Outsourcing

Core Competency 2.0: The Case for Outsourcing in Supply Chain Management

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"I can't understand why people are frightened of new ideas. I'm frightened of the old ones."
John Gage, Scientist

"Ideas are a commodity. Execution of them is not."
Michael Dell, CEO
For decades, outsourcing has been an integral part of most global supply chain management (SCM) operations. At many companies, in fact, the rise of third party logistics entities such as DHL and UPS has resulted in the elimination of in-house transportation fleets; likewise, the high-technology and automotive industries frequently outsource some or all of their manufacturing operations, thus making it possible for them to focus on activities such as research, product design and marketing. Still, there are many non-logistical supply chain functions—forecasting, supply planning, and inventory management, for example—that generally remain in-house. While most supply chain executives may never have considered outsourcing these non-logistics functions, the fact is that outsourcing such activities is now not just possible but in some cases preferable to performing them in-house. This article will argue that outsourcing even the highest-level supply chain function is quickly becoming an economic and strategic option. As this phenomenon gains more exposure, it is important to have a mechanism to structure decisions about keeping an SCM function in-house or externalizing it to a third party service provider. In this article we present such a framework, built around four key questions:

1. Is the function really a core competency?
2. Is the knowledge management strategy associated with the function fully understood and aligned?
3. Who will improve the function most in the future?
4. What is the externalization risk?

Understanding how to answer these vital queries can help readers determine if a particular supply chain capability is best outsourced or kept as an internal function. Based on our analysis of dozens of SCM outsourcing contracts, we will argue that in some cases engaging an outside company to handle activities such as inventory optimization or forecasting is actually superior to hiring, training and providing for those functions in-house. Our main contention, in other words, is that what matters most is not who executes a given function but who executes it best, and that the former will usually be the organization with the most economic incentive to improve that function.

After the analyses noted above (sections focused on each of the four questions), we present three case studies, followed by an examination of risk and liability in supply chain outsourcing.
Our contention is that what matters most is not who executes a given function but who executes it best—and that who executes best will usually be the organization with the most economic incentive to improve that function.
2.

Test one: is the function really a core competency?

Ever since Gary Hamel and C.K. Prahalad laid out the concept of the “core competency” in their seminal 1994 article, “The Core Competence of the Corporation,” legions of managers and executives have struggled to define, build and maintain their own versions of this concept. Sixteen years later, however, many companies’ idea of a core competency bears little resemblance to what Hamel and Prahalad described. Some executives think of their companies’ core competencies as “the things we need to get right” while others describe them as “the things we do best.” Still other executives define a core competency as “the basic skills required to compete in our industry.” Interestingly, some leaders simply ignore the concept altogether.

Returning to the original concept, however, it is interesting to note that Hamel and Prahalad define core competencies as “the collective skills and learning inside an organization that create competitive advantage.” This perspective is illustrated in Figure 1.

In other words, a core competency is not a competitive advantage in and of itself. Instead it is the source of a company’s competitive advantage. In their follow-up book, Competing for the Future, Hamel and Prahalad further argue that core competencies must provide a company with either a real or perceived competitive advantage in the minds of customers. For example, customers may think that a certain package delivery company is more likely to deliver an overnight package on-time, even though statistical analyses show that it is no better than its competitors. The reason customers hold this belief, however, is that the company has great advertising. Thus marketing is the real core competency that makes the company stand out. Of course, core competencies also can create real advantages, not just perceived ones, and surely this is the main idea that most supply chain executives have in mind when they seek to define their company’s core competencies.

In the context of supply chain management, like so many other business areas, the idea of core competency is as common as it is varied. For the sake of this article, however, let us consider what we believe to be the most common definition: A core competency is any function a company must execute well in order to be successful.

Given this definition, it is commonly believed that activities such as forecasting and inventory optimization are core competencies. But is this really the case? To answer the question, consider the case of logistics: a function that has been outsourced so often that most supply chain

executives would never consider it a core competency. In the 1950s it was rare for a company not to manage the physical distribution of its own products. After all, it was important to deliver products on time and to keep a watchful eye on one's goods. However, as companies such as FedEx and UPS arrived and focused their talent exclusively on the physical delivery of goods, their logistical skills significantly eclipsed those of many manufacturing companies. Moreover, since a company such as FedEx can amortize its investments over many clients, no single client has to bear the full cost of leading-edge logistics technology or a highly sophisticated logistics management team. Consequently, what probably was a core competency in most product companies in the 1950s now is seen as almost completely (at least in the "developed" world) as a function best performed by an external entity. What is interesting about this example is that the change in perspective was driven by external agents (the logistics companies themselves) rather than by suboptimal performance of in-house logistics teams. This observation points out an important critique of core competency theory—that a company can be great at something until an external force comes along that minimizes the relevancy of that capability and/or causes it to be handled better in some other fashion.

