

written by

Tim Jackson  
jackson\_timothy@bah.com

Kari Iloranta  
iloranta\_kari@bah.com

Shayne McKenzie  
mckenzie\_shayne@bah.com

# Profits or Perils? The Bottom Line on Outsourcing

# Executive Summary

---

Outsourcing is fast becoming a fixture in the organizational models of the 21st century. At first confined to nonstrategic business activities such as cleaning, transport, or legal services, outsourcing now encompasses functions that are closer to the core. As suppliers become more tightly integrated into the fabric of a company's basic business operations, the risks attending the failure of these relationships escalate. In fact, the very viability of the company can be threatened.

Nevertheless, outsourcing offers strategic and economic benefits that are too compelling to ignore. When it works, outsourcing decreases costs, increases flexibility, enhances expertise, increases discipline, and provides the freedom to focus on core business capabilities. So the question is: How do you make outsourcing work? More important, how do you make *strategic* outsourcing work?

Working with clients across a range of industries, Booz Allen Hamilton has identified six flaws in the way traditional outsourcing has been applied and managed:

## **Decision-Making Flaws**

- An emphasis on the "simple stuff" ignores most of the cost base.
- Noncore activities are outsourced too automatically.
- Insufficient consideration is given to the full economic impact of outsourcing.

## **Implementation Flaws**

- A lack of appropriate attention is paid to supplier selection.
- Ongoing supplier relationships are poorly managed.
- The organization is unable to transform itself to manage new processes and relationships.

Booz Allen has developed a framework that enables companies to avoid these missteps. Geared specifically to the more complex challenges of strategic outsourcing, the framework walks companies through six critical assessments:

1. Strategic priority and risk
2. Market considerations
3. Internal versus external capabilities
4. Economic evaluation
5. Ability to manage the supplier
6. Ability to manage the new processes

Outsourcing is increasingly not just a make-or-buy decision; it's a make-or-break decision. Booz Allen's six-step approach helps companies develop a firm understanding of what should and should not be outsourced and learn how best to manage these new supply relationships.

# Profits or Perils?

## The Bottom Line on Outsourcing

With all aspects of running a company becoming more competitive and complex, it is little wonder that companies are refocusing their efforts on what they do best — and outsourcing the rest. Yet many companies have encountered obstacles and upsets in trying to realize the promise of outsourcing, generally because of mistakes in decision making and implementation. This report examines the issues surrounding outsourcing and its inexorable spread and proposes a model for improving the likelihood of success in these new supply relationships.

While companies scramble to pinpoint where they want to play in their industry's value chain, they are outsourcing more and more of their business activities to external suppliers. Prompted by competitive pressures and the widespread conviction that outsourcing automatically lowers costs and promotes flexibility, companies have embraced these relationships, often without fully comprehending the risks involved.

As the outsourcing wave gains momentum, it is starting to encompass functions that are increasingly strategic to many companies' core business operations. Yet many companies have failed to master the basics. Traditional outsourcing of noncritical services and back-office functions has produced mixed results at best. In fact, recent research suggests that fully half

of the companies that have tried outsourcing have failed to realize the anticipated results.<sup>1</sup> As companies look to outsource activities closer to their core, the consequences of such failures escalate; indeed, they threaten the very viability of the organization.

### A Mixed Report Card on Traditional Outsourcing

Outsourcing is now a fact of life in most industries around the world. According to a 1999 survey, more than 90 percent of U.S. companies claim to outsource some or all of their noncore business activities, representing some \$50 billion in annual outsourcing expenditures. Worldwide, the outsourcing wave is growing at a compound annual growth rate (CAGR) of 25 percent.<sup>2</sup>

Services typically outsourced — at least until recently — are those deemed noncore. In a manufacturing context, those services include cleaning, transport, catering, maintenance, and training, among others. In other industries functions such as legal, financial, human resources, and Web site development are regularly farmed out. In general, the less strategic the activity, the more likely it will be outsourced. But as outsourcing takes hold, its reach is spreading into areas closer and closer to the core.

What is driving this phenomenon? In an accelerated, global competitive market that rewards focus, companies have little choice but to off-load those segments

<sup>1</sup> Dun & Bradstreet, "Dun & Bradstreet Survey Finds 50 Percent of Outsourcing Relationships Worldwide Fail within Five Years; Principal Cause Is Poor Planning for New and Evolving Business Process," *Dun & Bradstreet's Barometer of Global Outsourcing*, Business Wire, February 24, 2000.

<sup>2</sup> Ibid.

of their supply chain that are not adding optimal value. The current economic downturn only underlines this imperative. “Vertical” thinking (i.e., own or control every link in the supply chain) has given way to “virtual” thinking (i.e., create a flexible web of supply relationships and focus exclusively on what one does best), and companies are rushing to implement the new, networked business models that result. When it works, outsourcing offers companies compelling strategic and financial advantages, including lower costs, greater flexibility, enhanced expertise, greater discipline, and the freedom to focus on core business capabilities (see Exhibit 1).

But the plain truth is that outsourcing doesn’t always work. An international review of more than 200 outsourcing studies highlighted the mixed nature of the

results achieved to date. On average, respondents estimated a 15 percent reduction in costs, but almost a third of those surveyed believed their costs have declined only slightly or have actually *increased* (see Exhibit 2).

---

**When it works, outsourcing offers companies compelling strategic and financial advantages**

---

Furthermore, there is strong reason to believe that most studies conducted to date have overestimated the benefits generated from outsourcing. Many simply ask respondents to *estimate* the savings they have achieved rather than requiring a more rigorous economic analysis. In coming up with these estimates, many companies fail to consider the full economic impact of their outsourcing decisions. They frequently cite only the absolute reduction in costs since the relationship began, rather than looking at those savings from a net present value (NPV) perspective, including associated costs and effects on production levels. Companies also frequently ignore the fixed costs that do not go away when a task is outsourced. Plus they ignore the administrative costs incurred in managing a new supplier relationship. Based on our experience, fixed and transition expenses can account for up to 30 percent of the total costs related to an outsourced function.

