Best Practice Series

Outsourcing – Best Practice Impact

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Summary:

This article explores the practice of outsourcing of critical parts, products, services and processes. There are a number of impacts on the "host" company's ability to improve performance – achieve and sustain Best Practice status in key areas. The message in this article is that there is a Best Practice to the process of outsourcing – a best way to initiate it, select products or services for outsourcing, select the appropriate supplier, and to manage the resulting, altered ongoing business process. Key topics include:

- Outsourcing – goals and basics
- Impact on Best Practices essential factors
- Planning for Outsourcing Success

Outsourcing – Goals and Basics

Every company purchases various goods and services, from rent and utilities. Many also purchase items that are its life-blood. However, the term "outsourcing" doesn't usually refer to the every-day, basic stuff, or even exotic materials and parts that have always been purchased. Most often, the goals of an outsourcing initiative are in these categories:

- **Lower cost** – it is believed that an outside supplier can perform the tasks at a lower cost, compared to internal costs. This will provide a strategic or competitive advantage.
- **Higher quality** – the supplier may often have capabilities that cannot be matched internally, due to engineering or production expertise or that is difficult to provide internally.
- **Outside focus area** – management wishes to intensify the team's focus on certain key areas that are truly critical success factors, and to increase capability and performance in these areas. Off-loading non-critical activities is a good way to improve this focus.

It is generally when we decide to take something that has been, until now, performed internally, within the organization, and have an external supplier, a different company, do the work or make the item. This decision, increasingly popular has potentially profound effects on both the company's operating performance, and its financial results. So, our view is that it should be done thoughtfully, with serious rigor, and not be undertaken lightly. Business literature and informal stories are filled with stories of companies that rushed into outsourcing, only to discover that important aspects were not even considered.

Let's be clear up front – we believe outsourcing is a potentially very powerful tool, one that has the potential to transform a company's operating and financial performance. We have performed major, extensive projects on both ends of this spectrum – companies whose entire strategy depended on successful outsourcing, as well as contract manufacturing and services companies providing this outsourcing capability. These experiences have made us quite aware of the many factors involved, and what success in this area involves. We even built an entire ERP system for a client, driven primarily by their outsourcing management needs.

The key aspect to this decision is to understand that the key difference between a "supplier" and an "outsource supplier" is that the outsource supplier is really much more of a ***partner*** in your company, compared to the arms-length transactions with typical vendors.

There are several major factors involved in outsourcing that are common threads that "run through" other areas. These include:

- **Internal Communication and systems**– transferring what is currently an internal function or operation to an external location changes how communication to/from/with it will work. Much informal communication may be involved, which must be replicated or formalized. We once built an entire ERP system for a client to help resolve this challenge.
- **Cost impact** – these include the obvious (unit costs, transportation, etc.), but more importantly, the not-so-obvious, such as additional communication, problem resolution challenges, and information and work flow dependencies. It is failure to identify, and manage the not-so-obvious cost impacts that typically causes the most trouble.
- **External communication - Language** – typically the outsourcing supplier is outside one's home country – abroad. The people who run the supplier company, and who will be doing your work are not native English speakers, or writers, and more importantly, even if they are educated appropriately, their education is typically not in English.

  Having spoken, and written a couple of foreign languages ourselves at different points in life taught us the painful lesson that all of the knowledge and expertise one acquires resides in the vocabulary and understanding of the language in which it was learned. Translating this highly detailed, often subtle understanding into words that a native speaker, or writer, in another language would use, is difficult and challenging. It requires, really, to learn the additional vocabulary and usage subtleties. Technical language is called "jargon" for a reason – it is a form of local usage, like a dialect.

  During our recent project in China we were never far from the awareness of these facts. The written Chinese language is completely, ah... inscrutable to a foreigner. Even foreigners who speak good Mandarin readily admit to a difficulty with the written language. So, the opportunity for serious misunderstanding is ever-present.
- **Key Documents -** Engineering drawings, specifications, service or maintenance procedures, software design specifications, and other documents are critical to the success of an outsourcing initiative and must be considered in this context. Someone who can speak fluently, "do lunch" well, and is friendly, may have no clue whatsoever what is meant by various notations on these documents. People who have never wrestled with another language, especially writing it, have almost no effective way to grasp this particular challenge and its extent.

Impact on Best Practices - The 4 Essential Factors

The impact of outsourcing will fall also on the company's efforts to achieve Best Practice status in key areas. Briefly, the impact in each of what we call the "4 Essential Factors" includes:

- **Effective Leadership & Culture** – will your Best Practice-focused culture mesh well with that of the supplier? The highly participative work environments typical to well-run companies in the west are normally not found in 3rd world countries, where the "command and control" style of management is standard. Improvements are something the boss decides in these companies. And they never forget who the boss is.
- **Effective Enterprise Systems & Processes** – these are the communication and coordination functions of the company. If a key process is transferred to an external source, how will these

essential systems/process flows continue to be effective? How will information that will now reside within the supplier's infrastructure be integrated to internal sources that need it?

