Outsourcing Cost-Benefit Analysis

Abstract

Outsourcing, as defined by Merriam Webster is “to procure (something, such as some goods or services needed by a business or organization) from outside sources and especially from foreign or nonunion suppliers” (Merriam Webster, para. 1). This is a commonplace practice done by many companies in the corporate world today. While outsourcing can provide many benefits, it comes with its drawbacks and costs. This paper will do a study over these costs and benefits and what it can mean for companies who choose to pursue this option.

Introduction

As companies mature and grow, they are faced with new challenges around allocation of resources and use of money, and they must navigate costs and benefits of all decisions. Especially in the world of IT, internal teams can be costly and having a large number of software developers can come with a high budget. This has led companies to pursue methods of alleviating this financial cost, and one option is to outsource the work to a cheaper source. (Hatipoglu, p. 110) Outsourcing does not necessarily have to be to foreign shores, it can be to other regional companies. This paper will use outsourcing to mean either regional or foreign companies without loss of meaning. Also in this context, outsourcing will include buying software from other companies to use within the business environment, as that work was done by a different source and the work for that was outsourced.

Reasons for outsourcing

Outsourcing can be done for a variety of reasons. These reasons can include that experts are scarce or too expensive, the company wants access to foreign markets, or the company wants to dedicate themselves to their strategic items.

1. Expertise on Subjects - especially niche topics, can be hard to come by. Finding someone who is knowledgeable in older programming languages, like Cobol or Fortran may be tough as those languages are less prevalent in classrooms than they were years ago. Training someone in these is expensive and time consuming, so a company that owns a legacy code base may want to outsource the work to a specialized individual or company to avoid this cost. By outsourcing this work, the company would not need a dedicated person and can instead have the expertise that can come from an outside source. (Smojai, p. 158)
2. Access to Foreign Markets - companies may need to outsource work. Setting up offices in foreign countries is expensive and can be difficult to navigate with international trade agreements and foreign laws. In order for a US company to conduct business in China, for example, they would need to make sure to follow all international laws and regulations as well as all the local Chinese laws. To avoid this, companies might con­­­­­­­­­­­­­­­­tract a sub company already in place in the foreign nation to do business on their behalf. This can save legal battles and reduce the headache of navigating red tape. (Weidenbaum, p. 312)
3. Strategic Vision - focusing on too many areas at once can lead to a company losing their vision and edge. Instead of investing in a development team, coding team, support team, a company might choose to outsource a lot of this work. The company itself develops a plan and lends the work out to specialized sources so that it can still get the work done, but free up workers to support the vision better. (Hatipoglu, p. 113)

Benefits of Outsourcing

There are ample benefits from a company choosing to outsource work. A company may pursue outsourcing for one or more of the following reasons. These include getting field expertise, reducing costs, utilizing time zones for 24 hour coverage, getting around labor laws, sharing risk, gaining flexibility, and reducing employee overhead. The goal of outsourcing is to bolster the company in any way possible, and the following are seven potential benefits.

1. Expertise - One of the benefits is gaining access to experts in the chosen field. The outsourced company is going to be experienced in the field and have employees knowledgeable in the chosen area. For example, a security company like CrowdStrike provides enterprise tools to assist with security that an in house security team may not be able to compete with. (Somjai, p. 158)
2. Reducing costs - Another benefit is reducing costs. Supporting and maintaining code bases and systems can be expensive. Outsourcing the work to India or a different entity may be cheaper than trying to get US employees. Also, other contracts may be in place for work to be done at a cheaper cost than a highly paid internal employee. (Dinu, p. 103)
3. Time Zones - Also, outsourcing to India or China can lead to an increase in coverage for the company. While US employees are sleeping, India will be having normal day time routines. By splitting work to cover wide parts of the globe, the company can have workers active 24 hours a day. (Weidenbaum, p. 312)
4. Labor Laws - Further, outsourcing can provide ways to get around labor laws. Countries like the US have very dedicated labor laws that specify many requirements for businesses to follow. If a company chooses to pursue outsourcing, they can hire employees who may not have the same requirements. Companies will often hire consultants or help desk support from India since they can get around labor laws. (Indeed, para. 8)
5. Risk Sharing - A company that chooses to outsource may also share risk. Instead of taking all the risk onto themselves for security issues or company downturns, they can share the risks with the outsourced company. This way they have multiple resources pouring in for projects and are less responsible for certain responsibilities. (Somjai, p. 159)
6. Flexibility - Companies that outsource are also more flexible in what they can accomplish. By leaving certain business components to outsourced workers, companies can focus on their own mandate and vision while leaving the implementation or extraneous work to an outside source. (Hatipoglu, p. 113)
7. Reducing Employee Overhead – Employee count can put a huge strain on resources of the company. Having to maintain payroll, documentation, insurance, HR tasks, etc. can require a lot from the company. By outsourcing the work, the company can cut employee overheads as that is all managed by the outsourced work and not internally. This can free up resources in the company. (Weidenbaum, p. 312)

