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Outsourcing non-core services takes the right fundamentals

BUILDING BUSINESS

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Companies experiencing rapid growth often seek to outsource non-core activities to "experts" and thereby reduce costs and eliminate inefficiencies.

These can include such areas as information technology, records storage and file management, maintenance and repair and staffing of non-core positions.

Conceptually, outsourcing should permit management to focus on the company's core competencies and building the business.

However, many outsourcing relationships fail. Among the reasons are lack of defined scope of the services to be provided, lack of expertise and experience in selecting vendors and negotiating outsourcing contracts, failure to fully understand and underwrite the economics of the relationship, lack of oversight and lack of performance.

So, given that there are often sound reasons for pursuing such structures, how can you make it work?

Determine the fundamental rationale: Start by assessing the fundamental rationale for outsourcing a particular service.

Determine whether the service is core or non-core to your basic business. If the service is critical to producing your product or rendering your basic service, you need to staff it and perform the service internally.

If the service is not critical, or core, to your value proposition and you identify vendors for which rendering the service is core to their value proposition, then you are ready to pursue an outsourcing model.

Select the right partner: Once you have identified the service to be outsourced and determined that experienced providers exist, the next step is to select a provider.

Depending on the ultimate magnitude of the relationship, selection can be accomplished by identifying and negotiating with a vendor or by a competitive bidding process through the issuance of a request for proposal.

If the size and scope is sufficient to warrant a competitive bidding process, retain the expertise necessary to assist with preparing the RFP and managing the bidding, selection and negotiation process.

Negotiate the best contract: After the partner is selected, the next step is negotiating the contract. Where outsourcing fails, the failure can often be traced to the contract negotiations.

These contracts are complex and fraught with risk. Experience is critical in understanding the nuances and protecting the company.

The negotiating team must have an understanding of typical market provisions addressing issues such as scope, pricing, service standards, benchmarking, risk allocation, performance criteria, reporting, audit rights and termination.

Recognize that the outsourcers are typically very experienced at negotiating these contracts and will have a definite advantage over you. So hire experienced advisers who can protect the company's interests. Demand transparency, negotiate every issue to conclusion, fill in every blank and leave nothing in the contract for "subsequent agreement."

Proactively manage the relationship: Once the contract is executed, emphasis shifts to execution of the services by the outsourcer and management of the relationship by the company.

The first stage is transition. Far too often, from the outset the company will fail to devote sufficient time and resources to facilitate the transition and then adequately oversee and manage the relationship on an ongoing basis.

This can often lead to a dysfunctional transition followed by substandard execution, overall lack of accountability on the part of both parties and, ultimately, a failed relationship.

To avoid these pitfalls, design and implement an oversight protocol with sufficient human resources on both sides dedicated to building a mutually valuable relationship. This should include regular oversight meetings, regular reporting and regular audits.

Insist on complete transparency and strict compliance with the contract. This will foster disciplined performance on both sides and enhance the possibility of a successful relationship.

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Measure the outcome: The value and success of an outsourcing relationship can be measured in many ways, including cost savings, increased productivity, increased efficiencies, increased profitability and freeing up management resources to focus on core competencies.

Whatever the desired outcomes, it is imperative that they be measured on a regular basis. And, if the relationship fails to meet or exceed expectations considering the appropriate risk allocation, the contract must provide the opportunity for a graceful exit.

Understand your alternatives: Finally, keep in tune with the market, understand your alternatives and be prepared to pursue those alternatives if the outsource relationship fails.

This will provide you leverage in subsequent negotiations and a deeper and better understanding of the outsourcing landscape.

Outsourcing can work. But it takes a valid fundamental rationale, a full understanding of the scope of the services, the right provider, a properly negotiated contract, good execution, disciplined oversight and a continual understanding of market alternatives.

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