- **Continuous Improvement Process** – does the supplier have an effective continuous improvement process? How will it integrate, or support your own process? Will you have to educate, train and support the supplier's staff to achieve continued improvements downstream?

  Attempts to "install" leading initiatives such as 6 Sigma often produces what we call "eyewash" charts. Walk around and you see nice looking charts and graphs, while your guide says the appropriate buzz-word phrases he learned from the consultant. Look closer and often you find that the dates on these charts are months old. Speak to people (difficult: remember, they don't speak your language) and you'll find that often they don't really use any of it on a daily basis.

- **Education & Training** – Since you depend partly on your education and training program to both maintain capabilities of your team members, as well as advance them, what impact will transferring a key function to an outside firm have? Do they have an effective education and training program?

Planning for Outsourcing Success

In order to insure your best chances of real success in your outsourcing initiative, we suggest using the following as a *starting* but incomplete checklist:

- **Plan carefully** – make sure all important steps are covered. Especially critical is to plan in detail the transition, providing for pre- and post-support activities. Don't expect instant benefits to appear unless what is being outsourced is really simple and plain. We suggest using proven project management methods and tools to perform these initiatives. Don't just hand a list to a buyer and say "call me when it's done."
- **Document everything** – rigorously documented work flows, processes and parts are the exception. Often consistent high quality and repeatability depends on personal knowledge and expertise within your staff. Make sure you "capture" this information – after, of course, identifying what it is. Then – have them translated by someone YOU know and trust, generally not the supplier.
- **Recognize the new competency** – outsourcing important items (products or services) to an external supplier, and managing the ongoing result is a NEW skill for your team. Understand clearly that you most likely don't have this skill now, but can and must, acquire it. High blood levels of testosterone are not a substitute for this skill.
- **Select carefully; start simple** – if you are new to outsourcing, we urge you to start with simpler items, those with a low-rate of change, that don't challenge the supplier and your team's ability to communicate about it. Use these as a learning device to gain the new management skill in managing outsourcing that your team must acquire. It's harder than it looks. Other selection factors to consider:
  - **Don't outsource your core competency items** – these are products, component parts, assemblies, services that constitute your strategic and competitive advantage. Not sure what your core competency items are? Uh-oh!
  - **Strive for low rate of change** – don't start with an unstable process, or manufactured items that are highly engineered, in a constant state of change. Your supplier will never keep up with the changes, nor will your internal staff.

- **Labor intensive** – preferably, select items that do not involve a lot of skill or experience to do successfully, and consistently. In our experience, consistency is preferable to erratic, but sometimes high, sometimes low quality.
- **Simple / standard inputs** – your first outsourced production project is not the place to start if it is made of the proverbial “unobtainium” – material that is hard to get, harder still to work with, and involves subtle specifications that even your people have trouble understanding.
- **Shorter lead time** – the reason to select short-lead time items is so you will have time to recover from problems – which there most assuredly will be.

- **Perform serious vendor due diligence** – we suggest evaluating a vendor as though you were going to be a significant investor in the company. In a way you ARE becoming an investor; you ARE staking a part of your business success on their ability to perform well. Highlights of a good due diligence process from this point of view:
  - **Evaluate internal processes** – production, work flows, factors like dual-controls.
  - **Quality** – built into the processes, or by inspection-&-reject / supervision?
  - **Information systems** – effective, or antiquated? Capable of supporting integration with your system?
  - **Skill and expertise** – these should be at least equal, if not greater, to your internal capabilities. If they are not, they MUST be capable of being improved by training or you WILL have problems.
  - **Stability** – how long as the company been in this business? Financial strength? Who are the (real) owners?
  - **3rd world country factors** – in general, companies in the 3rd world have less in the way of management capabilities, non-participative culture with authoritarian management, and less advanced information systems. Conversely, they often have excellent work habits, and are very intent on “getting it right” with their customers. And, of course, the cost structure is what opened the door in the first place, which can often be dramatic.
  - **Political factors?** – no due diligence checklist for outsourcing would be complete without at least mentioning the political hot-button factors you should consider. Is the vendor really operating what many call a sweatshop? Are there environmental concerns? Is a revolution about to happen, or just did?

We have long learned that the optimum meshing of internal and external partners (i.e., careful outsourcing) can really strengthen a company’s performance – but with some caveats. Careful planning, real thought, discussion, and collaboration are essential threads through the points and factors that we’ve discussed above. Here, we have endeavored to “hit the high spots” of the many factors involved in this decision and process and trust that the reader will regard these as a good start in side-stepping the potential pitfalls and create lasting success in your outsourcing initiatives.