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Navigating the Ideal Outsourcing Balance in Choppy Waters

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The shipping industry worldwide is responsible for the carriage of approximately 90 percent of world trade, and is considered a barometer of the collective global economy. The clear waters witnessed by the industry in 2006-2008 were followed by the recession storm in 2009. In May 2008, the Baltic Dry Index (BDI) hit a record high of 11,793 but plummeted down to 663 points, six months later, indicating rough waters ahead. The year 2009 saw the industry adrift as economies staggered. Shipping line operators faced decreased trade, order cancellations, tightened bank-lending regulations, and reduced shipping rates, stocks and profitability.

With the global economy showing an upward trend, 2010 is a harbinger of the shipping and logistics industry getting back on-course. The BDI has risen to above 3,000, with trans-pacific shipping lines already reporting vessel use in the mid-to-high 90 percent range and hinting at significant increase in volumes this year. Pent-up demand has also developed for new logistics services.

The prospect of good times, however, comes with a note of caution. Moody's Investors Services has predicted that they do not anticipate a full recovery of the main players to start until the end of 2011. If companies are to maximize the potential of the current market conditions, they must re-focus on their core activities and leverage specialists to manage the non-core activities. Business Process Outsourcing (BPO) is thus a strategy that can be used effectively in achieving this goal. Morrison & Foerster's recent (2009) Annual Global Sourcing report pegs outsourcing as the solution for organizations to capitalize on the recovery, establishing that their overall strategy is value creation, and not merely cost containment.

Riding the Outsourcing Wave

Many players in the shipping industry adopt a cautious approach and retain complete control of all processes in-house. Some leading players, however, have opted for outsourcing and are realizing benefits. The processes being outsourced are operations, finance and accounting, customer relationship management and information technology.

The outsourcing model has indeed matured over the years. There has been a gradual movement from setting up captive or shared service centers to employing a third-party service provider. There are several reasons driving this change in thinking:

- **Ability to transfer operating and financial risk to service providers:** Instead of maintaining direct control and ownership, shipping and logistics companies are realizing the advantage of transferring operating and financial risks to service providers, who are today far more mature and financially sound to absorb them. For instance, a misrouted container can be a reality for most shipping and logistics companies, despite every effort to avoid the same. With an outsourced engagement, the risk of such a situation and the resulting pressure are mitigated by the provider.
- **Access to best-in-class capabilities:** With third-party providers bringing together a global delivery solution, the shipping and logistics companies gain access to the best talent and experience from all over the world. An established provider has access to the right talent and also has the capability to handle spikes in volumes. It also has robust process management methodologies, which can prove to be a boon for companies.
- **Leverage the flexibility and scalability that BPO service providers can offer:** With the business volumes being unpredictable or volatile, shipping and logistics companies often desire to have the flexibility to scale their business operations in alignment with their business volumes.
- **Cost pressures continue to exist:** The pressure on reducing costs continue to exist. In a recent interview to www.eyefortransport.com, Craig Simon, CEO FedEx Supply chain, indicated that their business plans call for only "a modest recovery in the global economy during calendar year 2010".

Steering Toward the Right Operating Model

When looking to partner with a suitable service provider and arriving at the optimal onshore-offshore mix, shipping and logistics companies have multiple operating models to choose from. There are two basic components that should be assessed when looking at outsourcing — the control structure and the pricing model. Let us look at these two components in detail.

Control Structure

Captive: A company-owned offshore operation where operational and management control and risk ownership are retained by the company.

Fully Owned, Assisted by Consultant: Also known as the 'Dedicated Team' model, the vendor acts as a consultant supporting the client's support and security needs by deploying its personnel or through Internet monitoring. Without adding to in-house manpower, a client can access a talent pool of technicians to resolve problems quickly.

Joint Ventures: Companies that outsource their operations get the opportunity to retain a piece of the ownership pie. They can also partake in the benefits derived from the creation of a new entity, such as revenue and tax advantages.

Build-Operate-Transfer (BOT): A company can partner with an offshore firm to start a subsidiary. The offshore partner can initiate operations and reach stability faster, compared to when conducted in-house. The vendor faces all the obstacles, including taxes, hiring, legal issues and management for a definite period of time before transferring the operations back to the company.

Reverse BOT model: The offshore provider provides implementation support initially and is allowed to buy into the entity at a later date.

Third-party BPO: This entails contracting of the operations and responsibilities of specific business functions (or processes) to a third-party service provider. It allows businesses to outpace competition and achieve rapid, sustainable cost savings, improve cash flow and drive top-line growth.

Pricing Models

Budget Pricing: Project specifications are clearly defined by the company and are undertaken with a fixed price quote, to be delivered in due time. The option of making changes to the scope of work or the cost factor is limited and hence, it is also known as a fixed price model.

Full-time Equivalent (FTE) based pricing: This is suitable for projects that are not clearly defined, where the development is spiral or evolutionary. The client is billed as per the actual amount of efforts spent on various activities, such as design, development, programming and set-up. The company has the option of controlling the lifecycle of the project, giving inputs and direction when needed. Essentially, the client pays time and material for the vendor resources and thus, is also referred to as the Time and Material model.

Unit Pricing: Also known as transaction-based pricing, the client pays the BPO service provider for transactions or per unit of work performed. Unit pricing is revolutionizing cost structures across the shipping and logistics segment. WNS is a leading provider of this model, as it allows each client to enjoy a variable customer service cost per unit of cargo carried or per document processed.

Outcome-based Pricing: The customer and the service provider must align with each other and work toward the same goal. Ideally, for this model to work, the client must have accurate baselines, and well-defined, measurable service levels and performance goals.

Fixed and Variable Pricing: Uses a fixed price at the low end of the service provider's service with variances coming into play with higher service levels. It involves a fixed fee for a baseline set of services and also a variable fee based on the frequency of delivery of a set of activities. The scope of processes and metrics need to be specifically defined at the start of the contract. WNS is fast becoming a leading provider of this pricing model.

The selection of the appropriate business model for taking advantage of an offshore service delivery is usually determined by the culture of each company, although more recently, the adverse economic conditions have been forcing their direction. The fact that third-party service providers such as WNS have invested heavily in building domain expertise and credibility in the shipping and logistics domain has resulted in a positive response from the industry toward such partnerships. In conclusion, there is no one single answer to the question on the model to be adopted.
The solution may well lie in an integrated network of service centers that allow companies to feel comfortable with having control in areas where it matters to them as well as have the ability to take advantage of outside expertise where it adds value.

To learn more, please write to us at **info@wns.com**