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### Outsourcing: Learning To Let Go

As manufacturers extend BPO to processes once considered too critical to farm out, they're reaping the rewards -- and discovering how to overcome the risks.

By [Jonathan Katz](#)

July 1, 2006 -- More than 8,000 miles away in Calcutta, India, a team of engineers is designing bottle caps and their production molds for a variety of products ranging from liquor to motor oil. Back home in Indiana, a team of engineers that used to design the same bottle caps now focuses on more value-added engineering work since some of their design responsibilities have been taken away.

The U.S. engineers work for Indianapolis-based Alcoa Closure Systems International (CSI), a business unit of \$26.2 billion aluminum manufacturer Alcoa Inc. The Indian engineers work for Tata Consultancy Services Ltd., an information technology consulting and business process outsourcing (BPO) firm based in Mumbai, India. Alcoa CSI's decision to outsource a process typically viewed by manufacturers as a critical part of product development is part of a growing trend in manufacturing.

What began as the movement of non-core processes -- such as human resources, IT, customer service and indirect procurement -- to third-party offshore locations where the jobs can be performed cheaper, is picking up steam in other business processes that directly impact manufacturing. As evidence, a 2005 study conducted by Boston-based AMR Research Inc. shows that 30% of 283 manufacturers surveyed are outsourcing a portion of their product-development process. In that same survey, 72% of respondents said they expected to increase the outsourcing of their R&D and engineering processes by 2008.

"We are seeing a trend toward people looking to globally source some activities that have been considered pretty crucial to their business, including this R&D and engineering area, and we're seeing it in not just indirect procurement but direct procurement, although that's a burgeoning market," says Dana Stiffler, an analyst with AMR Research.

But Stiffler emphasizes that most of the manufacturers cited in the AMR Research study are outsourcing only small portions of their overall engineering functions. And Cliff Waldman, an economist for the Manufacturers Alliance/MAPI, a public policy and business research organization in Arlington, Va., says much of the BPO talk has been overhyped. "There tends to be a lot of myths around this that we're sending all the R&D, the intellectual thinking, the capital overseas. That's way overdone."

Nevertheless, more manufacturers are outsourcing critical processes, and the main motivating factor for this trend, like most outsourcing activities, is labor cost savings. Alcoa CSI is saving 15% to 20% in labor costs through its offshoring efforts and has

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improved throughput rates approximately 25%, estimates Timothy Carr, Alcoa CSI's senior vice president for global manufacturing and technology. But manufacturers also look for increased efficiency and manufacturing flexibility through BPO. In fact, not all BPO even takes place outside the United States. Companies such as Caterpillar Inc. and Eaton Corp. have been locally outsourcing their plant-floor equipment maintenance to Peoria, Ill.-based Advanced Technology Services Inc. (ATS). And Dow Chemical Co. has been outsourcing the digitization of sensitive R&D documents to Xerox Global Services, a division of Stamford, Conn.-based Xerox Corp.

For these companies, achieving lower labor costs isn't the issue. Instead, they're hoping someone else can do the job function better than they could. "Most of the outsourcing that's happening has been triggered by cost, and if you want to minimize cost, it's mainly going offshore," says Manoj Kumar, a director with supply-chain consultancy firm PR™ at its Mountain View, Calif., headquarters. "But now what is being looked at is the total cost of ownership, so it includes the transaction cost, but it also includes the service-level impact and the efficiency and productivity gains."

Waldman, of Manufacturers Alliance, agrees, saying, "It's not so much cost minimization as maximizing your efficiency. For example, let's take payroll. Payroll is not outsourced so much because it's cheaper to do it that way, but because payroll processes are an industry that have developed along its own lines and can always do it better than most companies can do internally."

Other companies are utilizing BPO as a way to expand globally without relocating workers. "If the work really is in China, why should you go and try to send somebody from the United States to China," asks Joseph Collard, CEO of Sumpraxis LLC, a BPO firm based in Delray Beach, Fla. Collard also notes that many graduate-level workers in India are willing to perform engineering work typically undertaken in the United States by workers with undergraduate degrees.

