Tips and Traps of Outsourcing

Expert knowledge means success

Contents

Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

What exactly is outsourcing? Simply put, it's the practice of subcontracting "inside" work "outside" to other companies (or individuals).

The term "Outsourcing" has been applied to many different relationships across a variety of business areas and has existed in many forms for more than 30 years. Outsourcing or out-tasking, is the assignment of specific work to a third party for a specific length of time with an agreed-upon price and service level. These extended service offerings are now enabling companies to free themselves of any in-house departments that consume disproportionate time and money.

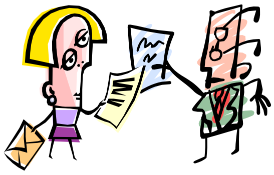
Unlike any other kind of work that is done "in-house", you only pay for the time involved in the completion of your job project. This practice makes it especially attractive to new businesses with little or no office space or staff as well as the established company experiencing downsizing or ones that occasionally incur large, undesirable, seasonal or periodic projects.

Outsourcing is not a new concept. It used to be called subcontracting. For example, some organisations have outsourced specific functions for many years, such as cafeteria management and payroll operations. The trend to lower operational costs by eliminating non-essential personnel is increasing at an estimated annual rate exceeding 15%.

In today's competitive business marketplace, outsourcing has become not only a reality but, in many cases, a necessity.

This publication has been compiled to emphasise the benefits and significant improvements that accounting outsourcing (the partial or total outsourcing of an organisation's finance department) can bring.

We've put together a story to illustrate the growing pains of a business that grows from humble beginnings to expand beyond the owner's capacity to keep up with the work demands - it follows next. In the story, you'll discover the benefits of a flexible and modular approach to outsourcing as a business grows from humble beginnings to a large-scale operation.



A Story to Start - "By the book"

This is a story about Eric and Teresa.

In the beginning the business was very small. It was called "Little Acorn Furniture".

Mr Eric N Trepreneur worked on his own. But soon it was too much for him and he asked his fiancée Teresa Trustworthy to help him. Eric was the machine tool operator, the cabinetmaker, manager, salesman and deliveryman. Teresa, who knew a few things about bookkeeping, kept the books and ran the showroom.

The small business began to do well. Sales started to expand. Eric couldn't keep up with it anymore. He'd heard about the management technique called "delegation". Eric decided to employ someone to deal with telephone and fax orders (by now Eric had invested some of his profits in a fax machine) and help out in the showroom. Eric also needed someone part-time to do the packing and some of the deliveries.

The ad in the local paper produced eight replies but only two of the applicants seemed to have a modicum of commonsense. That's how Clara got the job of dealing with customer's orders and learning how to sell in the showroom. Henry, a retired postman, was hired as the part-timer.

Teresa was able to take care of the bookkeeping when the business was small. But now that Eric had the bit between his teeth, the business was really taking off - it wasn't an acorn any longer, she thought, "it's more like a great big oak tree". Teresa had been able to deal with VAT and draw up rudimentary accounts for the taxman. PAYE was a new thing for Teresa - things were certainly going to be different now that the business had employees. And it was about time that Eric should start paying Teresa for all the hard work she'd been doing over the last couple of years.

Teresa decided that if the business was big enough to employ and pay people, it was also big enough to get the finances and accounts right. A great deal depended on getting the right financial information - Mr P Ernickity at the local bank had insisted on getting accounts sent to him every three months as a condition of the loan he'd advanced to Eric.

Teresa knew that a computer and accounts software might help, so one Saturday she *and Eric went shopping to look for something to fit their needs. After an hour or so among the PCs and software boxes, both Eric and Teresa admitted that they were overwhelmed by all the technology on offer. Fortunately a friend, who was a consultant, suggested a different path.*

Ken Knowing, the consultant, talked about a wonderful new service that he'd discovered. A business could have their PAYE, VAT, bookkeeping and accounts done by a company called Outsourcing - they'd take the day-to-day financial concerns out of Eric and Teresa's hands so all they had to worry about was the business.

What Eric and Teresa didn't know was that Outsourcing was neither good nor bad - it was just indifferent. They provided a service but it wouldn't necessarily help Eric or Teresa understand the financial state of Acorn nor help them set up an accounting system. No - Outsourcing's job was to handle whatever duties Eric and Teresa turned over to them.

Eric thought about it long and hard. He still wasn't sure if this was the path that Little Acorn Furniture should take. And Teresa wasn't sure she liked the idea of someone else being responsible for the bookkeeping. Eric asked other successful business owners how they handled the financial side of their business. Over and over, he kept hearing about accountants who undertook the financial side of a business - so he gave them a call.

Eric found that the accountants could help him do all the bookkeeping for Little Acorn Furniture, prepare the accounts, as well as helping him plan for the future. Not only that, Eric found that they would also help him implement his own accounting system. Their services included everything Eric and Teresa were looking for and much more besides. The great thing that Eric and Teresa liked was that the accountants could provide as much or as little service as Little Acorn Furniture wanted or needed.

Eric didn't take long to decide the right thing to do. He liked the idea of having some control over his accounting system. He decided to appoint the accountants to set up an accounting system that Teresa could use and understand. This would enable Teresa to ask the accountants for advice as necessary about the new system.

Working together in the way that the accountants explained would mean that there would be time left over for Eric to start concentrating on his future and to spend time working ON the business rather than to be consumed by working IN it. The management, personal and business development coaching the accountants provided was another great attraction as Eric was ambitious and wanted to learn more about business, finance and management.

Eric and Teresa were married in the next year and one day they hope that their son Tom will be able to take over the business. Little Acorn Furniture's business continued to thrive and grow and one day, Eric decided to change the name to Big Oaks Furniture. It wasn't long before Eric was telling other business owners about how to handle their accounting needs. The accountants expanded too with more and more resources so that they could provide a total solution for larger businesses that wished to get rid of their finance and accounts department and have someone run it for them.

