

# P&SM: Outsourcing



The process of contracting with the most suitable expert third party service provider



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## **Introduction**

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This document is about outsourcing.

## **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).

Near-sourcing is a strategic move by a business to locate some of its operations close to the consumption of the final product.

## **Background**

As a business strategy, outsourcing was not actually developed formally until 1989<sup>1</sup>. Dr Robert Handfield, in his article 'A Brief History of Outsourcing', attributes this development to companies finding they were 'handicapped by a lack of agility'<sup>2</sup> when attempting to compete globally during the 1970's and 1980's. These companies looked to increase their flexibility by concentrating on their core business and outsourcing non-critical processes.

## **Explanation**

The need to reduce costs is often the driving factor behind a decision to outsource work. CIPS believes that outsourcing to specialist providers can result in better value for money; however, using outsourcing without sufficient planning and oversight can be more expensive. Additionally, if outsourced work has a direct impact upon the customer then any lowering in quality through outsourcing will lead to customer loss due to increased frustration.

To avoid this, CIPS believes that P&SM professionals should be driving and guiding the outsourcing activity by suggesting those services that could be considered for outsourcing and they should then lead the process.

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<sup>1</sup> Mullin, Rick: Managing the Outsourced Enterprise, Journal of Business Strategy Vol. 17 Iss: 4, 1996.

<sup>2</sup> Handfield, Dr Robert: A Brief History of Outsourcing, <http://scm.ncsu.edu/scm-articles/article/a-brief-history-of-outsourcing>, 01 June 1996 (07 February 2012)

While any area can be considered for outsourcing, depending on the needs of the organisation, there are some areas that are more likely to benefit than others. A company may find it beneficial to outsource work that:

- **Requires specialist expertise** - this can be cheaper to outsource than to recruit into the company or to train within the company. For example, it may be cheaper for a car manufacturer to outsource the making of car windows than produce them in company.
- **Requires major investment** - outsourcing work like this can reduce the amount of investment needed. For example, work which requires modernisation in order to be effective could be outsourced to a third party that already has the capability to do the work.
- **Requires less strategic control** – companies which decide to focus more on their core activities in order to improve performance can outsource work which they do not consider critical. For example, a procurement department in a large company may need to concentrate on core negotiation and vendor selection rather than less significant issues such as delivery of materials in a timely fashion. Outsourcing more minor areas would provide the necessary time.
- **Is deemed non-critical** – some work that takes place in companies, while important, will have little impact on the customer if there is a short-term failing and are not strategically important e.g. many companies outsource their office cleaning. These can be outsourced in order to reduce costs and free up management time.

CIPS believes that in general it is not good practice to outsource core services (those that lie at the heart of the business or organisation) as this places the company at risk by making those core services harder to exert control over.

There may be cases where a decision is made to outsource such services, where specialist skills are required that are not in the company, for example. In these cases care must be taken to ensure that the buying organisation does not become isolated from the provision of these core services. For this to be the case it is very important that the communication between the company and the third party works effectively.

CIPS takes the view that P&SM professionals have a responsibility for ensuring effective communication and clarity of purpose throughout any outsourcing process.

This communication must be a two-way process, and it may well be necessary for the company to communicate relevant parts of its long-term strategy to the third party. This will allow the third party to plan for future demand and strengthen the bond with the company.

One of the key communications between the company and third party is the contract. CIPS firmly believes that all outsourcing arrangements should be supported by an expertly drafted contract. This should lay out clearly all necessary agreements for the outsourcing to work, such as service level agreements, timeframes and measurements, penalties and rewards and exit strategies.

In order to ensure the third party communicates necessary information and performs effectively, it may be appropriate to have milestone reviews written into the contract, whereby progress to date is reviewed. It is checked that services are on time and according to plan, and the contract is reviewed for compliance.

CIPS considers that, in general, outsourced service contracts should have a longer rather than shorter duration; this enables both the buying organisation and the service provider to obtain an appropriate return on their investment.

The length of contract should not prohibit alteration to the way the third party works, however. CIPS considers that encouraging and promoting innovation is one of the key aspects of outsourcing and long-term contracts can sometimes stifle this by maintaining the status quo. Thoughtfully constructed milestones in the contract would also help alleviate this problem by ensuring that the performance of the company is regularly reviewed, allowing action to be taken if the third parties processes are stagnating.

A major issue that often causes third parties to struggle to meet the needs of the outsourcing company is staffing problems. CIPS emphasises the need to give serious attention to the relevant staff issues including human resource management as well as legal considerations (TUPE<sup>3</sup> for instance).

### Make v Buy – Should I outsource?

Outsourcing needs careful consideration and therefore the options should be thoroughly investigated before any decision is made. Advantages of outsourcing include:

- The freeing up of your business to concentrate on core activities
- Gaining competitive advantage. Outsourcing may turn fixed costs into variable costs, thus freeing up important capital and allowing the organisation to be able to adapt easily to new market situations.

### The disadvantages include:

- Loss of direct control of key business functions
- The outsourcing company going out of business
- Reputational damage due to poor service delivery and/or confidentiality and security not being respected
- The depletion of in-house resources that have the ability to manage the outsourced provision and ensure its success.

### Conclusion

CIPS believes that outsourcing can provide great savings in costs, allow for better time management and help mitigate risk. However, the potential reduction in control means that outsourcing should be carefully planned and driven by P&SM professionals and supported by an expertly drafted contract. Effective communication and robust governance will go a long way in ensuring that the outsourcing activity is a success.

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<sup>3</sup> The Transfer of Undertakings (Protection of Employment) Regulations (TUPE) protects employees' terms and conditions of employment when an undertaking or part of it is transferred under UK law.



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