

IT Outsourcing: The Reasons, Risks and Rewards

Modern IT Management

Week 2

Background

- For a small company, the benefits of outsourcing seem obvious, touted by experts across numerous industries as the answer to cutting costs for business functions ranging from information technology to accounting, marketing and human resources; it seems possible that you could run an entire company without ever hiring a single employee.

- But is there more to outsourcing than the bottom line? What are the other reasons companies choose this route
- 3 R's of outsourcing: Reasons, Risks and Rewards, specifically as they relate to information technology (IT).

The Reasons

According to the Outsourcing Institute's Outsourcing Index 2000, there are many reasons why companies outsource. Here are some of the top reasons:

- **Reduce and control operating costs.** When you outsource, you eliminate the costs associated with hiring an employee, such as management oversight, training, health insurance, employment taxes, retirement plans etc.
- **Improve company focus.** It is neither practical, nor possible to be a jack of all trades. Outsourcing lets you focus on your core competencies while another company focuses on theirs

- **Gain access to exceptional capabilities.** Your return on investment is so much greater when you outsource information technology to a firm that specializes in the areas you need. Instead of just the knowledge of one person, you benefit from the collective experience of a team of IT professionals. Outsourced IT companies usually require their IT staff to have proper industry training and certifications as well.
- **Free internal resources for other purposes.** You may have someone in your office that is pretty good with computers or accounting, but most likely these were not the jobs he or she was hired to do. If they are spending time taking care of these things, who is doing what they were hired to do? Outsourcing allows you to retain employees for their highest and best use, rather than wasting their time on things that may take them longer than someone who is trained in these specific areas.

- **Resources are not available internally.** On the flip side, maybe you don't have anyone in your company who can manage your IT needs, and hiring a new employee is not in the budget. Outsourcing can be a feasible alternative, both for the interim and for the long-term.
- **Maximize restructuring benefits.** When you are restructuring your company to improve costs, quality, service, or speed, your non-core business functions may get pushed aside. They still need to be handled, however, and outsourcing is an optimal way to do this. Don't sabotage your restructuring efforts by failing to keep up with non-core needs.
- **Function difficult to manage or out of control.** This is definitely a scenario when outsourcing to experts can make a big difference. But don't make the mistake of thinking you can forget about the problem now that it's being "handled." You still need to be involved even after control is regained.

- **Make capital funds available.** By outsourcing non-core business functions, you can spend your capital funds on items that are directly related to your product or your customers.
- **Reduce Risk.** Keeping up with technology required to run your business is expensive and time consuming. Because professional outsourced IT providers work with multiple clients and need to keep up on industry best practices, they typically know what is right and what is not. This kind of knowledge and experience dramatically reduces your risk of implementing a costly wrong decision

The Risks

- Anytime you give someone else responsibility for an aspect of your business, whether a full-time new hire or an outside vendor, there is risk involved. Did I hire the right person/company to do the job? Will they do what they are supposed to do? How will they "fit" with existing employees or departments? These are the questions that nag owners of small businesses when handing over the reins to a new employee or vendor.

According to Yvonne Lederer Anotucci in her article "The Pros and Cons of IT Outsourcing," business owners who consider outsourcing IT functions need to be aware of the following risks:

- **Some IT functions are not easily outsourced.** IT affects an entire organization; from the simple tasks employees do everyday to the complex automated aspects. Be sure the outside vendor are qualified to take care of your greatest needs.
- **Control may be lost.** Critics argue that an outside vendor will never be as effective as a full-time employee who is under the same management as other employees. Other concerns include confidentiality of data and disaster recovery. However, a supervisor that is knowledgeable in managing an IT staff member will usually be required.

- **Employee morale may be affected.** This is particularly true if you will be laying off employees to replace their job functions with an outsourced firm. Other employees may wonder if their job is at risk, too.
- **You may get "locked in."** If the vendor does not document their work on your network and system, or if you've had to purchase their proprietary software, you may feel like you can't go anywhere else or take back your network. Many outsourced companies require you to sign a year to year contract which limits flexibility.

Most of these risks can be avoided altogether if you know what to look for in a vendor and ask the right questions.

These questions will get you thinking about what to ask and what to look for, whether you want to hire a full-time IT professional on staff, or outsource to a support provider.

The Rewards

Still not sure whether to outsource or not? According to Anotucci, who provided the list of risks outlined above, there are many rewards you can expect when you outsource your company's IT functions as well:

1. **Access to the latest and greatest in technology.** You may have noticed how rapidly software and hardware becomes obsolete in this industry. How is one staff person going to keep up-to-date with everything? Outsourcing gives you the benefit of having more than just one IT professional. And since it's the core competency of the company, they can give you sound advice to put your IT dollars to work for you.

- **Cost savings.** Outsourcing your IT services provides financial benefits such as leaner overhead, bulk purchasing and leasing options for hardware and software, and software licenses, as well as potential compliance with government regulations.
- **High quality of staff.** Since it's their core competency, outsourced IT vendors look to hire staff with specific qualifications and certifications. You may not know what to look for if you're hiring someone to be on staff full-time, so you may hire the wrong person for the job.

- **Flexibility.** Vendors have multiple resources available to them, while internal staff may have limited resources and capabilities.
- **Job security and burnout reduction for regular employees.** Using an outsourced IT company removes the burden from your staff who has taken on more than he or she was hired for because "someone needs to do it." You will establish a better relationship with your employees when you let them do what they do best and what they were hired to do

Why outsource? Five key reasons to outsource

- IT practitioners are often faced with this burning question: Why outsource? Or should I outsource?
- Outsourcing of manufacturing functions were the predecessor to IT outsourcing. Answers to the afore said question will be similar to answers to why manufacturing groups took the outsourcing route as early as IT departments.
- Is it always cost? Or is it to achieve better economies of scale? Is it shortage of technically trained people? Has it something to do with global reach in terms of supply and demand? Or is it just technology spread or the lack of it?