Eric's advice for the new and developing business is:

- Decide if you want to completely outsource your accounting arrangements or have an accounting system designed for you;
- Whichever service you decide to use, check the credentials of the firm. Ask to see certification and references;
- Make sure you can work with the person on a personal level and that your questions are answered in terms and language you can understand;
- Make sure that costs are agreed at the beginning with clear arrangements for extras when they apply.

The moral of the story is that before making a decision on accounting needs, you must do your homework and know your options. The range of outsourcing services on offer from the accountants was flexible enough in the case of Eric and Teresa to handle all stages of the growth of their business.

Modular Outsourcing

Many accountants have developed a modular approach to outsourcing. It comprehensively covers the requirements of the smallest to the largest organisations in today's competitive business environment.

How does it work?

In the Erica and Teresa story of *Little Acorns Furniture*, the stages were:

- Stage 1 - Back Office Services. During this stage, the accounts provided a complete accounting service from posting and processing orders, invoices and payments to producing monthly management accounts, cash flow projections and annual statutory financial statements. Even the payroll and company secretarial functions were handled by the accountants and the entire work was carried out from their premises. Little Acorn Furniture continued to flourish and another outsourcing solution was required.
- Stage 2 - In-House Outsourcing. Little Acorn Furniture continued to grow. The accountants offered to set up an accounting office within the premises of the business. They installed the systems, recruited and provided the staff and produced quality, meaningful management information. The accountants worked ever closer to the management team at the business. Little Acorn Furniture continued to grow and grow until one day it was clear that the business should recruit its own finance and accounting team and produce in-house management information.
- Stage 3 - Recruiting and Training the Finance Team. The accountants assisted the business to recruit and train the new accounting team. They wrote job and person specification to ensure that the business built the right management team. They wrote and introduced the accounting policies, disciplines and procedures required. The accountants continued to provide specialist assistance and coaching to the entire management team.

How Popular is Outsourcing with Small and Medium-Sized Enterprises (SMEs)?

A report by the Board for Chartered Accountants in Business (BCAB), at the ICAEW, showed that many SMEs were outsourcing at least one accounting or finance function activity. SMEs who outsourced finance activities have been able to achieve economies of scale while maintaining flexibility. The service provider offered resources not available internally, giving better value at lower cost and allowing resources to be freed for other purposes.

The report also found that most businesses tended to outsource non-core elements of the finance function especially those which consumed the least time - tax management, wage payments, pensions, internal audit, IT management and banking activities being the most commonly outsourced. The main deterrent to more extensive use of outsourcing was the fear of the loss of control over information.

The BCAB report identified two trends that might encourage the widening of the outsourcing market in finance activities. The convergence of accounting regulations between EU countries offered the ability to develop larger specialised supply companies, encouraging the potential market for industry specific suppliers of outsourcing services for SMEs to grow. In parallel with this, it was believed that the development of shared service centres should open up the market for SMEs to take advantage of potential economies of scale. Specialist shared service centres would serve to help overcome the concerns of industry knowledge being inadequate.

Sustainable competitive advantage comes from the ability of the company to conduct tasks in a way that has greatest value to the buyer in the market place. The aim for companies, therefore, is to create value within their supply chain that exhibits the maximum level of efficiency.

Processes suitable for outsourcing

- IT functions - you can outsource most IT functions, from network management to project work, website development and data warehousing. You may benefit from the latest technology and software upgrades without having to invest in expensive systems or keep up with industry trends.
- Business processes and HR - outsourcing activities such as recruitment, payroll and secretarial services gives you access to specialist skills, but you only pay when you need to use them.
- Finance - you already outsource auditing, so why not do the same with your entire accounting function, including bookkeeping, tax management and invoicing?
- Sales and marketing - many organisations use a consultant or an agency to handle marketing communications - smaller businesses, or those in specialised markets, can also outsource sales to specialist agencies.
- Health and safety - there are consultants who specialise in health and safety compliance tasks. They may be able to ensure you meet all the requirements, including those for complex risks, more cost-effectively than you can.

You could also outsource non-business-critical tasks such as cleaning, catering and facilities management.

Source: Business Link

Shortening product life cycles, deregulation and globalisation have increased competitive pressures in the market. In order to respond to these market conditions, companies need to achieve both high levels of flexibility and low reaction times. With a large corporate machine in action, this becomes difficult. Outsourcing has the potential to allow SMEs to attain competitive advantage in a manner that would otherwise be difficult to achieve as a single operator.

Outsourcing the Accounting function

Outsourcing is ballyhooed as an opportunity for organisations to focus on their "core activities." The implication is that finance is a "non-core activity." That view of the finance function is somewhat short sighted, because nearly all business processes are embodied in the financial accounting system. Order-taking and processing, sales, dues billing, invoices for meetings, and all collections and payments are either wholly or partially performed through the accounting system. Thus, arguably, the accounting system *is the business.*

What can an Outsourcing Service Provide?

Outsourcing services are flexible. It can contain as little or as much as you want.

Many companies want to outsource, on a permanent basis, the company secretarial function - to ensure that the Company Law obligations for directors and officers are complied with, the proper records are maintained and that the proper returns are made to Companies House on time.

