

# Taking offshoring beyond labor cost savings

*Offshoring becomes a powerful tool for business transformation once companies combine labor cost savings with other productivity and revenue-generating levers.*

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**Most global executives know** by now that offshoring can deliver more than just labor cost savings. A good offshore strategy should also generate new revenues, increase capital productivity, and manage risk in ways that would be unaffordable in home markets. (For a look at how offshoring plays out in the pharmaceutical industry, see “Pharma leaps offshore,” in the current issue.)

But in many sectors, relatively few executives are acting on this knowledge, even though leading companies are showing where the gains can be made. One reason for the lag is that many executives don’t fully recognize the potential for generating revenues and cutting costs through offshoring—or through broader strategies that combine it holistically with other restructuring initiatives.

Take the airline industry. A carrier with \$10 billion in annual revenues could save about \$100 million a year by offshoring labor-intensive tasks (such as reservations, the administration of loyalty plans, and customer care) to a region with lower

labor costs and comparable or even higher-quality talent pools. Today most multinational companies with significant operations in developed nations have analyzed the cost-cutting opportunities that offshoring can provide and understand them well.

Most companies also recognize that, in theory, utilizing this same lower-cost labor can allow them to pursue revenue opportunities that wouldn’t be profitable if handled by higher-cost employees. As yet only a few leaders have put theory into practice. An airline company, for instance, might find one such opportunity in recouping revenues lost when travel agents undercharge customers for plane tickets—either by mistake or to win over preferred clients. Traditionally, carriers could afford to audit only a small sample of their invoices to detect instances of undercharging, but when the task is offshored to lower-cost locations they can review all the invoices, thereby eliminating such losses. Further, carriers can improve their capital productivity by hiring staff in low-cost regions to process accounting invoices between airlines more quickly.

## Exhibit 1 More than just cost savings

Companies typically adopt cost-saving measures first, then seek other gains.

Benefits from offshoring, example of airline with \$10 billion in revenues; index: gains from labor cost arbitrage = 100



Exhibit 2

## A potent mix

Offshoring should be thought of as only a part of the operating-model redesign.

Insurance company's savings from combining offshoring and process improvements in servicing closed-book life insurance policies,<sup>1</sup> %

Offshoring	Process reengineering	IT automation, consolidation of IT platforms	Total benefits
16	11	18	45%

<sup>1</sup> Closed book refers to a product line no longer offered by a company—ie, an ongoing liability that generates no revenue to support itself.

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But many companies are surprised by just how valuable broader offshoring strategies can be. We estimate, for example, that a carrier could more than double the benefits it gains from offshoring high-cost business activities if it also invests in new programs to enhance revenues and improve capital productivity (Exhibit 1).

What's more, offshoring becomes even more potent when combined with other efficiency levers. An insurance company, for example, reduced the cost of servicing its closed-book life policies by 45 percent through a combination of several measures, including the consolidation of IT on a single platform, automation, process reengineering, and offshoring. The insurer would have saved only about 16 percent with offshoring alone (Exhibit 2).

As the offshoring industry matures, some providers are beginning to specialize in service lines in order to cater to new opportunities, from process reengineering to capturing previously unrecoverable revenues. Executives who think beyond labor arbitrage stand to gain a greater competitive advantage from offshoring. 