OUTSOURCING FOR BUSINESS EXCELLENCE

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Abstract

There has been a growing trend over the last decade towards outsourcing non-core business activities. The opening up of the global market place has seen the disappearance of geographical boundaries as barriers to doing business and consequently more and more potential suppliers are now available giving organisations much greater outsourcing options. There are however, a number of organisations that have failed to maximise the full potential of this means to improving overall business performance.
The driving forces behind the decision to outsource have allegedly changed from being purely financial to the consideration of such factors as the quality capability of a potential supplier. The relationship too, between customer and supplier has allegedly changed, from an adversarial one to one of partnership and mutual advantage. Customers and suppliers are now working together to reduce costs and improve quality and service. The aim is to achieve business excellence through world-class quality performance.
The decisions on what to outsource and who to outsource to are extremely important ones if a company is to achieve competitive advantage and business excellence. This paper examines the reasons for outsourcing, how a company decides what to outsource and the selection of suitable outsourcing partners, as well as the advantages and disadvantages of outsourcing. The aim is to develop a "best-practice" profile for outsourcing that will allow organisations to realise the full potential of this powerful management tool. With this in mind, the outsourcing of Information Technology (IT) is examined and a case study relates what happened when a UK company decided to outsource its IT requirements.

Introduction

This paper is about outsourcing, but rather than manufacturing outsourcing which concerns the process of determining how and where to procure manufactured goods and raw materials (1), it focuses on the outsourcing or sub-contracting of non-core business or services. In the last decade, outsourcing has progressed from ancillary areas such as security, catering, cleaning and laundry services to areas such as procurement, IT and Finance. However, there is a body of evidence that suggests that many organisations are not maximising the benefits of their outsourcing decision (2). The first part of the paper examines the kind of services more commonly outsourced, with particular emphasis on IT. It looks at the reasons for outsourcing and the possible advantages and disadvantages that can accrue. The aim is to develop a best practice guide to successful outsourcing. The second half of the paper offers a real case of a UK organisation that decided to outsource its IT requirements and examines some of the issues that emerged. In the interest of confidentiality, the company name has been changed.

Reasons for Outsourcing

The reasons for outsourcing can be divided into tactical and strategic reasons (3). Tactical reasons are short-term and associated with cost reductions or the lack of needed resources. Strategic reasons on the other hand are longer-term and associated with gaining access to world-class capabilities, the sharing of risks, and the concentration on core activities. McIvor (2), while advocating the strategic approach to outsourcing believes that many organisations adopt a tactical approach in order to achieve short-term cost reductions. However, the Outsourcing Institute (IO) (4) based on an industry report in association with Dun and Bradstreet, believes there is a shift away from tactical outsourcing to strategic outsourcing. This reports cites the main reasons for outsourcing as: reduction and control of operating costs, improved organisation focus, access to world-class capabilities and the freeing of resources to concentrate on core competencies. Johnson (3) argues that, where the outsourcing decision has been driven by financial savings, the service offered may be cheaper, the people paid less but ultimately the quality will be poorer leading to internal and external customer dissatisfaction. In fact, the very opposite of what is required for sustained profitable business.

What to Outsource

The perceived wisdom on outsourcing is that an organisation's core activities i.e. its *raison d'être*, should remain in-house, whilst non-core activities can be outsourced. Typically, outsourced services include: recruitment, IT, training, payroll, building management, fleet management and various administration services. Johnson (3) argues that "just about anything" can be outsourced. The aim must always be to achieve business excellence through improved performance and greater customer satisfaction, based on the belief that organisations exist that can both meet your requirements and provide a better service than your in-house provider. Ultimately, an aggressive outsourcing strategy could lead to the creation of a "virtual company", whereby even core activities are outsourced and only a business management group exists (6).

The Advantages and Disadvantages of Outsourcing

Outsourcing offers a number of advantages to an organisation, including; cost advantages, allowing staff to concentrate on core activities, reduced product/process design cycle time and the ability to fully utilise the professional capabilities of external suppliers leading to improved quality. There are benefits to employees, who instead of facing possible redundancy can be transferred to other more useful work, or be retrained with the new outsource supplier. In addition, existing suppliers can become more involved in the business rather than operating on the peripheries (3).

