

Not for Wimps Only

By Marek Jakubik

The outsourcing debate and, especially, its offshoring aspect continue to invoke elements of passion, fear, misinformation, and the occasional hostility. It already has brought a strong political response from Congress, which has been to include in the fiscal 2004 spending bill a provision prohibiting federal agencies from outsourcing certain kinds of work to private companies that use workers in foreign countries. Similar restrictions are under consideration in 23 states, and four states already have passed them.

Deliberations have been particularly animated within the IT field. Recently a fresh twist has been introduced to an already overheated debate: Only incompetent wimps do outsourcing.

An argument, presented in a column, which contains the sub headline “Outsourcing Is for the Lazy,” in the June 1st issue of CIO magazine, goes something like this: IT managers outsource because they find recruiting and retaining good employees too hard. In other words, it is a clear sign of laziness and incompetence. Judging from the responses the article provoked, the argument found a soft spot in many IT professionals’ hearts. A new sharp turn has been added to the emotional outsourcing roller coaster.

When talking to CIOs from the insurance industry, I see signs the volatility of the outsourcing debate has made many of them uncertain as to what to think and do about outsourcing. Politics of the election year, a slowly recovering economy, and pseudo-arguments such as the one above all contribute to a confusing and emotionally overcharged scene.

Outsourcing: A Tool for Business

Is outsourcing for wimps or heroes? Let it be known my answer is neither—outsourcing simply is an important tool for smart business people. I say business, not IT, very intentionally. Unless and until an IT manager learns to think and act like a business manager, he or she will not be able to select, negotiate, and execute an outsourcing deal properly. Such a manager can indeed be called incompetent.

Although white-collar service outsourcing is a relatively new phenomenon, outsourcing of products and services has a long and growing economic foundation and tradition built on twin factors: specialization and core competencies.

At the highest level of abstraction, the outsource-

ing formula says: Keep your core competencies; allow the specialists to do the rest (which happens to be their core competence). If you do it right, the reward always will be the same: Your company (department) will deliver more value at lower cost.

Large and predominantly multinational companies understand this very well. A majority of them have been using outsourcing in its many forms for many years. Still, midsize companies seem quite unsure.

Why Do Midsize Companies Hesitate?

While some of the CIO’s fears are quite rational, others are based on misconceptions. Here are reality checks for several commonly held fallacies:

- Outsourcing is not just about offshoring. While in some instances offshoring may offer the best financial leverage, it also brings high risks and relatively high management overheads. Other ways to structure an outsourcing contract include nearshoring, co-sourcing, in-sourcing, joint venturing, traditional consulting models, and their hybrids.
- Outsourcing in the insurance industry is not new. The industry has a long tradition of outsourcing in areas such as marketing, advertising, and most often, claims. How many of your companies still handle glass claims themselves?
- Opportunities offered by outsourcing never should be limited to a one-time expense-reduction exercise or simply looked upon as a labor arbitrage. Turning work over to specialists should result in ongoing, long-term process improvements. In properly structured deals, companies’ business targets should include ability to grow while flat-lining the cost or ability to turn their fixed costs (internal resources) into variable ones (paying per transaction).
- Outsourcing of anything to do with data is not prohibited by the PATRIOT Act or Sarbanes-Oxley. Yes, these acts bring certain restrictions, but at the same time they offer carriers opportunities to offload non-core aspects of specialized analysis for which insurers are not particularly well equipped (e.g., anti-money laundering).
- Outsourcing is not about giving up talent. On the contrary, it allows tapping into a large pool of otherwise unavailable talent. Many midmarket com-

panies simply fool themselves when they talk about “having the best IT talent.” The reality of the IT market is unless a company is located near one of a handful of major academic/commercial centers, it rarely will have a shot at either tier-one or tier-two IT professionals.

On the other hand, there are certain rational aspects that help explain slow adoption of outsourcing among the mid-market companies.

Size Matters

Three issues stand out in examining differentiators between global and midsize (which most often means regional) carriers: culture, capabilities, and competitive landscape.

