THE BENEFITS AND RISKS OF KNOWLEDGE PROCESS OUTSOURCING

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Competitive knowledge is increasingly being outsourced to Knowledge Process Outsourcing (KPO) vendors, indicating a shift in the opinion that core business activities cannot be outsourced. The KPO opportunity represents both risks and benefits, and managers must find ways to avoid costly failures. This article describes the risks and benefits of pursuing a KPO strategy.

Companies that implemented Business Process Outsourcing (BPO) strategies have experienced great gains in efficiencies and cost savings. Processes such as accounts payables, accounts receivables, and payroll are some of the processes that are considered good candidates for business process outsourcing. Process efficiency gains combined with reduced labor costs can generate from 20 percent to 40 percent savings. A global automaker, for example, outsourced its global accounts payables process doubling its on-time-payments and generating more than $400,000 in annual savings by avoiding the cost of late payments.

Because of the success of the BPO approach and the improvement in outsourcing vendor's offerings, companies are now considering outsourcing activities that involve core processes and competitive knowledge. In the traditional business process outsourcing model, outsourcing core processes requiring competitive knowledge would not be considered to be good candidates for outsourcing. This shift in thinking can be attributed to managers becoming more comfortable with the outsourcing model and the experiences gained from previous business process outsourcing efforts. Increased governance and improved offerings by outsourcing vendors also has stimulated the growth in companies considering outsourcing some of their core activities. Companies are now moving beyond outsourcing back-end process and moving to outsource core processes that require analytical thinking and judgment using proprietary competitive knowledge. Some examples are market research, financial planning, business intelligence and risk management. The outsourcing of core processes that require competitive knowledge and higher specialized skills is known as Knowledge Process Outsourcing or KPO.

Outsourcing back-end or core processes is not without risk. A large percentage of organizations have failed when they tried to adopt an outsourcing model. Some of the reasons why companies abandon the model include lower levels of service for internal and external customers, inferior quality of outputs, missed delivery times, cultural misalignment and exposure to other economic and environmental factors. Knowledge Process Outsourcing is not immune to these factors and managers need to manage the complete process of outsourcing carefully to avoid failure when pursuing a KPO strategy. This article describes the internal and external risks associated with pursuing a KPO strategy and includes strategies to improve the probability of success and avoid costly failures.

A recent history of Business Process Outsourcing

Business process outsourcing reached mainstream management thinking in late nineties. Today, it is no longer exclusive to large corporations. Business process outsourcing has shifted from outsourcing back-end, non-core, and repetitive processes such as accounts payables and accounts receivables to outsourcing core processes that require analytical thinking and judgement, processes like market research and data analysis. This shift has created a new opportunity for outsourcing vendors we now know as KPO.

The KPO sector has experienced explosive growth in recent years, with predictions of growth running $10-$17 billion (USD) globally. This growth will be driven in part by the adoption of international standards for professional qualifications, improved access to a large pool of skilled and experienced professionals abroad, and improved remote project management capabilities due to improvements in telecommunications and other enabling technologies. Industries that are increasingly using KPO include legal, financial services, management consulting and life sciences. Some of the core processes that are being outsourced include: data search, data integration, market research, fraud analytics, project management, remote education, research and development, radiology, medical transcript preparation and legal processes.

There are four categories of KPO vendors: off-shore, near-shore, captive, and on-shore. Off-shore KPO vendors are typically located abroad in places like India and Singapore. Other countries like Mexico and Chile are quickly becoming preferred locations for their time zone advantage and English language capabilities and are referred to as near-shore KPO vendors. Near-shore vendors offer added advantages because of shorter travel times, cultural similarities and political stability. Captive Outsourcing is another category of KPO that includes companies with company owned operations abroad, where the outsourced process activities are performed. Large management consulting companies, for example, own operations in India that provide centralized support for market research and data analysis to all their offices around the globe. Some KPO vendors also have operations in the same country, as their clients and they are referred to as on-shoring. Due to a number of outsourcing contract cancellations, some off-shore outsourcing vendors are choosing to open offices in on-shore locations to improve services levels and improve cultural and language alignment.

While the main benefits of BPO are improved efficiency and cost reduction, the main benefits of KPO are less tangible. Some companies can experience increased revenue and improved competitive advantages as a result of having access to a large pool of skilled professionals in knowledge intensive industries. However, cost still remains a significant benefit, since a skilled workforce abroad costs a fraction of what it would cost at home. Another benefit of KPO is converting fixed costs into variable costs, providing flexibility for companies to add or reduce personnel based on business cycles. Another attractive benefit is the continuous execution of work by taking advantage of different time zones. As an example, a financial institution may request research on a specific equity one morning and have the off-shore vendor perform the service overnight to have it available the next business day.

