

## **OUTSOURCING: HOW MUCH? HOW FAR? VALUE FOR MONEY?**

The gulf between management textbook theory and management practice is enormous, according to a survey by Sheffield University and the London School of Economics, especially in small and medium-sized UK manufacturing companies with the possible exception of product quality. Apparently there is no information for large organizations of all kinds but I suspect, I could be wrong, that many suffer from the introduction of the same plethora of management fads as smaller organizations but on a much bigger scale and when something goes wrong with products, promotion, price and place to customers then of course the consequences are that much bigger!

But just who is right when it comes to management practice, theorists, academics and management consultants - who dream up ideas such as Business Process Re-engineering (BPR), Delaying, Downsizing and Outsourcing - or the practicing manager at the 'coal-face'? It is very reasonable to suggest that many managers these days, because of downsizing and delaying programmes, rarely have much time to be proactive but, rather, spend much of their time 'fire-fighting' and, therefore, it is academics and consultants who have the time to sit and think. But it wasn't always like that, or was it? Didn't many of us come through the ranks and actually had practical experience of the particular career or profession that we entered and gained knowledge from spending time at different levels whilst learning the job?

Outsourcing, one of the many management fads of the past few years, is marketed as a management programme whereby companies can reduce overheads by sub-contracting out areas of work and responsibility for employees, including pay and pensions, as a means of reducing risk by concentrating on what is termed 'core competencies' or, to use the hackneyed phrase, 'sticking to the knitting'.

For example, if you believe that your company is in the business of providing services then why are you involved in manufacturing component parts for the services you offer; conversely, if you are a manufacturing organization then be very careful if you think you can move into providing services associated with the products that you manufacture now matter how good your quality control and reputation for quality engineering is. If you have no experience, you are likely to fail.

There are, of course, some areas, usually of a lesser importance, that can be given over to other specialist companies. Such areas might include, for example, security guards, catering, cleaning, drivers and delivery systems, printing and publishing and even planned maintenance of electrical and mechanical equipment perhaps even clerical and secretarial support, to allow a company to concentrate on what it perceives is the core business. But, a company or an organization must fully understand and appreciate that if it outsources any area of its business and the service provided by the outsourced company is not up to the standard they demand and customers are not satisfied then it is their reputation that will be sullied.

However, the primary purpose, in fact the only reason, for outsourcing services appears to be to save on costs. Many so-called specialist companies have won contracts by paying employees, sometimes the same people who used to work for the outsourcer, a lower wage level, no perks and often no pension scheme. However, whilst praying at the altar of profit some organizations are losing sight of the more important goal of customer service by maintaining standards of reliability and quality of services.

Whilst the case for outsourcing areas of business might present an attractive proposition there are no guarantees that the company to whom the services are outsourced will, necessarily, provide a more efficient and cheaper service whilst maintaining standards. Indeed, in one recent example a petroleum company found itself with an excess charge of £350,000 in the first month of an outsourced contract.

But, how far does one go in shedding responsibility and accountability, for that is what outsourcing is, for people and the provision of services connected to one's company and business? And, have you considered what effect outsourcing manufacturing or the provision of services might have on your customers especially if quality or standards drop? Have the following questions been answered?

- Is this really value for money?
- How much will it cost in the longer term, i.e. more than say 3-5 years?
- Is there a likelihood of regular increases in charges thus reducing any possible projected savings?
- What do we do if costs escalate? Are there other providers of similar services?
- Can we really afford to lose control of certain areas of our business and more importantly those connected to databases and communication networks?
- Have we assessed the likely effects on our customers?
- What is the fallback position should the outsourcing not be successful?
- Can we trust the chosen company to deliver to our standards?
- How quickly could we bring services back 'in-house' if there is a problem?
- Is this really in the best interests of all the company stakeholders?

The more successful proponents of outsourcing are those who establish an 'in-house' manager and support team, drawn together from the various outsourced specialist areas, to scrutinize the contracts and the level of services that are provided by the company with the outsourced contract. This team should be tasked to liaise and negotiate directly with the providers to ensure that quality, timing, standards, delivery schedules, and most of all costs, are meeting demands. If you are going to outsource any area of your business you must exercise tight managerial and financial control.

But, such in-house control teams take time and money to implement, which must come out of any projected savings, because you cannot outsource responsibility and accountability for products or services. In the scramble to outsource areas of business, to achieve short-term savings, some companies are in danger of going too far. And, by attempting to outsource responsibility as a way of cutting costs by reducing overheads through employing fewer and fewer staff the real problem is that companies could lose control. And, what is the fall-back position if, for whatever reason and it is likely to be a combination of control, communication and costs, an outsourced contract has to be brought back 'in-house'? Do you have the experienced staff to deal with the issue?

According to yet another study, this one conducted by the University of Sussex based Institute of Employment Studies, outsourcing does not form part of a coherent strategy and decisions are haphazard and based on short-term criteria and temporary needs such as perceived cost reductions driven by the finance function. The fact that outsourcing is looked upon as a 'cost-cutting' measure cannot be a sensible way of conducting business and is unlikely to enamour your customers if products or services are suddenly of a lesser quality, standard or value-for-money. Surely that approach is no recommendation to entrust your reputation with other organizations?

