

## Shifting Rationales for Outsourcing

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Outsourcing has traditionally been seen as a mechanism to cut costs. Those costs consist primarily of the salaries and other benefits payable to employees associated with the activity to be outsourced. Within the EU jurisdictions, those employees would generally transfer to the new service provider thus effecting a permanent reduction in the headcount for the outsourcer. Other cost-savings can come in the form of increased efficiencies which the service provider must achieve as a condition of contract, for example by reducing costs below their current levels or providing more or better services at the same cost. Are costs still the main driver behind an outsourcing?

If that were the case, the number of outsourcing transactions should have increased dramatically since the onset of the current economic crisis. And while the pundits did predict this development, no such trend has manifested itself to date. The explanation for this non-phenomenon is simple. Cash (or cash flow) is now king. There are few businesses willing to incur the immediate costs associated with an outsourcing transaction for the benefit of a long-term cost saving. Outsourcing transactions are certainly still contemplated and even actively discussed in boardrooms throughout Europe, but most do not lead to immediate implementation. Some outsourcing transactions are unavoidable, as service contracts for IT or BPO (business process outsourcing) services are now expiring and negotiations on next generation contracts now on-going. The more savvy of these outsourcers are applying instruments such as simultaneous negotiations with multiple bidders in order ultimately to extract maximum price reductions and other concessions from the successor service provider.

It is however very much the question as to whether costs are (or should be) the primary driver behind an outsourcing. Financial risk management is an equally valid rationale. For businesses operating with narrow profit margins, even a slight increase in the costs can have a significant impact on the bottom line. An outsourcing is one way to hedge this risk, for example by demanding the contractual right to downsize the scope of work outsourced as needed. Such a right, of course, cannot be unbridled. Few service providers (if any) are willing to take over a full headcount without at least some prospect of service fees in return. A finely calibrated mechanism is needed to allow for such a downsizing. That mechanism could, for example, apply bandwidths within which the quantity of services can be adjusted without penalty and/or a staggered set of financial consequences if the downsizing exceeds certain boundaries.

Legal risk management is a rationale less common than its financial counterpart, but all the same cogent. Imagine the operator of a highly integrated industrial site which includes a water purification plant. Both the plant and the operation thereof are heavily regulated. The company is therefore exposed to two types of compliance costs. The literal costs include the hiring of qualified personnel, their permanent training and education and, in some cases, the incurring of capital expenditures. The figurative (and higher) costs are the penalties – criminal, administrative, civil or in the arena of public opinion – for being non-compliant. Where the legal risks associated with a particular activity outweigh the commercial or operational need to maintain such an activity in-house, outsourcing makes sense.

The legal risks associated with the management of a particular activity or the end-product of such an activity are often higher than the risks associated with the actual conduct of that activity. Take the case of a publicly-listed company that opts to outsource its finance division as part of a BPO. At first blush, a finance BPO would seem to increase that risk dramatically, given for example the liability associated under most stock exchange rules with misrepresentation of annual accounts. Examined more closely, however, this need not be the case. The ultimate legal liability of course remains with the outsourcer. The outsourcer can however impose intelligent service levels that take into account regulatory and legal requirements and sensible control mechanisms to ensure compliance by the service provider.

The same finance BPO can also be seen in the context of core versus non-core activities. There is nothing new about the idea of hiring a caterer to run the company cafeteria or a cleaning crew to mop the floors at night; these types of support services have always been regarded as non-core activities and have traditionally been sourced externally. What is new is the bundling of all of these non-core activities into a single integrated package, known as facility services (FS), and the range of companies now interested in an FS outsourcing.

FS outsourcing was once the exclusive domain of large multinationals with large industrial sites located in virtually every country in the world. The need to manage and maintain each such site and the desire to do so through a single source gave rise to the FS outsourcing market. These days, however, there are large national companies, single site companies, non-industrial companies and even governmental agencies all considering the advantages and disadvantages of an FS outsourcing. The advantage is obvious: bring non-core activities to an external supplier in order to focus on the core activities. In some cases, this can free up a significant amount of management time. Take the example of an airline company that outsourced more than 300 different services in an FS outsourcing, ranging from activities as diverse as grounds maintenance to the printing of internal newsletters.

Given the wide variety in services that can fall within an FS outsourcing, so too do the providers come in all shapes and sizes. FS service providers can range from caterers to construction companies and from cleaning crews to security firms. This illustrates the unique selling point of an FS outsourcing: the ability to reduce the number of suppliers dramatically by retaining one single party – the FS provider – to provide all FS services directly or indirectly. This benefit is mirrored in the market of FS providers, some of whom are forming multi-disciplinary groups to offer a broader platform from which FS services can be provided. Here the thinking is bigger is better.

In the already mature market for IT and computer-related BPO outsourcing, the size of the providers may not be changing but the size of the outsourcer is. Five years ago, it was impossible to outsource desktop maintenance if only 100-200 desktops were involved. In the current market, this is no longer an issue. Mid-sized businesses are now just as welcome as industrial giants when it comes to an IT outsourcing. This new pool of outsourcers may have yet another rationale all their own to outsource: namely the ambition to grow. A growth strategy of virtually any kind tends to have an impact on the back office in general and the IT architecture in particular. The ability to scale up, convert to a more flexible technology platform or maximize employee mobility – and to do so on a moment's notice; these are only some examples of the IT consequences of an ambitious growth strategy. An outsourcing can enable company to take the business to the next level in as big a leap and bound as it desires

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