Embracing a Smarter World through Better Outsourcing

KH CHAN, China Hong Kong

Key words: Financial risks, non-core business, tactical contract management, outsourcing strategies, competitive edge.

ABSTRACT

Financial risks could create tremendous disasters in an organization if not managed properly. These risks would arise from poor human resources management, ineffective use of resources, over concentration of in-house services/non-core activities, and deficient cost engineering approach within an enterprise. For facility management, these risks could be mitigated through relevant strategic contract management by outsourcing an enterprise's non-core business services. Major stakeholders' comments will have significant effects in deciding the extent of outsourcing, in producing a healthier, financial-sound and effectively-managed organization to achieve its competitive edge.

In this research, quantitative methodology through a well-designed questionnaire will be sent to major stakeholders of a local mega sized organization with multiple departments. The pros/cons, efficiency, degree and implications before outsourcing and that after outsourcing will be investigated. Collected data shall be statistically analyzed to examine the correlation and significant effects among the important elements in outsourcing, aiming to cast some lights in concluding the relevant mix of outsourcing/in-house services for facility management.

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1. INTRODUCTION

Managing risk in an organization is complex, whether outsourcing or in-house management should be carefully considered (Chen and Khalid, 2002). Outsourcing is defined as the procurement of products or services from sources that are external to the organization (Lankford and Parsa, 1999). It involves allocating or real-locating business activities (service or activities) from an internal source to an external source (Grover, Kovach and Cudney, 2016). In-house management can be defined as internal sourcing of business activities. It is an allocation or reallocation of resources internally within the same organization (Schniederjans, 2005). The services or manufacturing activities, tasks, and jobs to be outsourced can vary substantially within the firm, but generically will be referred to as business activities.

There are basically two forms of labor markets, the internal labor market and the external labor market. The internal labor market is characterized by the followings (Schniederjans, 2005):

- vertical integration within the organization of processes and production;
- permanent teams of employees assigned to job-specific tasks; and
- direct employment by the organization.

Outsourcing does not take place unless there is a definite transfer of ownership and control of processes and/or assets (Brewer, Ashenbaum and Carter, 2013). When facility management (FM) is performed in-house, the following added values would evolve. Through less management effort, less activity is required to fulfill FM activities. That is, a self-sufficient system requires little managerial monitoring owing to the job specific nature (Mclvor, 2005).

- equipment idiosyncrasies – due to incompletely standardized yet common equipment the individual attributes of which are ‘learned’ by experience only;
- process nature – due to worker adaptations during production and individual fashioning and styles;
- informal team accommodations – due to specific team changes, which are only known by the team from mutual adaptations; and
- communication nature – which are information codes and channels only of value within the specific firm and which the employees are able to own for best fit purposes. For example, an in-house facilities manager is able to formulate and manage a comprehensive lift maintenance contract delivering better value to the organization due to the in-depth knowledge of each lift concerned – learned over time.

Management ability and discretion are crucial for adjusting labor input to match actual demand when required. For instance, to relocate a division to another building requires a cross-functional project team from various departments, utilizing existing resources to cope with business requirements (Corbett, 2004). When utilizing in-house procurement of FM, there is eventual tendency to evolve more internal bureaucratic structures. In-house support services within organizations have become defacto monopolies with little productivity incentives due to boredom. When required to improve productivity, more staff are then likely to be employed thus perpetuating the problem. That is, too many resources/wastages tend to balance off reduced efficiency. Moreover, in-house trades teams would become significantly less productive than external subcontractors, and require twice the number of labor inputs to achieve the same work output (Schniederjans, 2005).

1.1 Benefits of Outsourcing FM

Suppliers (external providers) would have under-utilized equipment/facilities, employed scale leverage, increased computer automation and purchasing power (Spencer, Rogers and Daugherty, 1994). They can combine these advantages to create a significantly lower per-unit cost; and let buyers (the organization seeking an external provider) to enjoy lower cost while allowing the suppliers to make a profit under the economies of scale. An outsource company can do the same works more efficiently at lower costs and larger operation encompassing unused personnel and equipment (Schniederjans, 2005). By giving up certain FM activities to outsiders, the organizations can focus their management resources towards core activities to improve efficiencies for attaining better competition advantages (Corbett, 2004). Fixed overheads, physical plant ownership and bureaucracy could be eliminated, as when financial institutions outsource its FM Departments; and adopt a *sale and leaseback program* of their owned properties. At the same time it decentralizes its banking operations, mitigating its company structure (Corbett, 2004).

1.2 Expenses in Outsourcing FM

The client organization would be more than likely divest the transfer of ownership and control to multiple services providers to avoid possible monopoly by a single entity. This would cause an increase in management time and effort (monitoring multiple contracts) (Corbett, 2004). Initial high switching costs associated with ownership and process transfers will lead to long-term contracts, which would step up the problem of monopolistic or duopolistic opportunism/ control. Opportunism arises when there exists no competition between the chosen multiple outsource providers. The staffing of outsourced providers are usually assigned for numerous organizations for limited times dictated by the outsourcing contracts. Outsourced working, scheduling, equipment training, supervision and working conditions are not directly controlled by client organizations. The service providers may encourage junior or under-qualified staff to fill this gap (Schniederjans, 2005).

