

# **Outsourcing – Why and How**

## **Motivations for Outsourcing and Required Controls**

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## **Introduction**

Many companies are benefiting from outsourcing. An equal number tried outsourcing and failed. Why is there such a disparity in results?

This paper explores the reasons for outsourcing and shows that if is done correctly, companies will reap huge benefits. It proposes criteria for selecting functions and projects for successful outsourcing. In addition, it identifies requirements for monitoring outsourcing arrangements.

Outsourcing occurs when one company buys or leases a product or service from an unrelated party. The two primary motivations for outsourcing are saving money or buying expertise that you otherwise could not find or afford.

Identifying functions or project to outsource is only the start. The next step is to clearly define the details. This requires identifying the functions to perform; developing a project plan with intermediate milestones; establishing monitoring systems to measure performance; and detailing performance criteria to evaluate the vendor's success. Without all four of these steps, outsourcing turns into a disaster.

By following these steps, a company can outsource with confidence. In addition, it will be able to easily measure the return on investment from the effort.

## **A Brief History of Outsourcing**

Contrary to popular opinion, no one in Dallas in the 1960's or Delhi in the 1990's invented outsourcing. Outsourcing as we know it grew up as the industrial revolution spread and companies specialized. The oldest form of outsourcing is specialized machinery. The original cotton and woolen mills that define the start of the industrial revolution were self-contained entities. Mechanics made everything on site except the bricks and mortar for the buildings. Over time, people discovered that they could sell equipment to mills by designing and making cheaper and better equipment. They succeeded and gave birth to the outsourcing industry.

Many people would argue that this is not outsourcing. However, it meets the criteria: An outside party provides a product or service designed to meet the buyer's specification; and the buyer is motivated because the seller is offering specialized expertise and/or a lower price.

Most companies outsource. Manufacturing is by far the biggest user of outsourcing and has done so with great success for many years. Industries such as automobiles, aircraft and shoes are major outsourcing users. Companies called them suppliers or sub-contractors for many years. They are now universally, partners. The buyer specifies what they are building and issues specifications and quality assurance standards. The seller then builds the part or item and delivers it. Once the buyer receives the product, it checks it against specifications using its own quality assurance procedures. This approach allows Nike to focus on what it does best, marketing, and leaves the manufacturing to offshore third parties in places such as Thailand.

In fact, today, most manufacturers outsource some or all of their products. See the follow label from a Callaway Golf Travel bag.



### **Succeeding or Failing at Outsourcing**

Companies that succeed at outsourcing do so by design. Companies that fail at outsourcing do so predictably. They fail to follow the basic procedures.

If the project or function is clearly defined then an outsourcing relationship works well. This requires the buyer to document what it wants. In the case of manufacturing, this is simple. Before you can manufacture anything, you need to know what it will do; where it will do it; under what conditions it will operate; how much it can cost; and how to test that it meets all the above specifications. The success rate in these relationships approaches 100%.

Outside of manufacturing, things get fuzzier. In other areas, the company desiring to outsource often does not do its homework completely. Just as manufacturers issue detailed requirements, everyone else who wants to outsource must do the same. Some areas are easy such as payroll. Because of this, payroll is the most commonly outsourced business function. Other areas present a greater challenge. As things move away from tangibles to services with intangible components, the challenge grows.

The author served as CIO of an outsourcer of call centers and fulfillment services. Defining the services provided is quite easy. Call center operators answer phones

and take orders or provide customer service. Fulfillment centers receive inventory, count it and ship it out. Mathematical models compute staffing levels. For a given call length and call distribution and a targeted hold time, formulas compute staffing requirements. Inventory management is a well-defined discipline. How to meet least cost shipping goals is a well understood.

However, this outsourcing business is very difficult because clients do not specify all their needs. The challenges are in the soft requirements. Once a person answers the phone, they need to interact with the client. How do you train operators to do what the client wants? How do you get the client to describe what they want precisely enough so you can train people to do it? How do they want their products packaged? What constitutes acceptable versus unacceptable packing?

This is analogous the IT outsourcing problem. IT has areas that are easy to outsource and impossible areas to outsource. Payroll is traditionally very easy to outsource. Accuracy needs to be 100%; timeliness must be 100%; and all legal compliance must be 100%. The vendor either delivers or does not. There are no gray areas.