According to The Economist magazine, firms in America are projected to spend some US\$100 billion on outsourcing work leading to a possible cost saving of 10%. There are no projected figures for spending on outsourcing in UK. But, according to PA Consulting Group in a survey of 250 leading UK organizations some 80% have either outsourced or are considering outsourcing responsibility for their Information Technology (IT) networks, the very core of internal and external communications systems. Of course, it is suggested that only manufacturing jobs will be outsourced and that higher paid work in, for example, research and development, will remain in the company headquarters. We have heard that before so don't be surprised if the process accelerates and other areas of the business are outsourced if there is the possibility of reducing costs.

Nonetheless, is it really wise to take such a risk with what is, after all, the equipment, systems and information that help you to manage and control the company and more especially when so much importance is placed in knowledge management? Information contained in data bases and networks can be commercially sensitive or of a personal nature so are the people handling and entering the information in your systems sufficiently vetted to ensure security? Outsourcing major areas of interest, like call centres, to other parts of the world means that senior managers in UK have no direct control over day-to-day operations and the security of information.

Conversely, 26% of those surveyed were planning to bring back those services in-house either because the contract was due to expire or, more simply, because it had not worked in terms of fitting in with the culture, reputation and social and ethical values of the outsourcing company. Even more interesting is the fact that of the same companies surveyed 70% could not identify savings beyond £100,000. There are a number of problems associated with outsourcing relating, mainly, to the areas of management responsibility and accountability. These drawbacks include:

- A reduction in staff morale exacerbated by the loss of jobs. This situation is further exacerbated if and when the company who won the contract employs your former employees and then abuses them, their commitment and trust by paying lower wages.
- A loss of internal expertise. Once it has gone you cannot get it back.
- A loss of control of sections of the business especially information technology (IT) and communication systems and internal Quality Control.
- A loss of control over procedures and quality standards.
- Over-dependence on the external supplier especially their choice of hardware and software and personnel to meet your demands.
- A lack of understanding, by the supplier or provider of outsourced services, of your company culture and social, moral and ethical values.
- Time needed to build solid relationships with the suppliers.
- Annual increases in costs of outsourced business.
- Difficulty in maintaining quality of services and the loss of customers if and when standards drop and your customers' desert to competing companies.

Again, according to the same article, when several large American and Japanese car manufacturers were forced to recall 8 million vehicles with seat-belt problems customers blamed the car companies and not the company with the outsourced contract to make the parts. That is because the customers of the car manufacturing company had a contract with them, and not with the manufacturer of the outsourced parts and materials, to sell them a vehicle that was safe and reliable in all respects.

The onus for checking outsourced contracts, and more especially financial accountability, quality control of products and materials, finish and delivery of products, still rests with the major company who outsourced the contract. If you have to establish additional in-house quality check teams how much have you saved?

Other organizations, like Harley-Davidson the motorcycle manufacturer, have, through improved production methods and Just-in-Time (JIT) techniques for materials, improved productivity such that outsourced component manufacturing has been brought back in-house to exercise greater control. Compaq, the PC manufacturer, hit all kinds of difficulties with outsourced contracts in design and manufacturing costs and quality. They now accept it would be cheaper, and more cost effective, to make the computers in-house in order to achieve the flexibility and speed essential when building to meet customer designs and demands. Outsourcing is not the be-all and end-all and, over time, it is very likely that any predicted savings will gradually disappear along with the experience and knowledge of the staff you used to employ. I wonder how long it will take many other organizations to realize that outsourcing is not all it is cracked-up to be.

So, when any area of business is outsourced it is imperative to determine and define such things as quality control methods, rate of production and output and supply and delivery schedules so that measurements can be taken to ensure that internal demands and programmes are being met. What you cannot see nor do not measure you cannot control and a loss of control means the possibility of not meeting schedules and deadlines, a possible loss in revenue and a possible loss of reputation.

How can you possibly control the vagaries of human resource management from hundreds let alone thousands or even tens of thousands of miles away? How can you possibly understand the attitude of staff and managers in another organization let alone another part of the world to the information contained in their data bases which affect the way you operate? And, how on earth can you assess any degree of risk, political, social and economic, associated with information and data handling if you do not exercise complete control over the hiring and firing and earning and learning processes. That is because the outsourcing company is the one with the reputation to lose if its products or services either worsen or are seen to be less than the previous quality expected by customers when components or services were provided 'in-house'.

Additionally, when you outsource any part of your business to another company let alone another part of the world, with a different culture, attitude and approach to business, you lose just a little more expertise and experience in your own company and country and when you outsource such important areas as research and development, information technology and database control and system or equipment design to another country you are, effectively, transferring not only future jobs but also future knowledge, experience, information, understanding and ability! Can that really be worth any predicted short-term financial gain? The answer must be a resounding no.

