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Outsourcing and issues in First Time Outsourcing

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Process Management - Accounting of onsite/ offshore for Indian and Overseas Companies, Experienced in Manufacturing, Hospitality and leisure industry; handling large assignments of Financial Accounting, Reconciliations, MIS, Payroll, Fixed asset management, Inventory management, costing and virtual services to SME segment and Virtual CFO services for Indian & International Companies.

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Outsourcing

Outsourcing is when a company hires a third party to perform their task; in other words, when a company employs another company to fulfilling its tasks, it is termed as outsourcing.

It is a technique of appointing another firm or company for a specific task. To simplify, we can say that it is the business practice to set specific third-party to give services previously done by the company's staff. The foremost cause of doing so is to cut down the costs and increase the company's profitability.

It also involves the distribution of labour so that the company outsourcing can focus on more important subjects and also have expert services for other areas which are not directly affecting the business but are important and indirectly affects the overall business. It is a matter of controversy in many countries. Some believe that it causes a decline in domestic jobs, whereas some believe that it allows the business to assign assets to the companies where they can be most effectively used.

Outsourcing offers several benefits, including

- Cost savings
- Increased flexibility
- Improved efficiency
- Uninterrupted services
- Multiple services under one roof
- Access to specialized talent pool
- Employee attrition being taken care of
- Shift from 'People' oriented to 'Process' oriented approach
- Reduced dependency on specific human resource

There are several types of outsourcing that organizations can utilize, depending on their business needs and requirements. Following are some of the common types of outsourcing:

Need for Outsourcing

Outsourcing is a popular business strategy that organizations use to improve efficiency, reduce costs, and focus on core business activities. Following are some of the key reasons why organizations outsource

- **Cost savings**: Outsourcing can help organizations save money by reducing the need for in-house staff, infrastructure, and technology. Offshore outsourcing to countries with lower labour costs can result in significant cost savings. It will also save time and ultimately cost, getting invested in talent acquisition.

- **Access to specialized expertise**: Outsourcing can provide organizations with access to specialized expertise and knowledge that may not be available in-house, particularly in areas such as IT, finance, and legal services.

- **Increased efficiency**: Outsourcing can improve operational efficiency by allowing organizations to focus on their core business activities, while third-party service providers handle non-core activities such as HR, payroll, and IT support.

- **Scalability**: Outsourcing can provide organizations with flexibility to scale up or down their operations based on their business needs. This can be particularly useful for startups and small businesses.

- **Remedy to Employee Attrition**: Every employer invests heavily in new talent and expects them to stay for long term while adding value to the business. However, despite this expectation, high employee attrition rates have become a major concern for employers worldwide, particularly for multinational corporations (MNCs). To address this issue, MNCs can consider outsourcing to companies or firms where they can enjoy cost benefits and mitigate the problem of employee attrition and improve employee satisfaction and retention.

- **Improved quality**: Outsourcing to service providers with specialized expertise can improve the quality of work delivered and lead to better outcomes for the organization.

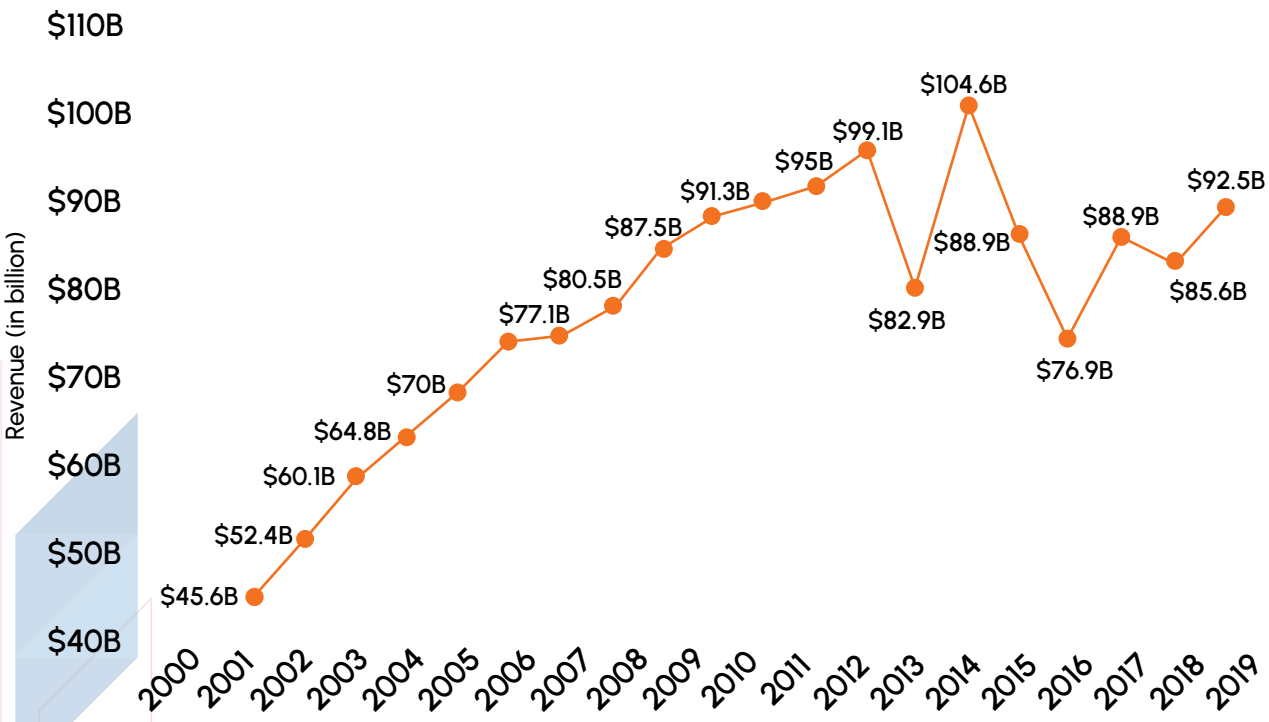
- **Risk management**: Outsourcing can help organizations manage risks associated with non-core activities, such as compliance with regulatory requirements, cybersecurity, and data privacy.