Suppliers would have their own profit/revenue imperatives when inadequate metrics exist, the temptation for the supplier is to achieve increased profitability by reducing the service quality (El Ouardighi and Kogan, 2013). In addition, suppliers are part of integrated supply chain. It would be extremely surprising if suppliers were allowed to set its own parameters to align with clients' organizational objectives. Moreover, suppliers' need for profit growth would drive to move the process components outside the original scope of services, to gain extra profit. This will demand focused monitoring and contract management by the client organization, whereby will lead to increased costs i.e. transaction costs for client organizations (Schniederjans, 2005).

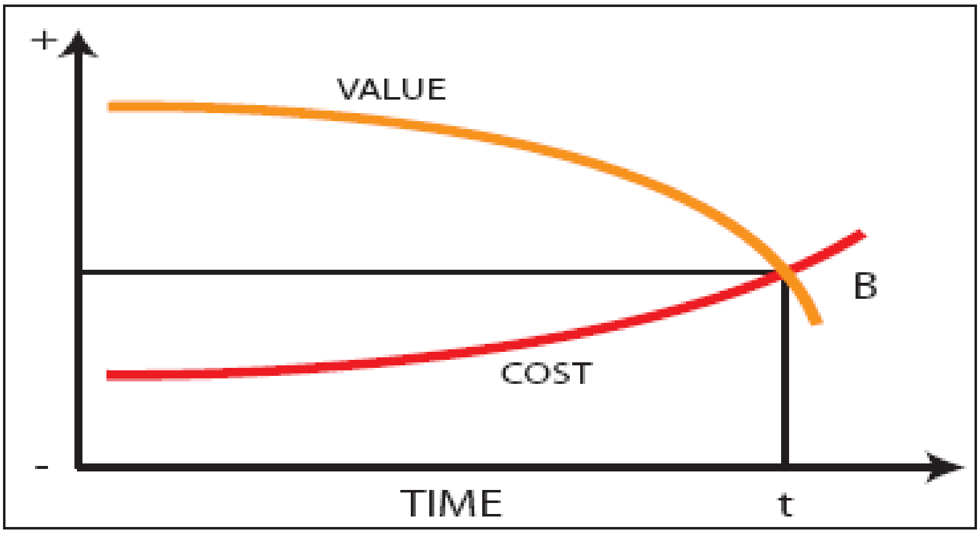


Figure 1. Value & cost relationship

2. LITERATURE REVIEW

Organizations face increasing pressures from new technologies and competition for trained resources when planning, developing, and maintaining projects. In response, managers have to use both internal and external resources to meet business needs effectively. External vendors have been utilized to meet agency demands, but concerns over rising costs and contract effectiveness have led to reevaluate the decision-making process. Mclvor (2005) contends that the decision whether to use internal or external resources must be made by:

- Identifying and prioritizing the goals of projects
- Understanding the needs and constraints of the organizations
- Identifying and quantifying the appropriate measures for internal and external operations
- Conducting cost-benefit analysis of the internal and external alternatives

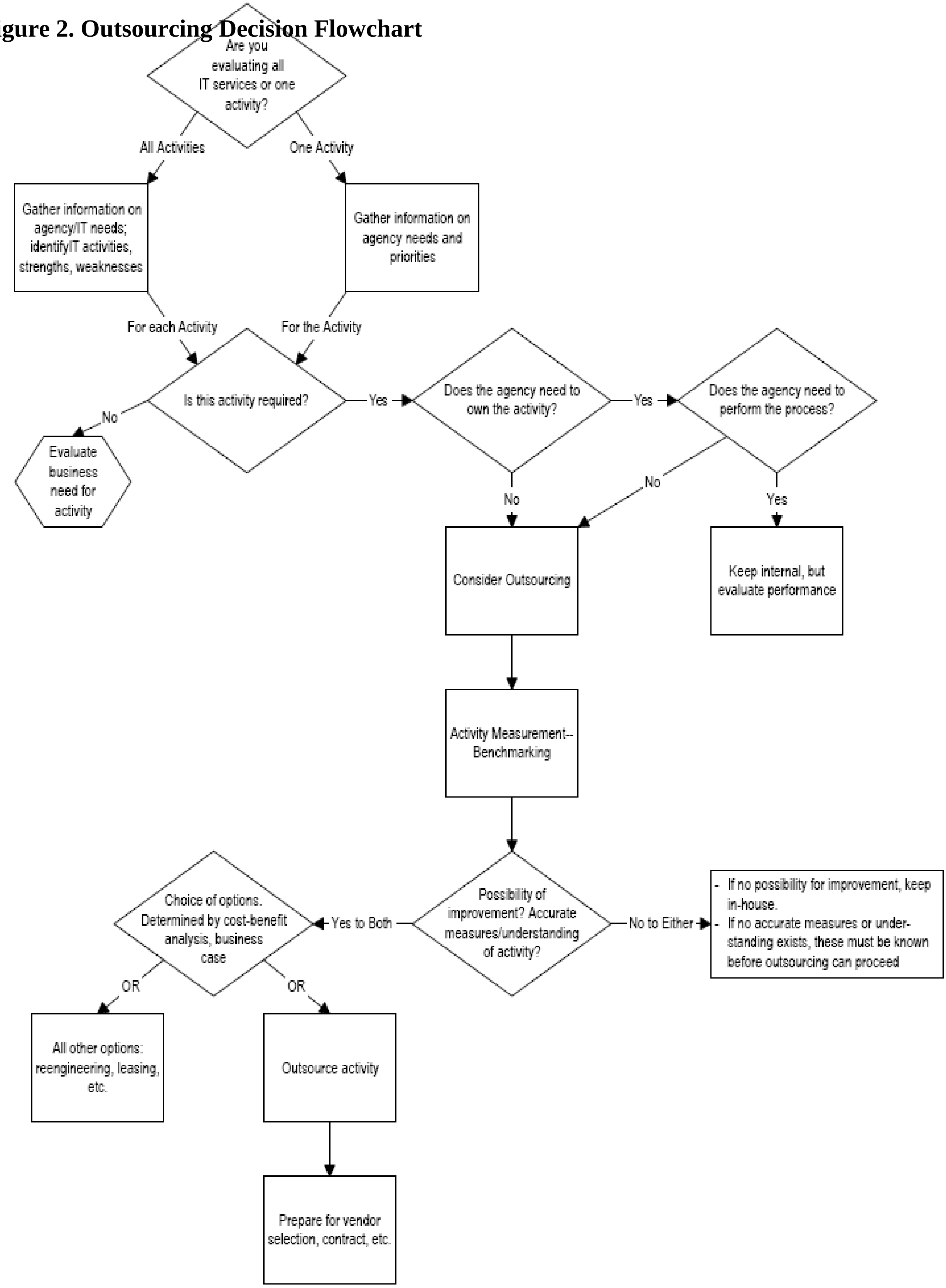
The reasons for adopting in-house resources maybe:

