

An **Executive Business Solutions** White Paper



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Outsourcing The Advantages and the Risks



Outsourcing

The Advantages and the Risks

There has been extensive heated debate about the value of outsourcing as a method for profitably growing your business and being more competitive in today's economic environment. Some of the heat and discord come about due to confusion and misunderstanding of what outsourcing is and how it will impact your business. In the simplest terms, outsourcing means transferring some or all of a business function to a third party. It does not mean giving up control over your business or even the activity you outsource. It means deciding that some functions are better done by others. The rest of this paper will discuss the reasons why this can make sense for your business as well as some reasons to be very careful when you contemplate outsourcing.

Outsourcing does not mean giving up control or ownership of business functions. The contractor you hire provides services to the specifications you supply and must meet your standards for timeliness, quality, detail, and so forth. You can control the way in which the work is performed and take advantage of the expertise of the contractor to improve the process to gain even greater cost and efficiency benefits.

Outsourcing is a way to allow yourself to focus on your core competencies while sending peripheral activities outside to experts in these areas. Many executives have determined that they are better able to improve operations and increase profitability by spending their time on these core competencies rather than trying to do all things. As a result, outsourcing becomes a strategic management option rather than just a cost cutting tool. You are able to achieve your business objectives more efficiently and devote your time to improving the functions that give you a competitive advantage leading to an improved market position. In today's world economy it has become even more important to focus your resources on your core competencies without the distraction of non-core functions. Simply stated: focus on what you do best and let someone else do the rest.

While this sounds reasonable, there is an important and often fuzzy underlying issue: what are your core competencies? All too often, executives haven't spent the time and energy to clearly understand their business and define exactly what it is that gives them a competitive advantage; what it is that are their core competencies. Before undertaking any outsourcing initiative it is imperative that you devote the time to determine exactly what you can outsource and what needs to be kept within your company's walls.

It is easy to determine that some functions would be better performed by someone else. Many activities have been outsourced for years and entire industries exist to fulfill these functions. For most companies, it's clear that they are not core competencies. Examples of these long time outsourced services include: call centers, contract programming, project management, security, building and property maintenance, and food service.



What's different today is the increasing importance to your business of the services that are being outsourced. There also is a greater level of management and control being handed over to the contractors. Deciding to outsource the company cafeteria is quite different than deciding to outsource the new product development.

Another issue that you need to consider is whether it makes economic sense for you to outsource functions when you have in house expertise. You might be a very good accountant but you would be better off spending your time managing the business rather than creating financial statements. A different way of thinking about this issue is to consider how much you should handle in house and how much to outsource for greater efficiency. An example of this is legal work. Many companies have in house counsel, but still outsource a significant part of their legal work. They make a determination that a few experts inside are necessary, but that the bulk of the work would be better performed by a law firm employing a collection of experts who are available when needed.

Outside experts spend all of their time working in their area of expertise which enables them to stay more current, work more rapidly, know the best ways to do things, have the best equipment, and provide better performance, often at a lower price and within a shorter timeframe. In addition, they are available when needed and you save the expense of maintaining high level expertise for limited need.

Another circumstance where outsourcing can make sense is if you have a function where the work load does not currently require a full time employee. Outsourcing can fulfill your immediate need while you determine if and when it will make sense to build the capacity to perform this work internally. Depending on how the contractor performs, and the cost, you might decide to continue outsourcing rather than expand your workforce. In uncertain times, outsourcing also gives you added flexibility since you have the ability to expand or decrease the work with the contractor on an ongoing basis. This eliminates the challenge of adding and laying off employees on a regular basis.

Finally, there are the financial considerations. Outsourcing can lead to significant cost savings depending on your cost of performing the function in house. Often contractors have lower labor costs, lower cost of materials and lower overhead and pass these cost savings along to you. In addition, they are competing against other vendors so there is always the opportunity to shop around for the best price. You have no need to build facilities, buy equipment, or keep it all up to date while struggling to operate efficiently. It becomes someone else's problem leaving you to do what you do best.

Now we'll look at the advantages and risks associated with outsourcing in greater detail.



Advantages of Outsourcing

Focus: On the Important Things

The biggest advantage outsourcing brings you is focus. Outsourcing allows you to focus your attention on those core competencies that drive your competitive advantage in the marketplace. Time, energy, finances, people, and other resources are all directed towards building company value by becoming the best at what you really do, while leaving all the other tasks to those outside the company. The variety of peripheral functions that draw time and energy away from critical, core activities all can be left to someone else, the outsource contractor, the expert in these non-core activities.

Change: The Obsolete Methods

Companies often get stuck. You probably have heard someone say that they always did it that way. The same people, doing the same thing, the same way, in spite of the changes going on around them, in the business community. It can be difficult to create effective change internally so sometimes outsourcing gives you the opportunity to eliminate the internal problem by hiring specialists to take over the function. Over time you might decide you'd like to bring the function in house again, but now you can start with a fresh look and create an in house department that operates in a new way.