However, outsourcing also comes with some risks and challenges, such as loss of control, communication difficulties, and cultural differences. Therefore, it is important for organizations to carefully evaluate their outsourcing needs, select the appropriate service provider, and establish effective communication and governance mechanisms to ensure that outsourcing is successful.

Outsourcing – General Market Statistics

- 45% of companies have planned to increase their outsourcing since the pandemic, often focusing on finding skillsets they can't access in-house.
- The cloud allows around 90% of companies to embrace more outsourcing opportunities by enabling teams to reach a wider range of distributed professionals.
- By the end of 2023, IT outsourcing should exceed a spend of $1.3 trillion as companies increase their search for digital transformation experts.
- The number one reason for outsourcing for 70% of companies is cost reduction, as outsourcing lowers the costs associated with hiring in-house staff.
- Around 24% of small companies say they outsource to increase efficiency levels. Many small businesses also use outsourcing to access specialist skills.
- Business process outsourcing is set to hit a value of $620 billion by 2032, as companies continue to work collaboratively with contractors.

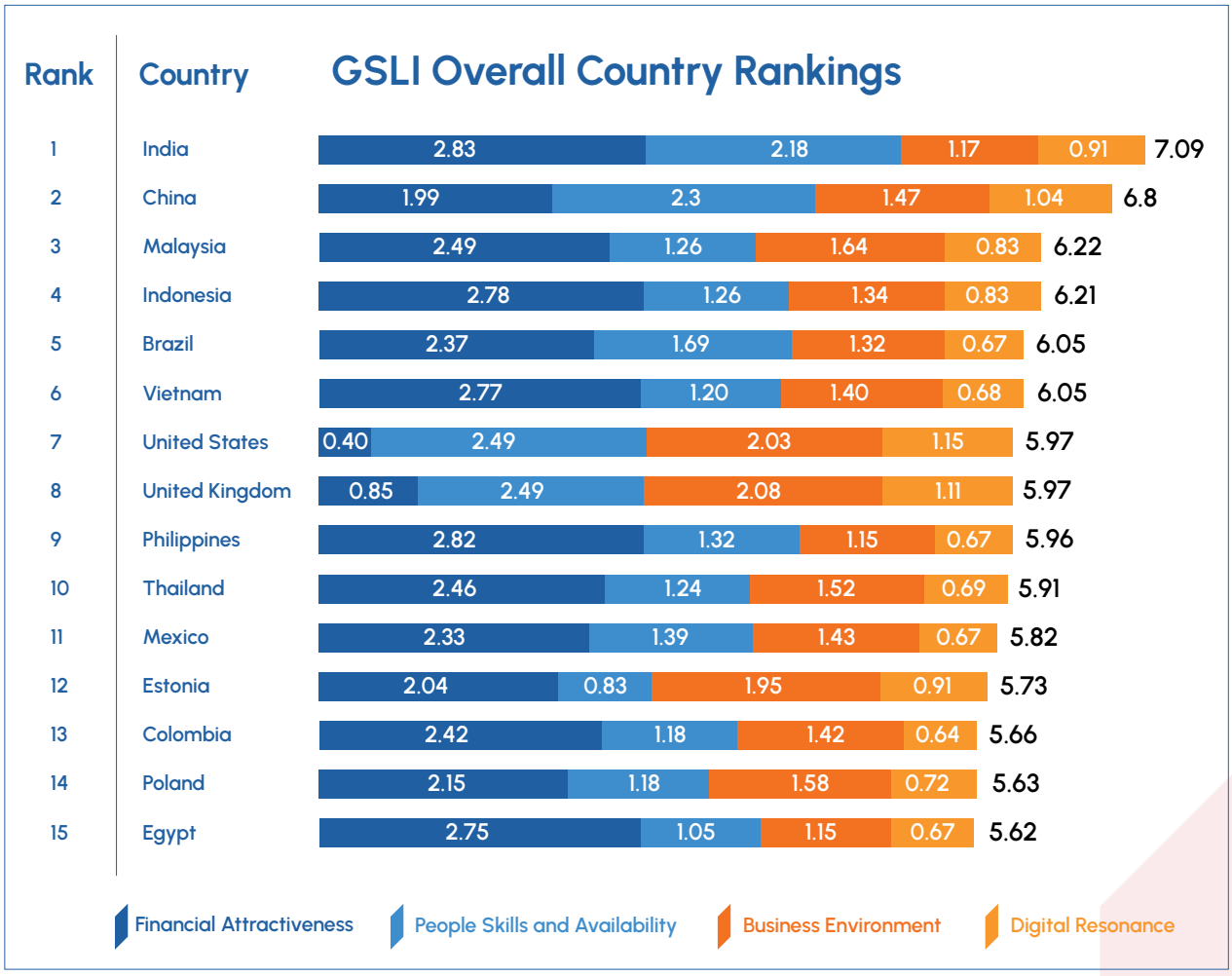
Global Market size of outsourced Services 2000-2019



