

## **Outsourcing: Solution or Setback?**

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**Abstract:** Outsourcing is a management tool that shifts a company's organizational structure, but it is also a business transformation process that can create the opportunity for improved performance. While many companies have had considerable success outsourcing tactical functions—audit, financial services, facility maintenance, etc.—outsourcing strategic functions, such as logistics, manufacturing, and distribution has proven to be more challenging if poorly pursued. First, you must be sure you outsource the proper business function. This presentation will help you determine what you should outsource and address the steps necessary to make outsourcing a core competency.

All businesses consist of three types of functions: Core Functions, Tactical Non-Core Functions and Strategic Non-Core Functions.

Core Functions are an organization's core competency—the unique business functions that make the organization successful and the critical activities that allow it to thrive. For example, a research organization may also do some manufacturing and distribution but their core function is research because that is the primary service the company provides.

But companies cannot exist by only performing core functions. Other functions are necessary too—payroll, audit, janitorial and food service are tactical non-core functions that are absolutely necessary, but should not, by definition, have an impact on the bottom line. Certainly you can argue that if your food service providers poison your staff, your landscape providers destroy vital electrical cables/connections, your payroll providers embezzle your funds, your auditors allow others to misreport your income or the janitorial staff throws away important papers, these things will certainly impact your bottom line. These functions are important, but for them to impact your bottom line they really, really need to be done poorly.

To the contrary, logistics or manufacturing operations, information technology and marketing are excellent examples of strategic non-core functions that, if done well, can have a major impact on your bottom line. The reason for these impacts on your bottom line is both the much greater costs of these functions vs. the tactical non-core functions, as well as the implications to the success of the business if these functions are not done well as compared to the tactical non-core.

For example, imagine that a company outsources food service and logistics functions. If you were not satisfied with the quality of the food service company's performance, you would bring in another company to provide this service. But if the outsourced logistics arrangement is not working, not only have you made a major investment in transition costs, you have also likely exposed your customers to poor service. As a result, you risk losing customers, and in the transition to a new provider, your existing customers could incur serious interruptions in service. Poor performance in either outsourcing scenario is not good, but poor performance in

your strategic non-core functions will have a major impact on your bottom line and may very well take years for your operation to recover from the impact.

For many companies, outsourcing tactical non-core functions is the norm. These service providers offer straightforward, end-to-end packaged services that require little customization. You walk the property with the landscape service provider; they send you a two-page proposal, a monthly fee and a one-page contract. You sign the contract, the provider performs the landscaping and invoicing as per the contract, and you pay the provider.

For a moment, consider the companies who, in an effort to provide even greater focus on their core functions, take the same simple approach to outsource their strategic non-core functions. This is where the outsource solution becomes an organizational setback.

**Taking the Plunge into Outsourcing.** Plunging into outsourcing strategic non-core functions without a robust outsourcing process will not only prevent an organization from achieving the benefits, but will likely result in a major setback for the organization. When considering a potential outsourcing effort for these functions, it is important to take a strategic approach. A solid, up-front effort is required to identify the functions to be outsourced, so that the right processes are considered that have the best returns and second, to identify the goals that the outsourcing should achieve. Consideration must also be given to the risks, potential benefits and market availability of the service providers. Once a good decision about what to outsource has been made, a robust process must be followed to ensure achieving the benefits of outsourcing. The process consists of seven steps:

**Step One: Defining requirements and the request for proposal (RFP).**

The first step in the outsourcing process is to define specifically what is to be outsourced and to develop an RFP defining the functions to be outsourced. The RFP should provide a clear set of requirements, communicate a desire for innovation and creativity, and include a realistic timeline for the outsource process. When building your bidder's list, you should perform extensive research to be certain that all viable candidates are asked to bid. In addition, after sending the RFP to each candidate and receiving assurances of their desire to submit a proposal, perform a financial and business due diligence check on each potential candidate.

**Step Two: Evaluating bids and selecting outsource partners.**

Once the responses to the RFP are received, there must be a methodical bid evaluation and provider selection process. It is important to control communications, and limit communications to a single point of contact with the potential providers in the process of evaluating bids. The team that will evaluate the bids should represent a variety of different "touch points" with the outsourced function. Do not release any details of the bidding process until after a binding term sheet or contract is signed. The evaluation process is a business decision, not one driven by low cost or personal preference.

**Step Three: Creating outsource relationships.**

It is very important that everyone associated with an outsourcing relationship understand that outsourcing is not just about buying services. Outsourcing is giving up internal control of a business function and trusting others to handle this function for you. Communication protocols, multiple touch points between the company and the provider

and determination of performance measures and service levels, must be established early on. Furthermore, outsourcing is a business relationship that must be developed and evolved. To truly make the relationship between partner and provider a win/win, both parties in the relationship must benefit when things go well.

#### **Step Four: Forming the legal relationship.**

Interestingly, the better the two parties do at forming the legal relationship the less likely it is needed. If the legal relationship is done well, the success of the relationship will be measured by the accomplishment of the goals established for the outsourcing. If the legal relationship is done poorly, the protection the legal relationship provides each of the parties will be the criteria used to determine how poorly the relationship was done.

#### **Step Five: Putting the relationship in motion.**

Start-up is not easy. Implement the transition plan as set forth in the contract. Deal with the FUD factor: Fear-Uncertainty-Doubt. People are afraid of the unknown, and it is human nature to resist change. So flood employees with information. You will not go-live at full production speed or efficiency. The learning curve requires time to get things right. The go-live of an outsource relationship requires that thousands of things go well. Irrespective of all the planning, hard work and testing, no go-live will ever be flawless.

#### **Step Six: Establishing the outsource relationship**

Getting past start-up is important, but it is a long way from ultimate success. Investing the time and resources to make the outsource relationship work is what is needed to help the relationship evolve. Outsource relationships are between both organizations and people. Establishing a regular, ongoing process for business planning, evolution and communications is critical to keep the relationship evolving. Guidelines must be established and implemented for how to handle continuous improvement. After start-up, a formal "lessons learned" round table meeting must take place by the company alone on the topic of outsourcing, as well as between the company and the provider on the specific outsource relationship.

#### **Step Seven: Managing the relationship**

Like all of business, the outsource relationship is alive and dynamic. Leadership focus, diligence, and follow-through on continuous improvement initiatives are important to push the boundaries of continuous improvement. Also, ongoing strategic discussions from both the company and the provider must take place to be certain the relationship stays current and focused on the correct priorities.

For any outsourcing venture to succeed it must be approached with the same efficient process knowledge and experience required of any other significant business transformation.

Companies who make outsourcing a core competency can effectively develop outsourcing relationships, successfully manage outsourced functions and continually recap the full benefits of outsourcing.

## **REFERENCE**

Tompkins, Ph.D, James A. *The Outsourcing Paradox: Achieving Success in Manufacturing and Distribution Outsourcing*, Tompkins Press, Raleigh, NC, © 2005.