While, outsourcing major processes can be advantageous, manufacturers considering BPO should be prepared for some growing pains. Just ask Alcoa CSI's Carr. The company has been working with Tata for more than one year, but only recently has the company begun realizing the benefits. Company engineers spent the first six months training Tata's engineers, familiarizing them with Alcoa CSI's business and the critical aspects of the company's parts designs, Carr says. "At first, when you're doing that you're actually spending more money than you would when you're doing it for yourself because there's all this training," Carr relates. AMR Research's Stiffler says manufacturers shouldn't expect major savings from BPO partnerships for at least one year to 18 months.

Additionally, manufacturers will need to explain to their employees what impact BPO will have on job descriptions or job security. At Alcoa CSI that meant selling engineers on the idea that stripping these lower-level transactional functions from their job duties wouldn't reduce their roles in the company. "When you start talking about doing some outsourcing or offshoring people get very nervous that what you're actually going to do is eliminate jobs or put people out of work, so it was very important to us that we keep our workforce engaged," Carr explains.

In some cases BPO firms help smooth the transition process by hiring some of the employees who otherwise would have lost their jobs. For instance, Palo Alto, Calif.-based Hewlett-Packard Co., which provides offshore outsourcing services for a variety of processes including procurement, may hire a manufacturer's former staff to govern the outsourced process, says Terry Hendrix, HP's director of BPO for software publishing services.

Another challenge for manufacturers is selecting the right BPO firm. The best BPO firms usually are the most experienced ones, says Panos Kouvelis, professor of operations, manufacturing and management at the Olin School of Business at Washington University in St. Louis. "The worst kind of outsourcing providers are the ones that are trying to win the very first contract to get into the business because they tend to overpromise, and there's a huge risk of underdelivering," he says.

When manufacturers start outsourcing their core processes the potential for pitfalls increases, especially in the area of intellectual property. Some manufacturers, including Alcoa CSI, limit the types of product designs they outsource to protect proprietary information. Alcoa CSI also includes nondisclosure agreements in its contract with Tata, according to Carr.

Even so, the IP risk remains high. "There's a lot of transfer of knowledge that happens, and the contract might be for five years, but within five years that firm that was your supplier can become your competitor, and in many environments it's hard to protect IP," Kouvelis says.

Loss of control and collaboration is another concern for manufacturers. Unlike call center and IT functions, essential manufacturing processes may require greater oversight and involvement on the manufacturer's end to ensure quality. This becomes much more challenging when the engineering firm or R&D department is thousands of miles away. "It's much harder to assess the quality because quite a lot of the effort is unobservable," explains Kouvelis. Alcoa CSI has helped bridge this collaborative gap by keeping a Tata engineer, who analyzes the designs and modeling of the company's bottle caps, onsite at its Crawfordsville, Ind., plant.

Communication between BPO partners also fails when manufacturers cede control of a process without fully understanding it themselves. "If you do not understand the nitty-gritty of your process, it is very hard to partner with your third party or set up a captive operation five to 10,000 miles away and expect for that to run well, so of course you have to clean your own house," Kumar says.

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Another common misconception by manufacturers is that once they hand over control of a process they can reduce focus in that area, Stiffler says. "You're not directly controlling the function anymore, but that doesn't mean you have to be any less vigilant, and you do have to invest in that resource, in that person or in that program-management team that you have managing for you."

For Alcoa CSI, BPO is simply a way to refocus its engineering objectives. With the partnership steadily progressing, Carr says the company is considering expanding Tata's role in product design. When asked whether that would mean staff cuts, Carr said: "I don't anticipate that now, but of course that could always happen, but it is not our plan to do so. What we would do is we would be able to do more projects for the same dollar. We always have a backlog of product-development projects to work on, and what this would allow us to do is just take on more of those projects."

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