

OUTSOURCING : A BOON OR BANE, SOME REFLECTIONS

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This research paper is a modest attempt to discuss on the concept, motivation behind the outsourcing, implications and need for outsourcing. Also backlash against outsourcing, manging outsourcing, the future of outsourcing and attributes of best practices of outsourcing in the perspective of Indian business.

Introduction:

Outsourcing is not new to India. For instance, we have known of the practice of many firms handing over catering, picking up and drop up services, photocopying and secretarial services besides estate maintenance and janitorial functions. Further, in the recent years new techniques, technologies and management innovations have extended the choices available in terms of organizational structure and business process. Some of the descriptions applied to the general process of deintegrating or consolidating the value chain at business are just in time,(JIT) total quality management(TQM) and business process re-engineering (BPO).

Perhaps, people may start questioning why firms need to outsource for their requirements. Peter Drucker long back gave the simple definition of what ought to be made within the firm and what could be brought in from outside as an outsource function. He wanted us to apply a simple test: Does this function provide scope for career progression to someone while staying in the profession? If it does, it belongs inside the firm and if not, it belongs outside. Good examples are the company lawyer or a medical officer. Both render highly specialized services that cannot be easily performed by a non-specialist. Further, both have externally validated professional standards and are irreplaceable. Perhaps it is in the company's own interest to allow them to practice at least to some extent independently if not, actually hire and pay for their services only on a pay-for-use basis.

Motivation behind Outsourcing:

In recent years the concept of core business has been assisted by the increased opportunities to manage the value chain through outsourcing whereby non-core activities (or core activities which provide less benefits for resources engaged than alternative uses) are transferred to a third party. The decision to outsource part of a company's function or activities is prompted by a variety of considerations. This include potential cost savings, access to technological innovations and strategic considerations, concerned with small scale and scope economies and possibly growth expectations. Both small size and large size companies are resorting to outsourcing. Theoretically, larger companies already enjoy economies of scale for most areas of their activities. On the other hand smaller companies which have the highest scale disadvantage and are generally more flexible in absorbing changes and innovations might therefore be expected to be enthusiastic users of outsourcing. Because, this would allow the smaller companies to achieve the same efficiency as large companies in sub-competitive parts of their value chain. However, the experience shows that the large companies are the biggest users of outsourcing.

If we look at the question of "What motivates the firms or companies to go for outsourcing we find that outsourcing as a process may be motivated by a desire to secure direct benefits, indirect benefits or

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a combination of these. Direct benefits are obtained where outsourcing companies provide the same or better service for the same or less cost than could be achieved internally by the company. Otherwise, these services would be retained in-house itself unless the indirect benefits could be obtained are significant. These indirect benefits would arise if opportunity benefits can be achieved by re-employing scarce resources liberated by outsourcing to more productive functions retained by the firm.

An outsourcing decision motivated by direct benefits is then a trade off between relative production cost and relative transaction cost of in-house as opposed to external provision. Production cost include the prime cost: direct material, direct labour and relevant conversion costs in the form of overhead. In addition, outsourcing motivated by opportunity costs considers the opportunity cost of capital and other resources tied up by an activity in terms of their alternative use.

Implications of Outsourcing:

Outsourcing has an direct impact on the ways in which a company manages its short term and long term resources. Because, the effects of outsourcing are not instantaneous and any one – off event will be marked by transaction costs incurred in setting-up the relationship, long-run effects, may be more significant than the short term effects. In terms of recurrent costs outsourcing companies are able to reduce wages and salary expenses, reduce maintenance and repair expenses and reduce their expenditure on technology support. Further, in the long run outsourcing allows these companies to reduce their long term obligations with respect to employees’ rights and pensions, capital investment in hardware and software and their expenditure in solving one-off problems such as year 2000 compliance etc. The implications of outsourcing can be seen as under:

Outsourcing implications

Examples	Reduce employment cost	Reduce equipment expenditure	Reduce research & development
Short-term	Wages and salaries	Maintenance and repairs	Access to immediate technology
Long-term	Solving future problems	Software and Hardware	Rights and pensions

Before we deliberate further on what makes the firms or the companies to outsource their requirements let us illustrate the benefits of outsourcing. The Open University of UK has successfully used the outsourcing for its requirements. At the Hub in Milton Keynes is the main University which is a centre of content preparation. However, it has neither resident students nor class rooms. The academic staff conduct research, write the course material and record it on all available media, from audio cassettes to CD’s to computer mediated conferencing with the help of over one thousand associates all of whom are on renewable contracts. In fact, very often they live and work from their own corners of the country and are also consultants and trainers. The material is freely available to them and in return they are able to contribute to the academic capital of the University at a cost far lower than that of having all of them in full time employment.

