

**Business Process Outsourcing –Need of Today
(With Reference to Make or Buy Decision)**

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Abstract

A Common problem usually faced by a manufacturing company is whether it should make all the components itself or buy source of them from outside sources. A company has competitive advantage whenever it has an edge over rivals in attracting customers and defending against competitive forces. Competitive advantage is derived from the key term cost advantage. Price cutting supported by cost advantage. That's why companies may arise a question whether it would be worthwhile to buy from outside rather than make it .The solution for this huge question may be make or buying or Business Process Outsourcing.

Business Process Outsourcing has been recognized as a means of achieving organizational strategy. The Harvard Business Review identified outsourcing as one of the most important management ideas of the last 75 years. In simple words we can say that outsourcing is "the transfer to a third party of the continuous management responsibility for the provision of a service governed by a service level agreement." The benefits of outsourcing fall into two categories: immediate gains (e.g. service cost reduction, focus on core services thanks to an "eyes on, hands off" mode), and longer-term benefits (e.g. flexibility, access to expertise, improved quality). In this paper an attempt has been made to focus on current trend and the need of Business Process Outsourcing in the current business Scenario.

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Introduction

Business Process Outsourcing (BPO) is the delegation of the Ownership, Administration, and Operation of a process to a third party. Many people see it as an evolution from Information Technology Outsourcing (ITO). Business Process Outsourcing (BPO) is the delegation of one or more IT-intensive business processes to an external provider that in turn owns, administers and manages the selected process based on defined and measurable performance criteria. Business Process Outsourcing (BPO) is one of the fastest growing segments of the Information Technology Enabled Services (ITES) industry.

Few of the motivation factors as to why BPO is gaining ground are:

- Factor Cost Advantage
- Economy of Scale
- Business Risk Mitigation
- Superior Competency
- Utilization Improvement

Generally outsourcing can be defined as – *“An organization entering into a contract with another organization to operate and manage one or more of its business processes.”*

Petter Gottschalk & Hanse Solli-saether in their book “Managing successful IT Outsourcing Relationship” have observed that , “Outsourcing has been called one of the greatest organizational and industry structure shifts of the century ,with the potential to transform the way businesses operate. Some proponents believe it will turn firms from vertically integrated structure in to virtual organizations and transform existing fixed structures in to variable cost structures where expenses can move up or down at the business climate dictates.”¹¹

Another definition of BPO is “the strategic delegation of ‘non-core’ IT intensive business processes to an external provider that in turn manages the selected process(es) based upon defined performance metrics. Such processes may include; Administration; Finance and Accounting (F&A); Human Resources; Payment services; Logistics and distribution; Sales, marketing and customer care.

BPO aims to raise a client company's shareholder value because it is about delivering outcomes— that is, higher-performing business processes. Companies essentially have three kinds of processes:

- Core processes (which give strategic advantage)
- Critical, Non-core processes (which are important but are not competitive differentiators)
- Non-core, Non-critical processes (which are needed to make the environment work)

It is suggested to outsource core processes; and it is recommended to invest in them. But many do recommend outsourcing critical, non-core processes to providers who specialize in those processes because they will invest in them and aim to make them world-class. And most advisors recommend outsourcing all non-core, non-critical processes. But outsourcing does not mean handing over an entire process. Generally, it means turning over to a BPO provider the “how” aspects of a process— the systems, infrastructure, administration, execution, and some of the design of non-core processes. But retain the “what” aspects of the process— the governance, policy setting, decision-making, and strategy of these processes. The intent is to outsource the work while retaining the direction-setting part.

Strategic Aspect Of BPO

- BPO involves withdrawing a part or whole from certain stages or activities in the value chain system and relying on outside vendors to supply the needed products ,support services or functional activities. Business process outsourcing makes good strategic sense in a number of instances:
- An activity can be performed better or more cheaply by outside specialists.
- The activity is not crucial to the firm's ability to achieve sustainable competitive advantage and won't hollow out it's core competencies ,capabilities or technical know –how.

- BPO allows a company to concentrate on it's core business and do what it does best.
- BPO reduces the company's risk exposure to changing technology and changing preferences of buyer.
- BPO streamlines company operations in ways that improve organizational flexibility ,cut cycle time and reduce co-ordination cost.