All is not wine and roses in many outsourcing relationships. In fact, more than half the participants in a survey of CIOs at *Fortune* 1000 companies reported severe problems in their relationships with information technology providers, including service-level failures, scope disagreements, cost blowouts, and personality clashes.<sup>4</sup> Another report found that 20 to 25 percent of outsourcing agreements fail within two years, and half fail within five years.<sup>5</sup> Some 5 to 6 percent of companies actually went so far as to bring back in-house functions they had previously outsourced.<sup>6</sup>

**Exhibit 1**  
The Advantages of Outsourcing

Area	Advantage
<b>Cost Savings</b>	Savings typically result because the outsourcing supplier can access a cheaper, more flexible work force and the latest, most efficient technology. Organizations claim that they achieve, on average, a 15 percent cost reduction through outsourcing.
<b>Technology</b>	Some suppliers may have proprietary access to technology or other intellectual property to which the company would not otherwise have access. This technology may improve operational reliability, productivity, efficiency, and the long-term total cost structure.
<b>Specialization/ Focus</b>	Focus frees up internal resources to concentrate on activities in which the organization has distinctive capabilities, scale, or experience. As a result, the organization can exploit <i>relative</i> advantage to maximize total value while allowing others to produce supportive goods and services.
<b>Market Discipline</b>	By putting certain functions out to bid, companies increase their choices and gain greater insights as to the true costs and benefits of these activities. Transparency and accountability are enhanced. Market-based contracts focus on output, not input, and they promote innovative work practices.
<b>Flexibility</b>	Using outside suppliers can sometimes improve the scalability of a company’s production capacity at a far lower cost. Outsourcing can enhance <i>functional flexibility</i> (i.e., labor can be redeployed to cover new work tasks or methods), <i>wage flexibility</i> (i.e., pay linked to performance), and <i>numerical flexibility</i> (i.e., headcount adjusts to demand). <sup>3</sup>

Source: Booz Allen Hamilton

<sup>3</sup> Jacques Rojot, “Labor Market Flexibility Trends in Enterprises,” Organization for Economic Cooperation and Development (OECD), 1989.

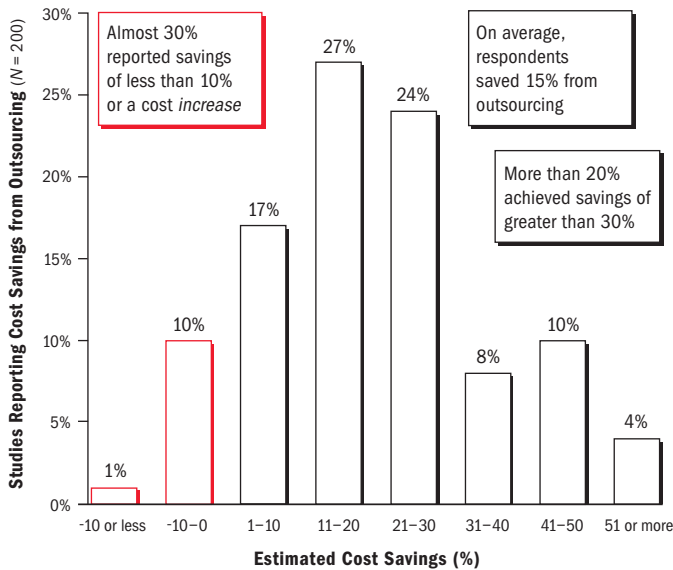
<sup>4</sup> Kristan Mulley, “IS Outsourcing Posing Problems for *Fortune* 1000 Companies,” *AS/400 Systems Management*, p. 49, October 1, 1998.

<sup>5</sup> Dun & Bradstreet, “Dun & Bradstreet Survey Finds 50 Percent of Outsourcing Relationships Worldwide Fail within Five Years; Principal Cause Is Poor Planning for New and Evolving Business Process,” *Dun & Bradstreet’s Barometer of Global Outsourcing*, Business Wire, February 24, 2000.

<sup>6</sup> Lisa Harrington, “Insourcing: Smart Move or Overreaction?” *Transportation and Distribution*, p. 109, May 1, 1998.

**Exhibit 2**

Studies Show the Cost Savings from Outsourcing Have Been Mixed

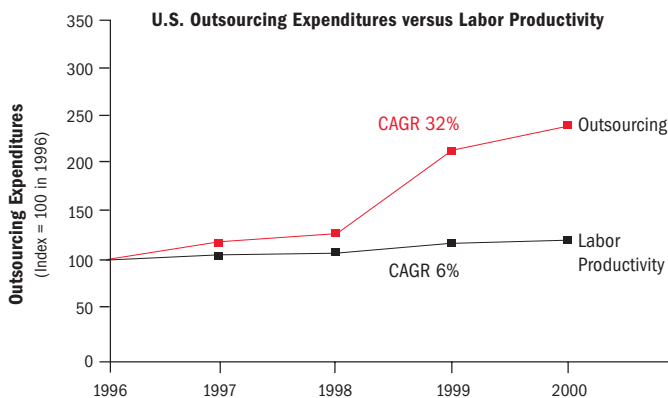


Source: Industry Commission, "Competitive Tendering and Contracting by Public Sector Agencies — Overview," Report 48, p. 533, January 24, 1996, Australian Government Publishing Service

Exhibit 3 sums up this disappointing situation. Although outsourcing expenditures by U.S. manufacturers continue to escalate at a CAGR of 32 percent, the expected commensurate gains in productivity have not materialized. At the company level, dramatic head-count reductions prompted by outsourcing are not

**Exhibit 3**

Outsourcing Fails to Deliver Anticipated Productivity and Profits



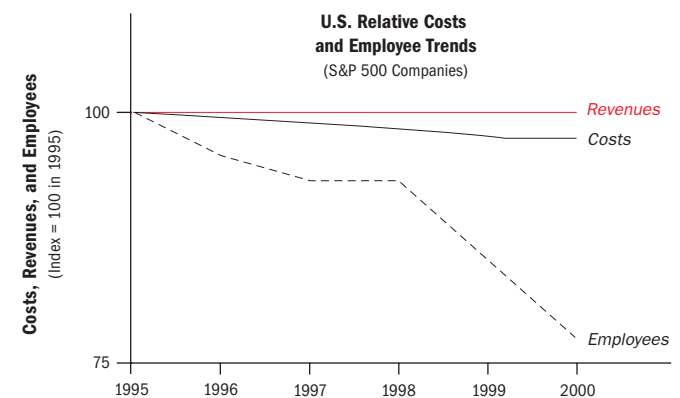
Sources: Outsourcing Institute; Bureau of Labor Statistics; Booz Allen Hamilton

translating into significant bottom-line improvements. It seems that the report card on traditional outsourcing contains some failing grades.