- To obtain needed services at lower overall costs
- To retain skilled personnel able to respond directly to instant organization needs
- To take advantage of employees' unique insight into a project or the organization's goals
- To have ownership and control over resource and personnel assets

Project success must always come from its ability to perform the desired service or activity. Identifying the best option for obtaining project success also stems from an understanding of the project processes. Establishing and analyzing quantitative/qualitative criteria indicate which staffing decision is most effective and states the rationales in reaching that decision. Outsourcing can be an efficient and effective alternative in considering in-house resources, but a full determination of costs/benefits is required to make that decision (Nordigården et al., 2014). Successful decisions are all dependent on having a clear understanding of all the options available.

Examining all management activities within an organization includes studying the opportunity cost of staff time. A project intended for outsourcing may in fact use internal resources more effectively. In order to free up internal resource time, a different/unplanned in-house service may need to be outsourced (Power, Desouza and Bonifazi, 2006). Cost savings, enhanced service levels, transition to a different technology platform, need for increased technical knowledge and skills unavailable within the organization, or insufficient staff resources to accomplish specific tasks are the primary considerations for outsourcing. These rationales should be recognized as costs or benefits according to the organization's decisions about its business needs (Power, Desouza and Bonifazi, 2006). To identify whether or not outsourcing is appropriate, several background questions must be answered. Figure 3 illustrates the analysis process that helps to ascertain if outsourcing is an option, or if in-house staff represents the best use of organization resources (Schniederjans, 2005).

Figure 2. Outsourcing Decision Flowchart



Chances for a successful outsourcing decision are maximized when the decision fully incorporates all known costs and benefits of internal versus external resources according to the type of activity (Mclvor, 2005). Knowing and comparing organization costs and benefits at the start enables the agency to make the best decision and act efficiently upon its decisions. It is important to compare costs as equally as possible, although confusion can arise for several reasons. Some of the problems and solutions are detailed in Table 1.

Criteria Dev. Problems	Solutions
Expectations regarding the project are unclear.	Do the planning at the start to identify the purpose of the project, the organization resources available for the project, and the specific type of outsourcing that would match the project.
A lack of understanding of the project makes it difficult to identify and weigh the costs and benefits of internal and external resources.	Allow sufficient time to research the project fully, contacting any internal or external experts available to the organization. Some rescuers readily available include other organizations/government information resources etc.
Failure to compare the costs and benefits of internal and external resources on an equal/basis leads to inaccurate analysis. A comparison of costs to the contract total does not account for the soft costs included in the contract. Costs to the organization for in-house resources will be higher than a simple count when soft costs are considered. Costs to the state as a whole may also be different from organization costs, as some operating costs may not be paid by the organization using the resources (e.g. utilities, floor space)	Evaluate the project on a matrix or weighted average list, providing consistent examination of the same options when discussing both internal and external options. Be sure that costs are clearly documented and all formulas for deriving costs are identified.
An accurate analysis of costs and benefits is difficult to make because there are no priorities in place to help identify and measure the needs of the organization.	The organization strategic plan to identify priorities and establish weights for each criterion. Involve stakeholders and ask executive sponsors for input.
The hard-to-quantify nature of some of the soft costs and benefits, such as business advantage or access to expertise, make these costs difficult to identify.	Identifying priorities and weights will help when including qualitative costs and benefits in the analysis. Establishing success measures that examine project outcomes in light of organization goals will add needed substance to the qualitative costs and benefits.

Table 1. Criteria Development Problems and Solutions

2.1 Quantitative Issues

The total cost remains one of the primary drivers for management interest in outsourcing (Patil and Wongsurawat, 2015). Cost savings are not always seen in outsourcing arrangements, depending on the reasons behind the outsourcing and the type of outsourcing used. For example, data center consolidation via outsourcing has provided some cost savings, but applications development and systems integration projects tend to rely more heavily on the need for expertise and resources, and can be just as expensive, if not more so, than the use of internal resources (Mclvor, 2005).