But there are many other functions that businesses want to outsource. For example, some companies just want to outsource the payroll function. That can include weekly or monthly payroll, variable payments, PAYE and NI accounting and maintenance of personnel records - it can also include writing job descriptions and implementing appraisal systems. Operating the PAYE system has become increasingly complicated in recent years for many employers. Employers' responsibilities have increased with the introduction of statutory sick pay (SSP) and statutory maternity pay (SMP), with the popularity of lump-sum incentive payments, and with the ever-increasing complexity of the benefit in kind rules. Since 6 April 1996, employers have to meet formal deadlines and to provide all employees with forms P60 and with details of the taxable amount of their benefits in kind. The benefits of using a dedicated computerised service backed by trained professionals working with a large number of employment law issues, are obvious.

Other companies wish to keep control of sales ledger invoicing and purchase ordering but wish to outsource the remaining elements of their finance and accounting functions to us - including the payment of creditors, credit control, monthly management account reporting and budgetary control systems.

In some cases, we recruit dedicated people for your existing accounts department and train them if necessary. Then we provide a watching brief to ensure that the induction of new people into your organisation is working effectively.

Who know what will happen in the future? Maybe one day there will be accountants around who offer sales ledger financing to the ever-growing array of their outsourcing services. It's not here yet but when and if it arrives, it would mean that they would not only run your accounting and financial systems but also advance money against valid invoices (usually 75%) and pay you the balance when your customer pays the invoice in full.

Reporting the financial results to you can go well beyond the paper format - financial information can be made available by e-mail, via the Internet, on CD-Rom, by Modem, by fax, by post or even printed directly to a specified printer within your own office PC network.

As you can see, outsourcing services can be both flexible and comprehensive.

Is Finance a "Core Activity"?

Whether one believes or doesn't believe that finance is a "core activity," outsourcing arrangements should not preserve outdated policies and procedures, as many in fact do. The role of the finance professional has changed from that of an observer and reporter to that of participant in the business process. Whatever the arrangement, either fully staffed or outsourced, those performing the finance function must begin to act as strategic business advisors rather than compilers of historical data.

Historically, in the business world, outsourcing has been viewed largely as a financial strategy. This remains true today. But, at the same time, it has gained renewed favour and momentum as a result of re-engineering efforts that leverage expenses by determining where value is generated within an organisation.

Outsourcing is not a panacea and it is not necessarily the right strategy for every company or situation. Each company's circumstances, objectives and business plans should be carefully considered prior to entering into long-term outsourcing agreements.

Business and government studies of a myriad of statutory requirements that are rapidly increasing the drain on employer financial resources conclude that it is no longer cost-effective to control "non-core essential" obligations in-house. The solution is outsourcing which enables companies to focus on core activities and increase their operational flexibility by knowing when to appoint outsiders better able to undertake the work. In other words, anyone whose workload exceeds their permanent staff's ability to meet deadlines as well as the company's financial bottom line is a prime candidate for outsourcing.

Administrative outsourcing could provide various traditional secretarial services such as typing, transcription of dictation tapes, bookkeeping, billing, taxes, copying and mailings, as well as extended assistance in computer software setup and programming, web site administration and management, and lots more - all at their office. More and more businesses are becoming open-minded regarding the multitude of obvious advantages obtained from outsourcing. In today's environment of ever increasing competition, companies are searching for ways to differentiate themselves and go beyond mass production. This has led to the evolution of customised product and service offerings. An integral part of customisation is having the capability to expeditiously respond to individual opportunities and to achieve this agile business strategy. Organisations need to concentrate on defining and identifying the most cost-effective and efficient way to accomplish various activities. Many have realised the benefits to their bottom line of outsourcing functions that can be better handled by a dedicated provider.

Today, employers have plenty of options when it comes to additional office support for their "other than normal" administrative projects:

- Recruit additional personnel;
- Call a temporary staff agency;
- Outsource through an accountant who offers these services.

Is your Financial Operation Low-Value or High-Value?

Here are some of the characteristics of a low value financial accounting operation:

- The presence of accountants performing primarily low value clerical tasks such as writing cheques, filing invoices, posting deposits, reconciling bank accounts, or processing payroll;
- Duplicative records, databases, and other information maintained in more than one functional area. For example, where the conference department maintains essentially the same or fragmented information about registrant invoicing, payment, and attendance as that maintained in the accounting department;
- Financial reports that are not generated on a timely basis or do not address the information needs of department heads, management, or the Board;

- Financial reports that require data to be manually re-entered from the accounting system into spreadsheet software and then reformatted.

A high-value financial operation should result in certain observable outcomes, such as:

- Reduced processing time for transaction cycles and generation of financial reports;
- Financial reports that compare actual with historical and budgeted results
- Financial reports that present historical (at least three years) trend information;
- Financial information supplemented by non-financial information such as number of members, number of exhibitors or meeting registrants, etc.;
- Elimination of fragmented or duplicative information in separate departments;
- Information available on a local area network or via an Intranet;
- Coordination with vendors in formatting their invoices and reports so that meaningful data can easily be extracted and integrated into the financial accounting system;
- Overall reduction in paperwork.

Focus on Core Competencies

Management should determine the critical functions in their companies. This will involve deciding which functions are super-critical, which are merely critical, which are important and which are strictly operational. Never outsource the strategic direction of your facility or unique core competencies. If a function isn't a revenue producer, if it isn't considered a good career opportunity for employees, and if it hasn't reduced costs by 20% to 30% percent in the past few years, it is ripe for outsourcing.

Low risk outsourcing functions include facility development and project management, property management, facility management, network management, data-processing and finance (including accounting), temporary staffing, supply-chain management, payroll, security services, food services, housekeeping, roads and grounds, and property maintenance.

Functions performed on a project-specific basis requiring specialised expertise should also be considered for outsourcing. When these periodic requirements crop up, the administrative staff are often overburdened with additional responsibilities falling outside their realm of expertise. Strategic planning, facility planning, design and construction activities often do not require full time staff. For example, demographic studies, new construction and renovation projects, and procurement and installation of major equipment can be performed more economically and efficiently by outsourcing to organisations whose core competencies fall into these areas.