There are a number of disadvantages to outsourcing, namely; the organisation becomes dependent upon its supplier for that service or services, employee morale can decline as jobs appear to "disappear", possible lack of control over activities outsourced, increased job insecurity - organisation or outsource supplier? depleted skill-base, costs may actually increase due to "hidden" outsourcing costs and lastly, the customer-supplier rela-

Who to Outsource to and The Purchaser/Provider Relationship

Effective external linkages in a company's value chain can have important consequences for a company's commercial success. The suitability of the service provider is arguably therefore, one of the critical success factors of an outsourced deal. The organisation should therefore, put the service to be outsourced out to tender, using precise documentation detailing the organisations exact requirements. The main aim of such a document should be to attract potential suppliers that have the capability of providing an enhanced service. Once the supplier is selected, in order for outsourcing to work, a company needs to manage co-operative relationships with the outsource service provider for the effective operation of outsourcing arrangements. This means a move away from the traditional, adversarial customer-supplier relationship to a more collaborative relationship. Thus, a partnership relationship or strategic alliance may be established with a supplier. This new relationship should be based on mutual benefits, trust and co-operation, where communications are enhanced and both organisations are more open than previously. However, McIvor (2) believes that it may be in an organisation's best interest to establish a relationship where it holds the balance of power rather than one based on equality, as this may give it more flexibility in dealing with a competitive supplier market.

Outsourcing IT

Many organisations with large IT budgets are either outsourcing or considering outsourcing their (IT) requirements (3). Outsourcing is not only being used to cut costs but to improve the quality of IT delivery. An organisations entire IT operation can be handed over to a specialist supplier or suppliers, depending on the range and level of services required. Indeed, the fastest growing areas for IT outsourcing are data centres, client/servers and help desk applications. The rise of e-commerce and the reality of the global marketplace have meant an increase in the number of organisations setting up web sites. This can be an expensive business requiring highly skilled individuals and has led to smaller organisations handing over their web sites to external suppliers (5).

"Best Practice" Outsourcing Profile

In order to get the most from outsourcing an organisation should outsource its services for long-term strategic reasons. Although cost reductions are viewed as important, the main aim should be to improve business performance and ultimately customer satisfaction, through enhanced service provision. Organisations should examine all non-core activities with a view to potential outsourcing as well as those that are expensive to maintain or will require specialist knowledge or expertise that is not already available in-house. A good relationship with the outsource service provider should be maintained and in particular communications should be more open and at a much higher level than in previous relationships with suppliers. For a well-managed relationship, the advantages include improved service quality, reduced costs and the ability to focus on core activities. The second half of this paper will now examine what happened when a UK company outsourced its IT requirements and will attempt to explain the outcomes by comparing their approach against the "best-practice" profile developed above.

THE CASE STUDY

Introduction

This case concerns a major UK chemical company; XYZ Ltd that decided to outsource its IT requirements then changed its supplier to reflect its changing business requirements. Located in the Northwest of the UK, the company operates as a standalone business in part of a global parent portfolio spanning many different industries. However, several corporate deals exist, including the outsourced IT services contract, executed on a global basis.

The chemical industry is undergoing radical change. Fragmentation is occurring as large global companies are divesting unattractive and unprofitable parts of their portfolio. Operating in cyclical, commodity markets, many of which are experiencing depressed pricing, the business pressure clearly focuses on two areas, reducing the cost base and increasing market share.
The new business autonomy, facilitated by a proposed divestment, forced XYZ Ltd to undergo a radical review of its outsourced IT services. The company had previously outsourced this area as part of a consolidated corporate deal. The supplier chosen also had a global focus and complemented the overall parent portfolio well in terms of size and global presence. Despite a competitively priced service provision, the partner's solution became increasingly problematic for XYZ Ltd. This led to a standalone solution being pursued with a new supplier. This case examines several of the problems with the supplier fit and how, through changing the outsourced service provider, the company is building a competitive advantage in the industry.

