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The outsourcing decision: advantages, disadvantages, and an online tool

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ABSTRACT

This study is a result of my findings on all aspects of outsourcing. Within my research I have found both advantages and disadvantages of this issue. By analyzing all of my research, I have proven my thesis that the outsourcing advantages outweigh the negatives. I have also found that it takes careful work in planning an outsourcing venture for it to be successful. Useful tips and tactics for choosing a vendor, establishing a relationship with the vendor, and making the venture a successful one overall are addressed in this study. This study will be helpful to businesses when they are looking at the option of outsourcing. Along with this report, my research enabled me to design a website that shows in more detail just how an outsourcing company runs its business and markets itself to potential clients. The website runs a survey form that asks the specifications the customer wants in the system. It then totals the cost of the system specified. The website address is

http://www.geocities.com/Melissa_Wesley/index/index.html.
INTRODUCTION

Over the past ten years, information systems outsourcing has become quite popular. Companies want to focus more on their core business issues, and spend less time thinking on how they would implement these decisions. Instead of putting up with the hassles of dealing with repetitive technological tasks, they hire an outside company to do it. Outsourcing has become popular also because businesses are looking to make their existing processes up to date and more efficient, and they don’t have the capabilities to do it themselves. It is usually very costly for a company to maintain and support new systems because they have to find competent technical people to do the tasks. The burden of this requirement is transferred to the outsourcing company.

Although there are many benefits to outsourcing not everyone takes part in it. There are also some risks involved including security, control issues, and guaranteed return on investment. It may be quite expensive to outsource also, but it is also expensive to do the processes in-house. This report will not only be exploring which option is more cost effective, but which option will provide the most long-term benefits for the company. It will also provide information on how to choose an outsourcing company, and if a company does, how to make the arrangement work. This paper will show that outsourcing can be beneficial for all companies, but only if a company takes the right steps to make the venture successful. In addition to this report, a website has been designed to show just how an outsourcing company runs a business and markets itself to potential clients.
AN OVERVIEW OF OUTSOURCING

Outsourcing has been becoming increasingly popular over the years especially after the economic downturn. Trends show that when outsourcing agreements come up for renewal, most companies are in fact renewing them rather than getting out of the agreement completely. Of companies that are renewing their outsourcing contracts, 97% of them want to make their new contracts more flexible and also they want to pay more attention to service levels (Casale, 2001). There is also a growing interest in outsourcing for strategic reasons (Anonymous Study Finds, 2002). Many companies turn to outsourcing to keep up with technology, build partnerships, and to broaden infrastructure and operations reach. Outsourcing is also becoming more popular because companies are now seeing e-commerce and information technology as a necessity for every business, and they see it staying that way for a while. 35% of companies that are outsourcing are outsourcing their Internet and intranet services. Companies are seeing the need for other outsourcing besides their Internet needs. Consulting, reengineering, training, and imaging were the top processes that companies are looking into outsourcing at 25% (Casale, 2001). This shows how companies are now looking at outsourcing as a more strategic and proactive move rather than just reducing costs and improving efficiency. By 2008 outsourcing services are expected to be 15 times more prominent than they already are now (Carnegie, 2001).

Although outsourcing can provide many benefits, it is not always viewed as an imperative thing to do in order for companies to be successful. In a survey done by Accenture, 150 fortune 1,000 companies were asked questions about their outsourcing practices. The results of this study concluded that about 87% of the companies
questioned outsource at least one aspect of their company. The areas that are outsourced are distributed pretty evenly between information technology, logistics and/or distribution, and customer service and technical support. It was also found that 65% of respondents that don't already outsource, they didn't have any plans in the next one and a half years to do it either (Anonymous Study Finds, 2002). These results show that most companies are not using the full potential of outsourcing to their advantage. 48% of respondents claimed that they were in fear of losing operational control if they let an outsourcing company take over certain business processes. Other barriers that are stopping companies from outsourcing are cultural barriers, cost, the threat of losing their jobs to an outsourcer, the diminishment of vendor relationships, and long-term dependency on an organization (Anonymous Study Finds, 2002). This study also shows that companies are not looking in the long-term. CEOs want immediate return on investments, and usually when a company outsources, the benefits achieved from this investment aren't shown until the long-term.

Another issue companies are afraid of is security. When a company handles over the management of a business process to another company, the security of their information is at jeopardy. Often an outsourcer will include management of dedicated firewalls for a company. This allows the company to specify their own firewall rules based on their security policy and protect themselves from other companies. This is why many government agencies rarely outsource. The Defense Department, for example, can't afford to have the possibility of secret government information getting into the wrong hands (Schwartz, 2002). However, outsourcing might also improve security. The
outsourcing company is a specialist in their area. They are likely to build a system that is more resistant from hackers than the original company can.