Another significant strategic change is the rise of outsourced manufacturing. Many people are surprised to learn that companies such as Apple and Sony—as well as entities in industries as diverse as fashion, pharmaceuticals and cosmetics—do not "make" their own products. Most people do know that a lot of manufacturing happens in low-cost countries; however, they probably think those manufacturers' factories belong to the brands themselves. Discovering otherwise, people's reactions are logical: "If a manufacturer does not manufacture, then what exactly does it do?" In other words, "if manufacturing is not a core competency at a manufacturing company, then what is?"

The rise of outsourced manufacturing is a complex phenomenon brought on by many factors. As was the case with logistics, even companies that wanted to keep manufacturing operations in-house came to see that outside specialists were offering higher levels of expertise and equal (if not lower) costs. In response, the manufacturers started letting subcontractors build their products, while the manufacturers themselves focused on engineering, design, brand management and (in some cases) supply chain management. Once again, what had been a core competency became less (or non) core, in large part because of the rising capabilities of external parties rather than the deficiencies of in-house
Nor are logistics and manufacturing the only examples of how core competency definitions evolve. Information technology, accounting and payroll also used to be considered "core" but seldom are now. However, the most interesting reference point in the core competency discussion may be the outsourcing of business strategy itself. One would think that defining a firm's strategy would be the most core activity of all. However, most large companies now employ consultants to help define their business strategy. In some cases, consultants conduct the basic research, analytics and strategy definition, so clients have only to select a strategic direction from among a small set of options. Again, if someone outside a company can successfully execute a critical function such as strategy definition, then why would most any supply chain function be considered off limits?

Activities such as forecasting and inventory planning have been less subject to outsourcing trends. However, that is about to change for the very same reasons that drove the shifts in the areas discussed above—namely, that specialist outsiders are enhancing their abilities in these areas at a faster rate than most in-house teams. Many of those outsiders also are reducing the fees they charge to clients, to the point where the service providers’ rates are equal to or even less expensive than what it costs to maintain in-house teams. This evolution is illustrated in Figure 2.

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We believe that supply chain management outsourcing has recently passed Line A in the evolution depicted in Figure 2. As a result, outsourcing will soon become a more common operational option for supply chain executives in many companies—even those known for their supply chain excellence. At this early stage, there is a spread in service performance versus service cost levels among different providers, but some of these entities have already passed the breakeven point, thus making SCM outsourcing an attractive option for many...
companies. We expect that, in the coming years, more service providers will pass the breakeven point and that SCM outsourcing will become more widely discussed and put into practice around the world.

The logistics and manufacturing examples noted above are evidence that functions previously considered core eventually became non-core and were outsourced after service providers became more proficient than in-house teams. If this is the case, then what actually is a “core competency” in supply chain management?

Our view is that the best definition is the original one Prahalad and Hamel suggested—with the addition of two criteria. Thus, for an activity to be a core competency within a given supply chain function, it must satisfy three conditions:

1. It creates real or perceived competitive advantage.
2. It cannot be done better at an acceptable higher cost, or equally well at a lower cost by an outside specialist.
3. Any increased risk in externalizing the function is both understood and manageable.

We call this definition Core Competency 2.0, and under this expanded definition, whether a company should be executing a function internally or externally depends not only on whether that function creates a real or perceived competitive advantage, but also on whether an outsourcing services provider can perform that function better than the company itself. Our third criterion is based on the fact that any externalization of a function involves risk. So it would be unfair to compare performance and cost of an internal operation and an external operation without considering the different risks these alternatives pose.

Returning to the example of forecasting, if a company finds that an outside specialist can execute this function better, even at a higher cost (so long as there is a positive return on investment on the marginal cost difference), then the company should consider outsourcing its forecasting operations. Likewise, if that same company finds that a specialist can perform equally well at a lower cost, then outsourcing also should be considered. This is especially true if the outside specialist plans to invest more to improve that function than the company is able to do itself. We will discuss this last point in more detail later.
Test two: what kind of knowledge does the function require?

