FINANCIAL ASSESSMENT

Cost reduction is the most talked about purpose for outsourcing. Outsourcing has a number of advantages, including cost savings and a boost to the bottom line. Financial assessment is the process through which a company evaluates and analyzes its financial features, as well as what it expects them to be in the future. In addition, we estimate the cost of current operations and processes so that we can compare a vendor's proposed cost to a solid baseline. It's also where a business must fully comprehend its own internal expenses as well as the various sorts of costs associated with outsourcing a process in order to make an accurate assessment of cost savings possibilities.

Direct versus indirect costs

Direct costs are typically very tangible and easily quantifiable. These are the costs that are typically included in any costing report or financial statement. This includes the cost of carrying out the process in terms of resource consumption, employee costs, and general administrative expenses.

Indirect costs are expenses that an organization must bear but are difficult to quantify. These include legal fees for developing new contracts, employee assistance and displacement fees as a result of job reassignment or termination, and communications costs. These costs are indirect in the sense that they do not directly affect the process that companies intend to outsource, but have an impact on the entire organization and, as a result, affect the overall cost.

Current costs versus future costs

A cost whose factors are valued at current acquisition and production costs is referred to as a current cost. It is determined by the current cost of materials, labor, and other factors. Future costs are those that will be incurred in a subsequent accounting period. Management typically determines these expenses based on likelihood, inflation, exchange rate, or expert review.

Type of Costing Method

There are two common approaches used when assessing vendors' proposals: price down and cost up.

Price down compares the organization's prices to real market prices paid by other customers who purchase similar products and/or services. When the pricing is detailed, the service or products are commodities, and service providers utilize similar pricing structures, price reductions work well.

Cost up determines the fair market pricing by modeling the vendor's expenses using known costs of in-house delivery of identical services. Cost up works best in huge multiservice contracts where some products and services may have cross-subsidized others, service providers' pricing is excessively high, and there is little competition for price comparison analysis.

RISK ASSESSMENT

Management is all about managing risks and uncertainty. Risk assessment analyzes risk and associated risk mitigation techniques by taking a broad picture of the organization and the planned outsourcing endeavor.

Strategic risks

The interaction between the organization and the proposed vendor is the focus of strategic risks. Intellectual property risk, for example, entails determining the likelihood of internal intellectual property being exposed to an external services provider.

Key questions include:

• Are the strategies of the two organizations compatible?

• Are the organizations' strategies in conflict and do they limit or inhibit the success of the proposed initiative?

• What is the partnering experience of both parties?

• Have they had experience and success in establishing and managing these types of relationship?

• What is the level of executive commitment? And are the executives truly supportive of the proposed initiative?

• Are they committed to providing the vision, leadership, resources and resolve to make the initiative successful?

Operational risks

The risk of managing the internal and external operational parts of the planned outsourcing initiatives is addressed by operational hazards. These risks cover a wide range of topics, including defining managerial and operational roles and duties, as well as deciding process, procedure, methodology, and mismatches between buyer and service provider organizations. Staff transition, retention, and attrition rates are all operational risks.

Technology risks

The technology risk assessment identifies the characteristics of the organization's technological support. This evaluation also identifies any potential hazards related with the proposed outsourcing project's technology, as well as their influence on both the client and vendor businesses. From cradle to grave, this examination evaluates all technology factors that may pose a risk.

Financial risks

All internal expenses and financial system maturity levels are defined and baselined in the financial risk assessment. It also outlines the financial risks connected with pursuing the planned outsourcing project. This can cover both the client's and potential vendor's financial stability.

Managing risks

The purpose of risk assessment is to alert executives to the fact that outsourcing is a high-risk business venture. First and foremost, executives must be aware of the risks and the nature of those risks. After that, evaluate the dangers.

Based on the list of hazards, their likelihood of occurrence, and associated cost, organizations can use a variety of risk management strategies. First, businesses must determine how much risk they are willing to take. Second, they must identify risk mitigation techniques in order to manage hazards. Finally, a backup option or contingency plan must be devised.

Integrating the four risk elements – the business case

The outsourcing team must prepare and submit the outsourcing business case after the organization has performed a thorough internal assessment of the risks involved with a successful outsourcing program.

The following elements are typically included in a business case:

• Executive summary: contains the high-level view of the outsourcing strategy. In particular, it summarizes each of the individual components of the business case.

• Case for outsourcing: outlines the rationale. In particular, it explores the business-value elements of outsourcing efforts.

• Executive sponsorship: highlights key personnel who endorse and sponsor the effort and their roles and responsibilities in terms of making the effort successful.

• Objectives, purpose and scope: covers the operational assessment, specifically highlighting the areas in which outsourcing would be an appropriate strategy to pursue and for what reason.

• Planned outcomes and benefits, cost and benefit analysis: explores details of the financial and risk assessments by highlighting the expected contributions of outsourcing to the firm.

• Risk, mitigation and assumptions: outlines the findings of the risk assessment analysis.

• Operational details: contains details such as the project plan, resource management issues, costs and schedules, communications plans and roles and responsibilities.