BPO and Make or Buy Decisions

There are many aspects are taken into consideration while making a "make or buy " decision .In addition ,we have another set of factors which are situation specific and environment dependent .These are discussed under the following two broad heads :

1. Endogenous factors
2. Exogenous factors.

Endogenous factors on "Make or Buy" Decisions

Sr.no.	Factors	Conditions Favoring	
		Make decision	Buy decision
1.	Volume of production	High	Low
2.	cost of production	Low	High
3.	Infrastructural facilities	Available	Not available
4.	Fixed cost	Low	High
5.	Profitability	High	Low
6.	Protect patent Right	High	Low
7.	Availability of manpower	Excess	Insufficient
8.	Integrated Production system	Vertical	Horizontal
9.	Utilization of production Capacity	Low	High

Exogenous factors.

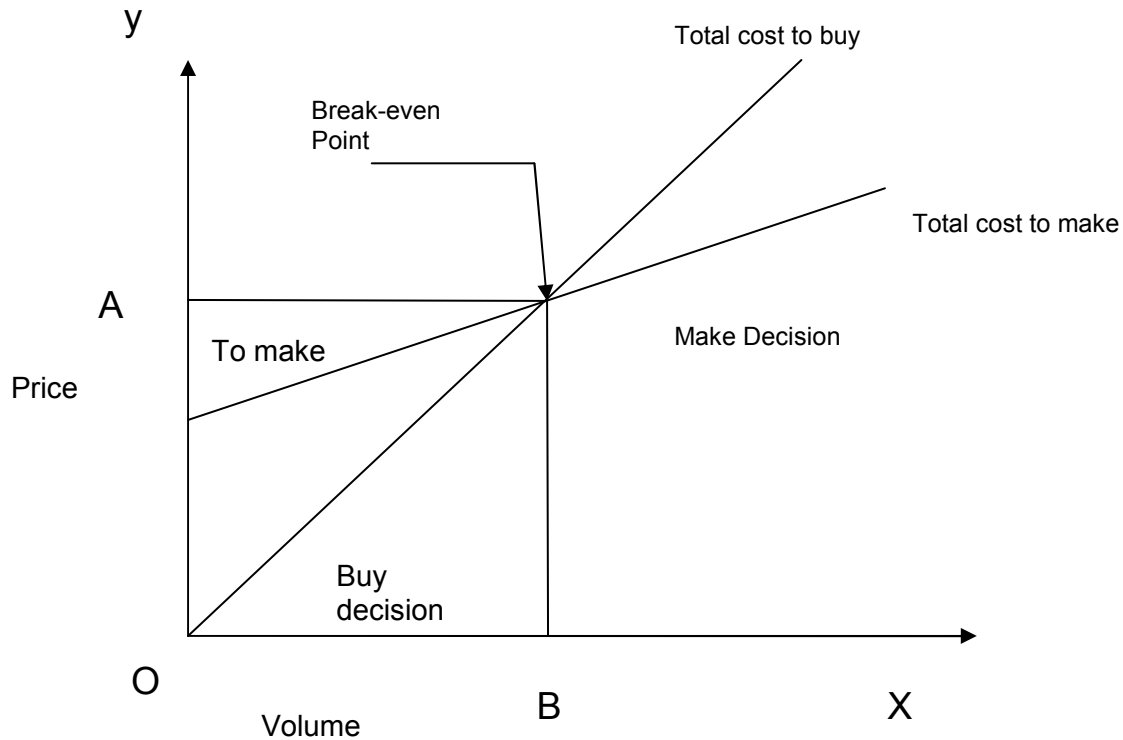
These are intrinsic factors on which a company does not have control. These factors also have decisive influence on make or buy. Some of these are:

Exogenous factors on “Make or Buy ” Decisions

Sr.no.	Factors	Conditions Favoring	
		Make decision	Buy(BPO) decision
1.	Foreign Collaboration	Exclusive rights	Non-exclusive rights
2.	Requirement of items	Long term	Short Term
3.	Availability of Vendors	Not Available	Easily available
4.	Competition	Low	High
5.	Govt. Control on monopoly	Low	High
6.	Commercial condition	Relaxed	Stringent
7.	End user	Defense	Others
8.	Standard item	No	Yes

Economic and Non-Economic Factors Influencing Make or Buy Decision

Decisions regarding whether to make or buy the components involve both economic (cost),non economic (non-cost) factors. Economically, an item or component is a candidate for in –house production, if the Economy has sufficient capacity and if the components value is high enough to cover the variable costs of production and make some contribution towards the fixed cost .Low volumes favour buying which incurs very little or no fixed costs.The following graph shows the relationship between cost factors.