Computer Operations is another area where objectives and measurements are easy. A given system has a targeted up time; a minimum storage capacity; a minimum and maximum throughput; and a schedule for backup and system updates. Staffing meets the client's needs. The vendor then calculates their cost to meet these criteria and makes an offer. If the vendor fails to meet the targets, it either loses the contract or pays a fine specified in the contract.

On the other hand, desktop support is almost impossible to satisfactorily outsource. While defining the job looks easy, in reality it is quite difficult. Certainly, the high-level definition is easy: keep all desktop computers and terminals functioning correctly. Keep all software and firmware current. After this, the view gets fuzzier. If a computer or terminal stops functioning, how long does the vendor have to repair it? If it is a PC, is the vendor responsible for salvaging the data? Are there different service levels for different people within the organization? Since most companies have not defined this when performing this function themselves, how can they measure the service quality that vendors are providing to them?

## The Steps to Successful Outsourcing

Manufacturers already know how to succeed at outsourcing. They use simple steps to accomplish this.

1. Provide a detailed design or functional specification for the item they want or provide a detailed functional description of the item.
2. Define a functionality and quality standard that the item must meet.
3. Define a detailed delivery schedule.
4. Have a quality assurance program that measures how well the vendor is performing.

In the IT world, many companies do not rigorously adhere to these steps. Notably in areas such as desktop support or system development or integration, the specifications are weak or do not exist at all. In addition, many people do not build a

delivery schedule with intermediate benchmarks. This leads to shock and dismay when the project slips beyond the deadline. In the course of speaking with potential customers at Fortune 500 companies, this author has heard of many bad experiences with outsourcing. When pressed, they most often say that the deliverable was not what they expected; that it was over budget; and it was late.

### **How We Do It**

At IT OnTime, we understand the need to have a well-defined starting point, a well-defined schedule and a well-defined quality assurance plan. To this end, we have defined or adopted a methodology for each of these steps. We based them on our extensive experience in building systems. Our tools are:

1. **Application Design** – We use a proprietary business rules and business process based design methodology. If the client already has a specification, we map their specification into our methodology. If the client does not have a specification, we interview end users and collect the data. The test for the resulting specification is a manual simulation.  
**Graphics and Design** – We use a questionnaire to solicit the client's needs, targets, likes and dislikes. We get the client to identify designs they like and provide the reasons that they then like them. We do the same with dislikes.
2. **Project Management** – We use standard project management techniques. These are Gantt charts and where applicable, PERT/CPM. Most people are familiar with this discipline through their use of Microsoft Project.
3. **Quality Assurance** – We again use standard industry practices. We define functionality test scenarios. The tests are then executed manually for simpler applications or using an automated testing product for complex applications. If the contract is for maintenance, updates or enhancements, we also define and run regression tests.

We document all this and then review it with the client. The client then signs off on the results. These are the working documents that guide the project. The client identifies a project liaison empowered to request changes. If we receive a request not routed through the liaison, we return it and ask the person to properly route it through the project liaison. This avoids the most dreaded of all IT project problems – specification creep.

### **Summary**

The outsourcing model first used by manufacturers has worked successfully for over 100 years. Why change it? To increase the odds of a successful outsourcing project, you must have a detailed plan for each project component: Deliverable; Performance Standard; Schedule; and Quality Assurance. While the substance of each one will change depending upon the nature of the product or service, the project's chance of succeeding diminishes if these steps are short cut. The IT world is especially prone to taking short cuts resulting in mixed outsourcing success. Increasing the rigor of defining the deliverable would improve this track record.

## **About the author:**

Max Rosenblatt is President and CEO of IT OnTime, a Web site and Web-enabled database application design and development and Web and print graphics, outsourcing provider. Mr. Rosenblatt started IT OnTime after experiencing many of the pitfalls of application development while CTO of an E-Commerce startup. Before that, Mr. Rosenblatt spent more than 27 years in the software, computer services, consulting and IT world. He has written or co-authored a number of articles and white papers about application design as well as other current topics in computing. He also hosted a weekly, one-hour radio show on business computing current events.