Measures are crucial to the success of a project, whether using internal or external resources. Quantifying the costs of providing services in-house and the vendor service provision costs provides a level playing field for making the most well-informed cost comparison possible. Measures also quantify the ability of both the internal and the external resources to meet end-user needs. Some measurement starting points are:

- Price/performance benchmarks
- Service levels
- Customer satisfaction surveys
- Inventory of professional skills
- Quantify Expectations
- Infrastructure and tool assessments
- Opportunities for improvement

2.2 Qualitative Issues

The time available to complete the project is an essential factor in the decision about what type of resources to use. Current organization resources may not be able to meet the project deadlines because of other responsibilities, resource shortages, or lack of needed skills (Keeble-Ramsay and Armitage, 2010). It may be more cost-effective to complete a project with internal resources, but the timeline prevents that from being possible. Time, as shown in Table 2, will play a role in three parts of the decision-making process.

Time	Significance
Planning time	Planning at the start is essential to all projects. Sufficient time is required to identify the project/service scope and define the project requirements and deliverables. Even more time is required if considering external staffing solutions, as the contract negotiation and management will rely heavily upon the identified goals, metrics, and deliverables. Negotiating advantages are in the vendors' court when an organization has allowed little time for establishing terms and conditions and a statement of work. Since they vendor knows the organization's project implementation deadline, the price for services will rise accordingly.
Project time	The needs of the organization during the life of the contract. Identify project deadlines, including interim deadlines if only a final implementation due date is

	known.
Ongoing considera tions	Consider transition efforts or ongoing maintenance efforts when examining costs and benefits. How will the organization manage the project after its completion? If an external vendor has worked on the project. What is the length of the transition period, or is the vendor expected to maintain the system forever? When type of impact will these ongoing time considerations have on the cost of the contract, particularly ongoing vendor contracts over time?

Table 2. Time Factors

Risk is also an essential part of the cost and benefits analysis process. When outsourcing part or all of a project, the contract must clearly state the important factors to reduce the risk of having a completed project that does not meet the needs of the organization (Mclvor, 2005). Internal and external assessments regarding skill levels and the successful outcomes of the project will determine what factors provide risk elements in the project staffing selection, and how the current selection of internal or external resources to support a project will impact the organization in future budgets, skills and staffing levels.

Internal and external resources issues are extremely important in cost-benefit analysis, as further illustrated below.

Staffing	Significance
Internal resources	● Identify staff interest in the jobs that they perform. Are current resources kept motivated and interested in their job? Would the organization and the staff benefit from using existing resources on new projects that require innovation? ● Identify current workloads. Are current resources able to perform additional duties? What are the organization priorities and time lines? ● Consider the impact on existing resources if an external vendor is procured. Determine at the beginning which internal members will be affected and plan for what will happen to them—will they be reshuffled, transferred to the vendor, or terminated? What will the impact on staff morale/retention be? ● Identify the skill sets required for vendor management in an outsourcing arrangement. Do internal resources have the necessary expertise? If not, should it be obtained? If so, are those people free to devote their time to the project?
External Resources	● Because of the competitive market for skills and services, vendors are also experiencing staff turnover. What will the impact of vendor staff turnover mean for project success? ● What are the capabilities of external resources? Ask for and evaluate resumes. Are the people needed for the project currently available, and will they be available for the life of the contract? How can you ensure that the people you want are permanently assigned to your project? ● Do the vendor resources show the necessary qualities for organization - e.g. match in work hours, culture and initiative?

Contingency Planning	● If an external vendor is used, the outsourcing contract will end at some point ● Changes will occur during the course of the project ● Change control procedures must be in place to monitor, track, and manage changes and their impact to the contract. ● Understand transition difficulties with outsourcing, whether evaluating a vendor-managed environment, managing an effort to take the service back in-house, or changing from one vendor/methodology to another. Know what staffing levels and skill sets will be required by such changes. Changes in outsourcing contracts are inevitable, and this information will be needed during the course of the contract.
Access to Expertise	● Gaining access to expertise that does not exist in-house is a common reason for outsourcing, especially when taken in the context of budget/time constraints. Some emerging arguments against this argument are: ● However, require that time lines and training funds are able to support this option. Choosing to use internal resources for a new project and then outsourcing existing services may lower operating costs and ensure a more efficient and successful outsourcing contract. This is because the internal service is so well-known that it is easy to measure and quantify. It is then much easier to determine the success of the vendor in meeting the needs of the organization. ● Assigning internal resources to develop new projects and learn new skills may increase staff morale and improve staff retention as employees are continually challenged and given new opportunities. ● It is also important to ensure that you have a knowledge transfer plan to avoid becoming dependent on one vendor for continued operation of the system.

Table 3. Staffing Issues

The overall reason why agencies are examining costs and benefits of using internal or external resources is to determine the best possible use of limited agency resources. Deciding whether outsourcing is viable maybe:

- If benefits are gained that cannot otherwise be achieved.
- If it is determined that an external service provider can meet all business requirements at a cost lower than by internal resources.

The lower cost argument is difficult to achieve, given the prevalence of soft costs in outsourcing arrangements and the fact that qualitative costs and benefits may be lost by comparing strict dollar values (Mclvor, 2005).

2.3 Essence of strategic outsourcing

What distinguishes an outsourcing arrangement from any other business arrangement is the transfer of ownership of an organization's business activities or the responsibility for the business outcomes flowing from these activities to a service provider (Fowler and Bridges, 2012). In a typical outsourcing arrangement; the people, facilities, equipment and technology are also transferred to the service provider, which provide services back to organization. An outsourcing arrangement can be either "tactical" or "strategic." Figure 3 has reflected the Organization Planning Stages Structure and Figure 4 illustrates the strategic planning stage leading to Outsourcing or In-house Strategy Decision.

