CFO Europe

Change of Fortune

Now could be the time to re-evaluate outsourcing contracts, writes Tim Burke

Shortly after news broke in January of accounting fraud at Indian outsourcer Satyam Computer Services, Manish Dugar, CFO at rival Wipro Technologies, launched his own crisis-management programme. He visited or called the finance chiefs of many of Wipro's customers to explain "what we do differently and why we believe Satyam is not representative of the industry."

It was a tough round of calls and visits to make, but one that Dugar thinks was imperative. "It would be hard to believe that it had not crossed the minds of some of our customers that if it happened in Satyam, why could it not happen in Wipro?," he says. And convincing them otherwise was a job that had to fall to Dugar and other members of Wipro's senior team: "You can't expect a junior guy to present to [a customer's] CFO," he says.

It's a telling example of the extent to which the Satyam scandal has shaken the outsourcing world. Dugar believes Tech Mahindra's recent takeover bid for Satyam means that "industry instability is taken care of" and customers "realise that probably [the scandal] was a one-off." But as Alex Blues, head of IT sourcing at PA Consulting Group, points out, Satyam's woes have dented many companies' trust in the top-tier business process outsourcing (BPO) providers in India.

Five-year Itch

Regardless of who's providing their BPO service, many companies are questioning the wisdom of relying on only one outsourcing vendor. Meanwhile, many more may be wondering whether they should now bring outsourced processes back in-house or renegotiate existing agreements to demand better terms or lower fees.

Even without the Satyam scandal, all cost-conscious CFOs will be feeling a greater urgency to review their outsourcing strategies. One continental European finance chief of a large technology firm says his finance team never felt a need to consider outsourcing its back office while business was booming. But as the signs of a downturn emerged last year, he is now overseeing the early stages of an outsourcing plan. He doesn't expect the company to realise any of the much-needed cost savings for at least another six months, but as he points out, "we'll most likely still be in the downturn next year and then the savings will be really welcome."

The latest research from consultancy TPI found that the overall number of outsourcing contracts — for finance and administration, HR, IT and other areas — signed in EMEA during the first quarter of 2009 was higher than both the previous quarter and the same period last year. But TPI also found that companies are being more conservative when awarding contracts — they may be signing more contracts but for less money per deal. Indeed, the total outsourcing contract value across EMEA during the first quarter was €7 billion, down 14% from the fourth quarter of 2008 and 44% from a year ago.

One thing CFOs signing new deals or renewing existing contracts should push for, advise BPO experts, are shorter contract durations. According to James Adamson of procurement specialist buyingTeam, BPO contracts traditionally span about five years, which can seem like an eternity considering how fast the technology that underpins most outsourcing changes. But it's not only about technology.

When directors start to review contracts nowadays, Adamson adds, they should look for areas that they can improve, from better service efficiency to adjusting the scope of outsourced services. "The fact is that companies make mistakes when they outsource," he says. "The more complexity, risk and business impact there is — the more moving parts there are — the more opportunities you have to make mistakes when you make that decision," such as handing over poorly managed processes to a third party rather than taking the time to fix them first. In this way, bad practices and inefficiencies aren't simply transferred from the company to the provider.

If a CFO does want to continue outsourcing, a crucial question, following the Satyam case, may be whether to spread risk by breaking down a BPO programme into different tasks handled by different providers. While big BPO names — IBM, Accenture and the top-tier Indian groups, for example — tout their one-stop shop capabilities, "it's just good commercial practice not to be overly dependent on any one vendor," says Anson Chuang, CIO of buyingTeam. If there is more than one provider capable of handling an outsourced process, "you shouldn't close off those commercial avenues for many reasons — risk and cost being the principal ones."

What should companies consider when re-evaluating their outsourcing providers? The starting point is to consider how commoditised the BPO service being provided is, says Blues at PA Consulting. "How easy is it to transfer that process to another supplier?"

The answer will vary. Companies may not be concerned about moving simpler tasks — invoicing, for example — to a new provider. But new providers may find it harder to get to grips quickly with more complex or sensitive tasks.

If companies start spreading their outsourcing risk, their existing outsourcing providers will have to work harder to retain as much of the business as possible — and that means that prices are likely to fall. Analysts at research and consulting firm Gartner predict that certain outsourcing options could drop in cost by up to 20% over the next year. "When times are tough, clients will be tempted to renegotiate the contract, especially if the knowledge transfer is minimal," says Blues. Since the Satyam scandal, "savvy clients are using this situation to drive prices down or, if the supplier is not prepared to accept, move to alternative providers who are."

Indeed, while Satyam's troubles may have given companies a jolt, it may also give them a position of power as providers clamour to reassure existing customers and pick up new ones. And BPO providers are aware of the need to offer more for less. As Elisabeth Maxell, a partner in the outsourcing team at accountancy firm Mazars, notes, "You can tell that what [customers are] trying to do is get us to think twice about the [prices we charge]."

Businesses that want to continue outsourcing, then, have an additional bargaining chip thanks to one company's mismanagement. If they use that power to their advantage, the next five years of outsourcing could prove better value than the previous five.