


# Outsourcing in Procurement and Supply Chain



The purpose of the concept is to provide an insight into the benefits and drawbacks of outsourcing in procurement.



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### Introduction

Outsourcing is certainly not a new phenomenon. Informed by the 'make-or-buy' calculation, organisations have long contended with which activities to perform in-house and which to buy in the market (Ellram et al., 2008). The contracting out of production activities has occurred for many decades by firms seeking the advantages of specialisation, efficiency and economies of scale. However the relatively new phenomenon of outsourcing services emerged only in the late 1980s. Three main factors underpin these trends: 1) technological advances; 2) economic/competitive pressures to reduce costs and improve productivity; 3) institutional developments favouring trade liberalisation (Olsen, 2006; Lysons and Farrington, 2006).

Today the outsourcing market includes many 'integrated service providers' that cover multiple functions and processes in a 'one stop shop' offer (Handfield and Nichols, 1999; Leenders et al., 2002). The latest figures suggest that the total value of commercial outsourcing contracts, of US\$25m or more for the second quarter of 2011, fell by 18% compared with the same period in 2010. This trend has been largely explained by the gloomy economy and the maturity of the commercial market - i.e. much of what can sensibly be outsourced already has been (The Economist, 2011). In the UK, there has been a marked increase in the outsourcing of public services to the private sector (Cooke, 2006) and recent policy announcements suggest that the market for mixed provision will continue to grow (Cabinet Office, 2011).

In P&SM, organisations may choose between total outsourcing of the procurement function and partial outsourcing of specific activities, e.g. e-Auction event management, procure-to-pay process, travel/fleet management services, or sourcing and contract negotiation. In supply chain circles third-party logistics (3PL) services have grown to become a global market worth \$200bln in 2008 (Blanchard, 2011). About 80% of companies within North America and 70% in other industrial regions around the world are using an outsourcer for at least one key supply chain task. Worldwide, the services most frequently outsourced to a 3PL are 1) domestic transportation (86%); 2) international transportation (84%); customs brokerage (71%), warehousing (68%), forwarding (65%), cross-docking (39%) (Georgia Tech. & Capgemini

### Definition

Outsourcing is "the process of contracting with the most suitable expert third party service provider" (CIPS: Outsourcing). It is the operational transfer of one or more business processes from an origin company to an external provider who then becomes accountable for the outcome of the agreed tasks (Cooke & Budhwar, 2009). Outsourcing to a foreign country is called 'offshoring' (here the provider can be external or affiliated to the firm) and to nearby countries is known as 'nearshoring'. Transfers to an external, international provider are referred to as 'offshore outsourcing' (Olsen, 2006).

### Successful Application

When deciding on outsourcing, firms are faced with a number of issues. It is important for a company to determine the non-core activities that can be outsourced. These activities should be divided into operational (e.g. cleaning, catering, security) and strategic (e.g. information technology, human resources). Human resources issues should be considered - process outsourcing may lead to discouragement and lack of motivation. This can be done through developing a good staff communication plan aligned with the outsourcing strategy. Selecting a

reputable service provider is a high priority. In the UK initial advice can be obtained from the National Outsourcing Association, or the Chartered Institute of Purchasing and Supply (Leeman, 2010 ). Another key issue in the implementation is outcome/output based specification in the outsourcing contract. Once the outsourcing relationship is up and running, there should also be regular contract management reviews to monitor performance, develop the service and assess satisfaction levels of all parties (CIPS: Outsourcing).

### Steps to Successful Application

- Fix and describe business processes, address any key internal processes first: unresolved issues transferred to the outsourcing partner are a critical reason why many outsourcing projects fail.
- Get basic agreement based on facts and think about small issues: develop trust with the provider before signing a contract: liaise, understand, and negotiate. Ideally, the service provider should study the process flows and conduct a pilot test before any contract is signed.
- Define the Service Level Agreement (SLA) and identify, describe and agree how to measure outsourced processes. Monitor SLAs in a weekly/monthly performance sheet. SLA provides ongoing focus on what needs to be achieved at different periods by both parties.
- Implement a system of continuous monitoring, e.g. List of Open Points (LOP), a weekly list showing operational problems which should be solved within X weeks, monthly costs p/piece, half year reviews.
- Ensure that both parties are aware of the formal channels to raise and solve problems.

*Leeman (2010)*

### Hints and Tips

- Do not not outsource 'broken' processes, as benefits delivered from outsourcing depend upon the degree of efficiency in the in-house services (CIPS: Outsourcing).
- Make sure the contract is well-written and sets out details of how the outsourcing firm can make changes - otherwise the service provider could claim for compensation (CIPS: Outsourcing; Leeman, 2010).
- Cultivate buyer-supplier 'goodwill' (relationship marketing) (Leenders et al., 2002).
- Plan an exit strategy: the relationship might end prematurely or just have run its course, so ensure that the SLA details how to bring the outsourced function back in-house and who owns particular assets (Leeman, 2010).
- The easiest and most suitable activities to outsource are: resource-intensive and relatively discrete processes that require specialist competencies; activities characterised by fluctuating work patterns, quickly changing markets, and rapidly changing technology; activities that require expensive investment (Lysons and Farrington, 2006).

