Book Inside Outsourcing

An Insider's Guide to Managing Strategic Sourcing

Charles L. Gay and James Essinger
Nicholas Brealey Publishing, 2000

Recommendation

Books that help a business consultant promote consulting can be suspect. After all, the consultants' first piece of advice is that you need to hire them. That caveat aside, you will find this a well-conceived view of the practical mechanics of setting up a good outsourcing program. The text can be redundant, telling you many times over that you need to agree on measures to define a project's success. However, even though authors James Essinger and Charles L. Gay don't dodge all the pitfalls, they do hand you the common-sense fundamentals you need to safely navigate the trendy world of outsourcing. Overall, *BooksInShort* recommends this as a useful volume that will help any executive who is thinking of setting up an outsourcing program or wondering how to do it better next time.

Take-Aways

- Strategic outsourcing is a useful approach in a profit-driven business environment.
- Outsourcing should do more than offload corporate responsibility. It should generate real, measurable benefits to the corporation.
- Outsourcing requires management to focus on outputs (not inputs) and results (not methods).
- To set up an outsourcing program, first set organizational goals and measures.
- Communicate with your employees, who may see outsourcing as a threat.
- Even if it is bureaucratic, a Service Level Agreement (SLA) - defining the service, its outputs and how you will measure it - will improve your success rate.
- The advantages of a partnership with the right supplier often outweigh the bottom-line price.
- Develop a contract that specifies performance levels and consequences.
- Monitor the success of the initiative.

Summary

Do What You Do Best

If you've ever flown British Airways, you might be interested to learn that the crew, cabin staff and even the aircraft itself are all outsourced. The company focuses on its one key area of expertise: customer relations. British Airways is not the only corporation that takes maximum advantage of outsourcing opportunities. The Harvard Business Review identified outsourcing as one of the most important management practices of the last 75 years. More than 90% of U.S. companies outsource at least one function - unfortunately, many of them don't know what they're doing.

> "'If it's a hassle, outsource it' is hardly a particularly dignified or coherent management theory, but it is one that is practiced every day in the U.S. and many other countries."

The main forms of outsourcing include:

- Contracting activities to outside organizations - Companies often contract out low-level ancillary services that do not involve strategic thought, such as cleaning and maintenance.
- Service outsourcing - When you outsource your company's service elements, you must carefully select the party who will represent you. Your goal is to tap into the service provider's expertise, so that your company can concentrate its resources on doing what it does best.
- Insourcing - When you have a small business unit that can take on work beyond its own needs, you may choose to insource your work from one part of your organization to another. This can help make a viable business unit out of a function that otherwise would be too small to stand on its own.
- Co-sourcing - Both the vendor and the host corporation work to insure a sufficient supply of the resources needed to complete the job. The vendor and host company become more interrelated.

Why Outsource?

Historically, organizations have performed non-core activities themselves, either because they could not find reliable vendors, or because pure size was a company goal. Today, the goal of "return on investment" has replaced the goal of "pure size." The top reasons for outsourcing are:

- To control operating costs.
- To sharpen company focus.
- To improve capability.
- To free resources for other tasks.
- To obtain resources that are otherwise unavailable.

> "Outsourcing is the most potent management tool ever invented for driving efficiency into an organization."

Increasingly, outsourcing is collaborative, more along the lines of co-sourcing. These relationships become partnerships, benefiting both the outsourcing firm and the host company.

Outsourcing can have a dark side. Deals that focus inordinately on cost reduction, or that the board makes without input from managers, are subject to difficulty. For any outsourcing effort to be successful, you must have a clear understanding of company goals and objectives, how the outsourcing effort fits into the company's strategic plan and vision, continuing management of the relationship with the vendor and the right vendor for the job.

> "Strategic sourcing is not just a matter of tapping into a supplier's expertise, it is also a matter of insulating oneself from a supplier's problems."

Outsourcing also brings less-obvious leveraged benefits, which include:

- Spurring change by exposing the need for improvements elsewhere in the organization.

- Supporting other business initiatives, such as IT implementations or process modeling.
- Initiating cultural change by educating people about creative service-delivery options.
- Stimulating internal competition.