Cut: High Costs

You have a certain cost structure in your company. It's based on your wages, your cost of capital, your rent, your equipment costs, and many other things. Other companies have different costs. Outsourcing companies tend to have the lowest cost for the activities in which they specialize. It's easy to see why. It's all they do. They know how to operate a company performing these specific tasks more efficiently than you ever could. They get economies of scale that you can never achieve. These savings can be redeployed into more productive parts of your business...or can be returned to owners as increased profits.

Access: Best Technology

Every company is limited in the resources they have. Trying to ensure that you have the best and most current technology is difficult for the specialist companies and almost impossible for most other companies. It takes too much time and money to stay up to date on everything and you find it hard to justify for limited use. Your outsourcing contractor has to stay current in their area of expertise. It's what they're selling. You gain their knowledge and their use of the latest technology without the expense of buying it yourself.



Access: Best Knowledge, Skills and Expertise

It's impossible for you to have people with the best knowledge, skill, and expertise in everything. It doesn't make any sense for you to have this in all areas and, besides, it would be cost prohibitive. Outsourcing allows you to have access to the best in all of these areas, when you need it, for a reasonable price.

You also gain access to the contractor's intellectual capital and property, as well as their specialized knowledge and expertise. Not only does this help you for ongoing activities but as they innovate in their field you gain access to this new knowledge. You can even use this outside expertise to support in house innovation.

Access: Speed to Market

Speed to market can mean the difference between success and failure, between a losing product or service and a star performer. Outsourcing enables you to accelerate your product development cycle leading to more rapid market entry. In combination with the cost advantages of outsourcing, this means you are able to provide a quality product or service, at a competitive price, in a timely fashion.

Specific Savings Come From:

- **Labor Cost Savings:** Decreased employee head count and associated costs, and decreased training costs.
- **Equipment Cost Savings:** Decreased purchase costs, maintenance costs, repair costs and upgrade costs.
- **Facilities Cost Savings:** Decreased space costs, utility costs, cleaning costs and building maintenance costs.
- **Balance Sheet Restructuring:** Turn fixed costs into variable costs, free up capital and lower borrowing requirements.

Additional Company Improvements Come From:

- **Talent:** Access to a large pool of subject experts, access to specialty expertise for limited timeframes, access to skilled employees 24/7, access to skilled employees for random workflow increases...and ability to easily cut back when workflow ebbs.



- **Quality:** Access to the most highly skilled workers and experts under contract to meet specified standards.
- **Contractual Arrangements:** Legally binding contracts specifying financial penalties for non performance.
- **Best Practices:** Access to best practices without the cost and time of in house development.
- **Capacity Management:** Use outsourced resources only when required, and use only as much as is required.

Risks of Outsourcing

Now that you've gotten excited about how outsourcing will help you be more successful and profitable, there are a few things to be aware of. You need to clearly evaluate your situation and these risk factors before proceeding.

Lose of Control

- Anytime you hand over a part of your business to someone else you lose some control. If you're uncomfortable with the thought of not being able to walk in and see what's going on with everything related to your business, outsourcing might not be for you.
- The contractor might run into financial or other difficulties impacting their ability to fulfill their obligations to you and, consequently, leading to the possibility of you being unable to fulfill your obligations to your customers.
- Contract terms might lead to a loss in flexibility to address changing business conditions.
- Clear communication is necessary with your customers about any area you outsource that touches them directly. Some customers may find it unacceptable that you outsource certain functions. The way they are treated may change if they have direct contact with an outsourced function. These things may lead to customer defections.

Security

- Everyone is concerned about the security of data and company secrets. Outsourcing opens up another channel for information to leak out. Clear security protocols must be implemented with severe penalties for their breach.



Employee Morale

- Employees may become concerned that their job is in jeopardy of being outsourced causing morale problems. This may also lead to employee defections as they look for new employment in expectation that their job will be outsourced. Morale issues lead to decreased productivity, lower quality, increased costs, and often higher medical costs.

Critical Functions

- Every business has critical functions and core competencies. Before outsourcing anything that approaches the areas of your main expertise, a thorough evaluation is necessary to ensure you are not going to outsource something crucial to the success of your business. Anything that requires you to oversee it on a regular basis and that gives you your competitive advantage should remain in house where you can control it on a daily basis.

So, Outsource or Not?

This brief paper discusses some of the issues you need to think about while investigating outsourcing part of your business. In many instances outsourcing can have a major positive effect on your business leading to increased success and improved profitability. However, there are some pitfalls you need to avoid. You need to carefully investigate the implications of outsourcing various functions of your company, your employees, your customers, and yourself. Take the time and thoroughly consider the impact on your business before deciding.