Most companies conduct periodic process improvement initiatives to increase supply chain performance and add capabilities. Some of these initiatives will fail due to underfunding or lack of sufficient executive support. However, the most common reason is generally the absence of knowledge—the skills and experience needed to execute the improvement project or acquire/implement a new technology. In this section, we will discuss the different types of supply chain knowledge that companies must acquire and retain, and how this supply chain knowledge dynamic impacts the decision to outsource a given function.

For the purposes of our analysis, consider three specific types of supply chain knowledge:

- Functional Knowledge, such as statistics, network dynamics and production optimization.
- Industry Knowledge, such as customer demand patterns, product lifecycles and material controls.
- Internal Company Knowledge, such as legacy systems, inventory strategies and company policies.

Functional Knowledge is specific to a discipline but independent of any particular industry or company. Examples of this kind of knowledge are abstract (such as math and statistics), applied (such as engineering or biotech) or procedural (such as project management and planning).

Functional Knowledge is acquired first through formal education: college, graduate school, certification programs, training, etc. Indeed, formal education plays the most important role in the acquisition of abstract Functional Knowledge, and thus it is very difficult to develop this type of knowledge internally within a company. For this reason, companies hire people with the required educational credentials to perform tasks that require abstract Functional Knowledge.

Practical experience following formal education typically complements the academic base, helping to consolidate and retain the concepts and skills an individual acquired in his or her academic setting. However, practical experience rarely provides the theoretical fundamentals required to really advance Functional Knowledge. For example, while someone with no statistics background can be taught how to input a forecast into a demand planning system, that person will not understand what mathematical functions may be applied to that forecast as it is merged with others and integrated into larger demand patterns.
Industry Knowledge is common to a group of companies operating within an industry, such as chemicals or retail. Supply chain resources working in these industries require knowledge that is unique to the products moving through their supply chains. For example, to manage the production of chemicals, employees need to know the general concepts of the manufacturing function, but they also must be familiar with industry-specific aspects, such as chemical by-products and co-products. Furthermore, the manufacturing of chemicals often requires handling hazardous materials whose use is governed by environmental regulations. In effect, the knowledge of how chemicals are made is almost always acquired in an industrial, not academic, setting.

Other industries, such as paper and steel manufacturing, may share many substance-related issues seen in chemicals manufacturing, but they will face other complexities and regulations that are specific to paper or steel production.

Internal Company Knowledge is specific to each company. Examples include: relationships with suppliers and customers; subject matter experts with particular insights that are not widely known or documented; experience with home-grown tools, internal processes and approvals; and political or organizational challenges and how to deal with them. These types of knowledge can be acquired only through experience within a particular company. There is no external education or past experience that can replace internal company knowledge. Despite these unique attributes, it is our experience that internal company knowledge is rarely documented properly: companies depend heavily on the people who have it in their heads. When these resources leave, the knowledge often gets lost, which generates unexpected disruptions in process performance. Of course, some companies do make an effort to formally document internal company knowledge. However, they are aware that it is virtually impossible to document each person's knowledge and every nuance of daily operations.

To achieve high performance in supply chain management, companies need all three types of knowledge. They need to understand what each capability means and involves, what constitutes the optimal mix of skills, and how they can best acquire or develop the complete set of required skills. For example, if a retail company wants to implement a statistical forecasting function, it will have to acquire talent with statistical and forecasting skills. Implementing a sophisticated forecasting tool and setting up the right forecasting process will not be enough without the right team to leverage the technology and manage the process. In this case, the company could be tempted to put its current planners in charge of the new forecasting process and tool.

However, given that new abstract Functional Knowledge is required, and that abstract knowledge is best acquired through formal education, it is quite likely that the knowledge required by the new process/tool and the knowledge available within the team will not align. When this happens, the tool, the implementation or the process are often blamed, since it is difficult for a company to realize that not having the right people with the required skills could have been the cause of the failure. This is why system implementations without the right teams often fail or (at a minimum) don’t deliver the expected results.