**WHY A COMPANY OUTSOURCES**

For a company to decide whether they should or need to outsource any business process, some factors should be accounted for. Companies need to analyze useful and critical commodities such as payroll, benefits, help desk support and construction. These are the processes that are most usually outsourced. A company should then analyze their useful and critical differentiators, which encompass daily business activities. These processes are usually done in-house (Jenkins, 2002). After analyzing these processes, it should be apparent what the problem areas are. The problems can be caused by lack of expertise, lack of resources, or profit loss. These signs are dead giveaways that these processes are not being done in a way that reduces costs and maximizes efficiency.

The reason a company decides to outsource depends on the company and the situation. One reason could be that a company is having trouble managing a certain process, and it is becoming out of control. In other words, this process may not be as efficient and up to date as it used to be. Another reason could be that they want to expand their business to world-class capabilities (The Outsourcing Institute). According to the Outsourcing Institute’s IT Index 2001, the top four reasons for outsourcing are to reduce and control operating costs, improve company focus, and to free internal resources and gain access to external resources. Other reasons are accelerating reengineering benefits, making capital funds available, cash infusion and sharing risks (Casale, 2001). In a study by Accenture, 70% said reducing costs is an outsourcing benefit. Eighty-two
percent said they would outsource if reduced costs were the only benefit (Birkland, 2002). This shows how important reducing costs to companies are.

There are numerous benefits of outsourcing. When a company lets another company take over certain business processes, they no longer have to rely on their company to manage it. If employees quit or retire, it is not up to the company to hire another person to fill their job (Anonymous How Outsourced, 2002). The outsourcing company is responsible for it. Also when a company outsources, they will have the capability to have the latest and greatest technology available. For example, a company may want to include a technology refresh of all their workstation PC’s every 3 years as part of their outsourcing contract. Also if things go wrong in the agreement, it is stated in the contract who is accountable for what, so there is no confusion. Often there are credits to the company defined in the contract if SLAs (service level agreements) are not met. If the company’s workload increases or decreases, it is easy to expand or reduce the number of staff working on the process (Schwartz, 2002).

SYSTEMS COMPANIES OUTSOURCE

There are different areas which companies require an outside company to run their business processes. They generally fall into six areas. They are client/server, network management, mainframe outsourcing, web hosting, human resources and print services. Often a large company will outsource all six areas. One advantage to the company is that mainframes and client servers may exist at the same outsourcer’s site. Network costs of having multiple network circuits to accommodate a split environment are reduced. Another clear advantage to a company that outsources is how they pay the monthly bill. Usually it is nothing more than a fixed monthly expense for services rather
than having many levels of salary costs, software & hardware maintenance, utilities, and other in-house cross charges. In client/server and mainframe outsourcing, the outsourcing company improves or adds on to the company’s existing technology and manages their processes. Often mainframe outsourcing is structured on a mainframe being shared by multiple companies. The structure is called LPAR and is best described as logical partitioning of a mainframe computer. Lower software and hardware costs can be realized in this type of environment. In networking management an outsourcing company takes on the responsibility of forming a network to compliment the company’s needs and also maintaining it. Network management consists of management of routers, switches, firewalls, CSUs (channel service units) and other network devices. Circuit outages are reported to Telco companies for resolution. Remote routers, switches, and circuits are sometimes managed on a 24x7 basis. In web hosting an outsourcing company designs and maintains a company’s website and/or intranet. This can also include developing an e-commerce system. When a company outsources their human resources, they give the outsourcing company responsibility to maintain insurance benefits, payroll, pension plans and the like. Outsourcing payroll has been getting increasingly popular. According to Automatic Data Processing Inc. Employer Services 53% of US companies have outsourced payroll (Charles, 2002). Outsourcing recruiting can be a viable option for a company. Some of the benefits included in this are as follows. Headhunter fees are reduced because there is no longer a need for this process. Also if the recruiting process is outsourced, better candidates for jobs are found than the ones that search firms found (Anonymous How Outsourced, 2002). In print services, an outsourcing company does any type of major print jobs a company needs to be done
routinely for their business to run properly (ex: monthly billing). One of the outsourcing options that is growing increasingly popular are application service providers or ASPs. ASPs deliver software over the Internet (Piazza, 2002). They provide email services, payroll, document storage, and online collaboration. These services are usually offered at a lower cost as compared to hiring an entire company to design and customize a company's processes. Some benefits of using ASPs are that it increases timeliness, enhances customer support, enhances the ability to integrate systems of acquired companies, and it enhances internal collaboration. A disadvantage of using ASPs is that they cannot be customized usually to the company's needs. Also security can be a problem because these services are constantly online (Trembly, 2002). Another important issue that has to be addressed in a contract is disaster recovery. An outsourcer may offer an alternate disaster recovery environment if the company requests it.

