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Outsourcing support functions: Identifying and managing the good, the bad, and the ugly

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Abstract Outsourcing the purchase of components or "hard goods" is not a new phenomenon: it is known as the "buy" portion of a company's common make-or-buy decisions. In the current service-oriented economy, however, make-or-buy decisions are now often do-or-buy decisions that reflect the strategic question of whether outside entities should be hired to perform significant support service activities. Support functions such as information technology and customer service can be outsourced to provide many organizational benefits. Companies frequently point to the cost savings for labor and training, but also cite the benefits of releasing corporate resources for alternative uses and allowing the business to focus on its core competencies. Outsourcing support functions is not simple, though, and companies must manage the related strategic, quantitative, and qualitative risk factors. This article discusses some of the potential risks that must be faced when a company outsources internal support functions, and describes how the Committee of Sponsoring Organizations of the Treadway Commission's Enterprise Risk Management (ERM) model can assist in managing and controlling these risks.
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1. Support service outsourcing

Competitive advantage is the reward for organizations that are able to adopt new technologies, achieve economies of scale and scope, serve global markets, change product range regularly, and satisfy customers through high quality and timely delivery. Since few companies have resources and competencies to meet all of these diverse pursuits, there has been widespread resort to alliances to meet the needs of this new economic order. Support service outsourcing can be an important component in a winning business strategy; however, this type of outsourcing arrangement also has risks that can undermine the potential benefits offered.

Outsourcing allows a firm to strategically use outside vendors to perform service activities that

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traditionally have been internal functions. Firms have found that support functions such as information technology (IT), human resources, or accounting can be accomplished by an outside vendor and can result in lower cost, higher quality, or both. Activities can be outsourced from one firm to another domestic firm, to a "nearshore" firm (one that is located on the same continent or in a substantially similar cultural environment), or to an offshore firm (one that is located on a different continent or in a substantially different cultural environment). Although this article takes a U.S. perspective, outsourcing risks are similar across the global environment.

Support service outsourcing agreements are often highly customized to the needs and capabilities of both the firm and the vendor. Outsourced tasks can range from the performance of a support function by an external vendor, to a "blended" co-sourcing arrangement whereby services of in-house and external suppliers are conducted in a combined workplace. These blended co-sourcing arrangements can be highly varied, but should be crafted to work to the best advantage of the outsourcing firm. Some companies have created new firms by spinning off organizational units and have outsourced support services to these new firms. In other situations, companies have sold organizational units to vendors, which then hire the selling firms' employees to perform the same tasks that were performed for their original employer.

Support service outsourcing can have significant benefits, but this type of outsourcing is certainly not risk free. Stories abound of organizations that regret outsourcing choices. Some risks, such as potentially higher offshoring costs due to the eroding value of the U.S. dollar, can be anticipated and addressed through the outsourcing agreement. There is a distinct possibility, however, that decision makers may be more likely to under-anticipate risks that have not previously occurred, but which might occur in the future due to workplace, technology, or global environment changes. Occurrence of such unanticipated events often creates the majority of costs for the outsourcing firm, since controls are not in place to help mitigate losses. This article discusses some risks associated with support service outsourcing and describes the most promising approach to managing service outsourcing risk.

2. The good

The reason most often given for outsourcing support services is cost savings. By offloading non-core activities to an external party, a company engaging in business process outsourcing (BPO) may increase profitability and create value, respectively, for the company's shareholders and customers. Cost savings may be gained because the outsourcing vendor operates in an offshore locale that has a lower pay scale than a domestic firm. Often, though, the savings arise because the specialist vendors experience the economies of scale that allow infrastructure, technology, and personnel costs to be spread among many customers, resulting in vendor service charges that are less than the amount that each customer would have incurred to internally perform those services.

Although projected cost savings is a viable reason to consider outsourcing, companies should also consider a two-pronged strategic rationale for outsourcing support services. First, support service outsourcing enables companies to leverage vendor competencies in highly specific areas. Leverage benefits include the increased corporate flexibility that is gained by having access to the latest and most effective technology, proven methodologies, and best practices without building and maintaining a complex and expensive infrastructure, allowing funds to be invested in more profitable activities. Additionally, metrics can be established that measure the quantity and quality of the work performed by the vendor, allowing the use of a pay-for-performance system that maximizes a cost-to-benefit relationship. Second, service outsourcing enables companies to eliminate the distraction of managing a peripheral function and, thus, develop long-term core competencies that provide a competitive edge on other market players. Companies can focus on improving critical measures related to time-to-market, quality, customer satisfaction, and responsiveness, once the firm is free to focus on essential strategic competencies.

3. The bad and the ugly

Satisfying the customer is the core activity of any business. Some support services—such as human resources in a cutting-edge technology company, or customer call centers in a computer manufacturer—may have significant internal and external consequences that should be critically analyzed before making a "buy," rather than a "do," decision. Such services should not be outsourced simply because, in the short-run, cost savings may result.

Support functions that "interrupt" the flow of product or service between the organization and its customers are the riskiest type of service to outsource. For example, delegating control of the distribution process by an online retailer can result in customers not receiving goods promptly; outsourcing call center responsibilities can result in customers

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