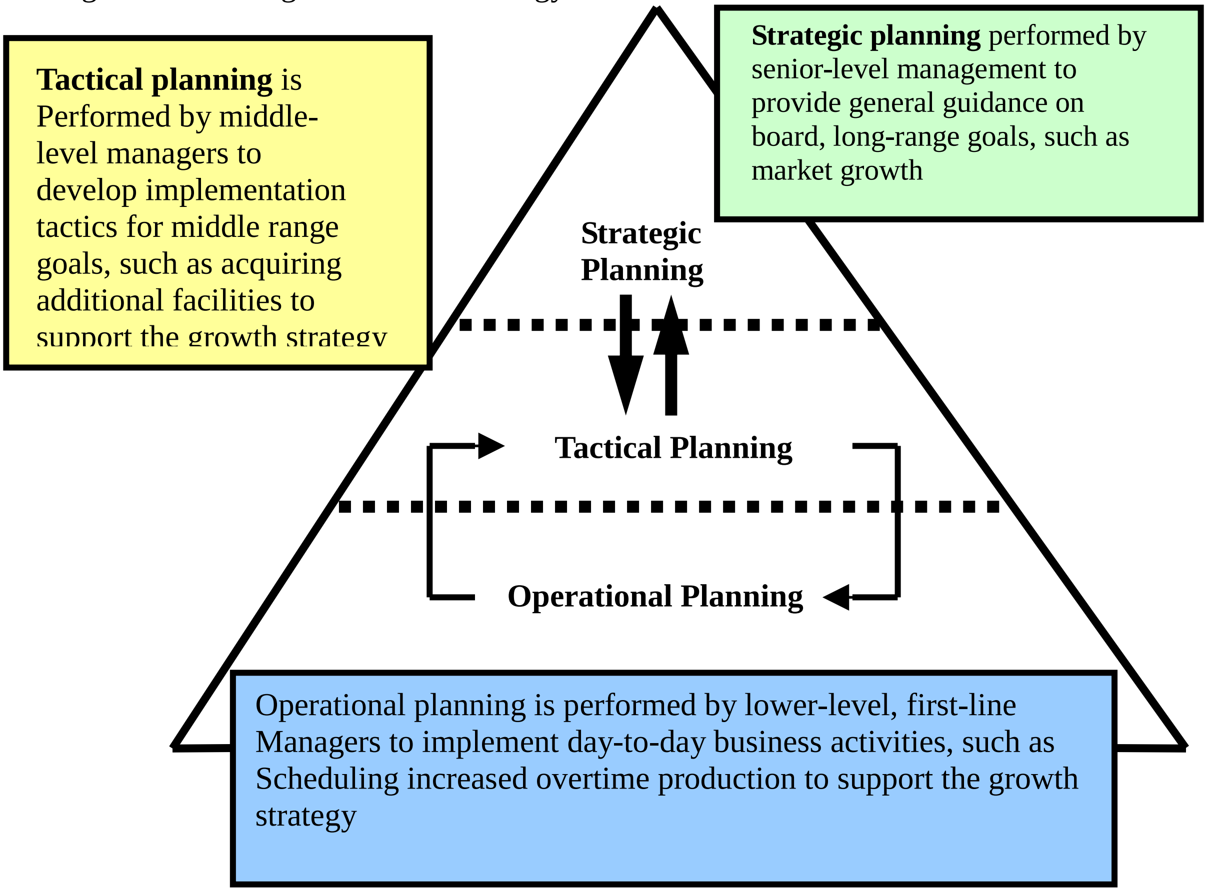


Figure 3. Organization Planning Stages

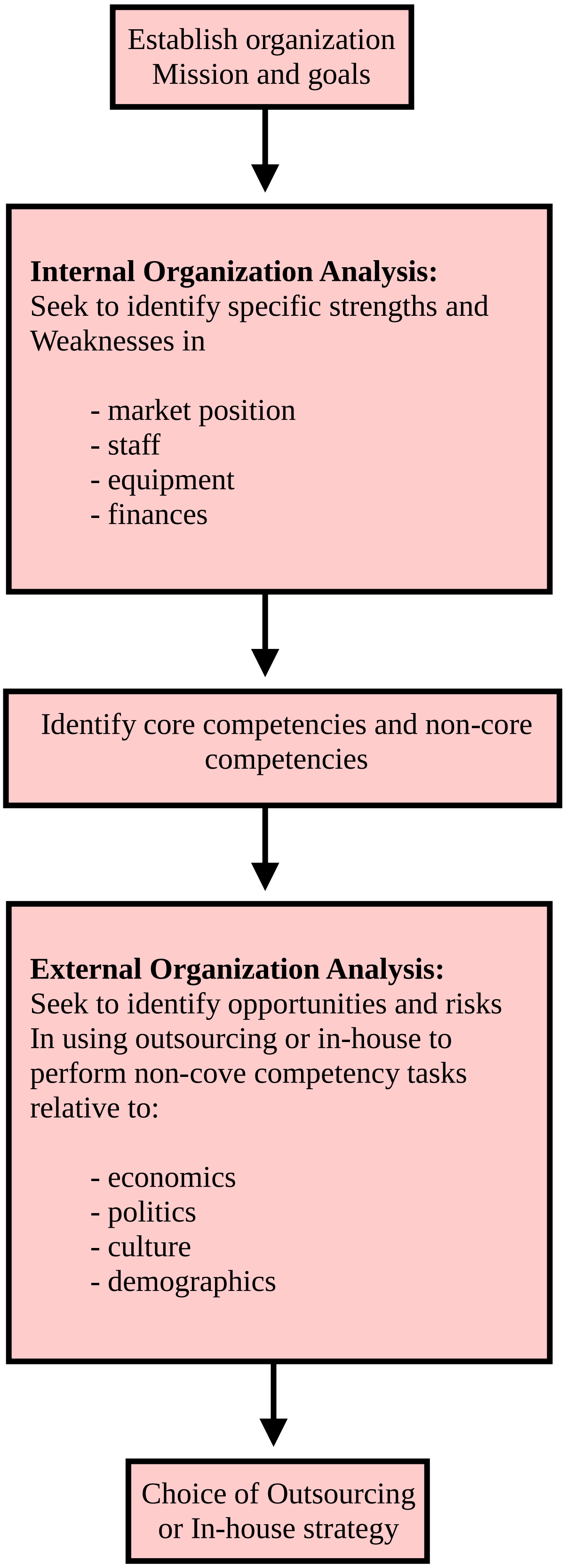

Establish organization
Mission and goals
Internal Organization Analysis:
Seek to identify specific strengths and
Weaknesses in
- market position
- staff
- equipment
- finances
Identify core competencies and non-core competencies
External Organization Analysis:
Seek to identify opportunities and risks
In using outsourcing or in-house to
perform non-cove competency tasks
relative to:
- economics
- politics
- culture
- demographics
Choice of Outsourcing
or In-house strategy

Figure 4. Strategic Planning Stage to Outsourcing or In-house Strategy Decision

Strategic outsourcing is not driven by a problem-solving mentality. Instead, it is structured to align with the organizations' long term strategies. Corbett (2004) opines that organizations' expectation from strategic outsourcing may vary, due to:

- Spending more time on those activities that are truly central to the success of the organization;
- Achieving a gain in competitive advantage;
- Repositioning the organization in the marketplace; or
- Achieving a dramatic increase in share price.

2.4 Merits & Demerits of Outsourcing & In-house Services

An in-house management team can demonstrate a greater commitment in the organizations (Furtmueller, Rolf and Celeste, 2011). If the FM conceives that the organization needs ongoing support and development, then hiring in-house staffs may well be the best way. Although this does produce an ongoing financial commitment in the form of salary, equipment and training; ultimately the overall costs would be cheaper than outsourcing. An in-house management team will understand the organization better than outsourcing management team and continuously push the organization's virtues internally. If the outsourcing management team provides the right kind of services these can be very much like working with an in-house team. The team will really get to understand the organization well, and can prompt it on a regular basis.

Reasons for Outsourcing	Merits & Demerits of In-house Services
Increased costs	● The expense of negotiating, maintaining, and enforcing outsourcing agreements may outweigh the benefits. ● Can be costly and difficult to change an outsourcing agreement without costly penalties.