Companies also should know how each type of knowledge is obtained so they can invest in the right methodology to acquire it. Continuing with the same example, an organization may be tempted to send its current planners to statistics training to fill the gap in skill sets required to manage a new forecasting process. However, it is unlikely that a short statistics course will provide planners with the depth of statistical knowledge needed to maximize performance. Similarly, a company whose demand depends highly on a few government customers could easily err by hiring a very advanced statistician or forecasting expert to run the forecasting process. The reason is that the variability of the forecast will depend mainly on decisions made by those few customers. In effect, company-specific knowledge (e.g., the company’s customer buying behavior) is key — potentially more relevant than the functional forecasting knowledge. Thus the company might be better off teaching forecasting techniques to internal employees who already understand the entity’s customers.

In summary, recognizing the types of knowledge required to perform each process allows companies to understand the mix of knowledge they need to optimize key supply chain processes, and to make the right investments to acquire or develop knowledge in the most effective way.

Unfortunately, even when companies know the types of knowledge they need and how to acquire them, acquisition and retention of such knowledge remains challenging. This is yet another reason why more companies are considering outsourcing various supply chain functions. In addition, talent attraction and retention are especially difficult when a particular set of Functional Knowledge is not critical for advancement in a company. Consider a retail company with complex demand-management challenges that is struggling to attract and/or retain talent with these critical skills. Since it is rare for a statistician to have a clear career path to a senior executive position in retail, a highly-trained individual is less likely to find the retail position attractive. Instead, the person may be more drawn to a company in which statisticians are valued as revenue generators, such as a market analysis firm, forecasting software vendor or supply chain services provider.
On the other hand, internal company knowledge is very hard to transfer from company to company. For example, the knowledge of a particular home grown software tool cannot be applied in a company that does not use that tool. Thus knowledge of that tool does not qualify an employee to do a similar job in a different company. On the positive side, deep knowledge of a company’s products and processes are strong assets for internal advancement.

From a skills-acquisition perspective, Industry Knowledge is a mixed case. Important areas of Industry Knowledge are developed inside each company and companies have a special interest in conserving these (and in ensuring that competitors do not acquire them). Also, there is Industry Knowledge that is enhanced by working with multiple companies in the same industry. In this case, companies benefit by hiring experts who have worked at competitors or in related industries, and who would bring knowledge of leading practices. This is one reason why consultants can be so valuable: they represent a way to leverage Industry Knowledge without having to hire experts from other companies.

In conclusion, when considering whether to outsource a supply chain function, one critical test is understanding the fundamental knowledge basis of that activity: functional, industry or company-based. This relationship between knowledge type and the outsourcing decision is summarized in Figure 3.

If a particular supply chain activity depends on knowledge that is function-based, then a top-notch service company probably will be more likely to attract and retain the best people in that field. As a result, outsourcing this function may be a logical decision since there is a strong chance that the services provider employs the “best of the best.” If the activity depends mostly on Industry Knowledge, then an external services provider with deep industry experience may again be a logical option. Only in the case where an activity depends mostly on company-specific knowledge might the choice favor keeping the function in-house.

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In the section that follows, we argue that it is in the area of Functional Knowledge that outsourcing services providers have the greatest economic incentive to improve performance of a supply chain activity.
4.

Test three: who will improve the function most in the future?

Consider the dilemma faced by a supply chain executive who takes over a poorly-performing organization. He completes the analysis described above and decides that the most critical activities depend primarily on functional knowledge. More specifically, what the executive needs most are people who understand complex multi-echelon inventory optimization mathematics and statistical forecasting. In our view, what should happen next is a classic "make versus buy" analysis.

- "Make" implies that the company owns the resources with the required knowledge (hired from outside or internally developed) and assumes the responsibility and risk of managing those resources to maximize the value and benefits the talent is expected to contribute.

- "Buy" implies that the company realizes the results and benefits generated by such talent by engaging a service, such as consulting, outsourced analytics or outsourced business processes.

The case for "make" has been made many times in many ways. However, the case for "buy" is largely new to areas such as forecasting and supply planning, and we believe there are several reasons why this alternative is not just a valid option for many companies but actually a preferred approach. Below are several reasons for this conclusion:

1. Third party services providers are better prepared to deliver high performance in operations that require deep functional knowledge. Third party services providers focused on a function (e.g., forecasting, inventory management, supply chain management) can create the right environment to attract and retain experts. Because they help to generate revenue, subject matter experts have a clear career path with the third party service provider.