External and internal risks

While KPO provides the benefits described above it comes with a number of significant risks that need to be managed in order to achieve the full benefit potential. Failure to manage these risks can result in costly mistakes and the abandonment the KPO model. The risks of pursing a KPO strategy can be grouped under external and internal risks.

External risks relate to factors that are outside the organization and are less controllable. Finding a suitable KPO vendor that can offer the necessary skills in a scalable, cost- effective manner can present some significant risk. Some KPO vendors are able to find suitable talent but they are suffering from salary inflation due to the increase in demand for skilled labour increases and the improvements of the standard of living abroad. Another factor affecting risk is the currency exchange fluctuations that can have an impact on cost savings. For example, a strengthening rupee can have a significant impact in the actual costs of outsourcing to India. The stronger rupee, combined with the impact of salary inflation, can make the benefits of outsourcing to India disappear.

Another external risk is the inability to protect a company's intellectual property. Although improvements have been made over the years, protecting intellectual property continues to be an obstacle to the full acceptance of the KPO model. The laws and compliance rules abroad expose intellectual property to a significant risk with little options for control. Recent events with outsourcing vendors involved in security breaches and fraud heightens the sensitivity in this area and forces companies to find better ways to protect their intellectual property and customers' privacy. For some industries, protecting data and privacy as well as conforming to the legal and compliance requirements at home and abroad are significant challenges to overcome.

The physical location of the KPO vendor creates risk associated with the economic and political environment of the country where the KPO vendor is situated. Companies that outsourced to India found their operations affected by the recent terrorist attacks targeting U.S. and British workers. Several studies have been prepared by KPO consulting companies ranking countries for outsourced operations. Those countries with higher political stability, language, time zone and culture alignment rank higher in the lists.

Internal risks relate to what the organization will experience when using a KPO vendor. A reduction in communication is a risk that is due to the language barriers sometimes inherited from doing business with countries where English is not the first language. KPO vendors are constantly trying to improve on their language capabilities by providing accent removal training or opening offices in locations with better English-

language capabilities, like Chile or Mexico. Effective communication amongst employees and KPO vendor resources is crucial to the success of a KPO model. When communication is not maintained the business will suffer, as turnaround times get longer. The culture of the organization will also start to shift as processes are outsourced to a provider in another country. This is particularly important in voice-based processes requiring discussion and interaction with the KPO vendor.

Voice-based processes that require interaction with customers present some of the biggest challenges, and there are numerous documented cases of KPO and BPO failures involving voice-based processes. For example, Delta and United Airlines brought back their outsourced customer service operations to North America when it started to experience low rates of satisfaction for more sophisticated conversations with customers. The same applies for internal customers who deal with outsourced processes. Voice-based processes that are combined with knowledge-based activities are not good candidates for outsourcing using a KPO model for off-shore or near-shore vendors. An on-shore vendor may be better suited to mitigate this risk.

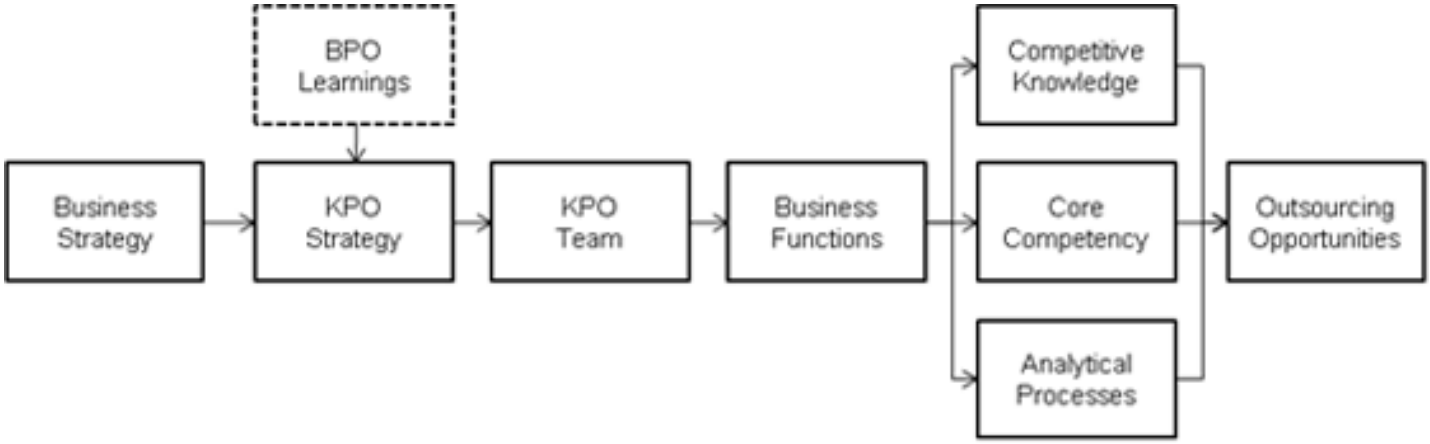
Another internal risk relates to the ability of management to manage KPO vendors in a remote location. Many managers are comfortable managing their own resources on an ad-hoc basis and usually lack a formal process that documents every decision made based on an analysis or specific parameters. Quality and performance metrics are usually non-existent and evaluated through a form-performance measurement process at the department or individual level. Managers will need to learn how to manage outsourced resources based on specific performance metrics and less subjective results.