Loss of control	● Loss of flexibility in controlling business activities, final product ● A dependence by the organization on the outsource provider can lead to a variety of problems e.g loss of markets, higher costs etc. ● Lack of contractual flexibility
Negative impact on customers	● Can disrupt operations during the transition of the outsourced activity from client to outsource providers
Negative impact on employees	● Negative impact on organization employee's morale when they become outsource provider employees. Causes organizational restructuring, resulting in dislocation and social costs for employees.
Difficulties	● Organization finds itself unable to communicate with the outsource provider.

in managing relationship	Outsource provider may be unable to communicate difficulties and opportunities. ● Can be difficult to quantity the advantages of outsourcing. Excessive investment of time in building relationship with outsource provider.
Other risks	● Can be costly and difficult to reverse outsourcing decision in terms of recruiting personnel in the longer term. Outsource provider may fail to achieve organization objectives ● Sharing knowledge with an outsource provider who may later share it with a competitor ● All of the outsourcer's risks are also assumed by the organization such as poor service, old technology etc ● Outsourcing business activities may cause the organization firm to lose skills that might be needed in the future ● Requires an alliance with an undesirable provider such as provider with a negative reputation ● Outsourcing business activities may cause the organization to lose its corporate knowledge within the organization over time ● Outsourcing can result in security or confidentiality breaches. Failure in outsourcing can mean the eventual failure of organization and weakens innovative capacity in the longer term

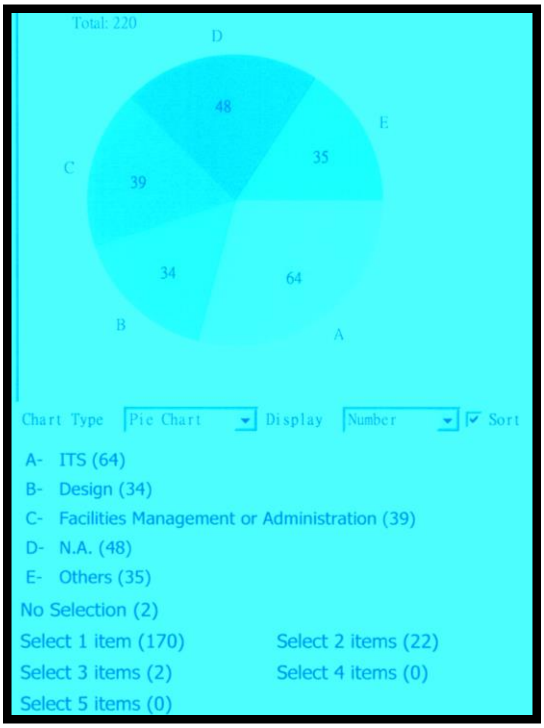
Table 4. Disadvantages of Outsourcing (Advantages of In-house)

3. RESEARCH METHOD

Quantitative method with a pre-set questionnaire is dispatched to colleagues of various departments of a Hong Kong mega commercial complex KKK to solicit their respective opinion in the effectiveness towards customers' satisfaction through implementation of Outsourcing or In-House Management Services. Generally 200 out of 1000 responses (20%) have been received; yet not all respondents answer all questions. These data are analysed by descriptive statistics for further discussion.