**Avoiding the Pitfalls**

Nonetheless, although outsourcing may be slow in delivering on its promise, there is no doubt that the promise remains. Many companies have already reaped significant benefits, and others are poised to capture that value. The imperative to enhance performance is still there; if anything, the bar has been raised. And there is no turning back. Traditional outsourcing has firmly taken hold, and now companies are embarking on a second wave as they consider whether to outsource activities that were previously regarded as too strategic to be performed by outsiders (e.g., manufacturing and product development).

As firms around the world reassess their industry value chains and the roles they should play in them, they are redefining their notions of "core" and "noncore" functions and outsourcing a greater number of previously in-house functions. In the meantime, suppliers, interested in realizing the higher margins offered in the "solutions" business, are meeting their customers halfway with a set of capabilities that enable the suppliers to manage larger and larger chunks of the value chain.



Sources: S&P 500; Booz Allen Hamilton

As companies extend outsourcing to the more strategic areas of their business, it becomes all the more important to understand what has *not* worked to date. Through our experience assisting clients with outsourcing programs, Booz Allen has identified six major flaws in the way outsourcing has been applied and managed. These fall into two main categories: flawed decision making and flawed implementation.

### **Flaws in Decision Making**

*Flaw 1: An emphasis on the “simple stuff” ignores most of the cost base.* If outsourcing never moves beyond peripheral functions like payroll and catering, it will never have a meaningful impact on the bottom line. To achieve visible results, companies need to target areas that have a significant impact on their business — that is, areas that provide opportunities to both reduce costs and increase output.

*Flaw 2: Noncore activities are too automatically outsourced.* If a company farms out everything except core competencies “just because,” it risks over-outsourcing or developing overly cumbersome and politicized definitions of what constitutes a core function. The decisions about which functions to outsource should be made only after thoroughly evaluating whether the activity can be performed most effectively, cheaply, and reliably in-house or by an external provider. The analysis may well suggest keeping noncore functions in-house. And it may well suggest moving certain business-critical functions out. Aiwa, for example, has outsourced the production of core electronic components to take advantage of the scale benefits and lower factor costs of overseas contract manufacturers.

Although a company might ultimately wish to outsource all noncore activities, the market may not be mature enough in particular areas to accommodate its needs. In the short term, it may be more efficient to assign these activities to an internal *shared services* organization, an arrangement that offers some of the transparency and market discipline that outsourcing provides.

*Flaw 3: Insufficient consideration is given to the full costs of outsourcing.* As mentioned earlier, many

companies fail to understand the full economic impact of their outsourcing decisions. An external supplier may initially appear to offer cost advantages given its lower labor costs or higher utilization rates, but

---

**To achieve visible results, companies need to target functions that have a significant impact on their business.**

---

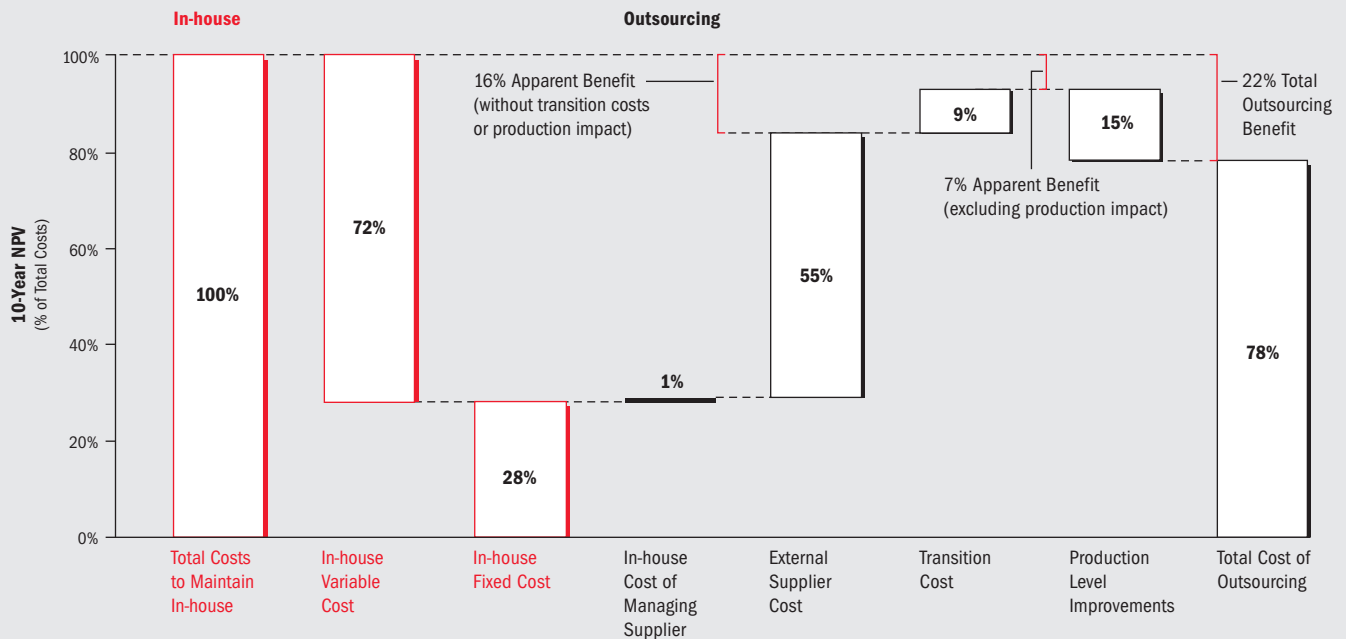
when total costs are taken into account — including remaining fixed overhead, new supplier management expenses, and transition costs — outsourcing is revealed to be the more expensive option. A full cost-benefit analysis should also include an assessment of production impacts (e.g., the impact on productivity of outsourcing plant maintenance).