Outputs and Results

Outsourcing should be strategic and not merely address an ad hoc need. It should systematically enhance your productivity and competitiveness. However, management must accept a new perspective on control. You must stop focusing on inputs (how things get done), and focus instead on finished output (what is to be done and how much). You must leave outsource vendors to their own internal processes and methods. If you are a host company manager, it is the output that ultimately matters to you.

New Approaches

To magnify your outsourcing effort, thoroughly assess your company's needs. Ask the following questions:

1. What are the goals of the outsource initiative?
2. What is the service or function you are considering for outsourcing?
3. Is the need compelling?
4. Is this initiative directly relevant to your strategic intentions?

"In our experience it is fear and uncertainty that generate staff turnover, not outsourcing."

The next step is to develop a business case that presents your proposal. This can vary from a few sentences on one piece of paper to a detailed feasibility study running 100 pages or more. Compare the way you currently manage things to the improvements you expect under the new arrangement. The business case should contain the following key sections:

- Executive summary.
- Strategic overview or context.
- Current status quo.
- Options available.
- Benefits of the recommended course.
- Costs.
- Analysis of vulnerability of your key assumptions to change or miscalculation.
- Risks.
- The plan.
- Recommendations.

"When a change on the scale of that demanded by an outsourcing initiative is announced it is, unfortunately, human nature to be against it."

Define the project's parameters, and define success. Go into your outsourcing program with the following benchmarks:

- A clear boundary defining the vendor's and your company's responsibilities.
- A method of measuring the success of the program.
- A definition of the relationship with the supplier.

Operational Plan

Once you make the decision to move forward, your organization must take the following steps:

- Create an operational plan, a set of instructions to the vendors on what you want done.
- Establish written objectives.
- Determine potential suppliers.
- Issue a Request For Proposal (RFP).

- Determine a short list of potential vendors.
- Evaluate supplier responses.
- Involve your senior managers in the selection process.
- Identify and train the people who will manage and supervise the contract.
- Negotiate the contract and sign the Service Level Agreement.
- Manage the transition to the outsource effort.

Legal Aspects

Break down the agreement-signing phase into two segments: 1) a non-binding memorandum of understanding that defines the scope and goals of the project, and 2) the actual service contract. The contract is an important risk-management tool that foresees different situations that may arise, and prescribes a response based on the relationship between the parties. The contract should be flexible enough to accommodate unforeseen changes in your business environment. It should describe the process you would use to address issues of poor performance. Laws exist that affect the relationship between your company and its outside vendors. Your human resources staff should properly define your legal parameters.

The People Part

Think carefully about outsourcing's impact on your employees. They may perceive outsourcing as a threat to employment security. Questions to consider include:

1. Are there other, concurrent initiatives that might overload the staff?
2. Have you thought through the staff's likely questions?
3. Can you provide a hotline for staff members with questions?
4. Are there ways to communicate as the process evolves, through team meetings, announcements or newsletters?
5. Are there other stakeholders with whom you should communicate, such as shareholders and customers?
6. Have you planned for a smooth transition to the outsource effort?

People = Resistance

You will experience some resistance to change. It's human nature. Staff members resist when they feel they have lost control over their jobs and lives, and you can anticipate this need and prepare to address it. Communication is the key - early, often and open. Your employees may think you are disenfranchising them. You may experience a "culture clash." Involving employees and managers early in the process will reduce stress. (For example, some companies have developed user roadshows for IT changes and use them to familiarize employees with the changes that otherwise would be thrown at them without their prior involvement.)

Checking Up On Results

You must commit yourself to monitoring the success of your outsourcing program. Use the clear objectives and standards in your Service Level Agreement to make sure the program is performing satisfactorily. Give periodic reviews. If the contractor is performing, you should be able to demonstrate measurable gains in efficiency and quality improvement. Look for other, less tangible benefits as well, such as leveraging off a vendor's specialized expertise and capabilities. Review the results regularly, and communicate them. Tracking results will give management the confidence to consider future outsourcing endeavors.

Conclusion

Planning is the key to running a successful outsourcing operation. If you define the results that you want, establish a consensus about your goals and use outsourcing as a way to improve your business - rather than simply as a way to shift costs and responsibility - then strategic outsourcing can be a valuable tool for building your company's future.

About the Authors

James Essinger has written more than 25 business books and many popular science articles. His most recent work is *Jacquard's Web*. **Charles L. Gay** is managing director of Shreveport Management Consultancy, which specializes in implementing outsourcing initiatives.