



THE RISKS AND BENEFITS OF OUTSOURCING

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Abstract *Outsourcing is a very well-known practice among both private and public companies and is an important element in business strategy. When a firm wants to focus its resources on fundamental capabilities, they take the decision to outsource some of their services that are not very profitable. Many companies decide on to outsourcing services for a variety of reasons. The organizations that choose to outsource must consider the benefits and risks very wisely and they have to take measures to mitigate the related risks and organize their personnel about the benefits of outsourcing.*

Keywords

Risk, outsourcing, advantages, disadvantages

JEL codes: G3

1. Introduction

In the current volatile business environment, effective and efficient day-to-day risk management is critical to an organization's people, processes, and long-term viability. The risk management department serves a vital role given its unique position within an organization at the crossroads of the operational, financial, accounting, and strategic functions. A proven, structured approach to assessing and developing a risk-aware culture—the core responsibility of a risk management department—can help to mitigate risk across an entire organization.

Outsourcing refers to the way in which companies entrust the processes of their business functions to external vendors. Examples of frequently outsourced activities consist of: sales and marketing services, IT services, human resources services, delivery, logistics and distribution services, finance and accounting services and procurement services.

The outsourcing activity has become one of the most extensive and profitable areas in the world. In a crisis context it seems that this strategy is the solution for companies who want to provide the same quality services, but to significantly reduce the budgets of certain segments.

The decision to outsource is an important strategic one for many businesses, because it involves evaluating the possible cost savings compared to the consequences of a loss in control over the product or service. Some examples of outsourcing are: manufacturing of components, computer programming services, tax compliance and other accounting functions, training administration, customer service,

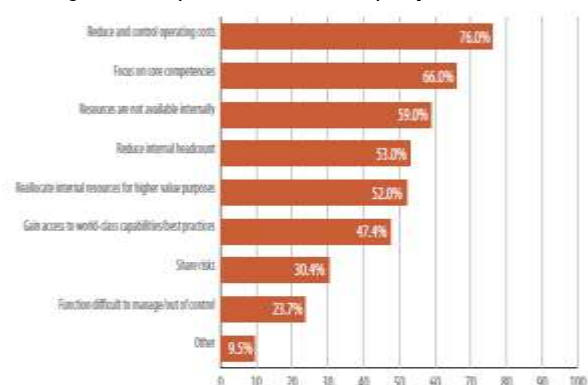
transportation of products, benefits and compensation planning, payroll, and other human resource functions.

The main question is: *Why do organizations outsource their business process?*

The main factors which have led to an increasing trend of outsourcing are the following:

- lower operational and labor costs are among the main reasons why firms decide on outsourcing,
- lack of employees that are specialized in some parts of the business process;
- accessibility to cheaper labor, without comprising the quality;
- ability and possibility to concentrate on the other profitable business process,
- share risks with a partner company,
- by delegating responsibilities to external agencies companies can wash their hands off functions that are difficult to manage and control while still realizing their benefits.

Figure 1. Top 5 reasons a company outsources



Source: www.esi-intl.co.uk

The advantages of outsourcing:

- the firm can specialize on its main object of activity, which ensures the highest profit,
- flexibility in the meeting the needs of services,
- forwarding the companies resources to core activities,
- continuity and risk management,
- lower costs.
- access to skilled resources,
- faster and better services.

The disadvantages of outsourcing:

- loss of managerial control,
- the weakening of innovative and creative capacity;
- the actual economic costs of transactions,
- social costs,
- threat to the security and confidentiality of the companies.

All of these disadvantages can be avoided by partnering with the right service provider. Before outsourcing, companies must take the interests of their customers and employees into consideration and then make an informed decision.

Risks in outsourcing strategy and mitigation guidelines:

Poor selection of vendor – companies must make detailed studies about vendors including current processes, customer references etc., rather than blindly believing their track record.

Process and quality standards incompatible with vendor – partner companies must agree upon standards and processes that have to be part of the mandatory contract.

Security gap with confidentiality and trade secrets – companies must require vendors to meet security standards and monitor with operative assessing.

Legal and regulatory risks – companies must be aware about the specific laws and regulations of the region to be prepared in case of incompatibilities and allowable tradeoffs.

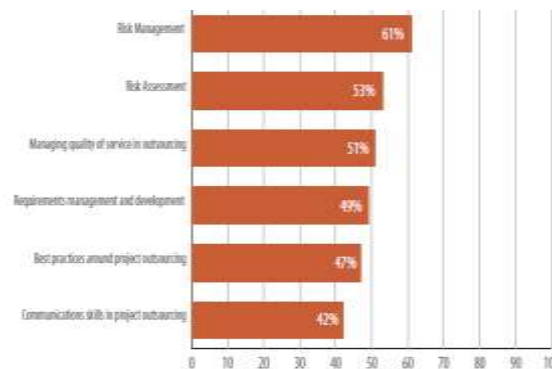
Dependence on a single seller for all outsourcing needs - main processes, deliverables designed to be inaccurately coupled with vendor's technologies, processes.

Cultural differences – companies must have an increased cultural awareness through specialized trainings.

Reduced employee motivation as outsourcing is observed as job loss – companies must establish strategies for employee retention for example retention bonus, performance map etc.

Lack of control or insight into vendor progress – must be completed well planned milestones, immediate deliverables along with suitable documentation plan.

Figure 2. Top outsourcing challenges



Source: www.esi-intl.co.uk

Currently, the choice to outsource is more complex and risky, because of the increased regulatory inquiry of companies' relationships with their service providers and the variety of third party service providers available in terms of size, scope, and geographical location. In any business, the most serious risks related with outsourcing are those that affect operations and transactions, business continuity, that affect the confidentiality of information and regulatory compliance

2. Conclusions

Risks must to be taken in consideration by every company which decides to outsource a part of its business because the failure can be very harmful. To obtain the complete benefits that outsourcing can offer, firms must be prepared for the risks and possible downfalls involved when forming the outsourcing relationship. Although outsourcing comes with its personal set of risks, the benefits of this process compensate the challenges. Risks can be mitigated by practicing protections while finalizing the outsourcing arrangement, learning from previous failures and choosing an established and experienced service supplier to make the outsourcing project profitable.

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