### **Flaws in Implementation**

*Flaw 4: Lack of appropriate attention paid to supplier selection.* Research has shown that supplier overdependence and “lock-in” are the two major reasons companies are dissatisfied with their outsourcing arrangements. Yet all too often scant attention is paid to selecting the right supplier. An effective evaluation process thoroughly reviews a supplier’s qualifications, track record, and cost structure. Moreover, it anticipates the risk of failure and provides for backup capabilities (either external or in-house) in the event the relationship breaks down.

*Flaw 5: Inadequate management of the ongoing supplier relationship.* If outsourcing relationships have not lived up to expectations, it’s largely because many have been wracked with day-to-day execution problems. Sometimes problems can be traced to a flawed or poorly defined original agreement that fails to clearly set service levels or establish appropriate incentives. More often, the problems arise later because the in-house liaison function has not been adequately trained or resourced to manage these new, more complex sourcing relationships.

### Cost Comparison of In-house versus Outsourcing



Source: Booz Allen Hamilton

### Outsourcing Maintenance: A Total Cost-Benefit Analysis

Booz Allen recently analyzed the decision to outsource maintenance activities for a global industrial company; the findings are featured in the chart above. Upon initial review, it seemed as though the external supplier being considered enjoyed a 45 percent cost advantage, primarily due to higher employee productivity and lower labor costs. However, closer examination revealed that 28 percent of the costs associated with maintenance (e.g., supervision, occupational health and safety, site services) were essentially fixed and could not be outsourced away. In addition, significant transition costs needed to be taken into account, primarily related to severance payments and new supplier management costs.

When these fixed and transition costs were included, the outsourcing proposition became decidedly less

attractive; the anticipated cost savings declined to approximately 7 percent. Given the risks involved in transitioning to an outside supplier and the likelihood that some of the savings would get lost in the implementation process, there was some debate about whether to proceed. However, there was still one factor left to consider — the potential impact on production levels — which proved to be a significant factor in outsourcing's favor. The higher perceived motivation and productivity of the new service provider, combined with improved planning processes, led company executives to conclude that maintenance-related downtimes would be sharply reduced if they went ahead and outsourced. On an NPV basis, outsourcing was estimated to deliver a 22 percent improvement to the bottom line.

### How Tech Tumbled: Outsourcing and Its Perils

An alarmingly long list of tech-related manufacturers have experienced reversals of fortune in the past year owing, at least in part, to execution problems in their outsourcing relationships. Whereas original equipment manufacturers (OEMs) had difficulty forecasting product demand, the contract equipment manufacturers (CEMs) to which they had outsourced their manufacturing were experiencing their own set of problems. Shortages forced CEMs to miss deliveries; systems implementations took longer than expected; and other problems kept the supply chains from scaling up as fast as promised.

When infrastructure development slowed and markets failed to materialize, OEMs cut forecasts. Dramatic revenue shortfalls were compounded by the OEMs' inability to step back from their commitments to inventory and capacity. As a result, balance sheets became bloated. Profitability forecasts at the unit level took a direct hit. And customers complained as the OEM marketing machines continued to help create unfulfilled demand. The overall message was clear: the OEM/CEM model didn't scale the way everyone had expected.

*Flaw 6: Inability to change the organization and manage new processes and relationships.* Outsourcing an activity implies loss of direct control, which can be a substantial cultural adjustment for many companies. Managing supply relationships used to mean securing process inputs; now it means manipulating process *outputs* through influence and incentives. Some organizations fall back on old habits and are overly prescriptive, specifying how tasks should be completed rather than relying on the supplier's greater skills and experience.

Outsourcing draws on a brand-new set of capabilities and skills and generally requires a brand-new set of people in key supply management positions. Successfully transitioning a company from a "make" orientation to a "buy" orientation often requires

reassessing every position within the organization and every process. Organizations that do not appreciate the magnitude of the required changes often fail to capture the full benefits of outsourcing — or worse, they see their costs actually *increase*.

### The Shift to Strategic Outsourcing

As companies continue to clear these hurdles to traditional outsourcing and they outsource activities closer to their core (such as manufacturing and new product development), they confront a host of new challenges. It's one thing to contend with disruptions in a back-office function, but disruptions in a production line can cripple a business. The risks are far greater — as any number of early adopter outsourcers have learned.

Suppliers' inability to produce sufficient flash memory chips threatened to disrupt the production of 18 million Philips telephones in 2000. Because of a shortage of graphic chips, Sony Corporation was able to ship only half the PlayStation 2 consoles it wanted for its U.S. launch in September 2000. And Palm Inc. estimates its revenues might have been 10 to 40 percent higher had it had access to all the liquid crystal displays (LCDs) it needed.

As increasingly strategic functions are placed under the direct control of contract manufacturers and other outsourcing suppliers, the consequences of a supplier failure can border on the catastrophic. Decisions about where to play in the value chain or which company to

---

**Organizations that do not appreciate the magnitude of the required changes often fail to capture the full benefits of outsourcing.**

---

partner with can often be make-or-break. Getting it wrong can leave a company exposed, without the internal capabilities to compete, and vulnerable to the increasing incursions of suppliers that want to expand their real estate on the value chain.

So why do it? Because the potential rewards offered are so great. For many companies, particularly those in technology-driven industries such as telecommunications and computer hardware, strategic outsourcing offers the opportunity to liberate their balance sheets. Companies like Nokia, Apple, and Cisco have eagerly outsourced their asset-intensive manufacturing operations so they can focus on what they get paid for: design, distribution, and understanding customer needs. These companies operate in tremendously accelerated environments, where technology obsolesces overnight. If structured and implemented correctly, outsourcing allows them to scale up and down quickly and flexibly, thus mitigating these business risks.