In some cases, the outsourcing effort exposes inefficiencies and weak areas in the process and a decision needs to be made to outsource the process as is or to optimize it before outsourcing. Companies need to decide if the process or knowledge area needs to be optimized before outsourcing. Some organizations decide against outsourcing after improving their processes, since KPO vendors are not able to match the cost savings from the new improved process. Technology can also present some risks, including those related to the lack of sound networking, software applications and security infrastructure. The information technology department must be involved from the beginning to ensure the infrastructure, applications and data are in place and well protected, and that the KPO vendor is using the data and applications as was contractually agreed.

The risks associated with the impact on employees must also be considered. The KPO process has a negative impact on employee morale, and employees are needed to aid in the documentation, transition and training of the KPO vendor resources. During outsourcing, loosing key talent at home is likely; managers must have a plan to mitigate the likelihood of key talent departing before the knowledge process has been fully transitioned to the KPO vendor. Associated with this risk is the potential negative publicity than an organization can receive by publicly sharing that jobs, knowledge and potentially private information are being outsourced to a third party.

Another risk is associated with the decision-making process and the program management of the KPO effort. Decisions to outsource a core competence must start with the C-Level executives and must be threaded into the strategy. Outsourcing efforts managed at the department or business unit level carry a lot more risk and higher probability of failure. Executive support and a formal vendor-selection process must be used to reduce risks. Identification of the knowledge process for outsourcing must be performed as part of a larger strategic effort and formally managed through an experienced program manager. It can also be managed as part of a centralized outsourcing group that oversees all outsourcing efforts and monitors implementation and the on-going performance of the KPO vendor.

To increase the probability of success, organizations must use a structured approach to managing the KPO opportunity. One such structured approach is depicted in the diagram below.



Organizations must start by defining a business strategy that incorporates the KPO operational model. Although, companies can pursue a KPO strategy directly without any prior BPO experience, organizations with prior BPO experience will have a shorter learning curve, less risk and a higher probability of success. Next, organizations must form a team that will be responsible for identifying opportunities to outsource using the KPO model. This team should perform a thorough analysis of the organization to identify core competencies, competitive knowledge, analytical processes and opportunities for outsourcing and it should represent all relevant functions of the business. The team must always be aware of the organization's strategic intent and translate them into objectives for the outsourcing effort. For example, if the strategic intent is to gain new process efficiencies, then the KPO team must include a metric for improved process efficiency as part of the KPO program's measures of on-going success.

The project manager responsible for the outsourcing efforts should be someone with prior experience in outsourcing projects and a high level of empathy, given the human aspect of the project. Experienced BPO and KPO organizations use a central group to oversee the complete portfolio of outsourcing efforts. This group can provide consistency in the way outsourcing projects are managed, evaluate adherence to outsourcing methodologies as well as monitor the on-going performance of the vendor. Vendor selection must be based on whether the KPO vendor can provide a significant competitive advantage and is able to provide the required talent and skills.

Selecting the process or function to outsource should also be done on a phased approach, starting with knowledge processes that present the lowest risk to the daily operation of the business and moving to knowledge processes that are more critical to the business. During the first phase only simple processes such as accounts receivables should be considered. A second phase can include processes with low, cross-functional dependencies and more judgement such as budgeting and planning. A third phase should deal with the more complex processes such as forecasting and financial reporting. Non-voice processes represent a lower risk and are less challenging to outsource, since they are based on process activities that can be replicated. Voice-based processes have a higher risk of failure. Some companies abandoned outsourcing of voice-based processes and brought them in house, mainly due to low customer satisfaction and lower service levels for both internal and external customers.

Knowledge Process Outsourcing can provide cost savings and process efficiencies and allow companies to focus on increasing revenue growth. KPO can also provide challenging and progressive positions for employees that want to move into supervisory and monitoring roles. At the same time KPO offers a great opportunity to outsource analytical-intense processes that contribute to the development of new products, evaluate new markets and offer new services. But KPO should not be considered as the only option. Companies must be able to look within their organizations and apply all their management know-how to find better, more innovative ways of doing business before outsourcing a knowledge function. The probability of failure is high due to the risks involved and a structured approach and program management should be used to execute this type of strategy. KPO is here to stay and organizations will succeed if the KPO strategy is used augment their services and performance, and not just to cut costs.