From the figure given in the next page ,it is clear that production up to OB level is not profitable because of smaller volume of requirements .Hense,it is better to buy from outside sources .If the requirements is more i.e., beyond OB level the cost will be less and consequently it is wise to make rather than buy .At the point of B ie.,Break Even Point of production ,cost of making and cost of purchase will be the same.

Buying from Outside Sources

It is better for an organization to buy a component, if the following factors are found favorable .

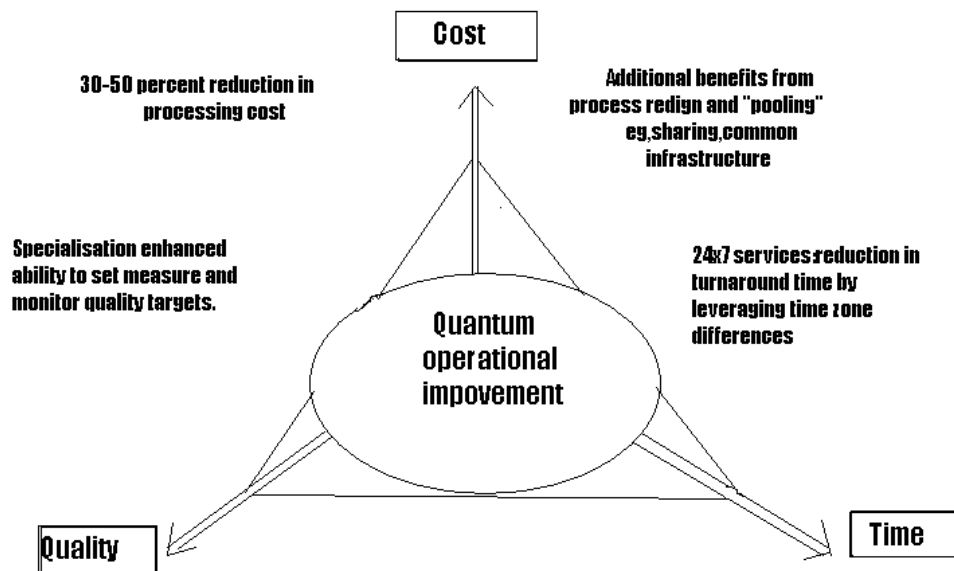
- The existing facilities are capable of being used more profitably to make other components.
- Patents or Legal barriers may prevent the company from making the components.
- Demand for the component would be only temporary.
- A wide selection is available from a large number of suppliers.

1.1.2. Significance of Business Process Outsourcing

Today Business Process Outsourcing is considered not only as a simple cost cutting mechanism but also a strategic innovation ,which is expected to shape and prepare the organization for future business dynamics .Apart from cost cutting, Business Process Outsourcing saves precious management ,time and resources by allowing companies to concentrate on core competencies . Business Process Outsourcing providers always have a process expertise and enjoy significant economies of scale and scope by offering the same services to different client .The figure given below shows how Business Process Outsourcing can save a significant amount of costs for companies.

Figure 1.4

Significance of Business Process Outsourcing



Source: <http://www.nasscom.org> [Retrieved on 21st June 2008]

There are several benefits from Business Process Outsourcing –such as improved performance, profitability and shareholders value. More specifically these benefits include:

1. Achieving cost reduction

With the help of re-engineering, process improvements and advanced technologies, we can eliminate unnecessary operating cost while reducing and bringing other administrative cost under better control.

2. Improving service quality

With the help of business process outsourcing businesses are managed and organized with a view to provide a higher level and quality of services to the business units, subsidiaries and users throughout the company.

3. Focusing on companies core business

Business Process Outsourcing allows companies to concentrate or focus on core processes by outsourcing non-core activities. This makes companies extremely lean and agile, thereby allowing the Chief Executive Officer and top management to spend more time on the very purpose of their existence. They can spend time understanding the customer better and serve him better by understanding his taste preferences, changing trends etc.

4. Maintaining competitive Edge

Business Process Outsourcing enables to focus on building a more competitive business and provide the supporting systems and services to help companies compete more effectively in global market place.

5. Obtaining outside expertise

In Business Process Outsourcing contract the vendor firm's top business, industry and technical specialization provide management with valuable guidance and skills which are their core competencies and which the company may not have in house.