Harnessing the opportunities in strategic outsourcing is a formidable challenge, one that will draw on new skills and supply management capabilities. Both outsourcer and supplier will need to adopt a long-term value perspective on the relationship and will need to work as partners, structuring an agreement with clear

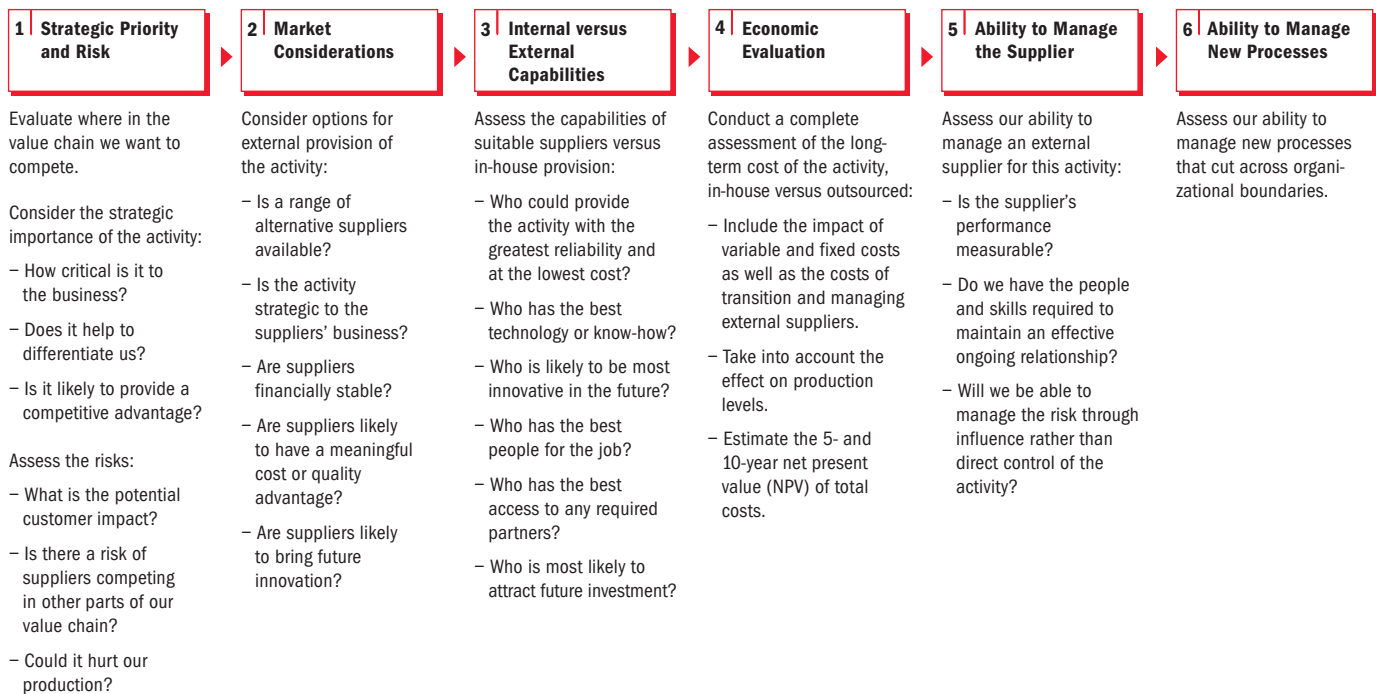
and objective performance measures and gain-sharing incentives. As suppliers become more integrated into a company's value chain, companies will need to upgrade their procurement and project management skills as well as their risk management capabilities.

### Booz Allen Strategic Outsourcing Framework

Based on our experience with clients around the globe, Booz Allen has developed a framework that enables companies to avoid the decision-making and implementation pitfalls of outsourcing and achieve a better sense of their own capabilities and their requirements for success. By rigorously and periodically applying this methodology, companies can pinpoint what should and should not be outsourced and discover how best to manage these new supply relationships. Our framework is specifically geared to strategic outsourcing decisions; it explicitly considers the more complex risks and requisite capabilities associated with outsourcing business-critical functions (see Exhibit 4).

#### Exhibit 4

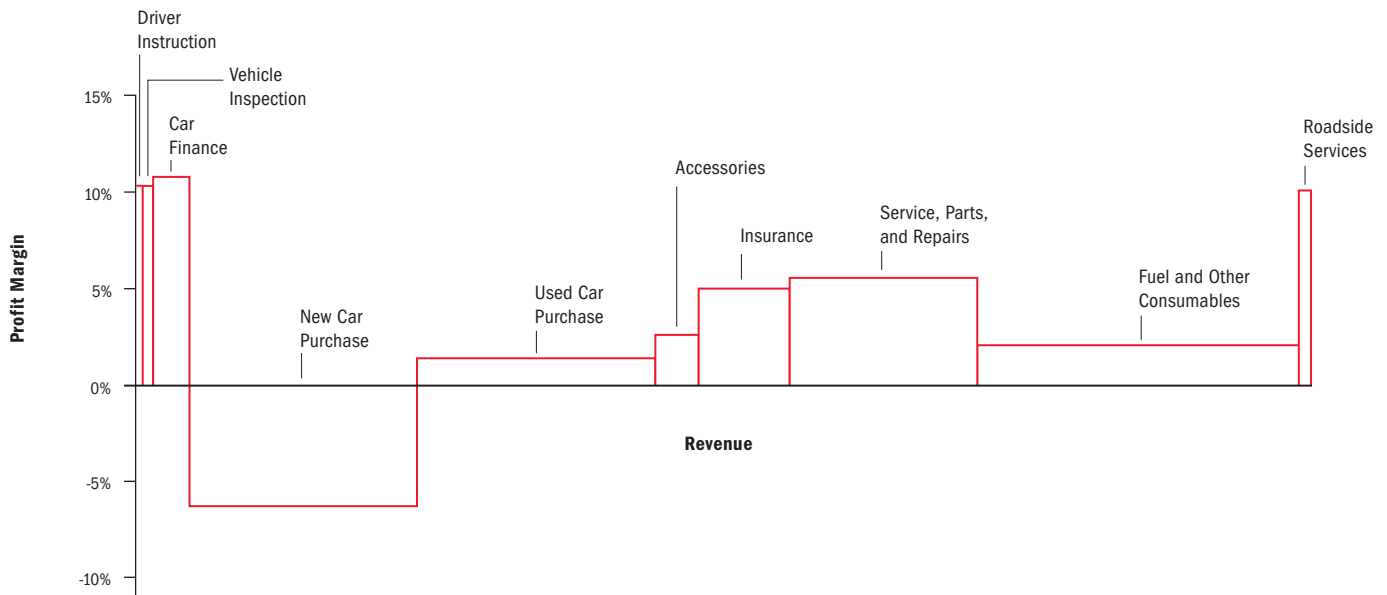
##### Booz Allen Strategic Outsourcing Framework



