Making the intelligent IT outsourcing decision

Lose Control, Gain Sanity

By Joe Santana

How does outsourcing work and what can you get out of it? How do you decide what to outsource?

Outsourcing, the practice of companies turning over portions of their IT operations to another company in the business model, came into being in the 1960's. Until recently, IT outsourcing was a game played only by large companies. By outsourcing, these companies gained a multitude of benefits, including:

- Services of experts that the companies would have difficulty attracting as employees
- Refined processes and practices that produced consistent results
- Continual investments by outsourcing suppliers in leading technologies
- Increased capacity for adaptation to change
- Reductions in costs
- Reductions in the risks associated with tying up capital in ever changing technologies
- Reductions in headcount
- Fewer logistical distractions for management
- Improved return on dollars invested in IT

Today, these benefits from outsourcing are also available to smaller companies. As such, the owners and executives of smaller businesses now confront the same questions and choic-es as their larger counterparts.

Leverage is the source of the power behind outsourcing

In order to be competitive, all companies need to perform maintenance tasks in various parts of their company. In the IT department, these tasks include setting up new computers, fixing computers when they malfunction, writing programs and upgrading machines and programs. Building and maintaining this infrastructure requires investments that tie up people and capital. If all these investments were undertaken within the company, even the largest players would not be able to fully realize the benefits generated and transfer them to clients. These "unmined" benefits represent wasted capacity dollars.

To get a better idea of what we are referring to, imagine a company that decides to do all of its computer repairs in-house. Let's say the business requires same-day to next-day repair for a high percentage of problems. Let's also assume that it has six offices in different states. With the exception of its home office, where it has 300 people, it has no more that 20 people in each of these offices. In addition to spending on software installation and maintenance, it will also hire at least one technician for each of the offices. The technicians at the offices with the smallest number of employees will be idle for most of the time, since the population at these offices is not enough to generate the level of activity that would keep a technician busy for a full day. Nevertheless, the company would need to have at least one technician in each of these offices in order to meet its repair commitments. For each office, this represents the cost of a full-time salary for someone who may be performing five hours of work a week. The alternative is to have someone fill the role of repair technician in addition to other responsibilities. This "jack-of-many-trades" approach, however, does not work either, since the designated individuals are usually not as proficient as specialist repair technicians. Also, their other obligations make it almost impossible to consistently meet repair commitments.

Outsourcing suppliers on the other hand, with multiple clients in each of the states where these offices are located, could leverage their investment in their team of professional repair technicians across many clients. For example, one of their technicians might be assigned to service eight of the clients that consume only five hours per week of the technic-ian's time, thus filling her workweek. This enables the outsourcing company to supply a superior level of service at a lower cost to its clients, while running the operation as a viable business.

By giving ownership of certain IT functions to a supplier, who can do it better and at a lower cost, you get, in effect, more quality for fewer dollars. Furthermore, since you've turned over the ownership of managing that process to the out-sourc-ing company, you free up your own time to focus on other matters. So, you might think at this point, "This sounds great. How much of my company's IT operation should I outsource, then?"

Dos And Don'ts Before You Outsource

By Michael R. Wilkinson

- **DO:** Ask detailed questions about the company's staff members. Are they permanent or temporary? You should feel confident that the engineers working on your project will be around until its completion.
- **DO:** Find out about company standards. Standards for measurements and vocabulary vary among engineers. Make sure your company chooses a set of standards and sticks with them.
- **DO:** Check the company's facilities. Where the engineers work says a great deal about their company.
- **DO:** Ask for references. If at all possible, ask to speak to customers who aren't on the "reference list" for a clearer picture of the company's track record.
- **DO:** Talk to the engineers. If they are truly interested in your project and have taken ownership in it, they are more likely to produce quality work.
- **DO:** Require that companies provide documentation that includes schematics, diagrams, and details on every step of the design process. Be specific about how you expect to receive documentation.
- **DO:** Review the proposal in person with the provider and make sure you understand the contract.
- **DO:** Evaluate how detailed the proposal is. Is it just a one-pager? Are price estimates rounded off too far? Is there evidence that the company evaluated how it would build your project and where the costs would lie?
- **DO:** Avoid "midnight operators," i.e., two buddies in a garage doing your project as a night job. On-time delivery and consistent, quality performance is often sacrificed while they concentrate on their "real" day job.
- **DON'T:** Hire a company without a solid track record. Determine how long the company has been in business. Even check its credit history. You want to be confident about its sustainability, so that customer support will be available even after your project has been completed.
- **DON'T:** Choose a company solely focused on meeting your deadline. There's no need to sacrifice quality for quick turnaround when both can be achieved.

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What should you outsource?

The companies that have mastered the art of outsourcing will tell you that they outsource everything that doesn't give them a competitive advantage, i.e., the functions that directly contribute to building the company's shareholder value. Some call these their "core competencies." C.K. Prahalad, a professor at the University of Michigan Business School, who coined the term "core competencies" in 1990, defines them as "the soul of the company." Therefore, only the IT components at the soul of a company should be kept in house.