2. For the implementation of new supply chain capabilities, companies frequently face implementation risks, cost overruns, extended timelines and requests for functionality that is not needed at present but may be needed sometime in the future. By contrast, third party services providers have the advantage of lessons learned from multiple implementations, and thus may be able to shorten time-to-value and eliminate much of the implementation risk.
3. Third party services providers can take advantage of economies of scale. An advanced statistician may be required only a fraction of the time at a retail company, so it is hard to justify a full-time position. However, the third party services provider can assign the functional expert to multiple projects and clients and thus divide the cost among them.

4. Third party services providers often have valuable industry knowledge because of their lengthy exposure to multiple companies within an industry. Third party services providers usually specialize in specific functions and organize their teams along industries to create industry subject matter experts. These entities therefore have a mix of industry knowledge that internal company talent can rarely match, since the latter are exposed mainly to the realities and practices of their one employer.

5. Third party services providers can be a particularly preferable choice if their client has positioned supply chain expertise as a source of profit to be maximized rather than a cost to be minimized. Most in-house supply chain teams struggle to acquire funds to invest in new skills and technology. However, a world-class service firm will make these investments more readily, since it sees those costs as investments for which there is a direct and measurable revenue stream.

It should be acknowledged that in-house operations may be a superior choice when internal company knowledge is a key leverage point. After all, internal knowledge is not repeatable across multiple clients and thus economies of scale and past learning curves do not present an advantage for a third party services provider. However, this scenario is comparatively infrequent; instead, most companies seeking to improve supply chain performance are likely to determine that outsourcing’s strengths far outpace its weaknesses.
Perhaps the most critical issue that arises in any discussion about outsourcing a supply chain management function is the issue of risk. Using forecasting as an example, this issue typically is summarized by two logical questions:

1. Why should I risk letting an outsider do something as complicated as (say) forecasting demand for my products?

2. Who is liable if a forecast created for me by an outside entity is wrong, and my company loses sales as a result?

Point 1 might accurately be deemed “execution risk”: the fear that a partner will not be able to execute the function for which it was contracted. This concern is legitimate. However, in Accenture’s view, the real issue is not the failure of the services provider but whether that firm has a higher probability of failure than the organization that hired it. After all, internal teams can (and do) fall short as well.

**Direct Risk in Supply Chain Outsourcing**

To answer the first question more fully, consider the five potential causes of functional failure in supply chain management noted in Figure 4. Of these five, only one is potentially more prevalent in an outsourcing context: “incomplete or wrong information used to perform a function.” Because many supply chain processes depend on company knowledge, failure to apply or communicate that knowledge may increase the chance of failure when performed by an external partner. An example from retail might be promotional forecasting: in these operations, knowing which category managers really understand the impact of sales or rebates on final consumer demand is critical. However, this determination is seldom easy to make without several months of experience. Another example could be spare parts planning in consumer electronics—where calculations are heavily tied to new product introductions and products’ end-of-life cycles. Both these scenarios present potentially higher risk with a service partner. But the key to ameliorating such problems is not complicated: thorough documentation and constant communication between client and service provider can diminish this risk to a level similar to that encountered by an in-house team.
Indirect Risk in Supply Chain Outsourcing

Along with direct risks, there also are indirect risks involved in any decision to outsource. Examples include:

- Bankruptcy of the service provider.
- Sensitive information not handled correctly.
- High turnover in service provider staff.
- Commitment of the service provider to supply chain management outsourcing as a long-term strategy.
- Poor chemistry/working relationship between client and service provider.
- Challenges posed by extended time differences and geographical dispersion of teams.

It may not be possible to fully eliminate these risks; however, they can be managed at an acceptable level if the relationship is anchored by committed, communicating and highly competent third parties and framed by an appropriate operating model. Moreover, it is Accenture’s experience that, in areas such as data security, outsourcing can actually increase the level of rigor within client organizations.

Liability in Supply Chain Outsourcing

In the outsourcing arena, “who is liable when something goes wrong?” is a viable concern. Imagine that a third party forecasts X amount of sales for a fashion retailer and, based on that forecast, the retailer only stocks Y levels of merchandise. When the merchandise reaches the store, demand far exceeds supply.

Who bears responsibility for the lost (missed) sales? Or perhaps a third party is inaccurate in its planning and purchasing of MRO materials for a manufacturer?