Source: Booz Allen Hamilton

**Exhibit 5**

Using Value Chain Analysis to Assess Core and Noncore Activities in the Auto Industry



Source: Booz Allen Hamilton Automotive Industry Value Chain Analysis, February 2001

**Decision-Making Strategy**

The first step in embarking on any strategic outsourcing initiative is evaluating where in the value chain a company wants to compete. Whole articles have been written on the topic of value chain restructuring, and it seems everyone is currently engaged in this existential

---

**Decisions about where to play in the value chain or which company to partner with can often be make-or-break.**

---

exercise. Specialists are carving out niches and building dominance through scale. Suppliers are looking up the chain for opportunities to grow margin. Competitors are seeking to differentiate their offerings by developing new “solutions” to customer needs. The list goes on.

The emerging message is that to succeed, a company needs to be exceptionally good at everything it does. And that means looking beyond a few steps in the value chain and assessing the *entire* value chain, not just from a company perspective but from an industry-wide and even cross-industry perspective as well. It also means anticipating future developments, assessing how customer needs will change, and adapting operations to supply the greatest value against that emerging demand.

Exhibit 5 shows what such an industry value chain analysis might look like from the perspective of a car manufacturer. It's quite clear from this example that related services such as car financing, repair, and roadside assistance offer the highest profit margins. The base business — the actual purchase of a new car — is actually a money-losing proposition.

As this example highlights, a thorough industry value chain analysis can prompt companies to redefine what is core and noncore. Although seemingly straightforward, this process is often the most challenging part

### A thorough industry value chain analysis can prompt companies to redefine what is core and noncore.

of an outsourcing program, subject as it is to intense political and emotional points of view. Senior management must consider questions related to operations, knowledge, and skills (see Exhibit 6) to determine whether an activity is truly core or whether it's a viable candidate for outsourcing.

Two companies within the same industry can arrive at starkly different conclusions about their core capabilities based on this assessment and on their unique vision, mission, and strategy. For example, some airlines (e.g., Lufthansa, Qantas) regard maintenance and engineering as strategically critical and a key to their competitive differentiation in terms of cost and reliability. However, an equally large contingent (e.g., Southwest) views these activities as a drain on resources and outsources them to scale-advantaged suppliers.

There are risks that need to be weighed in outsourcing, as we've mentioned. In our methodology, these risks are considered at the outset of the process. It makes little sense to proceed with an outsourcing decision if a company determines that the risks to its business or to its customers' businesses are too great.

#### Exhibit 6

##### Key Questions to Help Identify What Is Core

Operations Related	Knowledge Related	Skills Related
<ul style="list-style-type: none"> <li>▪ Does it have a direct impact on our license to operate or on our production, quality, yield, or reliability?</li> <li>▪ Does the equipment have a direct impact on our production capability (core product) or quality?</li> <li>▪ Does it require a specific understanding of operational processes and parameters?</li> <li>▪ Does the activity have a measurable and direct impact on products, quality, yield, and/or safety?</li> <li>▪ Is the activity critical to achieving our business plan?</li> <li>▪ Will we have the ongoing capital to maintain the required knowledge and skills?</li> <li>▪ If the answer to any of the above is no, can we adequately manage the risk if an external supplier performs the activity?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Does the task require industry, plant, or process knowledge specific to our products?</li> <li>▪ Is the knowledge readily available in the manufacturing community?</li> <li>▪ Is the knowledge readily gained?</li> <li>▪ Does the activity require or generate specific intellectual property?</li> <li>▪ Does the activity include intellectual property that must be maintained in-house?</li> <li>▪ Do we have the critical mass to maintain the required knowledge and skills?               <ul style="list-style-type: none"> <li>– Do we have the required number of people?</li> <li>– Is the activity performed frequently enough?</li> </ul> </li> <li>▪ Does the activity require our product-specific process knowledge?</li> <li>▪ Does the activity require product-specific equipment knowledge?</li> </ul>	<ul style="list-style-type: none"> <li>▪ If we do not own the skills and knowledge to carry out the activity, could we manage the risk of outsourcing it?</li> <li>▪ Does the task require product-specific plant and process knowledge and have a direct impact on our production, quality, yield, or reliability?</li> <li>▪ Does the task or activity require continual review to stay abreast of the technology and methods that could improve outputs of the process?</li> <li>▪ Does the task involve managing activities around an out-of-control situation that puts people, the environment, or output at risk?</li> <li>▪ Do we have the skills to manage the suppliers of goods and services?</li> </ul>

Source: Booz Allen Hamilton

Of course, identifying one's core and assessing risks is merely the first step in the strategic outsourcing decision-making process (see Exhibit 7). A company then has to determine whether the market will even afford the option of outsourcing (step 2), whether the activity can be more effectively and efficiently performed in-house or externally (step 3), what the full economic impact of the outsourcing decision will be (step 4), and whether the company has the skills to manage the supplier relationship and ongoing risk (step 5). Each step draws on a series of rigorous analytical tools that help companies arrive at a sound and well-reasoned conclusion.