In short, any task that takes the focus off the administrative and operational duties necessary to maintain a facility's competitive advantage should be seriously considered for outsourcing.

Before you outsource, do your homework. Perform due diligence of total actual internal costs of the function you are contemplating outsourcing. Investigate outsourcing firms and their references. Ask to visit their offices and observe how their organisations operate.

Benefits of and Reasons for Outsourcing

Besides lowering operational costs and increasing productivity, in areas where outsourcing does make sense, you may gain access to world class-capabilities by selecting organisations that specialise in those specific areas. Many outsourcing organisations have developed methodologies over the years that far surpass what a company is able to develop and maintain internally. The outsourcing firm may, for example, have made investments in training far beyond what most companies may be able to afford for tasks outside their core competencies.

Successful outsourcing creates the opportunity for organisations to single-mindedly pursue key business objectives and focus on core strategies. The organisation that can focus on strategic issues without the continued distractions of operations outside the core business will enjoy a substantial competitive advantage.

The Best Financial Reasons to Outsource

- To reduce or control operating costs - The single most important tactical reason for outsourcing is to reduce or control operating costs. Access to the outside provider's lower cost structure is one of the most compelling short-term benefits of outsourcing. Some companies report that on average they saw a 9% reduction in costs through outsourcing.
- To make capital funds available - Outsourcing reduces the need to invest capital funds in non-core business functions. This makes capital funds more available for core areas. Outsourcing can also improve certain financial measurements of the firm by eliminating the need to show return on equity from capital investments in non-core areas.
- To gain a cash flow benefit - Outsourcing can involve the transfer of assets from the customer to the provider. Equipment, facilities, vehicles, and licenses used in the current operations all have a value and are, in effect, sold to the provider as part of the transaction resulting in cash payment. The Outsourcer then uses these assets to provide services back to the client. Depending on the value of the assets involved, this sale may result in a significant cash payment to the customer. When these assets are sold to the vendor, they are typically sold at book value. The book value can be higher than the market value. In these cases, the difference between the two actually represents a loan from the vendor to the client that is repaid in the price of the services over the life of the contract.
- Access to resources that are not available internally - Companies outsource because they do not have access to the required resources within. For example, if an organisation is expanding its operations, especially into a new geographic area, outsourcing is a viable and important alternative to building the needed capability from the ground up. Companies outsource because they do not have access to the required resources within the company. New organisations, spin-offs, or companies expanding into new geography or new technology should consider the benefits of outsourcing from the very start.
- The functions are difficult to manage or are out of control - Outsourcing is certainly one option for addressing these types of problems.

Outsourcing doesn't, mean abdication of management responsibility, nor does it work as a knee-jerk reaction by companies that are in trouble. When a function is viewed as difficult to manage or out of control, the organisation needs to examine the underlying causes. If the requirements, expectations or needed resources are not clearly understood, then outsourcing won't improve the situation; it may in fact make it worse. If the organisation doesn't understand its own requirements, it won't be able to communicate them to an outside provider.

The Best Strategic Reasons to Outsource

- To improve business focus - Outsourcing lets the company focus on broader issues while having operational issues assumed by an outside expert. For many companies, the single most compelling reason for outsourcing is that several of the "how" type of issues are siphoning off huge amounts of management's resources and attention. Freed from devoting energy to areas that are not in its expertise, the company can focus its resources on meeting its customers' needs.
- Access to World-Class capabilities - By the very nature of their specialisation, outsourcing providers bring expensive worldwide, world-class resources to meeting the needs of their customers. World-class providers make extensive investments in technology, methodologies, and people. They gain expertise by working with many clients facing similar challenges. Partnering with an organisation with world-class capabilities can offer access to new technology, tools, and techniques that the organisation may not currently possess; better career opportunities for personnel who move to the outsourcing provider; more structured methodologies, procedures, and documentation; and competitive advantage through expanded skills.
- Accelerated Re-engineering benefits - Outsourcing is often a by-product of another powerful management tool - business process re-engineering or BPR as it is often called. Re-engineering aims for dramatic improvements in critical measures of performance such as cost, quality, service and speed. But the need to increase efficiency can come into direct conflict with the need to invest in core business. As non-core

internal functions are continually put on the back burner, systems become less efficient and less productive. By outsourcing a non-core function to a world-class provider, the organisation can begin to see the benefits of re-engineering.

- Shared risks - There are tremendous risks associated with the investments an organisation makes. When companies outsource they become more flexible, more dynamic, and better able to adapt to changing opportunities. Companies that try to do everything themselves may incur vastly higher research, development, marketing and deployment expenses, all of which are passed on to the customer. Markets, competition, government regulations, financial conditions and technologies all change extremely quickly. Keeping up with these changes, especially those in which the next generation requires a significant investment may be very risky. An outside provider's lower cost structure, which may be the result of a greater economy of scale or other advantage based on specialization, reduces a company's operating costs and increases its competitive advantage. Outsourcing providers make investments on behalf of many clients, not just one. Shared investment spreads risk, and significantly reduces the risk born by a single company.
- Freeing resources for other purposes - Every organisation has limits on the resources available to it. Outsourcing allows an organisation to redirect its resources from non-core activities towards activities that have a greater return in serving the customer. The organisation can redirect these people or at least the staff slots they represent onto greater value-adding activities. People whose energies are currently focused internally can now be focused externally - on the customer. There is tremendous competition within most organisations for capital funds. Deciding where to invest these funds is one of the most important decisions that senior management makes. It is often hard to justify non-core capital investments when areas more directly related to producing a product or providing a service compete for the same money. Outsourcing can reduce the need to invest capital funds in non-core business functions. Instead of acquiring the resources through capital expenditures, they are contracted for on an "as used" operational expense basis. Outsourcing can also improve certain financial measurements of the firm by eliminating the need to show return on equity from capital investments in non-core areas.

