

CAPTIVE VERSUS BPO OUTSOURCING

# Five Critical- Path Decision Factors

ISG



Should we outsource our domestic shared services processes or run them ourselves in a low-cost offshore location? Which will provide the best mix of quality, efficiency and lowest risk?

Many companies looking for the next significant step-change in shared services are struggling with these questions. Each path will offer you low-cost options and significant improvements in efficiencies. So what are the decision criteria? In helping hundreds of clients in evaluating their choices, we have found that choosing one path over the other comes down to five key decision factors.

## 1. Internal Bias

Regardless of internal pressures to reduce costs, many companies simply will not outsource. During ISG's 21-year history, we have seen the following drivers for avoiding outsourcing:

- Highly customized processes: Companies with complex back-office processes that are highly customized to their internal customers' needs typically fear a loss of control when outsourcing. In this scenario, the knowledge transfer process involved in outsourcing is extraordinarily long and is seen as risky. Fear of degradation of service levels is also high. Finally, the internal pressure from below the executive level (typically at the business unit functional level) to keep the processes in-house is high because those functional owners are the original architects of the customized processes and are closest to the customers.
- Industry: A subset of companies, typically in manufacturing (or other older, established industries) are wary of the outsourcing blow-back from their constituents. In industries where layoffs are common and customer reaction may cause loss of market share, outsourcing avoidance is higher than the norm.
- Cultural aversion: Some companies will not outsource as a matter of internal policy.

Captive centers can offer a practical compromise for companies that want to gain outsourcing-like benefits while keeping the work in-house. Companies looking to choose between outsourcing and establishing a captive center should conduct an internal change readiness assessment to determine the level of internal bias.

## 2. Scale to Build a Global Service Delivery Model that Rivals Outsourcing Providers' Cost and Delivery Structure

Most outsourcing providers have a global service model they have built over many years in order to offer their customers the greatest cost efficiencies while also meeting their clients' needs for 24-hour processing and global language skills. Their delivery centers are usually in India, China, the Philippines, Eastern Europe, Central and South America, and the United States. These centers are connected by common processes, technology and leadership. By establishing these global footprints, outsourcing providers can meet



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European language skills and regulatory compliance by processing from Poland or Hungary at the lowest possible cost. U.S.-based processes can be done from India or the Philippines or, if language skills are less important, China; again, at the lowest possible cost. Nearshore processing to offer similar time-zone processing may be done from Costa Rica, Mexico or Brazil, again at a much lower cost. And finally, service providers with U.S.-based operations can handle processes that require American presence.

This global service delivery capability was built over many years, requiring a significant investment. But the key is scale. In order to justify the time, effort and capital to build a global model, companies considering a captive solution must have the sheer size to justify it. ISG has assisted many companies in establishing a global service delivery captive model, and those that have been most successful not only have built this capability over many years but also have the scale to populate it. We have also found that some smaller companies have established captives in India, or nearshore in South or Central America. Although this provides significant cost relief from U.S.-based operations, it rarely approaches the cost and quality improvements offered by a true global delivery model.

### 3. Availability of Capital

As discussed above, establishing a global delivery model is expensive. Even establishing a single captive center requires significant capital. Some examples of the investment required include:

- Real estate: Finding and buying/leasing a new center.
- Fit-out: Making the new center “process-ready” || requires new computers, telecommunications, workstations, cafeteria, etc.
- Consulting fees: Standing up a captive center is complex work, requiring consulting help that is typically three times the level of outsourcing consulting fees.
- Legal and tax fees: Country-dependent, but in most cases this constitutes a significant investment to establish the tax entity and ensure legal compliance.
- Knowledge transfer: Typically double that of outsourcing knowledge transfer because the client must play both the “catcher” || and the “pitcher” ||
- Human resources: Recruiting and hiring the right personnel for the work in a foreign country requires a third party and is expensive. Additionally, competition for the best talent is fierce. Brand name is important, and hiring personnel in these markets requires more than competitive wages.
- Technology: The new global delivery model must be interconnected and utilize enterprise resource planning (ERP) capability. This requires establishing reliable communications, additional ERP licenses, and additional on-site hardware/software to maintain the new operations and ensure transparent processing.



Establishing a global delivery model is expensive.

Outsourcing providers, on the other hand, will charge a transition fee, which typically averages about 10 to 20 percent of the first year's outsourcing fees – so their transition is not free, either. However, establishing a captive is likely to require about double the investment of outsourcing.



Keep in mind that the outsourcing provider has done hundreds of transitions; this will be your first.

#### 4. Time and Patience

A typical outsourcing cycle, starting when a provider is engaged in discussions and ending when the first process is running on a stable basis in the new outsourcing center, is about nine to 12 months. Expect 12 – 16 months to establish a well-running captive center. Additionally, keep in mind that the outsourcing provider has done hundreds of transitions; this will be your first. Although with both scenarios there will be miscues, expect the – three steps forward, two steps back dance to be a bit higher when establishing your own captive. There will be more mistakes.

You should also expect financial payback to be slower with the captive option. Typical payback with business process outsourcing is about 15 – 18 months. Expect a 24 – 30 month payback when establishing a captive.

The upside of – doing it yourself || is that the new center will be completely customized to your needs and internal requirements. It will be exactly what you want and where you want it.

#### 5. Talent Retention

Many back-office processes such as finance and accounting, human resources and procurement, although not core to your business, are critical. In some cases, the future leadership of a company comes from these fertile grounds. Also, retaining talent to ensure compliance with the constantly changing regulatory landscape (Sarbanes-Oxley, for example) is reassuring.

Finally, the enormous institutional knowledge and people investment can never be recovered once lost. Companies looking to decide outsourcing versus establishing their own captive model must carefully consider these important people considerations. Personnel in a captive are your employees and will perform as such. The outsourcing providers' employees work for the provider.



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### SUMMARY

The choice between outsourcing and building a captive center comes down to internal bias, scale, capital availability, patience and talent retention. Both options offer world-class cost structures. Companies looking to explore either option should remember to be patient in either case, get some external help and keep in mind that change management will be a critical success factor for either path.

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