6. Meeting changing customer demand

The outsourcing terms provide management with flexible and scalable services to meet their customer changing requirements and to support company moves consolidations and acquisition.

7. Gaining access to advanced technology

Vendor design and implement leading –edge enterprise system to support the

business processes and so manage the technology infrastructure with lower capital investments and training cost.

8. Achieving revenue enhancements

With the help of outsourcing non-core processes, management can focus on increasing sales and market share, developing new and improved products, expanding in to new markets and enhancing customer service.

9. Achieving greater internal flexibility

Through outsourcing, management can focus on more strategic issues and other important company initiatives and has more flexibility to assign staff and allocate resources to higher value projects.

10. Changing of cost structure –going to fixed cost to variable cost

When a process is being performed in house ,all the employees are paid fixed salary and benefits .There is also a fixed cost associated with investments in fixed assets. The cost are the same regardless of the level of work productivity etc .In contrast to this if the process is outsourced the customer pays only for the volume of output that the outsourcing gives .In lean months ,when the volumes are low, the cost reduced.²⁶

According to the Jacob Parambi,Vice President –Operations ,IBM Global Services India Pvt. Ltd (BTO operations),“ Organizations are now looking at outsourcing their processes to low cost destinations so Indian firms need to keep their cost competitiveness in place and in this regard attrition is a key concern”.

Reasons of failure of outsourcing

A study conducted by Oxford University and University of Missouri analysed 29 of the biggest outsourcing deals in the last decade. The researchers concluded that more than 35% of the deals had failed. The reasons of failure of outsourcing is the following:

- 1) Stated cost reduction is not achieved
- 2) Deterioration of service quality
- 3) Violation of SLAs (Service Level Agreements)

- 4) Deterioration in the relationship between the Outsourcer and the Service Provider
- 5) Strain in employee-employer relationship in the outsourcing company.

This leads to non-achievement of the greatest benefit sought from outsourcing – the opportunity for the outsourcer to focus on their core strengths and achieve a competitive edge.

Outsourcing deals begin with a lot of excitement and gung-ho optimism. After some time, however, the partnership between the outsourcer and the service provider sours when expected benefits are not seen. By the time the outsourcing deal is called off, careers are destroyed, morale is down, time, money and effort is wasted. The service provider also loses reputation, which significantly impacts ability to win future deals.

Research indicates that there are several key reasons why outsourcing deals go wrong.

- **Absence of proper commitment** A number of organizations commit the cardinal sign of treating an outsourcing decision as just another purchase decision. These organizations approach outsourcing with a cost-benefit and a make or buy mindset. Key issues like why they should outsource, legalities involved, human resource concerns, and slack Service Level Agreement (SLA), are often ignored. Lack of a strategic perspective results in the wrong deal being made.
- **Unclear Objectives:** Outsourcers set targets for cost reduction and enhancement of quality and value as well. This enhancement of value and improved quality requires investment on the part of the service provider. The service providers in their eagerness to close the deal, do not point out the impracticality of the objectives. The end result is an outsourcing deal, which is doomed to fail.
- **Poor Management:** The singular focus on cost reduction, above all else, impacts the selection of the service provider. Often, the lowest-cost provider is selected for executing the outsourcing deal, with very little consideration for other parameters like quality of service, expertise, past experience etc. The service provider is treated as a vendor rather than a partner in creating long lasting value for the outsourcer. This lack of a partner relationship is evident in the way the

Service Level Agreement documents are prepared. Outsourcers request the prospective service provider to draft the agreement, as opposed to preparing the SLAs themselves, to set expectations. SLAs are thus not clear in terms of quality of service and performance expectations. Sometimes, outsourcers commit inadequate resources to the project.

Conclusion

Very simply outsourcing can be defined as a process in which a company delegates some of its in-house operations / processes to a third party. Thus outsourcing is a contracting transaction through which one company purchases services from another while keeping ownership and ultimate responsibility for the underlying processes. A make or Buy decision is by no means simple. It not only involves the tangible factors mentioned above ,but may involve an analysis of the present and future market and economic trends, the disadvantages of inflexibility in the supply source , possible adverse developments in raw materials and process ,etc. Every decision requires to be reviewed later on in the light of the circumstances then prevailing. Instances where problems have arisen subsequent to decisions to outsource aspects of operations and functions appear to be attributable to inadequate planning, poor contracting processes, or ineffective management of contracts.

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