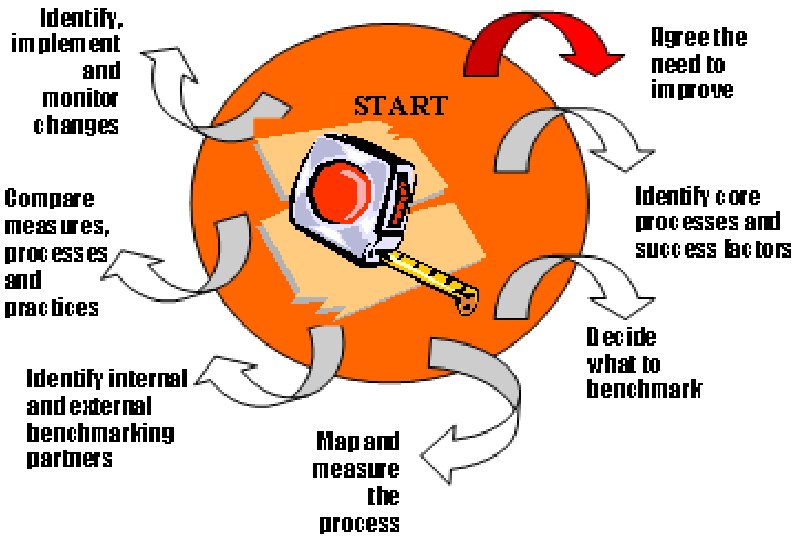
Where Benchmarking comes in

Any outsourcing effort starts with some benchmarking measurements. Benchmarking is the continuous process of measuring services and practices against the toughest competitors or recognized industry leaders. In simple terms, it is the mechanism of finding and implementing the best practices. Benchmarking needs four things to document the process:

- a picture of the process;
- a work description of the process;
- what is done;
- how it is done.

It is the only credible way to make a comparison between what you do and what other businesses do. Conducting outsourcing evaluations is an excellent vehicle to both benchmark and bring discipline to a variety of corporate activities.

Benchmarking Process Steps - "when you can measure it, then you can manage it"
See how the benchmarking circle works:



Outsourcing - How it's done in Practice

Organisations that have successfully outsourced go through three major phases in the process:

- Phase 1: Internal Analysis and Evaluation;
- Phase 2: Needs Assessment and Vendor Selection;
- Phase 3: Implementation and Management.

Phase 1: Internal Analysis and Evaluation.

In phase 1, senior management examines the need for outsourcing and develops a strategy to implement it. This phase is mostly internal and conducted in the highest level of the organisation.

For an organisation to benefit from outsourcing, the initiative should come from the top. Only the top-level executives have the power to define the vision and implement the changes that are necessary for outsourcing to succeed. As you develop a strategy, consider the following:

- Clarify organisational goals in relation to outsourcing;
- Identify areas to outsource. Define the core competencies of the organisation and the functions of the business that are not core. An organisation should outsource its non-core functions so that it can focus on its core competencies. Having identified non-core functions, gather facts and figures to determine where you will get the quickest and best return on investment. To determine the return on investment, analyze current return compared to what an outside vendor may offer;
- Develop a long-term strategy. If you are outsourcing a function that already exists, remember that employee support and morale will be critical. Job retention should be a major feature of your strategy. In some relationships, workers are hired by the new vendor. From the beginning, communicate honestly and openly with employees about how their needs will be met.

Phase 2: Assessment and Vendor Selection

In phase 2, people inside and outside of the organisation provide more detailed information and advice. This is a research phase in which you learn about your own specific needs and find out which qualified vendors will be best to meet those needs.

Research needs

To find out more about your own needs, research the needs within the organisation, and learn from other companies who have outsourced the same kind of function. Plan to visit these companies to find out what their experience has been. Form a team of people to help you ask the right questions and analyze the information you gather.

Outsourcing Checklist

Rate on a scale of 1 to 5
(1 = poor, 5 = excellent)

1. What is our current situation?
   ___ Expense levels
   ___ Skill level of people
   ___ Satisfaction level of internal customers

2. What is our five-year projection?
   ___ Expense levels
   ___ Skill level of people
   ___ Satisfaction level of internal customers

3. For other companies in our area of core competency and marketplace, how do we stand?
   ___ Expense levels
   ___ Skill level of people
   ___ Satisfaction level of internal customers

4. (a) Is this function super critical to our success and a core competency?
   ___ Yes ___ No

   (b) Critical to our success but not a core competency?
   ___ Yes ___ No

   (c) Important to our success but able to be satisfied by service-level agreements with key outsourcers?
   ___ Yes ___ No.

5. Who are the key outsource vendors with acknowledged skills, reputation and financial skills?

Source: Innovators in Outsourcing issue of Forbes, October 23, 1995

You may need team members with expertise in the following areas:

- legal;
- human resources;
- finance;
- procurement;
- specific function to be outsourced.

Write a Request for Proposal (RFP)

By now you have learned quite a lot about specific services, costs and other issues pertaining to the function you wish to outsource. You will now write a request for proposal. A request for proposal should do the following:

- Be structured in a way that will allow assessments and comparisons to be done in a meaningful way;
- Define requirements in complete and measurable terms;
- Describe the type of relationship you are looking for;
- Explain the problems that you are trying to solve;
- Ask specific questions about corporate culture;
- Present the current costs to the organisation;
- Specify a service level.