For example, if a company's strategy is heavily predicated on its success as a provider of a unique solution for traveling salespeople and executives, then the mobile commerce technology it uses to differentiate itself from competitors is a key strategic component that should be owned internally. The company may use consultants to work on various aspects as needed, but for the most part it will be the general contractor for this process. The remaining non-core IT functions are out-sourced. The key is to accurately assess which IT components are core and which are not.

Dividing Core from Context

One model that you will find extremely useful in helping determine what should be done in-house and what should be outsourced is the IT Investment Portfolio Model developed by Dr. Howard Rubin of the META Group, a technology industry analyst firm. In Dr. Rubin's model, companies are encouraged to view the dollars they commit to IT as being part of an investment fund comprised of three distinct portfolios. Each of these portfolios contains certain types of IT investments.

"Transform the Business" portfolio

This category includes investments that are made to change the business into a new model or way of doing business. For example, a company's investments toward creating a new e-commerce model is a "Transform the Business" investment.

"Grow the Business" portfolio

These are IT investments that directly support the generation of revenue and profitability out of the current business model. Again, there are certain types of IT services and products that generally find their way into this portfolio, such as client relationship management applications.

"Run the Business" portfolio

This portfolio contains IT investments that are needed by the company to be in business, but that do not directly help the company differentiate itself. Some items that generally go into this category include repair services, e–mail operations and the IT help desk.

In general, anything that falls into the "Run the Business portfolio is a candidate for outsourcing. Outsourcing these functions will immediately get you a better quality of service for a price far less than if you did it yourself. You will also free up dollars for reinvestment in core areas.

The real determining factor in how you categorize IT investments is the role that a particular IT product or service plays within your company relative to your core strategy. To get a better idea of how to use the model in practice, let's look at three examples.

How the IT Investment Portfolio Model is Used To Decide What to Outsource

ABC Textiles

ABC Textiles is a hypothetical textiles a manufacturing company focusing on growing its current business by selling more of its products to existing clients, as well as expanding its market share. This strategy relies heavily on the collection of customer purchase activity and patterns in anticipation of the customers' future needs. These patterns are captured and charted using a highly-customized customer relationship management system. As a secondary focus, the company is exploring opportunities to expand the market for its products using the Internet. ABC classifies its IT investments as follows:

Growth - Development and customization of the customer relationship management tools is a key to ABC's growth. While IT consultants may be used to supplement efforts, it wants to own this function and keep a top-grade, in-house staff to manage these projects.

Transformation Currently, the key strategy is to expand business with existing clients within the existing model. ABC is also carefully exploring new Internet-based models that will enable it to develop a global market. This may prove to be a key differentiator in the near future, so the company classifies its e-commerce investments as transformational and also wants to keep these in-house.

Run All other current IT services consist of things such as the help desk, repairs and administration of networks. These are viewed as commodity services which can and should be outsourced.

GHI Financial Services

GHI is a hypothetical financial services company with a transformational focus

Based on expert studies, GHI Financial Services and its competitors have saturated their current market and there is zero room for growth in their current space. None of them have clear differentiating qualities in this space. Clients do business with GHI because there is no advantage to switching to a competitor. The same rates and service are provided by each competitor. GHI Financial Services is now completely focused on transforming its business from a brick-and-mortar and e-commerce operation into a highly differentiated mobile-commerce business. It is targeting a specific segment of existing and new customers, comprising highly-mobile, well-compensated executives. GHI wants to be the number one mobile financial services provider for this group by positioning itself as the only company in its space that is offering services available from virtually anywhere in the world via wireless technology. In the meantime, it also wants to hold steady on its current legacy business. GHI's IT investments are as follows:

Growth As aforementioned, there are no growth opportunities in the current market. It is of a fixed size, saturated and held by a totally indistinguishable group of service providers. In light of that, there are no IT investments being applied to the growth of the current model, which is static.

Transformation M-commerce (mobile commerce) technology development and integration are all considered part of supporting the com-pany's core transformational efforts. The company is betting its future on building differentiation under a new model powered by these investments. All of the technology functions and resources represented by these investments are things the company wants to own and operate internally.

Run All other current IT services, including the technologies used to process transactions in the current business model, are considered commodity services that can and should be outsourced.

The Heart of the Matter

- Identify your key competitive strategies and objectives as a business. Ask yourself, what is the "soul of my company?"
- Sort your IT investments across the three portfolios based on how they impact your business. As a rule of thumb, no matter how sexy the technology is, if it does not directly differentiate you from your competitors, it is a run-the-business item.
- Target all run-the-business portfolio items for outsourcing. You will gain a higher level of service quality at a much lower cost by having an expert run these for you.
- Keep IT efforts that directly impact your ability to execute your current and future competitive business strategies in-house. You want to keep these in-house because you want to own and control access to those IT processes that give you a competitive advantage.

The success formula for getting the maximum benefits out of outsourcing has been practiced and fine-tuned by larger companies for several years now with great success. By carefully selecting only core IT functions to do yourself and outsourcing everything else, you will greatly enhance the total economic benefits resulting from your IT investment dollars.

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