These examples might seem to suggest that outsourcing a function such as sales forecasting or spare parts management is inadvisable. However, evidence and experience suggest that this is not the case. Moreover, the actual process of determining liability can be very useful to both sides. Consider the methodology outlined in Figure 5: a formalized approach to determining “degrees of separation” between output and outcome.
To understand the degrees of separation concept better, consider the case of an electronics company that outsources spare parts planning to a third-party services provider. The services provider collects return and warranty data from its client’s repair centers, combines the data with product launch and termination plans, and creates a parts plan that it provides to the client and its main suppliers. So what happens if the third party orders too many or too few parts on behalf of the repair centers? Referring to Figure 5, the service output in this scenario is the forecast, while the service outcome is the client’s inventory level, which ideally is neither too low (which would cause service disruptions) nor too high (which would elevate inventory costs). The key is determining the degrees of separation between the output and the outcome. Two potential analysis results are presented in Figure 6.

Referring to Figure 6, it is not hard to see that the relationship between the service provider’s output (forecast) and the client’s service outcome (inventory levels) is more closely linked in Scenario A than in Scenario B. Consequently, one would expect that there is greater likelihood of risk/liability transfer from client to service provider by applying Scenario A. However, this is not always the case. In outsourced supply chain contracts, clients sometimes opt to not transfer risk, even when they are able to do so. This reluctance has several causes, not the least of which is that service providers will usually seek a premium for agreeing to a risk transfer. More often than not, it is simpler to develop a performance mechanism based on service level targets and incentives/disincentives.

Whose Risk Is it Anyway?

The question of risk and liability is extremely valid. However, Accenture’s view is that not only can the issue be resolved, but that the resolution process often produces additional benefits. For example, the kind of analysis illustrated above can help companies identify the real drivers of supply chain performance and better understand the relationship between a supply chain function and specific business outcomes such as product sales, working capital requirements, and new product introductions. In the end, the supply chain executive must understand the drivers of both internal and external risk. But he or she should not assume that externalizing any function automatically entails higher degrees of risk.
Figure 6: Output-outcome analysis results

**Scenario A**

**Output:** Spare parts forecast created by service partner  
**Degree 1:** Forecast accepted by client with (at most) only minor deviations within 72 hours  
**Degree 2:** Forecast accepted by repair centers and suppliers with no changes within 24 hours  
**Degree 3:** Suppliers send forecasted materials with (at most) only minor deviations from forecast within 7 days  
**Degree 4:** Materials received in repair centers in good condition and put into stock in accordance with forecast within 24 hours  

**Outcome:** Inventory of materials calculated per a given period becomes reality in repair centers within 7 days of Output

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**Scenario B**

**Output:** Spare parts forecast created by service partner  
**Degree 1:** Forecast accepted by client two weeks later but with major changes  
**Degree 2:** Forecast accepted by repair centers one week later  
**Degree 3:** Forecast accepted by suppliers two weeks later  
**Degree 4:** Suppliers send forecasted materials with often significant deviations from forecast  
**Degree 5:** Suppliers send forecasted materials in shipments that often arrive weeks late  
**Degree 6:** Materials received in repair centers in various conditions  
**Degree 7:** Materials put into stock in as late as two months after original forecast  

**Outcome:** Inventory of materials calculated per a given period becomes reality in repair centers only months after Output is created and then with changes
Supply Chain Management
Outsourcing Examples

Fashion Retailing
A North American retailer specializing in women’s fashion and household products has more than 1,000 retail outlets. With the help of a third party services provider, the company implemented a state-of-the-art statistical forecasting software package. However, the company was unable to train or recruit enough people to master (and thus leverage) the new software. For this reason, it opted to outsource forecasting to the same services provider. The “externalization decision logic” was clear:

• Is forecasting a core competency in our company? No; others can perform it better than we currently can.

• Does the function depend on company knowledge? No; it depends primarily on functional knowledge of mathematics and statistics.

• Are we likely to invest heavily in forecasting in the future? No; the major investment was already made and there are no plans for further investments.

• Does externalizing mean higher risk of failure? No; since the forecasting services provider implemented the system, it clearly knows best how to make it work.

The services provider that implemented the forecasting system subsequently deployed an expert forecasting team staffed partly at the client’s location in North America and partly in India. The team successfully managed statistical forecasting for three years and the contract was recently renewed and expanded to cover demand analytics.