CHOOSING AN OUTSOURCING COMPANY

Before choosing a company to outsource from there are a few factors that need to be considered. Choosing a vendor could be a tricky thing. In this day and age outsourcing is a very competitive market, and there are a lot of options a company can choose. The most important factor to consider in choosing a vendor is price. Another factor a company needs to consider is the vendor's commitment to quality (The Outsourcing Institute). Heavy research also needs to be done on what kind of technology and software are needed to make the business process that will be outsourced run the most efficiently (Schwartz, 2002). A company shouldn't go into an agreement with an outsourcer blind-sightedly. They should have their own knowledge on what technology and management would work best with this process. When choosing a vendor a
company has to look at their resource capability (Schwartz, 2002). This is important because the vendor might not be able to give your company what they want with their resources available. Objectives and expectations should be clearly defined. It should be kept in mind that technology should be used to drive results (Anonymous How Outsourced, 2002). A company should talk to as many outsourcers as possible about their technical capabilities and their financial stability. This will give the company a good idea as to which companies are competent to do the job. Also when trying to find an outsourcing company, a company should make sure that their own corporate culture matches the outsourcing company’s culture (Schwartz, 2002). This is essential because the agreement will run much smoother if both companies have the same outlook on the business. Before a company signs an agreement with an outsourcer, they should request proposals from many potential outsourcers to increase their knowledge on each potential business agreement. A standard practice in selecting an outsourcing company is to develop an RFP (Request for Proposal). The RFP will define in detail the scope of work desired. It will include a matrix of responsibilities, expected time-frames of implementation, and a definition of the SLA’s required. The RFP will also specify in detail on how the outsourcing responses need to be structured. The RFP is normally sent to bid to several outsourcing companies in order to receive a response or quote. Since each outsourcer’s response is structured, this creates an ‘apples to apples’ comparison of quotes. Also every company should look for a vendor who has flexible contract terms (The Outsourcing Institute). This is because certain factors can change, and a company should want to make sure that they could change specifics in the contract to accommodate these changes without any problems. Location could also play a fair part
in deciding which company to outsource from (The Outsourcing Institute). A company also quite often chooses a vendor by their reputation. It is important to talk to CIOs who have had successful outsourcing contracts to see if they have any suggestions on what company to go with. Other potential people to ask advice from are market research firms and government and industry groups such as the CIO Council, Federation of Information Processing Councils (FGIPC), Industry Advisory Council (IAC), and the Information Technology Association of America (ITAA) (Schwartz, 2002). Most importantly, it is essential for a company to remember to include an exit strategy with their outsourcing partner in case things don’t go as well as planned. Once you have a partnership, results should be measured rather than efficiency (Anonymous Study Finds, 2002). This type of consideration should give you an accurate measure of how this partnership has benefited or weakened your business.

HOW TO HAVE A SUCCESSFUL OUTSOURCING VENTURE

In order for outsourcing to be beneficial to a company, there are some guidelines the companies have to follow. Dun & Bradstreet’s Barometer of Global Outsourcing reported that over the span of 2 years 20%-25% of outsourcing arrangements fail. Also noted was that almost half of the relationships will fail within five years. Almost seventy percent of the companies have the same reasons for failure. They said that the outsourcing company didn’t know what they were supposed to do, the cost was too high, and the vendor provided poor service (Carnegie, 2001). These problems could be easily avoided if some precautions were taken early on in the venture.

The most important issues that have to be looked at for successful outsourcing arrangements are as follows. The number one concern should be selecting the right
vendor. Also a properly structured contract is important. In order to make these first two decisions, a good understanding of the company's goals and objectives is necessary. Once an agreement is made there has to be an ongoing management of relationships (Casale, 2001). If these four issues are addressed and accomplished, there should be a successful outsourcing partnership in the working.

Outsourcing can be beneficial to a company if the company keeps some kind of control over their business process, or they risk the possibility of parts of their business being taken over by the outsourcing company. It is important that when outsourcing a company makes sure that they have the rights to access the information and also have a say in the standards and requirements. As Peter Scalone, area manager for Computer Associates' federal systems group says, “If an agency is going to outsource, it should retain title to the networking software and any other products being used for network management. That keeps their options open on the back end of the engagement. (Schwartz, 2002) Businesses that do not have control of their outsourced processes are likely to pay more in money, time, and current technology. Also before a company decides to outsource, they should make sure they would be able to back out of the deal if the outsourcing company fails to meet expectations of the company.