### Potential Advantages

- Buying organisations can outsource peripheral tasks (e.g. payroll) and focus on the core activities and competencies that add value and enhance process effectiveness (CIPS: Outsourcing; Kotabe et al., 2008; Handfield and Nichols, 1999).
- Outsourcing can help reduce costs through superior provider performance and the provider's low cost structure (CIPS: Outsourcing; Chase et al., 2004). Other potential benefits in-

clude access to innovation and improved risk management due to the provider's specialist knowledge (CIPS: Outsourcing).

- Through outsourcing a firm can obtain expertise (e.g. compliance with industry standards), skills and technologies from its providers that it did not have, or would not have been able to develop itself, because it does not have the degree of specialisation that the provider has (CIPS: Outsourcing; Chase et al., 2004).

### Potential Disadvantages

- Outsourcing work may lead to anxiety and job insecurity among procurement and supply management staff. Generally unions do not support the relocation of processes to external providers, as outsourcing can potentially result in layoffs (Chase et al., 2004). Other potential risks include the loss of key skills and a reduced ability to change direction quickly (CIPS: Outsourcing).
- Security of information and data is a potential risk in business process outsourcing (Yang et al., 2007). Through outsourcing a firm can lose control over activities or knowledge that might be its competitive differentiator. For example, if a third party obtains direct access to a firm's dealer network (as was the case with Blaupunkt and Panasonic) it may lead to some loss of its competitive advantage (CIPS: Outsourcing; Chase et al., 2004).
- Purchasing and supply management can be seen as a core competence that requires effective engagement across the firm's disciplines (sales, marketing, operations and so on) and project groups. The potential for losing sight of cross-functional policy issues and these critical connections means that outsourcing of the P&SM; function may not be appropriate (CIPS: Outsourcing).

### Performance Monitoring

- Service level metrics: these should be discussed and negotiated at the outset before signing any contracts.
- Service quality measurement: measure provider service quality on metrics such as user satisfaction with the service, average and maximum response times, vendor meeting all legal requirements.
- Measure total cost reduction, utilising figures from previous years before outsourcing, factoring total outsourcing costs.
- Return on investment (ROI): even if the figure is low or negative, the cost associated with dropping the outsourcing provider and going back to in-house processes might outweigh the benefits. Switching to a better provider (having learned from experience) might be the best solution than dropping outsourcing altogether (Plunkett, 2006).
- Percentage of business outsourced/offshored to providers (Chase et al., 2004).

### Case Studies

- The retailer J.C. Penney has offshored every aspect of its supply chain for shirts to TAL Apparel Ltd., a Hong Kong-based manufacturer. TAL receives selling information (size, price, colours, etc.) directly from the points of sale, analyses sales data and fills out its own order forms to be forwarded to J.C. Penney for replenishment. The result is a lean, streamlined and efficient replenishment system with no delays between the sale of inventory and replenishment order, and no stockouts or overstocking (Plunkett, 2006).



- Hewlett-Packard (HP) is an example of innovative outsourcing in logistics. HP outsourced its raw material warehousing to Roadway Logistics, which manages the process in a Roadway's warehouse in Vancouver, Washington. The warehouse operates 24/7 and 140 Roadway employees co-ordinate the delivery of parts and manage storage. This outsourcing decision allowed HP to transfer 250 of its own employees to other company activities and save 10% in warehousing operating costs (Leenders et al., 2002; Chase et al., 2004).
- In the electronics industry, contract manufacturers, such as Flextronics and Solectron, take complete responsibility for making decisions over, and manufacturing of, certain components. These companies undertake around 11% of manufacturing in the electronics industry (Chase et al., 2004).

### CIPS Source Downloads

- BuyIT: IT outsourcing
- CIPS: The decision to outsource the procurement function
- CIPS & PACG: Business process re-engineering & business process outsourcing
- CIPS: Outsourcing
- CIPS: Savings
- UWE, CIPS & KPMG (2002) I-SAVE: Independent savings analysis verification and evaluation

### Further Reading/References

#### Web Resources

- The Outsourcing Institute <http://www.outsourcing.com/>
- Article on procurement outsourcing <http://www.theguardian.com/society/2010/sep/01/procurement-outsourcing-public-sector-goods>
- Outsource Magazine <http://outsourcemagazine.co.uk/>
- NOA (National Outsourcing Association) <http://www.noa.co.uk/>
- Latest news on Outsourcing <http://www.procurementleaders.com/outsourcing>

#### Books

- The Outsourcing Revolution, Michael F. Corbett, ISBN 978-1607146766
- The Handbook of global Outsourcing and Offshoring, Ilan Oshri, Julia Kotlarsky and professor Leslie P. Willcocks, ISBN 978-0230235502
- Smarter Outsourcing, Jean –Louis Bravard & Robert Morgan, ISBN 978-0273705604
- The Outsourcing handbook, Mark J. Power, Kevin DeSouza and Carlo Bonifaz, ISBN, 978-0749444303
- The Offshore Nation, Atul Vashistha & Avinash Vashistha, ISBN 978-0071468121

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## Video

ABC News report on outsourcing to India

[https://www.youtube.com/watch?v=FwwgXCOEYks&feature=player\\_embedded](https://www.youtube.com/watch?v=FwwgXCOEYks&feature=player_embedded)

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