Students are reached by these associated lecturers in various convenient locations spread over through out the country and indeed the world at periodic seminar meetings in hired spaces with no investment in the infrastructure. In other words the university succeeded in reducing the staffing to the real core activity and basis of their business i.e., those who create new knowledge and learning materials. Further, they also examine and award degrees to students, thus ensuring a set academic standard and quality of out put. All dissemination starting from physical storage and dispatch is carried on by other firms which are in other business at which they are clearly more adept then a bunch of lecturers can ever be.

This arrangement benefited both the service provider and seeker. For the University the justification for such out sourcing has typically been the greater flexibility, lower long term costs, freedom from the hassles of carrying people on permanent roles. On the other hand the service provider benefited in terms of economies of scales, specializing and learning that comes from a specific business focus.

Why Outsourcing?

Companies are turning to Business Process Outsourcing to move labour intensive activities to offshore locations where those processes are performed at the same or better quality level but at a lower cost. Further, this is basically resorted to by the companies to increase their competitiveness. They separate their core operations/ processes from non-core support processes and then utilize third parties to perform those support processes for them.

For instance, the US Head Quartered \$600 Million Timex is contemplating to outsource its accounting, administrative and other support functions to India by setting up a 40 seater BPO facility at Noida near New Delhi (F E, May 5, 2004). Even as parent Timex is turning to India for cost cutting via outsourcing it is sharpening it's focus on its core time ware business. In other words, companies resort to outsourcing for those activities which are either un-economical or saves cost if they get it done from outside.

Outsourcing has enabled the organizations to survive the pace of change in the new economy at a time when business activities need to be focused on the right activities and resources need to be kept lean and align with a core business. In the late 2000 as economies moved into a more recessionary climate, renewed emphasis on cost savings followed with increased interest not just in ITO but also in offshore and business process outsourcing as new sources of cost reduction.

For instance, Japanese companies have historically looked inwards for their IT systems primarily due to fears of sacrificing quality, confidentiality and timeliness of programs for their businesses. However, after the prolonged bleak economic prospects that prevailed in Japan many firms have grown more receptive to outsourcing as a way to boost their operating efficiency, improve their financial performance etc. According to N.T.T. Comway, One of the Japan's leading Systems integrators it is possible for Japanese companies to save as much as 30% when they use overseas facilities for software development even after factoring in the travel and communication expenses (E T, July 1, 2004). Further, it is added that, the cost benefits accrued in a hierarchy when using overseas software production. So, it is in their own interest that the companies/countries outsource for their requirement. However, recently there was a backlash in US against outsourcing jobs to countries like India.

Is the recent backlash against Outsourcing justified?

Recently, the backlash against outsourcing jobs to countries like India got intensified in the US. Now, the question that needs to be answered is, whether outsourcing was not beneficial to US and other markets? According to **The US Chamber of Commerce**, this backlash against outsourcing is not based

on facts but, on emotions and politics. The US Chamber of Commerce President, and CEO Thomas J Donahue said, at a recently CII Organized meeting, that , extensive investigations reveal that no one really knows about the actual number of jobs that have been moved to other countries (Bus St, April 21, 2004) Infact, according to him the outsourcing of jobs strengthened company's bottom line, boosts earning.

Further, according to a study by ETIG, Unemployment rates have come down in different regions of the US and there is no correlation between the attempts by various states to ban outsourcing of jobs and unemployment (E. T, June 10, 2004). In other words, economic recovery had a greater role in job creation in US rather than the outsourcing or otherwise of jobs. American companies are outsourcing to reduce their operating costs. If they do not outsource the US Corporations could be out competed by low wage products from abroad. That is, if they do not outsource, they would probably have to move their operations abroad. So, the US economy is better off with outsourcing some business than with losing all of it. Besides, the overall effect of outsourcing on the US job market is marginal.