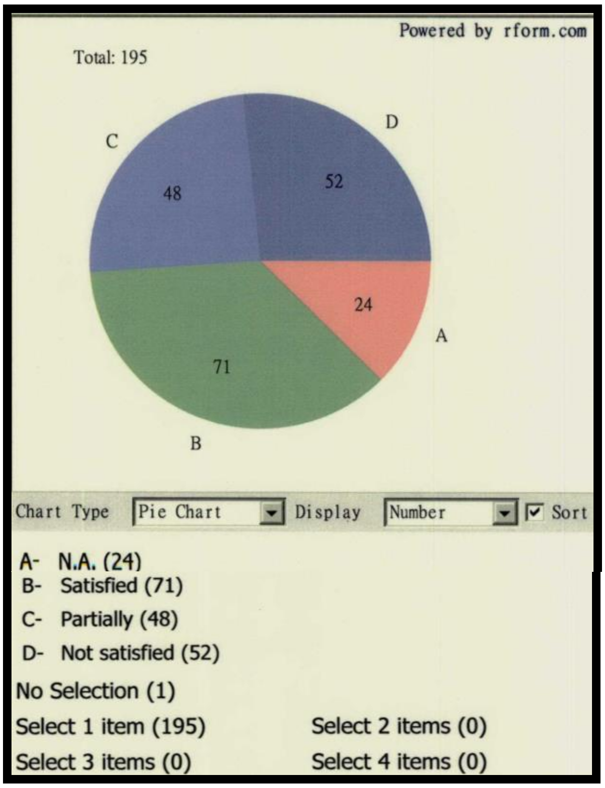
3.1 Findings & Analysis

The Information Technology Services (ITS) Department of KKK has been outsourced for several years. In Question 1 (Do you know which departments/services in KKK have been outsourced?) of the questionnaire, most respondents know that the services of ITS Department are outsourced to service provider PPP. The scope of works is only partially and not all; only operation team services has been outsourced. The main services of this service provider include fixing term maintenances computer systems, technical supports and setting up ITS 24 hours Customer Services; oversea offices and the exhibitions which are hosted by KKK. Besides, PPP also provides adequate technical staffs in office relocation, office renovation period and fair grounds to process the PCs installation & removal works from area to area or from floor to floor.



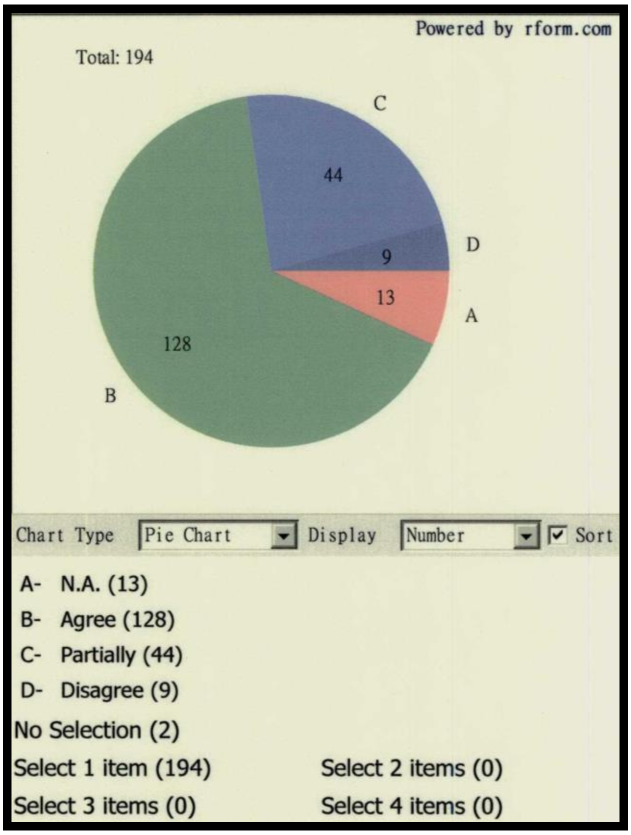
Q.1 Do you know which depts./services in KKK have been outsourced?

In Question 2 (Are you satisfied with the existing in-house services in KKK?), most colleagues also do satisfy the current and existing in-house services such as programming, system analysis, website design etc. from the FM Department, Design Department and adjusted ITS Department. As a result, KKK has no intention to outsource the works of these departments.



