

# Thinking of Outsourcing?

*Things to consider when contemplating outsourcing; the good, the bad and everything in between.*

**Article Published by AllBusiness.com**

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*Published January 8, 2009*

## Pros

1. Lower operating costs. Access to the outside provider's lower cost structure is one of the most compelling short-term benefits of outsourcing. In a recent Outsourcing Institute survey, companies reported that on average they saw a 9% reduction in costs through outsourcing.
2. More capital funds. Outsourcing reduces the need to invest capital in noncore business functions, thereby making capital funds more available for core areas. Outsourcing also can improve corporate financial measurements by eliminating the need to show return on equity from capital investments in noncore areas.
3. A cash infusion. Outsourcing can involve the transfer of assets from the client to the provider. Equipment, facilities, vehicles and licenses used in current operations all have a value and are, in effect sold to the provider as of the transaction, resulting in a cash payment to the client.
4. Access to new resources. Companies may outsource because they do not have access to the required resources within. For example, if an organization would like to expand its operations, especially into a new geographic area, outsourcing is a viable and important alternative to building the needed capability from the ground up.
5. Better overall IT management. Outsourcing is certainly one option for managing an out-of-control IT function. Outsourcing does not, however, mean abdication of management responsibility, nor does it work well as a kneejerk reaction by companies in trouble.

## **Top Five Long-Term Benefits**

1. Improved business focus. Outsourcing lets the company target broader business issues while leaving operational details to an outside expert. For many companies, the single most compelling reason for outsourcing is to relieve management of the "how" issues that siphon off huge amounts of management's resources and attention.
2. Access to world-class capabilities. By the very nature of their specialization, outsourcing providers bring extensive worldwide, worldclass resources to meeting the needs of their customers.
3. Accelerated reengineering benefits. Outsourcing is often a byproduct of another powerful management tool--business process reengineering. It allows an organization to realize immediately the anticipated benefits of reengineering by having an outside organization--one that is already reengineered to world-class I standards--take over the process.
4. Shared risks. There are tremendous risks associated with the investments an organization makes. When companies outsource, they become more flexible, more dynamic and better able to adapt to changing opportunities.
5. Free resources for other purposes. Every organization has limits on the resources available to it. Outsourcing permits an organization to redirect its resources from noncore activities to activities that have a greater return in serving the customer.

## **Cons**

Loss of control. Critics of IT outsourcing argue that no out side vendor can match the responsiveness and service levels offered by an in-house function, largely because the outsider is not subject to the same management direction and control as employees. In addition, concerns exist with outside vendors about confidentiality of data, strategic applications and provisions for disaster recovery.

Bad for employee morale. Outsourcing often results in layoffs or the transfer of existing employees to the IT vendor. Such displacement can set morale into a tailspin and cause even talented staff to fear for their employment security.

As companies rely more on information technology (IT) to conduct business for example, accessing large market research databases to find new customers and

using the Internet as a storefront IT development and maintenance costs have exploded. It is easy to understand, therefore why companies

Whether you are an IT outsourcing expert or simply considering the option for your client or company, you will benefit from this look at the pros and cons of IT outsourcing.

## **Balancing Risk With Reward**

As users become more aware of the possibilities and limitations of information technology, they tend to become more critical of the internal IT function. A recent study revealed that a majority of senior managers viewed their companies' IT functions as cost burdens rather than as strategic resources. They also perceived internal IT departments as being outdated, inflexible, expensive, unmanageable and lacking a customer orientation.

It is not surprising then that IT outsourcing has experienced such growth. Nevertheless, there is no conclusive proof that outsourcing always will lead to more focused organizations, higher flexibility, lower costs and staffing levels and economies of scale or to the solution of all problems with internal IT departments. In fact, outsourcing is not for every company or client.

With all the media attention focused on the projected benefits of major IT outsourcing deals, several questions emerge: "Is IT outsourcing really as effective as proponents say it is? What are the risks, disadvantages and hidden costs?" Here are some answers.

Media hype and outsourcing benefits. In *Beyond the Information Systems Outsourcing Bandwagon*, the authors concluded that managers often reported glowing success stories during the honeymoon period when the outsourcing contract was first signed. At that point, the client and vendor possess high outsourcing expectations. Projected savings often make the headlines while exorbitant fees for amendments to contracts are not made public because few companies wish to advertise mistakes.

IT is not easily outsourced. Because IT permeates an entire organization, it is not like other resources a company successfully outsourced in the past. IT outsourcing cannot be compared with outsourcing of security, logistics, legal services, advertising or the procurement of raw materials and components.

The cost of switching is high. A shakeout has taken place among IT vendors, with mergers and takeovers becoming commonplace. It is likely that fewer

suppliers will survive in the future, making it more difficult to shop for the right price.

Less flexibility. The outsourcing vendor provides the level of IT services specified in the contract using the technological platform it deems appropriate. Unless specifically spelled out in the contract, a company may lose the flexibility of moving to new computing platforms.

Being held hostage. IT professionals argue that outsourcing allows the user to become a "hostage" of the vendor--the company may lose technical staff and be locked into the vendor's proprietary software and hardware. In a long-term contract, the customer has more leverage in negotiations, but the vendor has more leverage after outsourcing is under way.

Cost savings? Many managers assume that outsourcing vendors are inherently more efficient due to economies of scale. (The economies-of-scale theory says large companies can achieve lower average costs than small companies due to mass production and labor specialization efficiencies.) In the outsourcing arena, however, this model may not always apply. For example, small companies may have lower costs than large companies by employing older technology, offering below-market wages and maintaining tight controls and procedures.

Subcontractors. Companies that outsource often are unpleasantly surprised to find that their vendors aren't working on their projects--someone else is. Outsourcing vendors in search of hard-to-find technical skills often subcontract portions of their computer system work to small, unknown companies--all without the knowledge of their clients. These subcontracts can cause problems, including viruses brought in by subcontractors, poor communications, high costs and low-quality service.

## **Choose Wisely**

Outsourcing major IT functions will continue to grow at a rapid pace. The continued strong growth of both the depth and breadth of IT outsourcing suggests that this management practice is more than just a passing fad and that, under the right circumstances, IT outsourcing may provide the advantages noted by its proponents. For companies that have successfully outsourced various IT functions, the question is not "Should we outsource?" but, rather, "How much should we outsource?"