**Implementation Strategy**

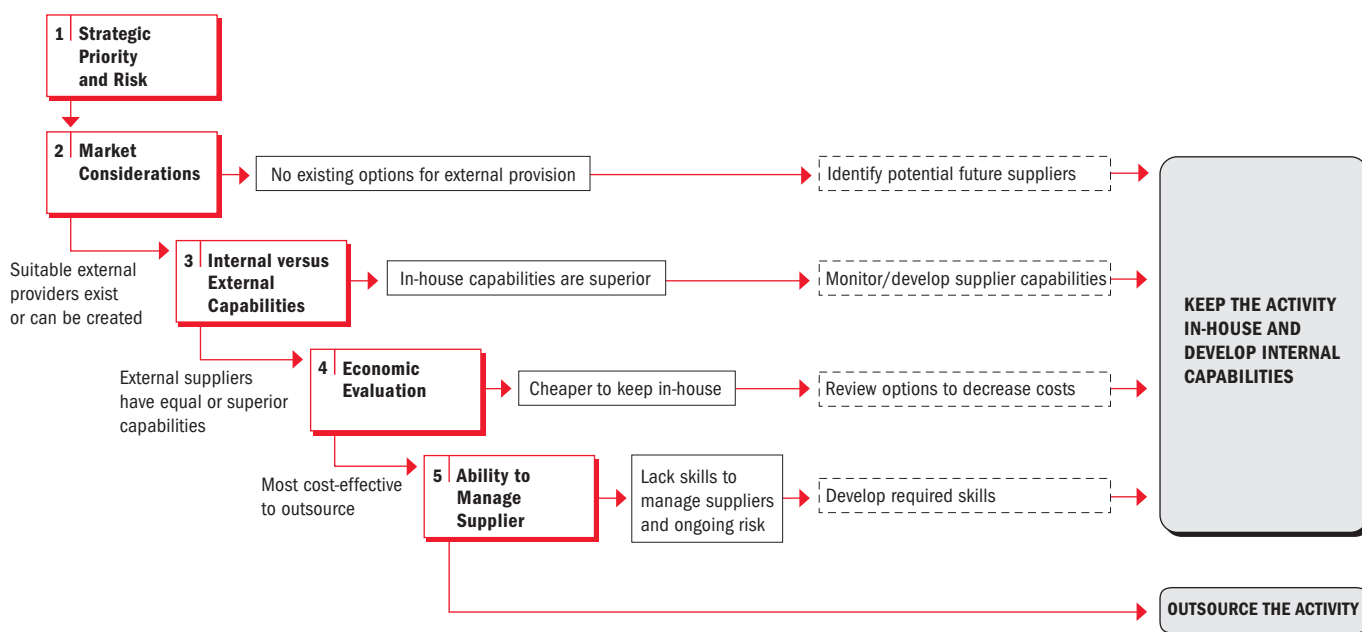
Arriving at the decision to outsource is the easy part. Now the hard work begins. Most of the organizations that have registered concerns about outsourcing cite issues such as poor supplier performance, overdependence on

suppliers, and service-level failures as the main stumbling blocks. Yet few, if any, question their original decision. In other words, outsourcing *most often fails in the implementation*, specifically in the management of these new supplier relationships.

**Outsourcing most often fails in the implementation, specifically in the management of new supplier relationships.**

The foundation for any outsourcing arrangement has to be a clear definition of the parameters of the supplier relationship. These parameters should include, but are not limited to, the degree of integration, the extent to which the customer retains management responsibility, and the comprehensiveness of the arrangement (see

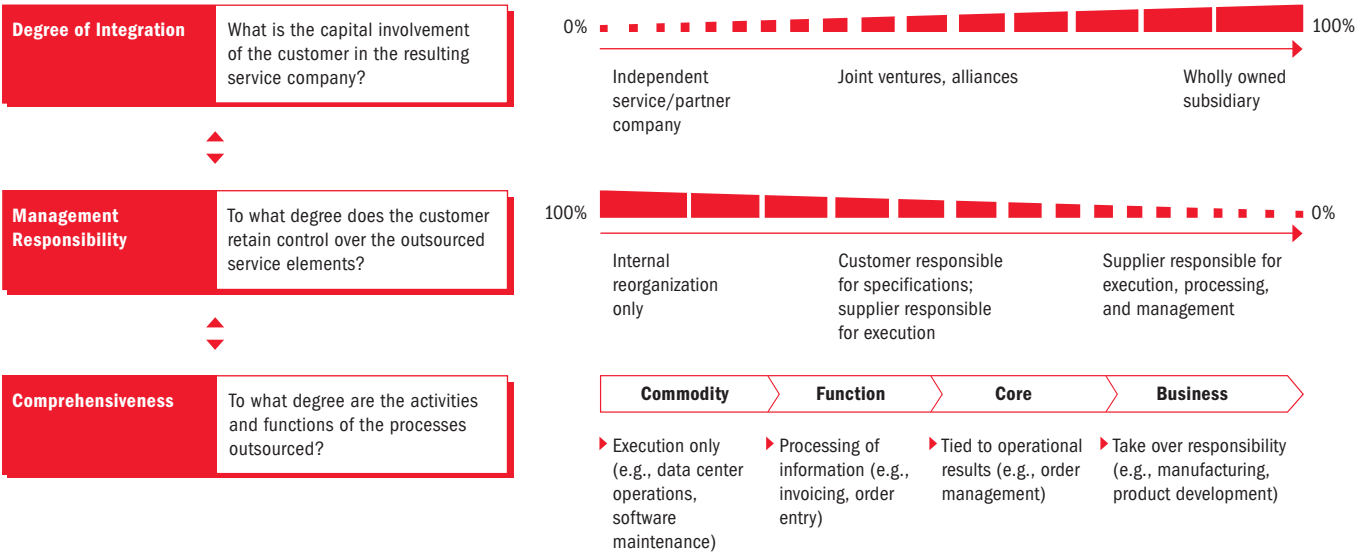
**Exhibit 7**  
Decision Model for Strategic Outsourcing



Source: Booz Allen Hamilton

**Exhibit 8**

Negotiating the Parameters of a Supplier Relationship



Source: Booz Allen Hamilton

Exhibit 8). For example, will the supplier act as an independent contractor, a joint venture partner, or a wholly owned subsidiary? Will the supplier be responsible for executing customer specifications or will it be participating in product development and innovation activities? Will the arrangement encompass only back-office transactional functions or will it include business-critical activities?