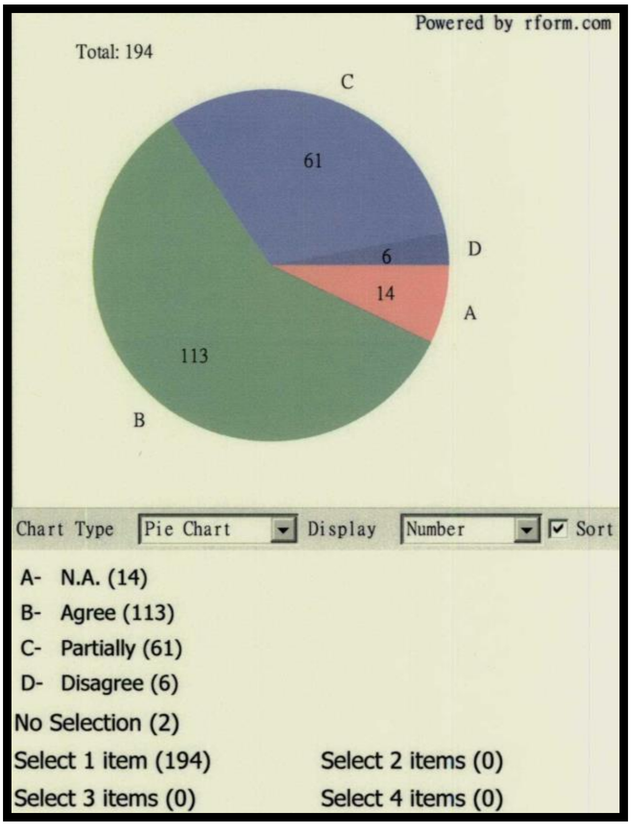
Q.2 Are you satisfied with the existing in-house services in KKK?

From Question 3 (Do you agree the following advantages claimed for outsourcing management services?), most colleagues also do agree KKK to outsource some works especially regarding cost saving. It is proven that outsourcing to PPP initiates budget saving with good technicians/engineers and services. There may be disadvantage e.g. lack of control over PPP due to its own internal problems and higher staff turnover; resulting in KKK's security management. There are complaints from some KKK staff too.



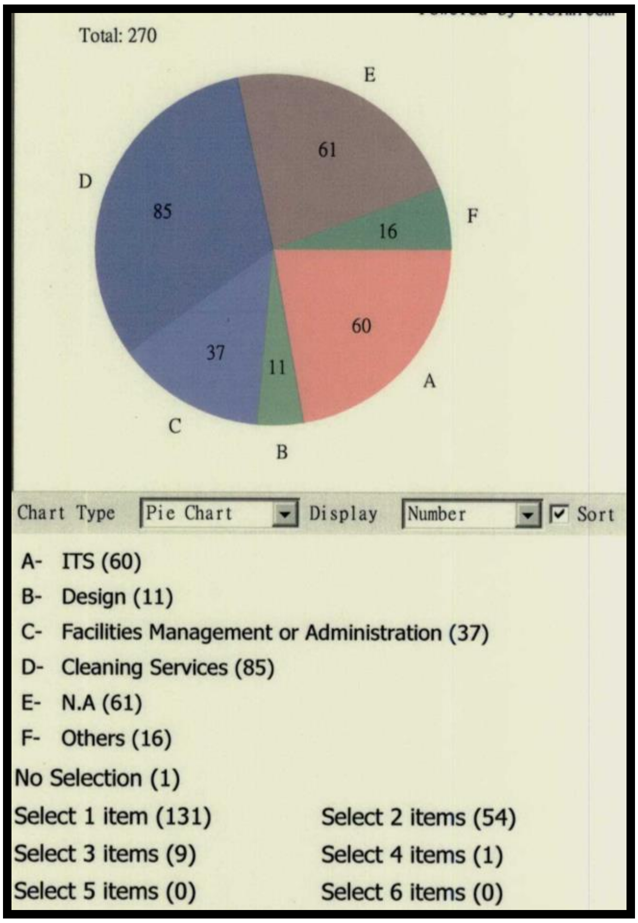
Q.3 Do you agree the listed advantages claimed for outsourcing mgt. services?

In Question 4 (Do you agree the listed advantages claimed for in-house management services?), most respondents concur with the advantages and disadvantages of in-house management services. If there is no outsourcing, KKK may restructure the internal departments. The disadvantages of in-house management services are lack of updated expertise and knowledge to handle specific works, lesser chance to improve services for customers, and increase the operation costs.



Q.4 Do you agree the listed advantages claimed for in-house mgt. services?

In Question 5 (If you were the facility manager, which departments/services can be outsourced?), some other departments' services could be outsourced too, such as Cleaning Department. It is observed that cost is saved and the outsourced cleaning services offer adequate skillful workers.



Q. 5 If you were the facility manager, which depts./services can be outsourced?

CONCLUSION

Outsourcing has become a trend worldwide, whereby relevant outsourcing is deemed acceptable. Most outsourced projects can attain better quality of services, advance in new technology, higher competitive advantages when compared with in-house services in the longer run. It provides more flexibility to meet uncertainty in the industry such as:

- Mitigate risk and increase productivity.
- Speed up the works, and share innovations for best practices. The organization can achieve more opportunities with new innovative ideas continuously.
- Organization can save cost on an average with outsourcing.
- Improved customer satisfaction with better processes.
- Renewed and increased focus on core business.
- Risk reduction due to confidence on experts and infusion of new technology.
- Project enhancement and effective cost management through financial engineering.

- Visible cost reduction and avoidance of capital investment e.g. eliminate fixed overheads and physical plant ownership, thus cutting costs.
- Renewed opportunities for employees with skill upgrade and access to newer skills.
- Asset adaptation.
- Value and savings gained.

Outsourcing leads organizations to concentrate on their core business function, and takes care of secondary functions in part or total. An organization's growth can rely on its core or specific business. It can minimize the operating costs by focusing on its major business areas. From this, the capital funds always remain available for the core businesses instead of being distracted to other supporting areas. In addition, it assists employees to be more effective in coping with the competitive working environment globally.

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