toward value creation. Indeed, in a highly functioning governance model less can be more. Focusing on the “what” and holding people accountable is more effective than focusing on the “how” and creating shadow organizations to micro-manage the service provider.



Doing more for less requires a strong culture of operational excellence that doesn't constrain the freedom and incentive for innovation, collaboration and continuous improvement.

Enhancing productivity is a worthy and achievable goal of outsourcing. It is necessary for individuals, organizations and nations. Doing more for less requires a strong culture of operational excellence that doesn't constrain the freedom and incentive for innovation, collaboration and continuous improvement. The key to boosting productivity is in defining expectations to improve outputs and reduce inputs and to retain the clarity of those expectations through the life of the contract as circumstances and people change. With courage up front and strong ongoing governance, an organization can reimagine outsourcing as a driver of improved productivity and do more for less.

⁶ISG Governance Services analysis of existing clients indicates a savings of 16% of ACV

⁷Adam Smith, *An Inquiry into the Nature & Causes of the Wealth of Nations*, Ch 2, I.2.2

ABOUT ISG

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