High-Tech Manufacturing
A global consumer electronics company based in Japan set out to implement a spare parts planning system for its European service operations. However, the project was over budget and behind schedule, and the company was having difficulty finding staff in central Europe to execute the function once it was implemented. Like the fashion retailer, the electronics company’s “externalization decision logic” was straightforward:

• Is spare parts planning a core competency at our company? No; others can perform it better than we currently can.

• Does the function depend on company knowledge? No; it depends primarily on functional knowledge of mathematics and transport optimization.
• Are we likely to invest heavily in spare parts planning in the future? No; the major investment was the software implementation.

• Does externalizing mean higher risk of failure? No; the company was already facing a high risk of implementation failure.

An outsourcing services provider with deep skills in spare parts planning was contracted and the company’s internal software implementation was halted. The services provider licensed a different spare parts planning application, implemented it, and then staffed a team in Europe to forecast and plan spare parts for its client’s repair facilities. The contract’s financials were based on parts volume and driven by the performance of the outsourced planning team. Three years later, the relationship has been a great success and the contract was recently renewed and expanded to include additional products across Europe.

Chemicals
A large European chemicals manufacturer had no advanced forecasting systems or team, nor was it equipped to handle global demand-supply synchronization. Sourcing and transport of raw materials (mostly from China) was neither optimized nor synchronized with production demand in Europe and North America. To reach an outsourcing decision, the company addressed key externalization decisions, such as:

• Are advanced forecasting and demand-supply synchronization core competencies? No; this activity does not provide a perceived or real competitive advantage.

• Does the function depend on company knowledge? No; it depends primarily on functional knowledge of mathematics and transport optimization.

• Will we really invest in the function in the future? No; the company did not want to spend money on new systems or staff.

• Does externalizing mean higher risk of failure? Possibly; which is why the outsourcing arrangement began with a full-scope, six-month transition period, during which the internal/external model was defined, implemented and refined.

Two years later, the external team is performing at a high level and the company has asked the service provider to assume long-term responsibility for this function. Moreover, the company and service provider have begun to refine the service in other ways, such as accounting for carbon impact to help confirm that the operation meets the company’s environmental supply chain standards. This green investment was driven primarily by the service provider.
Supply chain executives often ask us if there is a "decision tree" that can help a company determine if a function is worth "externalizing." Figure 7 illustrates this sort of "externalization decision logic."

Obviously, a great many factors influence an outsourcing decision. However, the decision tree is a good place to begin because it can guide high-level options for improving a flawed function, determining whether to "build or buy" needed capabilities, and deciding if significant supply chain investments are justified, given a company’s long-term strategic direction.

We also recognize that corporate culture and external (e.g., industry and market) factors influence the outsourcing decision process as much (or more) than cost and current performance; and that these drivers cannot easily be mapped. However, it still is possible to chart the state of supply chain management outsourcing (as distinct from areas such as strategic sourcing or logistics). This "state" is presented in Figure 8.

Based on the trends implied by the graphic—combined with evidence presented in this paper—it should not be surprising that more and more world-class companies are outsourcing supply chain management functions such as product forecasting, retail replenishment, inventory management and spare parts planning. At first glance, some supply chain practitioners may perceive this evolution as a threat. But a closer look could reveal to them the strong potential for turning one or several supply chain functions into a competitive weapon or even a revenue generator. This is a profound change that can open new career paths, create broader recognition of supply chain management’s power and even create stronger companies that subsequently become leaders in internal as well as market growth.

The foundation is being set for a world where virtually any operational function—from logistics to manufacturing to engineering—can, with the right effort, be performed equally well inside or outside an organization.
Outsourcing’s evolution also will be significant because it could generate new options for executives and operational strategists who, until now, have had to depend exclusively on internal organizations to achieve excellence in supply chain management functions. Already, the foundation is being set for a world where virtually any operational function—from logistics to manufacturing to engineering—can, with the right effort, be performed equally well inside or outside an organization. As this happens, supply chain strategists will discover more (and more impactful) operating models. This freedom will allow entirely new companies to be built—companies that operate in fundamentally new ways. For all these reasons, supply chain outsourcing will ultimately be a positive force that will continue to move supply chain management toward the forefront of business strategy.
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