As we've mentioned, the inexorable shift in outsourcing is toward more tightly integrated and comprehensive arrangements characterized by shared goals, mutual trust, open communication, and long-term commitment. To achieve this end, the outsourcer and supplier must together establish objective performance measures and incentive schemes designed to encourage innovation. Performance measures should include a benchmarking component that tracks whether selected suppliers still deliver cost and quality advantages when

compared with other external and internal alternatives. Overhead should be minimized through the appropriate sharing of systems, equipment, and resources.

**Outsourcer and supplier must together establish objective performance measures and incentive schemes designed to encourage innovation.**

These supplier management techniques lead to a result we at Booz Allen call "balanced sourcing," wherein the customer and supplier strike an optimum balance between cooperation and competition.



## What Booz Allen Brings

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for more than 80 years. Booz Allen combines strategy with technology and insight with action, working with clients to deliver results today that endure tomorrow.

With 11,000 employees on six continents, the firm generates annual sales of \$2 billion. Booz Allen provides services in strategy, organization, operations,

systems, and technology to the world's leading corporations, government and other public agencies, emerging growth companies, and institutions.

To learn more about the firm, visit the Booz Allen Web site at [www.boozallen.com](http://www.boozallen.com). To learn more about the best ideas in business, visit [www.strategy-business.com](http://www.strategy-business.com), the Web site for **strategy+business**, a quarterly journal sponsored by Booz Allen.

---

**Tim Jackson**, a Vice President in Booz Allen Hamilton's Sydney office, leads our operations consulting in the Asia Pacific region. He consults with a range of industrial clients across all aspects of operations strategy and strategic sourcing.

**Kari Iloranta** is a Principal in Booz Allen Hamilton's Helsinki office. He consults primarily with clients in the energy industry across a broad range of operations and organizational issues, with a particular focus on make/buy strategies and supply management.

**Shayne McKenzie** is a Principal in Booz Allen Hamilton's Sydney office. He consults primarily with aerospace and industrial clients and specializes in operations strategy and operations transformation programs.

Also contributing to this report were Booz Allen's Sarah Butler, Vice President ([butler\\_sarah@bah.com](mailto:butler_sarah@bah.com)), Ed Frey, Vice President ([frey\\_ed@bah.com](mailto:frey_ed@bah.com)), Tim Laseter, Vice President ([laseter\\_timothy@bah.com](mailto:laseter_timothy@bah.com)), and Chris Manning, Principal ([manning\\_chris@bah.com](mailto:manning_chris@bah.com)).

## Worldwide Offices

<b>Abu Dhabi</b> Charles El-Hage 971-2-6-270882	<b>Buenos Aires</b> Jorge Forteza 54-1-14-131-0400	<b>Göteborg</b> Kenny Palmberg 46-31-725-93-00	<b>Malmö</b> Kenny Palmberg 46-40-690-31-00	<b>Paris</b> Panos Cavoulacos 33-1-44-34-3131	<b>Stockholm</b> Kenny Palmberg 46-8-506-190-00
<b>Amsterdam</b> Peter Mensing 31-20-504-1900	<b>Caracas</b> Jose Baquero 58-212-285-3522	<b>Hong Kong</b> Reg Boudinot 852-2634-1878	<b>McLean</b> Timothy Laseter 703-902-3800	<b>Philadelphia</b> Molly Finn 267-330-7900	<b>Sydney</b> Marty Bollinger 61-2-9321-1900
<b>Atlanta</b> Joe Garner 404-659-3600	<b>Chicago</b> Gary Ahlquist 312-346-1900	<b>Helsinki</b> Kenny Palmberg 358-9-61-54-600	<b>Melbourne</b> Marty Bollinger 61-3-9221-1900	<b>Rio de Janeiro</b> Paolo Pigorini 55-21-2237-8400	<b>Tampa</b> Joe Garner 813-281-4900
<b>Bangkok</b> Marty Bollinger 66-2-653-2255	<b>Cleveland</b> Les Moeller 216-696-1900	<b>Houston</b> Joe Quoyeser 713-650-4100	<b>Mexico City</b> Alonso Martinez 52-5-230-6900	<b>Rome</b> Fernando Napolitano 39-06-69-20-73-1	<b>Tokyo</b> Yuji Nishiura 81-3-3436-8600
<b>Beirut</b> Charles El-Hage 961-1-336433	<b>Colorado Springs</b> Glen Bruels 719-597-8005	<b>Jakarta</b> Ian Buchanan 6221-577-0077	<b>Miami</b> Alonso Martinez 305-670-8050	<b>San Diego</b> Foster Rich 619-725-6500	<b>Vienna</b> Helmut Meier 43-1-518-22-900
<b>Berlin</b> Rene Perillieux 49-30-88705-0	<b>Copenhagen</b> Kenny Palmberg 45-3393-36-73	<b>Lexington Park</b> Neil Gillespie 301-862-3110	<b>Milan</b> Enrico Strada 390-2-72-50-91	<b>San Francisco</b> Bruce Pasternack 415-391-1900	<b>Warsaw</b> Reg Boudinot 48-22-630-6301
<b>Bogotá</b> Jaime Maldonado 57-1-628-5050	<b>Dallas</b> Tim Blansett 214-746-6500	<b>London</b> Peter Bertone 44-20-7393-3333	<b>Munich</b> Richard Hauser 49-89-54525-0	<b>Santiago</b> Jorge Forteza 562-290-0500	<b>Wellington</b> Marty Bollinger 64-4-915-7777
<b>Boston</b> John Harris 617-428-4400	<b>Düsseldorf</b> Christian Fongern 49-211-38900	<b>Los Angeles</b> Tom Hansson 310-348-1900	<b>New York</b> Reggie Van Lee 212-697-1900	<b>São Paulo</b> Maurizio Mauro 55-11-5501-6200	<b>Zurich</b> Claudia Staub 41-1-20-64-05-0
<b>Brisbane</b> Marty Bollinger 61-7-3230-6400	<b>Frankfurt</b> Hermann Bierer 49-69-97167-0	<b>Madrid</b> Emilio Montes 34-91-5220606	<b>Oslo</b> Kenny Palmberg 47-23-11-39-00	<b>Seoul</b> Jong Chang 82-2-2170-7500	