The culture of most midsize carriers tends to be strongly tied to the community in which they operate. That, in turn, means placing a premium value on loyalty, relationships, and community involvement rather than simply focusing on costs.

Capabilities of midmarket companies often limit their ability to deploy resources to address outsourcing—an endeavor for which they usually have no internal expertise.

Finally, the competitive pressures within the midmarket insurance industry are not as intense as experienced among the large, global players.

However, if after balancing various pros and cons a CIO decides outsourcing may indeed improve IT’s performance, his or her next step would be to analyze where the best options lie.

The Best Opportunities

First, let’s talk about what not to outsource. For guidance, I’m going to quote one Midwestern carrier CEO recently featured in this very magazine: “I’m not against outsourcing, but I’m against outsourcing the brain.” So, what’s “the brain” of an IT unit in a typical midsize P&C insurance carrier?

Generally, it means those IT jobs where the core expertise of the insurance business resides. The best examples of such functions are business analysts and data analysts. In other words, the people who have the best knowledge of core insurance business processes and the underlying informational content flowing through the systems.

To this rather short list I’d also add functions that provide “glue” between the business-level design and its system-level implementations: architects, designers, and project managers.

For you—an insurance CIO—these are your core assets. Develop, nurture, and protect them at all cost.

Look for Specialty and Commodities

Conversely, functions that are technology oriented but non-insurance related are likely available from multiple sources and quite often their quality will exceed what your company can develop internally. Think about it this way: Who can attract better programming talent—Midwestern Mutual Insurance Co. or Microsoft? Furthermore, while your shop is hard at work to retool for J2EE or .Net, how much focus can you dedicate to keep your legacy maintenance team that still grinds COBOL/CICS code?

As IT matures, many of its functions commoditize and, in many instances, already have become a relatively low-tech game. Help desks, technical support, or various infrastructure services that provide processing, security, e-mail, collaboration, and office support have become relative no-brainers.

A more complex assessment needs to be applied to outsourcing of application or entire business processes. CIOs must look at them in a holistic way and with their strategic hat firmly on.

Test for Fit

Business process outsourcing (BPO) or application outsourcing must be subjected to a stringent analysis in at least three dimensions: suitability, readiness, and risk.

Suitability must test both strategic value and technical cohesion. Functions that can yield new, high-value business capabilities, those with high numbers of complex interfaces, or those dependent on difficult-to-find functional skills are best kept in-house.

Readiness assessment tests the current state of functional, organizational, and technical preparedness. Factors such as poor technical quality of application, complex interfaces, substandard documentation, or dependence on key resources inevitably will diminish the effectiveness of any outsourcing arrangement. These and similar conditions serve as red flags, raising questions as to whether cost-savings benefits indeed can be realized.

Risk assessment concerns all other tangible and intangible areas. For example, the highest risk categories include processes and applications that have direct impact on a company’s reputation or those having a clear need for a frequent, dynamic interaction between business users and IT developers.

At the same time, as the quality of outsourcing services grows, the risks associated with processes that touch companies’ customers are perceived as more and more acceptable. A good example is billing, outsourcing of which has been gaining steadily in popularity.

The analysis of suitability, readiness, and risk vs. the potential value leads to the consideration of specific alternative sourcing options. C-level discussion of these options always enters into sensitive areas and includes such issues as control, organizational pride, vulnerability to vendor- or platform-specific developments, and effects on the broadly meant community of stakeholders.

Regardless of the method and function that are the subject of outsourcing analysis, the CIO must rigorously test the planned financial outcomes from short-, mid-, and long-term perspectives. Also, it is worth remembering that to be a win-win, the savings should exceed a rather steep initial threshold defined by overhead plus vendors’ profit margin. Experience shows a typical overhead (i.e., resources that must be retained by the organization to manage outsourced services at the right level) is between 5 and 15 percent. Adding a net profit margin of, say, 10 to 15 percent gives an idea of a reasonable cost-savings threshold that must be maintained.

Only 70 years ago, Ford Corporation used to go as far as to run its own rubber plantations to control the supply of natural rubber for tires. Today, General Motors, a \$190 billion corporation, runs its entire IT operation with only 1,700 people. You can guess how they do it.

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