Be honest. A proposal is a valuable opportunity for a vendor to grapple with very real costs and problems and prove to you that they can do an excellent job. Just as you will use the proposals to assess vendors, vendors use your RFP to assess you. A well written, clearly defined RFP tells vendors you are serious about the project. They will work hard to solve your problems and get your business. On the other hand, a vague or unrealistic RFP will make the most qualified and experienced vendor think twice before spending any time going after business that may be unprofitable and unmanageable.

Assess vendors and make selection

Form a team to review proposals. The team should identify which vendor comes closest to meeting your needs. As they assess proposals, team members should use networks and references to find out about vendor reputation in the industry and look at the vendor's total plan and capabilities, not just price or a single aspect of what they do.

To make the right choice, be sure the vendor demonstrates:

- a clear understanding of your needs and ability to solve your problems;
- financial stability;
- cultural fit;
- proven track record.

Negotiate a contract

Once the vendor has been chosen, you'll negotiate and sign a contract.

- negotiate a reasonable price and performance measures;
- communicate often and openly;
- show your willingness for both sides to succeed;
- write a contract that defines the service level and the consequences if the level is not met;

Phase 3: Implementation and Management

Decide in advance how you are going to manage the relationship. Create a system that allows you ways to:

- monitor and evaluate performance;
- identify and communicate issues early;
- resolve issues quickly and fairly;
- help people in your organisation adapt to a new way of doing things.

What to look for in an Outsourcing Partner

- Complementary strengths - Look for a partner whose needs, objectives and strengths are complimentary to yours.
- Mutual commitment - Seek a partner whose commitment to risk sharing and extra effort are at the same level as yours.
- Mutual trust - Ensure that the partner you are evaluating treats you as a true equal, works to build an understanding and expects to solve problems together.
- Cultural compatibility - The best relationship is one where you feel a comfortable fit. Turf protectors make poor partners. Corporate cultural differences stand out far more with strategic partners than with traditional business relationships.
- Track record – Look for a partner that has a track record of service commitment and customer satisfaction. Find out if they have existing customers

with a similar industry profile to yours. If so, check how satisfied their customers are and how the partner deals with problems. Try to visit both the partner and a customer to see the outsourcing in operation.

- Financial stability – Make sure that your potential partner is financially stable. If it is a limited company, get copies of its recent accounts, ask for banker's references and consider getting a report from a credit checking agency.
- Geography - If you choose to outsource to a company outside the UK, remember that distance and time zone differences could make control more difficult. Language problems and different cultures can also present problems and you will need to allow for exchange rate fluctuations in your costings.

Ask your potential service provider if they plan to subcontract any of your work and if so apply the same checks to the subcontracted company.

For example, here's a checklist to use when you are evaluating an outsourcing partner for your payroll services:

- A personable customer service contact;
- Quick response time and ability to follow up;
- State of the art technology;
- Ability to grow rapidly with you;
- Seamless payroll, PAYE, NI and P11D tax reporting service;
- Flexible, user-friendly systems that are easy to tailor to your needs;
- Easy accessibility of your data;
- Easy to read, customisable reports;
- Complete summary and detailed checks;
- Holiday accruals;
- Direct upload to your nominal ledger;
- Electronic funds transfer.

An outsourcing firm will begin by looking at the tasks to be performed and what the current staffing level is. The more inefficiently the tasks are being performed, the better the outsourcing proposal will look.

Staffing

Staffing is the major element to be considered when reviewing a function for outsourcing. It is always the major cost involved. To achieve maximum efficiency and productivity, the function must be staffed properly, workers trained quickly and managed well, and turnover kept to a minimum. Before making an outsourcing decision, facilities must review the current staffing of the function and ask themselves these questions:

- Is productivity at the level it should be?
- What is the full cost of managing the staffing function presently in line with pay rates in the function of the work to be outsourced?
- Are pay rates in the function presently in line with pay rates in the external labour market?
- Does the present staffing involve high employee turnover rates?

Making a Success out of Outsourcing

To succeed in outsourcing, you need to:

- Create a shared vision for the outsourcing - Reflect this vision in the contractual arrangements. In a shared vision, both partners contribute. A specialized provider can help define realistic requirements and added benefits. Major investment in getting to know and understand each other is essential.
- Agree upon effective performance measures that motivate the outsourcer to ensure that its actions serve the client's business objectives - Specify requirements in terms of outcomes rather than inputs. Attach a service standard against which to measure performance. Though it is difficult to set performance standards, they are an extremely effective way to ensure high quality service, particularly when incentives and penalties are attached for over or under performance. But remember - to be effective, performance standards must be realistic.
- Establish clear communication mechanisms - The approach to communication between the partners will reflect the spirit of the outsourcing contract and the complexity of the services being delivered. This may include joint planning of service delivery and problem resolution, discussion of proposed innovations or changes in approach, consultation on staffing changes and so on. This will be supplemented by regular monthly reporting showing performance against standards, pricing and problems encountered.
- Develop a clear contingency plan and exit strategy - Accept it. It's a fact of life. Despite having good communication systems in place, the relationship between two parties can

break down. That's why a well-defined contingency plan, centered on people, is essential particularly in relation to essential and time-critical services.

The Outsourcing Contract

It's best to start all contracts with the company's business objectives. Why is this process being outsourced? Which parts of the process are to be outsourced? Then you:

- Determine and align clear business objectives with the supplier's capabilities.
- Employ internal and external benchmarking to determine current capabilities and costs to help the company set a baseline and refine business objectives.
- Develop performance and cost targets to develop initiative (Supplier).
- Create and build initiative-based targets into the contract (Both parties).
- Fulfill the initiatives. The buyer achieves control over the outsourced process, accountability, cost savings and improved profitability and performance. The outsourcer achieves revenue growth, extra profit (depending on incentives) and possible contract extension or renewal. Both parties benefit from the relationship.
- Review performance regularly (monthly, quarterly or annually) and mete out rewards or penalties to the supplier. Benchmarking also helps the company develop new business objectives.
- Decide whether to expand or shrink the relationship with the outsourcer.
- Work together with the gathered information in the external benchmarking, evaluation and initiative creation stages to conduct scenario planning and develop new business objectives.