A recent report by the **US Labour Bureau of Statistics** shows that only 9 % of the non-seasonal jobs layoffs in the first part of this year were due to outsourcing and 2/3rds of the works lost on account of outsourcing was reassigned within the US. Only 2.5 % of the non-seasonal layoffs were on account of offshore outsourcing of jobs (E. T, May 24, 2004)

How to meet outsourcing

We all know job displacement is the direct result of innovation and productivity, an essential feature of the new economy. Today's joblessness in the US is essentially due to lack of commitment to good corporate governance practices and social responsibility by US Corporations. One of the primary responsibilities of the companies is to continuously strategize for new technologies, products and services and train and retrain staff to meet the future challenges. It is true that, the outsourcing has increased the vulnerability of a large section of the labour force, in US and elsewhere. The technological advances have made it possible for companies to hire highly educated computer programmers and relatively low skilled workers (especially for medical transcription jobs) at call centers in India or the Philippines at a fraction of cost.

In today's global economy, the workers have to constantly upgrade their skills to remain employable. Many workers who get laid up during recessions go back to school or collage to improve their job market skills. However, this is not to take away the responsibility of the managements. The companies need to make investments and devise strategies for the future and on training of employees for jobs to meet these challenges. Many of the companies which are raising their voice against outsourcing are the ones which believe in cutting costs by downsizing, ignoring top line opportunities which will increase revenues and create jobs. The companies those invest in employees' and innovation have never looked back. For instance, let us take the classic example of **MedTronic** a US medical technology company providing life long solutions for people with chronic diseases. This company has demonstrated a steady improvement in business performance with revenue earnings increasing steadily during 64 consecutive quarters. Infact, 70% of their revenue comes from products launched during the last two years. Unlike, the short term oriented companies MedTronic does not focus on increasing share holder value but on long term customer management. That makes it constantly hooked on what the customer needs. In other words, the company has a culture of nurturing staff to foster innovation instead of worrying about the threat being posed by things like outsourcing.

Scope for outsourcing

The purpose of outsourcing, as we have seen above, is to free up the company resources used is

repetitive and non-core work and put them to more productive use. According to T J Rogers, Head of Cyprus Semiconductors, they have been able to keep their home fires burning and continue employment of indigenous work force primarily because of outsourcing. It may not be out of place to mention here that, the unemployment rate in Silicon Valley is much less than the US national average.

Notwithstanding the backlash on outsourcing in US and UK, MNC BPO players are said to deluge India with jobs. According to US Consultant Mckinsey & Company Big Blue which recently acquired the Gurgaon based BPO Firm Daksh is planning to scale up around 25,000 BPO professionals in India over the next five years (ToI, June 10, 2004). Similarly, EDS plans to tie up 3,000 people in India for the next three years.

BPO Buoyancy

IBM	25,000 People in 5 years
Accenture	10,000 People in 3 years
Convergys	15,000 People in 5 years
EDS	3,000 People in 2 years

(Sources: Times of India, June 10, 2004)

Further, according to Mr Raman Roy, Chariman and MD of Wipro Spectra Mind, Indian business outsourcing firms have only touched so far the tip of the iceberg of World Wide BPO market and they can tap huge business opportunities available in the European market. According to Mr. Roy, outsourcing is the need of the day as the business world is facing some realities in the form of skill shortages, need to reduce cost and focus on core operations, technological changes etc. The outsourcing market is growing as both service lines and specialists needs of industries are growing and that is the big opportunity for the Indian BPO firms. However, there is a need for caution. In other words, high attrition, poor infrastructure and lack of data production loss could derail India's booming outsourcing industry.

The business process outsourcing is basically depends on reputation and the ability to deliver quality service. Every year about 70,000 jobs are added in the IT area alone and the main challenge is how to attract the people. Further, the challenge is not only to attract but also how to retain the pool. Analysts says outsourcing attrition rates vary between 20 – 40% in some companies while at top firms it averages atleast 15% So the companies need to take a holistic approach to expand the pool, train them and retain them to deliver quality and value. Now, before we gloss over on the mistakes being committed in the arena of outsourcing let us try to list out the attributes of a best practice outsourcing arrangement.

a. On Relationship:

- Both the parties must have mutual respect and trust towards each other
- There must be willingness to work hard together and aim at continuous improvement.
- They should be proactive and reactive to other parties needs and concerns.
- Apart from frequent and open communications, regular and ongoing monitoring and evaluation must be done by both the parties.

b. Supplier

- Deliver promises made during life cycle particularly during the selection process
- Seek client's needs and address them
- Assess the satisfaction and take necessary action
- Be honest in reporting and seek opportunities to solve business issues

c. Client

- ❑ Recognize suppliers right to make a profit and ensure prompt payment.
- ❑ Communicate business goals, issues, manner of operating and early warning of major issues affecting the services.
- ❑ Involve the supplier in the planning process and do not abdicate from the responsibilities.

