

The Outsourcing Decision and Process Group 2

Outsourcing has become an increasingly discussed and debated topic over the past few years – battling opponents in both the business world and the political arena. Although relatively new in the mainstream, the practice of executing an entire business function by a third party service provider has been around for quite some time. Outsourcing became a popular buzzword in business in the early 1990's as technology companies were growing very rapidly. These companies found they didn't have the infrastructure, or the capital, to put together large enough customer service departments to manage their expanding customer base. They found the answer to their problem in a very basic strategy using "temp" workers close to home. However, as time has passed, and technology has improved, outsourcing has become synonymous with "offshoring" – the relocation of business processes to a lower cost location, usually overseas. Many companies have found it both cost effective and convenient to outsource many of their processes, but the decision to outsource is much more complicated than asking "should we or shouldn't we?" Today's global market is forcing both large and small companies to decide if they should outsource, what they should outsource, and what they should consider before they outsource.

Why outsource?

Outsourcing can have many benefits if implemented correctly. The CQ Researcher reported last year that, on average, a programmer in the United States was being paid eight to ten times the amount a programmer would be paid for the same job in India.

Specifically, a team of five programmers in the United States salaries would fall approximately between \$300,000 and \$400,000 a year. The same team in India would receive anywhere from \$30,000 to \$50,000 per year. Besides cost savings, outsourcing has several additional benefits. For example, generally outsourcing requires a relatively small initial investment. Also, outsourcing allows a company to be more flexible in what they produce and how they produce it. By working with various suppliers, companies are able to create many different products, and/or gain access to numerous technologies previously unavailable to them. Overall, there are many benefits to effective outsourcing, but it is important to identify if it is possible to effectively outsource in your organization, as outsourcing is not necessarily for every company.

Should we outsource?

PriceWaterhouseCoopers introduced a simple approach to deciding if outsourcing is right for any given process/company (see exhibit A). The two-by-two matrix first addresses two major issues: How important is the activity for strategic competitive advantage? With respect to time and cost, how competitively is the activity being performed compared to the external marketplace? According to the article, putting the two elements together gives four possible outcomes: First, if a

function is both of strategic importance to the firm and being carried out competitively, it should be left as is. Second, if the function is strategically important to the firm and is not being carried out competitively, the firm should rework (re-engineer) the process to be more cost/time effective. Third, if

	Strategic	Non-Strategic
Competitive	As Is	<i>(Needs discussion)</i>
Non-Competitive	Re-engineer	Outsource

Exhibit A

an activity is not being run competitively and is not of strategic importance to the company, the activity should be outsourced. Fourth, if a process is being carried out competitively, but isn't of strategic significance to the company, many options exist. Because the firm is efficient in this area, they could turn it into a profit center. For example, if a firm is very cost effective and efficient in their payroll processing, they could provide the service to external customers. Additionally, these areas of competitive advantage could be sold or enhanced to become part of the firm's strategic functions. Using this matrix to identify portions of your business that can/should be outsourced is among the first steps to optimization, but there are some items to take into account before moving ahead.

What should we consider first?

Frances Karamouzis, an analyst at Gartner Research, was quoted in the April 19, 2004 issue of Newsweek as saying, "Companies are focusing on relentless cost-cutting and are off-shoring their problems rather than finding a true business solution." Rushing into any business decision can have poor consequences, but giving away control of a portion of

one's business without informed precision can be disastrous. Consequently, it is wise to avoid diving right in to sending things overseas. Rather, a simple process can be followed to avoid some of the more common mistakes of outsourcing. Initially, it is critical to identify your core competencies and to assure that what is being outsourced is not one of them. Next, assess the risks associated with outsourcing that activity. In other words, identify how loss of control of this activity will affect the organization. Finally, if outsourcing is the correct decision, identify specialized firms whose core competencies match the activities you are seeking to outsource, and then manage very closely the transition. The process may seem tedious or slow, but the rewards can be great if done properly. For example, Summit Information Systems, a software developer for credit unions, is a success story grown out of this process. SIS outsourced disaster recovery services four year ago for its data center, located in central Florida. Mr. Steinbach, the individual ultimately responsible for the processing center, was extremely nervous initially. However, after assessing the core functions of the firm, it became clear that this function was not central to their business strategy and could be performed more efficiently by someone outside of the reach of the all-too-common Florida hurricanes. He felt the firm best equipped to manage disaster recovery systems was Hewlett-Packard, but "[his] biggest concern was a lack of control." Steinbach managed the transition to HP very closely and found that once the two organizations had a good sense for each other the need to micro-manage the process almost entirely disappeared. Now, several years later, the process continues well because Steinbach followed the steps for effective outsourcing.

Summit Information Systems is not alone in their success; many companies have reaped the benefits of outsourcing. Similarly, many firms have suffered from the ills of poor planning and miscalculations. With the steps outlined above, and a solid understanding of your organization, outsourcing can become a competitive edge and margin enhancer in your business.

Sources & Additional reference material:

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