The Problems

Operating as a strategic business unit in a diverse parent portfolio, XYZ Ltd has contrasting needs and a different focus than many of the other businesses in the group. The outsourced IT services deal has largely standardised solutions on a global basis to maximise efficiency and financial savings for both parties. Consequently, however, some individual businesses had areas of specialist or non-standard services not covered by the contract. This necessitated a need for continued local expertise (employed in-house or via consultants). The costs of resourcing these extra areas negated some of the financial benefits gained by the global contract. Additionally, the resource retained in-house subsequently lacked investment and strategic direction, as it was not viewed as a core function of the company.

Another issue presented by buying into the corporate contract concerned the service management. The internal management team employed to oversee the contract consisted of senior personnel representing the corporate view. Indeed, in order to co-ordinate the global contract effectively and negotiate commercial terms, central control was necessary. While this presented some financial benefits for the individual businesses, concern remained over loss of control and direction. The situation intensified as the global portfolio of the parent company increased in diversity through a series of acquisitions. The

tionship has to be managed if it to be successful (1) (5).
businesses that did not constitute long-term strategic concerns for the parent company arguably had insufficient representation in the service management team. Although communication processes to the team existed, decisions were taken largely in the interests of the majority. This left some of the businesses to find additional solutions outside of the contract. Occasionally this created friction at the ground level of contract implementation, as the company felt undervalued as a customer when left to solve problems in isolation. End customers in the company lacked confidence in the supplier because of their lack of knowledge regarding business drivers.

Perhaps understandably, the supplier concentrated largely on the most profitable businesses in the group as they represented the greater area of profitability. A strategic match also existed between these businesses and the supplier both in terms of global presence and their commitment to leading edge IT development. The relationship facilitated a partnership style approach and contributed to business excellence. Consequently, however, this compounded the disparity between XYZ Ltd and the supplier. The gap between their strategic fit widened as the company contracted and internal pressures grew to reduce costs, thereby seeing a further reduction in new projects.

In addition to lack of strategic fit, the two parties experienced some cultural problems. As a number of employees were retained in-house, many people utilised their services for standard requests, rather than the correct route through the external supplier. A number of factors contributed to this situation ranging from lack of communication to the company's own inability to relinquish control to a third party in which key individuals had little confidence. The original strategy behind outsourcing the IT function was to reduce costs and to gain access to expert technical innovation. Failure to use the contract to its full advantage resulted in sub-optimisation of the outsourced service. In addition to the financial implications of paying for two services, access to the supplier's technical expertise was hindered and therefore did not strengthen the company's competitive situation.

It is important to note that the problems were not with the supplier *per se*, but with the incompatibility with XYZ Ltd. This was the result of incongruity with the individual needs of the company and the outsourced solution offered in the context of a global corporate contract. An imbalance of power existed and although this was not 'abused' by the supplier, there was insufficient interdependence to create a base for long-term collaboration. The company had a requirement for a more locally executed service that would provide a more flexible solution based on changing business needs. Owing to inadequate bilateral communication, the supplier had insufficient knowledge of the company's changing demands fuelled by changes in the industry.

The Solution

Because of a more demanding and business-orientated management, the competitive pressures to deliver bottom-line results and transform the company increased. The company therefore made the bold decision to break away from the global, corporate deal and create a new standalone, outsourced contract. Despite the high exit costs, long-term benefits could be achieved through realigning the outsourced provision with the strategic direction of the business. After an extensive tendering and supplier selection process, a new supplier was chosen to manage all of the IT activities for the company. The new supplier is similar to XYZ Ltd in terms of size and there is an equal balance of power.

Relationships require time to develop, particularly those aiming to work towards collaboration. However, with the new supplier there is higher interdependence owing to an improved balance of power. Coupled with the business climate shifting toward collaboration, solid foundations, not based on power, exist for mutual commitment to the partnership. This facilitates a tighter focus on the company and its specific needs, many of which were specialist in nature. The rationale for the new outsourced deal remains consistent with that of the original contract - to provide bottom-line savings and to maximise the supplier's contribution to business excellence.