BUILDING A SUCCESSFUL OUTSOURCING RELATIONSHIP

When an outsourcing agreement is formed, there are certain aspects that have to be included in the relationship in order to have a successful partnership. Both companies have to have a strong vision of what they want the process to be like. Also there needs to be a project manager that is in charge of the design, implementation and daily operation of the new venture. All goals that are set should be reasonable, attainable, and
measurable with SLAs being clearly defined (Anonymous How Outsourced, 2002). When using outsourcing to improve a business process, it is more likely to see changes in the long-term. Sometimes there are short-term changes that are handled by amendments to the existing contract. The amendment will identify the cost impact or hardware or software changes that impact the contract. Feedback is very important on these kinds of relationships. It should be honest and clear, and no one should be hesitant to give it (Anonymous How Outsourced, 2002). Also most importantly, manage employee resistance. In a study done by Accenture in November 2001, 57% of employees were worried that outsourcing would change the company's business structure. About 53% of them were worried that some employees might resist the change (Boudreau, 2002).

Some employees do not respond well to change. It might take some training and persuading of employees to help them see the benefits of this new business venture. Although all of these things are important, the three most important factors involved in having a successful outsourcing relationship are trust and confidence, responsiveness, and innovation (Boyd). In order to attain trust and confidence, it is necessary to communicate with all partners regularly and consistently. Everyone who should be involved in the communication process is involved in it, and appropriate information should be shared with whomever it is supposed to be shared with. Failure to do this can result in a loss of trust between colleagues and/or confidence in them to do their job. Responsiveness is achieved when every person who should be notified on a situation (good or bad) is told about it on a timely basis. The quicker the responsiveness is the better. The more responsive an associate is the better another employee can do his/her job. Innovation is also important because as much software and technology there is out there, it cannot
accommodate everyone’s specific needs completely. For example, quarterly technology briefings could be scheduled to keep the company informed on newest technology that they want to take advantage of. Innovation is then needed to customize the technology so a company can make use of it most efficiently.

DETERMINING THE COSTS

Many companies don’t outsource because they complain that it is too expensive. This is because they are only looking at profits in the short-term. Long-term benefits are more important for a company that wants stability and opportunities to expand their business in the future. Hence, long-term benefits are more important to a business, but this is easy to overlook them because an immediate profit isn’t shown. Companies don’t realize that if they keep some of their existing processes in-house when they need to be improved, it could cost them more in the long run than it would to hire an external company to complete them. It can be quite expensive to outsource. The price of services could range anywhere from less than $1 million to over $100 million dollars depending on the processes needed to be done and the difficulty in doing the processes (Casale, 2001). For a small business this could be quite an expensive venture in terms of their size, but if they can afford it, it could possibly increase their size in the future.

When an outsourcing company makes a proposal for a company looking to outsource, they have to estimate the cost of the project by what the company needs. The size of the company plays a big factor in how much the outsourcing venture will cost. Also what kind of business processes they are looking to outsource. A completely new operating system, like an ERP system, will cost a lot of money. Cost depends on whether the company already has an existing system or not. If a company just wants to upgrade
an existing system, it will be cheaper because they already have the majority of the equipment needed. Each service that a company wishes to outsource is going to cost them more money. For example, if they wish to outsource their web hosting, there are a variety of services that they can choose from. They have an option of having a database backend, having an email system in their website, a virtual private network, and redundant internet access. Each of these services adds on to the cost of the venture.

An outsourcing company determines the cost of a system that a company desires by adding the costs of the hardware and software, circuits, internet bandwidth, and the facilities needed to build and maintain that system. Also the cost of full time employees is very expensive. This cost is figured into the total cost of the project also. Another factor that goes in when considering the cost of the project is maintaining the system. If a company requires 24 hour 7 days a week customer service if a problem arises, it will be a more expensive project. Determining the total cost of a project is very tricky because there are a lot of variables involved. For an estimation of the costs of a web hosting system or network management system with personal specifications, an online cost calculator is available at http://www.geocities/Melissa_Wesley/index/index.html.

CONCLUSION

Outsourcing, as with any business venture, has a lot of risks, but it also has a lot of benefits. In order for this type of endeavor to work, both companies involved need to pay a lot of attention to detail. The company's needs are most important in this type of project. They are the ones paying for the services, and they should get what they pay for. In order to minimize the risks of an outsourcing venture, a contract should be designed between the two parties that addresses each specific issue and is flexible, so the
agreement can be changed if the need arises. In order for a company not to lose control of any part of their business processes, they should not let the outsourcing company take over a process completely. They should be involved in the process too. If security is a big issue for a company, a system designed to meet the company's security needs should be one of the top priorities. Most importantly, the relationship between the two partners should be excellent. Communication is key and very important in order for a venture like this to work because the company trusts another company with their business. If these steps are followed outsourcing can be very beneficial and useful. Like Tom Moran, VP of business development for NCS Technologies said, "Outsourcing, in and of itself, is not a silver bullet. Outsourcing planned and managed effectively, however, offers a compelling value proposition in an increasingly stratified world of niche and expert professional services, and technology solutions providers (Jenkins, 2002)." Outsourcing is only as beneficial as you make it.
REFERENCES