- **Cost Optimization**

Optimization of costs within the IT function will be one of the primary reasons why IT functions are outsourced globally. A combination of engagement models will be employed to arrive at the best possible outcome.

- **Management of Technology**

The ever changing technology landscape is throwing up challenge after challenge to CIOs. Gone are those days when you could afford to keep people on your payroll who have got skills across all the technologies that you may have within the organization. On the other hand, if you have a portfolio of vendors who can provide you such services, your technology management becomes all the more simpler.

- **Economies of Scale**

It is always a huge challenge for CIOs to meet the demands of a dynamic business. When you outsource and save some money in the process, you also tend to get some freed up budgets available for doing new projects. This in turn contributes to greater economies of scale within the IT group and empowers the whole organization to move forward.

- **Skills Availability**

Heavily drawing upon the second reason mentioned above, outsourcing is an avenue to avail those rare-to-find skills that are badly needed to support legacy systems and keep the business running.

- **Global Reach**

When businesses grow globally there is always a problem of addressing demand as well as supply of IT functions to the global users. To what extent can a centralized IT organization serve a global business user base? There are always limitations. When you outsource some of these functions, you can leverage upon the global reach of the vendor organization to address such issues.

IT Outsourcing is here to stay. But you have to get your outsourcing models right, and you also need to zero-in on what you should outsource.

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IT OUTSOURCING

Ref. :Smith Suksmith

Outsourcing Categories

- Application Software
- IT Infrastructure
- Business Process Outsourcing
- Manufacturing

Application Software Outsourcing

- Maintenance and support of existing legacy software systems
- Enhancements to existing software applications
- Integration between multiple application software solutions
- Development of new software applications
- Migrating older applications to new technology
- Quality assurance testing

IT Infrastructure Outsourcing

- Physical facilities setup and maintenance
- Site security and environment control
- System security
- Data storage, backup and recovery management
- Disaster recovery
- Hardware/software procurement
- Help desk/end-user support
- Desktop break-fix

Business Process Outsourcing

- Transaction Processing
- Finance and Accounting Billing
- Customer Relationship
- Human Resources Payroll Management
- Supply Chain Management and Logistics

Shall Our Organization Outsource?

Why Do It?

- Lower Costs
- Improve Services
- Obtain Expert Skills
- Improve Processes
- Improve Focus on Core Activities

Why Not Do It?

- Too Small to Effectively Outsource
- In-appropriated Culture for Outsourcing
- Customer Reasons
- Government Policy
- Required Different Type of Management Leadership in the organization

KEY SUCCESS FACTORS

Key Success Factors

- Define the Objectives
- Outsource for the Right Reasons
- Answer Key Questions
- Use a Methodical Approach
- Consider All Stakeholders
- Get the Right People Involved
- Understand the Vendors
- Realize that Outsourcing is not All or Nothing

Key Success Factors (cont.)

- Choose the Right Relationship
- Negotiate a Sound Contract
- Use Performance Incentives and Penalties
- Establish a Relationship Management Structure and Processes as Part of the Contract
- Use Objective Performance Criteria
- Emphasize the Development of the People Responsible for Relationship Management
- Manage the People Issues

Define the Objectives

- Must be done carefully, Systematically with Explicit Goals
- Consider Both Strategic and Tactical Concerns on both Department and Organization Level
- Justifiable for a department with high costs that cannot be reduced or a lack of competency in specific areas
- Not an Excuse to Wash Poorly managed, costly, or misunderstood function

Outsource for the Right Reasons

- Assess Potential Tactical and Strategic Benefits and Disadvantages
- Tactical Reasons
 - Reduction or Control of Operating Costs
 - Increased Availability of Capital Funds
 - Cash Infusion
 - Lack of Internal Resources
 - Problematic Functions

Outsource for the Right Reasons

- Strategic Reasons for Outsourcing
 - Improve Business Focus
 - Access to World-class Capabilities
 - Accelerated Re-engineering Benefits
 - Shared Risks
 - Redirection of Resources
- Potential Disadvantages
 - Wrong reasons
 - Losing control of the resources

OUTSOURCING –STEP BY STEP

Outsourcing -Step by Step

- Defining the Problem/Need
- Creating the Outsourcing Vision
- Tactical Planning and Preparation
- Selection Process

Creating the Outsourcing Vision

- How does outsourcing relate to your objectives?
- What are your core competencies?
- What activities are not core to your objectives?
- What is your outsourcing strategy?
- What is your vendor selection strategy? Single (Suite Provider) or Multiple (Best of Breed)

Tactical Planning and Preparation

- Conduct an Organization Readiness Assessment
 - People
 - Process
 - Technology
 - Risk Profile
- Decided What Specifically shall be Outsourced
 - Legacy Application
 - New Application Development
 - Reengineer/Migrate/Port to a New Technology Platform

Tactical Planning and Preparation (cont.)

- Decide What is Needed from the Relationship
 - Obtain Flexible Capacity
 - Transfer Existing Employee
 - Obtain Legacy/New Technology Skills
- Decide What is wanted from the Outsourcing Provider
 - Specific Project Model
 - Supplemental Model
 - Onsite Model
 - Offsite Model

Vendor Selection Process

- Develop Vendor/Solution Viability Matrix
- Compare Strength and Weaknesses of Each Vendor
- Conduct Due Diligence on Finalists by Contacting Reference Accounts
- Conduct Site Visit – if deemed necessary

Q & A