The BCAB report referred to in this publication said that the outputs of the finance department not only facilitate the smooth day-to-day running of the organisation, but also have a critical influence on the future direction of the company through inputs into product mix decisions and, associated with these, into process and technology decisions. The benefits to the business of a strong finance function are clear. However, this does not address the issue of whether the conduct of the activities in-house leads to a significantly better service than if they are provided externally. The issues underpinning the decision making process are as follows:

- Can the activity, which is to be outsourced, be decoupled from other processes in the finance function? In cases where there are shared facilities, shared personnel and joint information inputs, this clearly becomes more complex.
- Can the contractor meet the service, and other non-monetary aspects of performance?
- Are there economies of scale to be gained? If so, how can they be measured and what is the expected gain to be defined?
- How expensive will it be to locate a suitable contractor, negotiate an agreement and subsequently monitor that agreement?
- Where is the buyer/supplier power? In cases where the power is unbalanced, the concept of mutual dependence collapses. This may not be a problem in markets that are mature with a large number of suppliers, but may be critical in new markets.
- Associated with the question of power is the issue of business knowledge. The question which must be addressed here is: will the supplier get to know our company well enough to supply information of a high enough standard for the strategic decision making element of the company?
- What are the switching costs at the end of the contract?
- The relative importance of these issues will depend on both the size of the contract and its importance to the company. The decision-making process is also dependent on the size and maturity of the market for the activity that the firm has decided to outsource.

The contract is the only "deliverable" from the outsourcing negotiating process. It's essential that this contract reflects a meeting of the minds regarding all issues - most importantly, those of scope, performance and pricing. Subsequently, the outsourcing agreement must contain a detailed description of services to be performed in a "Services Schedule". Without this, disputes will arise as to whether a particular request is outside the scope of the basic services. Both parties must strive to document a complete listing of services, service levels and deliverables. This should be accompanied by agreements regarding benchmarking, price, and/or performance migration milestones and project schedules.

The outsourcing contract is the parties' real understanding of what happens during the life of the agreement. It must be a vital document and not live in a file cabinet. Therefore, contracts have schedule-upon-schedule of very substantial detail, but in a living way.

It is useful for parties to agree on guiding principles to take them through the contract process. Guiding principles don't dictate what to do in specific terms; they ensure a productive and positive relationship through the negotiations. These principles can address priorities, success criteria and day-to-day operations to help avoid surprises while constructing win-win situations. Further, guiding principles are intended to resolve all high level business and operating issues within a certain time frame.

Service level agreements

Service level agreements (SLAs) are contractual obligations, which normally form part of the contract. SLAs can be used in any supplier contract where a business' ability to meet its customer requirements is dependent on the supplier.

SLAs cover all aspects of the outsourced work - they define the service that suppliers must provide, the level of service to be delivered and set out responsibilities and priorities.

SLAs are complex documents that should be well defined. The Service Level Agreement and SLA Guide website sell a pack that provides advice, a training guide and an SLA template at www.service-level-agreement.net.

It may be worthwhile getting advice from a service management consultant. If you have any doubts, seek advice from a commercial lawyer. You must be involved in drawing up the SLA together with the supplier.

Typical SLAs include:

- the service provided
- the standards of service - see our guide on quality management standards
- the delivery timetable
- responsibilities of supplier and customer
- provisions for legal and regulatory compliance
- mechanisms for monitoring and reporting of service
- payment terms
- how disputes will be resolved
- confidentiality and non-disclosure provisions
- termination conditions

If service providers fail to meet agreed levels of service, SLAs usually provide for compensation, commonly in the form of rebates on monthly service charges. Identify the most critical components of the deal, apply the strictest penalties to these and build periodic performance reviews into the SLA.

SLAs require constant discussion and renegotiation. If your business needs change, you may require different criteria. The SLA should be also updated to take account of technology changes.

All outsourcing contracts should contain an exit strategy. The contract should also include clauses covering:

- dispute procedures
- who has responsibility for what - and the lines of reporting

When entering an outsourcing contract you should ensure that you're interpreting the contract in the same way as the outsourcing company. This is a long-term partnership and misunderstandings could cause difficulties.

Pricing

Pricing is an area where there can be a great deal of flexibility designed in the contract that can reward both the buyer and the supplier. A new trend in spreading business risk, or "risk-reward," is starting to emerge in this area, and is meant to guarantee that the vendor has a significant financial interest in the customer's business performance. While difficult to negotiate, these profit-sharing models offer a good deal of flexibility to the buyer.

Most commonly used are the following pricing methods:

- Fixed price: used for elements such as tax where the service that will be required can be relatively clearly specified at the beginning of the year. There is usually a facility for the provision of additional services should they be requested.
- Volume based pricing: this is especially useful for companies that experience fluctuations in demand. The supplier may be in a position to offset the expected fluctuations of one client against those of another, thus

operating at full capacity most of the time, and achieving significantly reduced prices. This is one of the most commonly used pricing methods for outsourcing, as it is a clear case of the conversion of fixed to variable costs thereby protecting the business against some of the problems of seasonality and fluctuating activity levels.

E-Outsourcing

Electronic outsourcing (e-outsourcing) refers to services that are delivered electronically, usually over the Internet. These range from conventional business functions, such as bookkeeping, to technical and IT services, such as website hosting.