Whilst there may be some areas of lesser importance that can be successfully sub-contracted when it comes down to other more sensitive areas associated with any business the decision to outsource must be very carefully considered by both client and supplier for the fundamental reason that whilst it might make financial sense on paper there are risks and the risks could outnumber the positive factors. Too many directors and companies make a decision to outsource parts of their business based purely on perceived financial savings but risk losing their reputation!

And, too often government departments and other public organizations and institutions are too quick to outsource work based purely on financial considerations and not on the longer-term need to retain control not only of the management of information, reliability of procedures and the overriding security of data but of the need to retain in-house control of selection and recruitment, experience and skills of employees and responsibility and accountability for the provision of services.

So, what you must do is find a company or an organization that can and will put as much time, effort and care into providing the product or service as you do. You must find a company that has the same attitude to social, ethical and environmental values as you have otherwise the operations and smooth running of your company could suffer and, importantly, so could your reputation. Will your company or organization actually operate more efficiently and effectively if you outsource any part of your business? Is it really worth small savings if over a period of time your company suffers because of the attitude of one of your outsourced companies?

Too many directors and senior managers appear to be of the opinion that it is too costly to retain call centres in advanced western nations to service their customers in western advanced nations who may have bought goods or services in those countries and the contract may be worth hundreds of thousands, millions or maybe more. Besides, it makes sense to locate call centres, with people who speak the same language, near to where your operations are to meet the needs of customers. Putting call centres in other continents and in other parts of the world in different time zones, where people do not necessarily speak the same language, is one way of clearly indicating to your customers that you are providing a service merely to answer their calls and not necessarily to answer their questions or queries on goods and services.

The real questions are can you do more efficiently and effectively what is required, in terms of manufactured product or service, better than other companies in a specialist field or the same area? If the answer is yes then do not outsource but, rather, make much greater investment in people, product and plant and put more effort into training personnel to become even more efficient in quality control and reliability of product such that you could supply such products to other companies. In the longer-term it is more cost-effective to invest in technology and training to make existing employees more efficient, effective and productive rather than outsource their jobs. But, do not think for one minute that automation alone necessarily makes your company more competitive, it is also a matter of the attitude and professionalism of your employees.

Does the company you are considering to manage your services fit with your ethical, social and environmental standards and values and do they treat employees as you treat your employees? Is the country politically and economically stable? If the answer is no, then do not outsource because it will damage your reputation.

Outsourcing is yet another management fad that can lead to a loss of customers and eventually to a loss of business. For example, you outsource your IT support department and customer care department to a part of the world where your and your customers primary language is not their primary language and it leads to misunderstanding and subsequent frustration; security issues relating to information stored on data bases and computer systems is paramount and an outsourced contract cannot be totally relied on; or, the introduction of new systems and procedures leads to chaos; and, do not forget that management at a distance throws up additional problems.

Even when a contract is outsourced responsibility and accountability for regulation and delivery to customers and meeting customer demands still rests with the outsourcing company. If you are a manufacturer and you outsource the provision of certain parts to another specialist manufacturer if something goes wrong with your product customers will blame you and not your suppliers. And, if you are a service provider and data is lost or incorrect information entered into databases leading to false records and subsequent incorrect procedures or even to stealing personal details and information then the fault lies entirely with the organization that outsourced the contract.

The important point to note is that once jobs are outsourced, exported, to another country the experience, knowledge and skills associated with each and every job, and the people to train successive generations, disappears never to be replaced. And, once the country who accepts the jobs gains experience in each and every area that is where the knowledge and experience remains until such time as someone else dreams up a way of shifting jobs from advanced industrial nations to developing nations simply to reduce overhead costs. In the process unemployment rises, income taxation from employment falls, stress levels increase on those still in work and governments find it increasingly difficult to hold down rising social costs and pay for public services. This is why the UK is gradually sinking into economic mire brought about by the loss of employment opportunities and skills and rising levels of economically inactive people.

I wonder how long it will be before companies and organizations wake up to the fact that its most valuable asset, after its employees, is its reputation, based on the quality and cost of products or services to customers, and the way that it is perceived by the public in terms of corporate governance, corporate social responsibility and attitude and approach to environmental as well as social issues and ethical values in the countries in which it is based and operates. There is more to an economic model than concentrating solely on profit and greed at the expense of other societal considerations? As the Canadian-born US economist John Kenneth Galbraith suggested,

“The modern conservative is engaged in one of man’s oldest exercises in moral philosophy; that is, the search for a superior moral justification for selfishness.”

**(J K Galbraith (1908 – 2006), Canadian-born US Economist and government advisor)**

Companies must recognize, surely, the most important factor that keeps them afloat is not the share price, it is not rapid expansion, it is not beating down suppliers so that they make even bigger profits, it is customers. No company can exist without customers and no company in its right mind would outsource the most important business function and hand over control of customer-facing jobs to another organization, and certainly not one in another country that might not provide the service customers can reasonably expect or even demand. Companies should not, sensibly, hand over responsibility and accountability for customer-facing services or systems, on which they depend; and, companies must ensure that safeguards are in place to protect brands, property rights, integrity and reputation and the physical and electronic security of data storage and handling of sensitive information. Not to do so is commercial folly.

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