

# Outsourcing Can Do Much More Than Just Cut Costs

**F** [forbes.com/2010/06/15/outsourcing-capability-sourcing-leadership-managing-bain.html](http://forbes.com/2010/06/15/outsourcing-capability-sourcing-leadership-managing-bain.html)

Michael Heric and Bhanu Singh

Companies that successfully create and sustain value year after year are rare. Many try to, but a recent study of 2,000 companies over 10 years by our consulting firm, Bain & Co., found that only one in 10 achieved sustained, profitable growth. One activity that sets such winners apart: They often use capability sourcing in more innovative ways than their competitors.

Outsourcing and offshoring began as cost-cutting measures, but companies that create real sustained value routinely use them for far more strategic ends—to gain capabilities that they don't have in-house, or to strengthen capabilities they do have. We have found that 85% of those winners use capability-sourcing broadly and strategically for everything from developing world-class talent to bringing new products to market faster and enabling business model innovation. In other words, they've moved way beyond mere cost-cutting.

Based on our research and experience with clients, we've found that leading companies use capability-sourcing to build five strategic capabilities.

—*To tap into global talent.* Particularly in emerging markets, shortages of talent can impede a company's ability to grow. Texas Instruments has overcome this obstacle with an R&D center in India that has not only delivered cost savings but also nurtured a rich talent pool that has delivered an increasing stream of U.S. patents.

—*To build partnerships that both capture value and reduce risk.* Even though sourcing risks have increased over time, many companies continue to manage their sourcing relationships at arm's length. The reality is that they need to exert control. Companies like the toy manufacturer Hasbro accomplish this by viewing their external relations as strategic partners tightly integrated with their domestic operations or overseas subsidiaries. That's a major reason why Hasbro was largely unaffected by the toy industry's lead paint crisis in 2007. Among its sourcing safeguards, the company prequalifies and continually monitors its overseas factories to ensure that quality management systems are in place. The risk of a quality issue arising can't be totally eliminated, of course. The key is to limit potential problems and act quickly when one occurs to keep it from happening over and over again.

—*To seize new local market opportunities.* As new markets emerge, companies need ways to establish a presence before their competitors. AstraZeneca tapped into the booming Chinese pharmaceutical market by making large-scale, multiyear offshoring investments in everything from manufacturing to sales, partnering with local universities, government organizations and Chinese companies. As a result, AstraZeneca has become the largest pharmaceutical multinational in Chinese prescription drugs.

—*To get to market faster and boost innovation.* Bringing out new products ahead of competitors is critical for consumer products companies in a rapidly changing market. When Procter & Gamble outsourced some R&D activities it boosted its innovation productivity by 60%, to generate more than \$10 billion in revenue from over 400 new products. Today, about half of P&G's innovation comes from external collaboration.

—*To disrupt traditional business models.* Since the spin-off of its contract manufacturing operations in 2000, Acer, the Taiwan-based personal computer maker, has used capability sourcing to make itself into the world's second-largest PC manufacturer. The company's executives knew it was good at branding and marketing and chose to outsource everything it had a harder time with, like manufacturing. The move led Acer to faster-growing sales and gains in market share. The company now maintains a strikingly lean and flexible operation. Its 6,800 employees represent a workforce less than a tenth the size of its largest competitor.

Being a follower has advantages in capability sourcing. Fast followers can learn from others' mistakes. There are capability sourcing models and offshore locations and vendor options today that didn't exist five or 10 years

ago, providing the chance to catch up faster. We've found that building a local team offshore with an independent charter and autonomy improves a company's long-term odds of success. For example, General Electric used offshoring to develop its largest multidisciplinary, integrated R&D hub, in India. The hub supports the company globally and has fostered a large Indian talent pool with strong onsite leadership.

---

Our experience suggests that if a company doesn't get a return of at least 25% on its sourcing investments, it needs to carefully review and fix its current programs before moving on to new projects. Experienced practitioners should challenge the status quo. To avoid becoming complacent, even the most successful veteran outsourcers need to hold regular comprehensive reviews of their sourcing strategies and programs. For example, many companies in financial services, an industry with long experience in capability sourcing, have reevaluated their programs in the global downturn, as the relative benefits of owning and operating captive offshore centers has declined and even pioneering firms such as Citibank and American Express have sold off some of those operations.

In some instances, experienced practitioners have used outsourcing and offshoring to change the game in their industries. The semiconductor industry was redefined when companies started outsourcing manufacturing to low-cost Asian foundries. Those pioneers took off because their outsourcing strategies freed them to focus on R&D rather than pouring most of their investment into capital-intensive fabrication.

Companies also have developed repeatable formulas that apply what they've learned from their increasingly complex outsourcing and offshoring activities, sometimes by building an internal organization to manage partner relationships and transfer experience from one project to the next. Cisco Systems is expert at continuously applying its outsourcing model to new products and services with remarkable efficiency and effectiveness.

In today's uncertain business climate, adopting a strategic view of capability sourcing isn't an option. It's imperative if your company is to have any hope of leapfrogging the competition.

*Michael Heric is a member of Bain & Company's global capability sourcing practice and is based in New York. Bhanu Singh is the co-leader of the firm's global capability sourcing practice and is based in Palo Alto and New Delhi.*