One of the potential issues of changing the supplier and moving away from the leveraged, corporate contract was the possible cost increase. Reducing the cost base was a fundamental objective to ensure the company's continued survival in struggling markets. However, competitive pricing was maintained for several reasons. Firstly, owing to its size, the new supplier had a much smaller cost base than the global supplier did, secondly, as the company had failed to optimise the previous contract, a number of activities had not been fully outsourced. Under the new arrangement, all these legacy areas were included, which provided additional leverage and eliminated some of the inefficiencies of running two systems. This improved the contractual clarity, as the new outsourced deal in effect was a one-stop-shop for all the company's IT needs. This provided a mutual advantage. The supplier was able to develop scale economies through managing the entirety of the IT services, the cost benefits of which were shared with the company.

However, to maximise the full benefits, the company was keen not to just focus on cost elimination. Through open communication and working closely with the new supplier, they looked to add value through enhancing their use of IT services. Operating on a smaller scale, the supplier was able to be more responsive to the company enabling the exploration of a number of initiatives to develop its competitive offering to customers.

IT is not a core competence of the company, which was one of the underpinning factors that led to the outsourcing decision. Paradoxically however, harnessing IT did present some strategic opportunities. The company planned to achieve some major financial and commercial benefits through improving the IT systems in their supply chain. The company worked with their new supplier to improve the efficiency of their Enterprise Resource Planning (ERP) system. They also extended elements of their system and integrated it with key players in the supply chain. Understanding the company's strategic direction and limitations became critical elements in enabling appropriate solutions to be developed. Close supplier relationships were necessary therefore to ensure effective communication.

The alignment also allowed the company to work closely with the supplier to explore technological enhancements to its manufacturing capability. Coupled with improvements in the supply chain, this dual approach delivered improvements in the company's service and quality performance. In a competitive industry with supply exceeding demand in some sectors, consistent business excellence was essential in building and retaining customer loyalty. Supplier selection is an important factor in enabling these improvements to be realised. Technical capability is an obvious requirement, although the view could be taken that this is a prerequisite to receiving the invitation to tender. Without a partnership style approach to the relationship, it can prove difficult to capitalise on the expertise primarily through lack of trust. Consideration therefore needs to be given to the congruence of the two companies to allow a solid base on which to develop the relationship.

To deliver many of the value-added benefits, the company employed a partnership style philosophy with the outsourced service provider. Trust was developed between the parties allowing the implementation of improvement projects without requiring a high degree of costly day-to-day management. Win-win arrangements also provided for mutual advantage through the sharing of benefits delivered. One of the problems with the previous supplier relationship was the lack of trust. Trust is engendered on an individual level based on evidence of performance. However, these opinions failed to be developed with the original supplier owing to the lack of full service utilisation.

Conclusion

As part of a parent organisation about to "go it alone", XYZ Ltd were left with an IT requirement that had been outsourced by that parent company. IT was not a core activity at the company. There was no "fit" between its requirements and those of the parent. The previous agreement was based primarily on reducing costs. Although savings were achieved, these were not reinvested into developing the core competencies of the company. The approach was short-term and tactical.
The second outsourcing arrangement, although intended to reduce costs, also had a main aim of improving business performance. A tender process was initiated and the most suitable supplier selected. A collaborative relationship between customer and supplier was developed and actively managed to the mutual benefit of both parties. This more proactive, focused supplier working in partnership with the company required less day-to-day control of the service. The development of trust freed up this resource allowing management to concentrate on improving its manufacturing excellence. The new approach was long-term and strategic and many of the benefits discussed earlier in the paper have been achieved, thus maximising the outsourcing relationship and improving business performance.

The above case study demonstrates the improvements that can be brought about by well planned and managed outsourcing decisions. It illustrates perfectly the difference between the short term, financially oriented, tactical approach and the long term, improvement oriented, strategic approach to outsourcing. Used correctly, outsourcing can be another weapon in the company's armoury as it strives for continuous improvement and business excellence in a highly competitive global marketplace.

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