The benefits

E-outsourcing delivers a range of benefits, including:

- Reduced costs - you pay for services only when you use them, with little or no investment in new equipment, staff or training.
- Greater efficiency - you don't need a complex IT network or a specialist IT department.
- Commercial advantage - you can work closely with business partners and customers. It also enables staff to work remotely and have access to high-performance software at affordable rates.
- Better use of people - staff can concentrate on business-critical and value-added operations.

Implementation

Choosing and using an e-outsourcing solution needs careful consideration:

- Do the research - does it make sense for your business? Will it give you access to new markets or technologies? Do your competitors outsource any of their processes - if so, what?
- Identify the advantages - will you save time and money, improve your e-commerce capabilities or gain a competitive advantage?
- Perform a cost/benefit analysis - what will it cost and how long will it take to pay for itself?
- Assess the suppliers - draw up a supplier shortlist and ask them questions about cost, deliverables, security, ownership of data, and termination clauses.
- Try before you buy - if you take advantage of low cost/no cost trials, make sure you are protected against damage to your data.
- Assess the impact across your business - how will e-outsourcing affect other areas of your business? What processes will you need to modify?
- Create an implementation schedule - think about running your conventional system alongside the e-outsourcing solution until you are happy with it - keep staff, customers, suppliers and business partners fully informed.
- Regularly review your arrangements - ensure that e-outsourcing delivers what was promised.

Potential Pitfalls of Outsourcing

Many businesses are wary of outsourcing. They're concerned about handing over key business functions to an external organisation over which they have no direct control. Other pitfalls may include:

- Service delivery falling below expectation.
- Confidentiality and security not being respected.
- The outsourcing contract proving too rigid to accommodate change.
- Management changes at the outsourcing company leading to friction.
- The outsourcing company going out of business.
- Failure to provide sufficient management resources in-house to safeguard the success of the outsourced business processes.

When you plan to outsource tasks, you also need to plan what you will do if any problems arise. Consider:

- having other service providers to whom you can turn relatively quickly
- how you might take the outsourced processes back in-house

It is important that the contract between you and the outsourcing company sets out the circumstances in which you can make such changes. If not, the outsourcing company could claim compensation.

Books on Outsourcing

- The 2007-2012 Outlook for Outsourcing Services in India (Also available for China, Japan, US, World) by ICON Group International, Inc., Sep 2006. ISBN-10: 0497563177 by Philip M. Parker
- The Relationship Between Transaction Costs and Savings in Offshoring Information Technology by Large U.S. Companies: A Doctoral Research on IT Outsourcing by Dar Manarang; published by AuthorHouse, April 2008. ISBN-10: 1434323781
- The Outsourcing Handbook: How to Implement a Successful Outsourcing Process by Mark J. Power, Kevin Desouza and Carlo Bonifazi; published by Kogan Page Ltd, Feb 2006. ISBN-10: 0749444304
- Outsourcing Human Resources Functions: How, Why, When, and When Not to Contract for HR Services, by Mary F. Cook; published by Society for Human Resource Management, Sep 2006. ISBN-10: 1586440683
- Information Technology Outsourcing Transactions, by John Halvey and Barbara Melby; published by John Wiley & Sons Inc; Nov 2005. ISBN-10: 0471459496
- Offshore Outsourcing: Path to New Efficiencies in IT and Business Processes by George Albert and Dr. Nandu Thondavadi, published by AuthorHouse, Mar 2004. ISBN-10: 1414055153
- Information Technology Outsourcing Transactions: Process, Strategies, and Contracts (Supplement 2001), by John K. Halvey and Barbara Murphy Melby; published by John Wiley & Sons, Jun 2001. ISBN-10: 0471414239
- IPD Guide on Outsourcing, published by Institute of Personnel and Development, Feb 2000; ISBN-10: 0846450895
- Outsourcing and the Virtual Organisation, by Jim Durcan and David Oates; published by Random House Business Books, Nov 1998. ISBN-10: 0712679057
- Outsourcing Solutions: Workforce Strategies That Improve Profitability, by Carleen Nelson-Nesvig, et al; published by Bee Tree Consulting, Oct 1998. ISBN-10: 1890394017
- Outsourcing IT - the Legal Aspects, by Rachel Burnett; published by Gower Publishing Ltd, Jul 1998. ISBN-10: 0566076985

Tips to make outsourcing work for you

- Although the supplier takes responsibility for the process, you should still actively manage the relationship.
- Take your time making decisions and make sure you are clear about the terms on which you and the supplier are working together.
- Make the effort to establish a good relationship through constant communication and flexibility.
- Nominate a member of staff to take responsibility for liaison.
- Establish effective and regular communication within your company - staff may have particular concerns about their own jobs, so keep them informed.
- If staff are being transferred to the outsourcing provider under the arrangement, consider the relevant employment legislation.
- If you can stay with your supplier for several years, you are likely to get the best results. Switching suppliers can be a lengthy process, so it pays to commit to building a long-term relationship from the outset.
- You may need to renegotiate the contract before the end of the term. A flexible contract benefits both parties allowing the supplier to innovate and you to react to changing circumstances.
- Aim for a smooth transition/migration. Even with good planning, it's a learning curve for both parties, so use it as an opportunity to modify the service level agreement (SLA) for the future.
- Measure success by identifying financial benefits. Other reasons for outsourcing are harder to quantify but could include generating a higher profile for your business, more credibility, fewer defects or greater speed to market. Include these factors in your assessment and consider how you'll measure them.
- Plan a clear exit strategy in case the relationship ends prematurely or for when it has run its course. It should detail how the outsourced functions should be brought back in-house, clarify who owns what assets and specify when and how much compensation is due.

Source: Business Link

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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