If both the service provider and the client follow the above few tips, inter alia, the outsourcing will prove mutually beneficial. Having said this, let us look at the common mistakes often committed by the parties involved in outsourcing.

Five classic outsourcing blunders

1. Don't get entangled in a long term contract : Traditionally, outsourcers often try to persuade companies that only a long duration agreement justifies the high up-front investment needed to provide great service. However, it is not advisable to go for a long term contract. Especially, when both business and technology is changing so rapidly it does not make any sense to have an agreement longer than one or two years. Further, Long term contracts can also act as a disincentive for good service because outsourcers may grow complacent without the hovering threat of a cancelled contract.

2. Don't let your responsibilities collide with those of the outsourcer: Many of the contracts are frequently vague on exactly what the outsourcers' responsibility is versus the customer's. Without a petrollable boundary neither side knows with certainty what it should be doing. The result : each side blames the other when things inevitably don't get done. The problem becomes more serious when business thinks that outsourcing obviates the need for corporate strategy. When people think that the outsourcer will do everything and they don't need to take charge of the strategy the result would be a sluggish operation, operated with minimal oversight. Ultimately, the outsourced operation will be so much unresponsive to the business that it may ultimately threaten the company's ability to compete.

3. Don't neglect to measure success (or failures) : Parties to an outsourcing agreement often fail to set the parameters for measuring the performance simply because it is difficult and time consuming process. However, the results would be disastrous. For instance, a company formed a relationship with another to manage its day to day operations of its website. Initially, the relationship was very good and everyone was pals and friends and just wanted the relationship to work. However, things grew difficult as the operation took off. The dotcom started with two servers and 10 MB of bandwidth but quickly needed 8 servers and 100 MB of bandwidth and was adding 10 -12 GB of storage per day. Ultimately, the service provider found it increasingly difficult to handle the growth and the client grew dissatisfied with the supplier's performance.

At this stage, it has become clear to the client that they have been operating without a contract that spelled out performance measurements. Consequently, when things started to break down there were no guidelines to help, define performance and satisfaction levels. Hence, it is suggested that customers define acceptable levels of performance in terms of business relevance.

4. Don't be a control freak: Companies which go into outsourcing often expect to retain control of how their operations are carried out. But, it is a big mistake. Forcing the outsourcers to do it your way prevents your supplier from doing what it does best i.e, leveraging its own experience and best practices. Outsourcing is a transfer of ownership of a process to a supplier and it is different from consulting where you own the problem but pay people to try to help you fix it.

5. Don't bet on a dark horse: Normally, it is tempting to choose an outsourcer with an alluring low price. But experience shows that many of the new outsourcers have unproven track records and are not as stable companies that have been around for years rather than months.

When it comes to outsourcing the biggest mistake which some of the companies commit was going with a provider that did not have an established track record. For instance, when it comes to outsourcing technology you may proceed with caution. We have to weigh for ourselves the risks of outsourcing a technology versus holding off on implementing that technology. But, when outsourcing is the only choice the companies shall try to avoid the common mistakes as we discussed above.

Conclusion:

Despite the furore in US over sending jobs to countries like India business process outsourcing (BPO) has gained corporate acceptance with offshoring of human resources along with Finance and Accounting apart from IT. However, Business Corporations don't need to worry about outsourcing.

The worst threat to business today stems from the wide disparities that exist between various countries even in the 21st century. In an inter-connected and inter-dependent economy people are not going to sit back and suffer. The repercussions in the form of civil unrest etc in different parts of the world have already been witnessed. It is not simply about bringing GUCCIS for the urban reach.

Globalization will be doomed if it does not benefit the poor. Companies which have substantially enhanced their purse, prestige and power without trying to transfer the benefits of globalization to the poor/oppressed will be the great losers.

Outsourcing offers a great hope and had come to stay. If a Beckham fan in UK wants a special mass to be done for his hero, it will in all probability be in Kerala. But outsourcing is definitely a small step in a long journey to a more harmonious and prosperous world of business. Let us hope that corporates hereafter will continuously strategise for new technologies, products, services, train and retain staff to meet future challenges and follow good governance practices with commitment to social responsibility.

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