Risk versus reward

MORE COMPANIES ARE OUTSOURCING TECHNOLOGY PROJECTS AND FUNCTIONS, BUT MANY HAVE BEEN DISAPPOINTED WITH THE RESULTS WHILE THE ASSOCIATED RISKS HAVE RISEN, ACCORDING TO A NEW REPORT. **GRAHAM BUCK** INVESTIGATES.

The global IT and business process outsourcing market has enjoyed phenomenal growth in recent years. Its total annual value is about to exceed $500bn and the market is still expanding rapidly, reports accountancy and consultancy firm Deloitte. However, it also warns that the growing reliance on offshore entities and other third parties for business and IT processes has led to a commensurate increase in the potential risks.

Deloitte highlights several trends that it believes have contributed to mounting outsourcing and offshoring risk:

- Companies are outsourcing not only specific projects and back-office functions, but also core business processes;
- Greater global competition for top talent has created shortages of suitably qualified individuals;
- More regulation has made senior management and board members accountable for non-compliance in outsourced work;
- Companies' brand value, intellectual property and other intangible assets are increasingly at risk from piracy, security breaches and theft of information;
- Efficient operations in some offshore locations are hampered by a volatile political environment, or poor infrastructure; and
- Outsourcing relationships can become partnerships in all but name over time, but without providing the analysis, reporting, visibility and control typically offered under a true partnership.

Mark Layton, Global Leader of Deloitte's Enterprise Risk Services Practice, recommends that companies employ a risk-intelligent approach to guide their decision-making at each stage of the outsourcing/offshoring life cycle. "Aligning objectives, risks and controls throughout the outsourcing/offshoring lifecycle enables organisations to identify, assess, prioritise and mitigate outsourcing/offshoring risks at the right stage," he says.

DISAPPOINTMENT Deloitte's study found a number of companies disappointed by their outsourcer's limited ability to provide continuous process and technology improvements. Peter Lowes, Deloitte's Outsourcing Advisory Services leader, says many outsourcing and offshoring initiatives fall short of their potential or the company's expectations. In some cases the failure is total, forcing the company to bring the operation back in-house or sever the relationship and search for a reliable outsourcing/offshoring partner.

This, he suggests, can be avoided through the risk-intelligent approach. So what is the risk-intelligent approach? Deloitte defines it as practices that:

- account for the full spectrum of risk in business decisions and activities;
- cut across "silos", to provide an organisation-wide review of risk;
- consider both upside opportunities and downside possibilities;
- identify, avoid, mitigate, detect and report on risk in comprehensive, cost-effective ways;
- provide a common language and context for risk management; and
- allocate risk management resources based on the importance of the threats and opportunities.

FIVE STAGES The report identifies five critical stages during the offshoring/outsourcing relationship, and breaks down each to examine the most important risks:

- **Strategic assessment** The company decides whether, why and how its business strategy can be supported by outsourcing/ offshoring. Does it have any gaps in its resources, processes or culture that might hamper this?
- **Business case development** The anticipated cost savings and other expected financial and operational benefits of the outsourcing initiative are analysed;
- **Vendor selection** A service provider, who best meets the criteria set by the strategic assessment and the business case, is chosen;
- **Contracting**: A contract is negotiated that addresses the compliance and risk factors identified in the previous stages, and also recognises the needs and expectations of both parties. This should be "a relatively easy exercise", provided enough effort and due diligence has been expended in the first three stages and a draft contract prepared; and
- **Service transition**: Managing the setting up, or migration, of the service to the vendor's offshore location. The ongoing performance and risk of the relationship will then be monitored to ensure that it meets the contract and service level agreements and the strategic objectives are being achieved. As the report observes: "Even if you have everything right up to now, you still have work to do."

All being well, delivery and post-transition management represents the "happily ever after" stage of the lifecycle, says Deloitte. But constant vigilance is needed to maintain the productivity and benefits of the ongoing relationship.

Even outsourcing and offshoring initiatives that start strongly are "prone to entropy", the report warns, which means that management must be alert to potentially negative trends. This means monitoring the quality and timeliness of service delivery and that compliance with key provisions of the contract are continually met.

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A full version of *The Risk Intelligent Approach to Outsourcing and Offshoring* is available from www.deloitte.com/RiskIntelligence