Costs of Outsourcing

Although there are plenty of opportunities with outsourcing, there are quite a few drawbacks as well. These include reliability of outsourced firms, legal contracts, potential long-term commitment, legal requirements, customer frustration, loss of control, and security concerns.

1. Reliability of Outsourced Work – The outside company may not have the same standard of work and may be slower in delivery than an internal team. A company that seeks outsourcing is reliant on the reliability of the work. (Dinu, p. 104)
2. Legal Contracts – Often times there are legal contracts that need to be in place. This can take time and pursuing a breach of contract can be lengthy and expensive. A company not ready to engage in legal affairs could be taken advantage of or suffer from unfair restrictive requirements. (Tayauova, p. 190)
3. Long-term Commitments – Building up relationships with outsourced vendors takes time. Also switching vendors in the near term can be costly, so companies may be locked in for the long term to a chosen company. If that company is failing to deliver or the outsourced work is not meeting standards, switching away might be expensive. (Tayauova, p. 194)
4. Extra Requirements – Depending on the type of work needed, there might be certain requirements needing to be met. For example, if a company chooses to outsource to a foreign country, the internet infrastructure might not be up to date, so the company may need to invest in building other offices. (Weidenbaum, p. 313)
5. Customer Frustration – Customers might report negative feedback from having to work with foreign help rather than domestic help. Oftentimes customers are frustrated with having to work with IT support from India that they feel cannot help them as much as a direct line. This can lead to a loss of customers and revenue. (Weidenbaum, p. 313)
6. Loss of Control – The outsourced work is no longer a part of the company. It is managed by the other party and although there is say in how things are done, there is no direct management of the other company. This may lead to companies feeling like they have lost their share in the work. (Dinu, p. 104)
7. Security Concerns – Security can be a major concern in all companies. If the outsourced company suffers a data breach or other event, then private information may be exposed. Further, the other company could steal intellectual property since they have access to internal information. Having a strong trust and requirements for security are important. (Somjai, p. 159)

Agile Team Considerations

Another thing that companies need to consider is the impact on the agile team. Should a company decide to outsource development work, then more considerations need to be made. Having more team members can be a boost to the team and morale as work can be better done. But it also can lead to frustration about synchronizing meetings, never meeting the coworkers, and feelings of loss of control of projects. Depending on how well the company does with outsourcing, the agile team can be positively boosted, or the outsourcing can ruin the team. Especially in IT, the cohesion of the agile team is a necessity to produce a good product. If the agile team cannot trust the outsourced work, or the internal company to protect their interests, the quality of software will be negatively impacted, and work will be slow.   
Conclusion

Businesses have many factors to consider in their operation, and it is the goal of the company to reduce costs and increase their revenue. When looking at ways for the business to continue to grow, many will consider outsourcing. According to a study done by Accenture, “87% of the [1,000] companies surveyed outsourced at least one aspect of their company” (Melissa Wesley). Outsourcing is a common part of businesses, and it can have many benefits to the company. Along with these benefits there are plenty of drawbacks and factors to consider before a company decides to go with outsourcing. After fully considering the benefits and risks, companies can best determine their appetite towards outsourcing.

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