Outsourcing

"the procurement of products & services from sources that are external to the organisation"

Why Outsource?

- Rapid changes in technology & business rules make it difficult for in-house functions to offer services which make the best use of available technologies & integrate these rapidly into the business

Why Outsource Cont.

- Managing an IT Dept often requires vastly different skills & performance measures to that which is used to manage the core function
- Competitive strengths seldom lie in service units outside of the core function
- Organisations have come to recognise that others are in a better position to perform certain services more effectively whilst core competencies are retained

Objectives of Outsourcing

- Reduce & control operating costs
- Improve company focus
- Gain access to world class capabilities
- Free internal resources for other purposes
- Resources are not available internally
- Accelerate re-engineering benefits

Outsource Objective Cont.

- IT function is difficult to manage
- Make capital funds available
- Share risks
- Cash infusion
- Reduced IT costs
Key Benefits of Outsourcing

– Allows the organisation to focus on core competencies
– Organisations may obtain the benefit of more specialist skills
– Organisation is able to keep abreast of market developments
– Allows for flexibility in workload planning & flexibility in general

Disadvantages of Outsourcing

– Without proper management, solid contracts & realistic expectations can become difficult
– Reduces a company's control over how certain IT services are delivered
– This in turn can raise exposure to liability
– Reduction in staff & loss of employee IT knowledge
– Higher than expected costs

What is Being Outsourced?

Some services outsourced more than others
Training is the most frequently outsourced activity
Payroll & back office operations
Systems planning & development

What is Outsourced Cont.

Data Centre operations
Applications development & maintenance
Technical Support (help desk function)
Wide area communications
Building on-line relationships with customers & suppliers
Initiating web commerce/website development

What is NOT Outsourced?

– IT Management
– Infrastructure development
– Strategic Planning
– Organisations usually maintain a Chief Information Officer with a four dimensional portfolio

Key Industry Trends

US outsourcing market reached $100 billion in 1998
World market reached $150 billion
1998 in US 80% of Fortune 500 companies were outsourcing some of their information management functions
On average companies experience a 9% cost saving & a 15% increase in capacity & quality through outsourcing
Key Industry Trends Cont.
- 61% of companies state outsource decision was made at "senior executive" level
- 50% of companies with It budgets in excess of $5 million are either outsourcing or actively considering it
- 85% of banking & finance companies with IT budgets in excess of $5 million are either outsourcing or actively considering it

Who are the Major Outsourcing Vendors?
- More than half the global outsourcing market controlled by IBM, EDS, Andersen Consulting, DEC, Computer Sciences Corporation & AT&T
- United Technologies Corporation (UTC) recently became the largest global company to cut supply chain costs by outsourcing its procurement function

Who is Outsourcing Cont?
- Banc One Corporation recently turned over all telecommunications & data processing responsibilities to AT&T & IBM
- Sears, Roebuck & Co has been a major player in the selective outsourcing of information systems & mundane IS’s tasks to better utilise IS staff
- Motorola signed a 5 year agreement with EDS in 1998 to manage IT infrastructure for more than 6,000 users

What are the Risks of Outsourcing?
- Outsourcing of IS/IT central to business strategy may be a dangerous diversion if IT operations already efficient
- Possibility of Weak Management
  • A problem if the IT function historically poorly managed inhouse
  • Co executives need to be able to manage contracts & third party relationships

Risks Cont.
- Inexperienced Staff
  • Relatively new IT service businesses don’t necessarily have either the best expertise or solid experience so can be counterproductive to providing the skills in-house
  • Problem of "headhunting" good staff by other providers

Risks Cont.
- Business Uncertainty
  • If a firm decides to outsource IT services because of costs or focus it is assuming that its future direction & needs are clear
  • Often sign away a resource that can take a long time to replace
  • Unknown future business needs and long term opportunity costs which can increase with business uncertainty
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<thead>
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<th>Risks Cont.</th>
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<tr>
<td><strong>Outdated Technology Skills</strong></td>
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<td>• How can a firm be certain that the IT skills of the outsource Co stay</td>
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<td>current?</td>
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<tr>
<td><strong>Endemic Uncertainty</strong></td>
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<tr>
<td>• IT operations &amp; development have always been inherently uncertain</td>
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<td>• Companies should avoid outsourcing that are set in concrete</td>
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<td><strong>One year reviews can involve costly annual contract amendments</strong></td>
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<td><strong>Better to pay for flexibility rather than tight performance contracts</strong></td>
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<td><strong>Hidden Costs</strong></td>
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<tr>
<td>• When cost reduction is the objective of outsourcing there is typically</td>
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<td>a promise of early cash flow benefits &amp; long term cost reductions</td>
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<td>• Two tendencies of concern</td>
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<td>• Firstly, companies inevitably underestimate setup costs or longer than</td>
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<td>expected parallel running costs</td>
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<td>• Secondly, Companies underestimate management costs</td>
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<td><strong>Lack of Organisational Learning</strong></td>
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<td>• Much of the learning about IT is experiential</td>
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<td>• Management tends to learn about the value of IT applications by using</td>
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<td>them &amp; seeing further opportunities for development</td>
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<td><strong>Fuzzy Focus</strong></td>
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<td>• Outsourcing essentially concerned with supply side of IT providing IT</td>
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<tr>
<td>operations, development, service &amp; training</td>
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<td>• Not able to provide acceptable, innovative application ideas, the</td>
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<td>challenging effort &amp; requirement in systems implementation &amp; harvesting</td>
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<td>&amp; delivery of IT benefits (Earl, 1996)</td>
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<td>• Real problem with outsourcing IT is that it concentrates on the HOW of</td>
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<td>IT not on the WHAT</td>
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<td>• Focusses on Supply NOT demand</td>
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<td><strong>Loss of Innovative Capacity</strong></td>
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<td>• Need to maintain innovative capacity in IT because there will be new</td>
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<td>ways of providing IT services &amp; of exploiting IT for the business</td>
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<td>• If IT outsourced and downsized as well a Company’s ability to innovate</td>
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<td>may be impaired</td>
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Solution to the Dilemma?
– Smart or Selective Sourcing?
– Article on Smart Sourcing