Source - https://www.zippia.com/advice/outsourcing-statistics/

India – Preferred Outsourcing Destination

India has emerged as the preferred outsourcing destination by providing quality solutions at a low cost. During the past several years, India's economy has become one of with the quickest growth rates in the world with an average annual growth of almost 7% over past 10 years. It is one of the world's fastest growing major economies. As per the recent survey conducted in US, 82% of the US based companies have given preference for India as their most preferred choice for software outsourcing. China and Philippines also offer low cost services and fast turnaround time, however, India is the country which provides unmatched quality and has the largest number of skilled resources. India's technological capabilities have grown significantly, and it can now handle more complex and advanced projects beyond just back-end work like data entry and customer support.



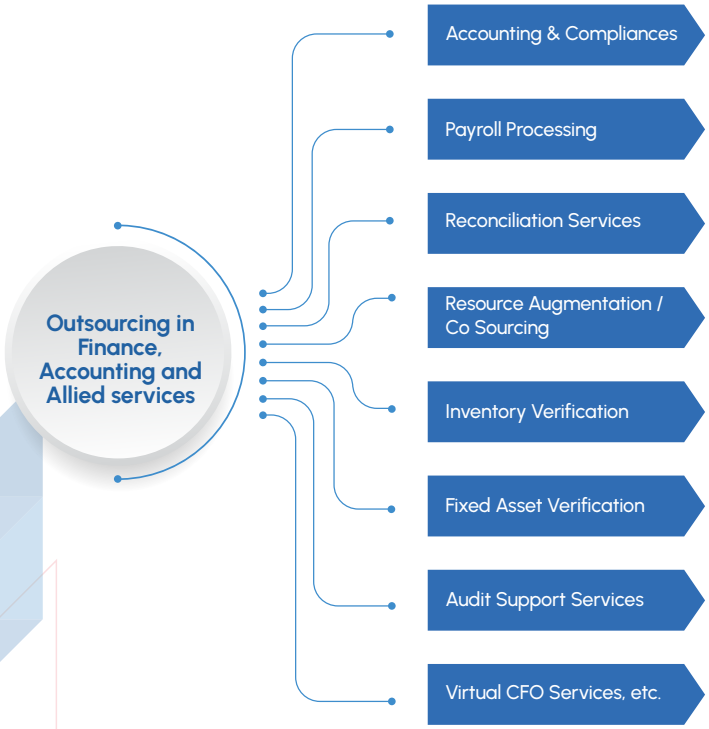
Source - The 2021 Kearney Global Services Location Index

Outsourcing of Accounting, Finance and allied services

- Today's business environment is highly disrupted and unpredictable. Operating a small proprietary firm, a start-up or any multinational organization has been quite challenging in this business environment. In this scenario, managing the finances of business, it's accounting, auditing activities and other allied activities has been more chaotic leading to the path of mismanagement and non-compliance by many businesses.

- While adapting to the dynamic and disrupted business environment, it is the need of hour for every business to upgrade its finance department. This leads to energy, capital and resources spending on training staff, investing in high cost software, employing qualified professionals to manage these tasks effectively.
  Thus outsourcing the Accounting, Finance and allied services is seen as emerging area from last decade.

- With the recent technological advancements, the traditional way of doing things may not necessarily be the best way of tackling the company's finances. By outsourcing their accounting tasks, companies will make use of a professional finance team that's perfectly able to handle all accounting activities, relieving the organization from the drawbacks of having full-time employees while still enjoying the benefits. Such services include -



Issues in first time outsourcing

Outsourcing for the first time can present several challenges, and it's important to be aware of these issues before embarking on an outsourcing initiative.

Finding the right outsourcing partner

One of the biggest challenges of outsourcing for the first time is finding the right outsourcing partner. There are many providers to choose from, and it can be difficult to assess their quality and reliability. Some companies may be tempted to choose the provider with the lowest price, but this can be a mistake. It's important to thoroughly vet potential outsourcing partners and look for a provider that has a proven track record of delivering high-quality services.

Solution

- Reputation: Look for a provider that has a good reputation in the industry and can provide references from satisfied clients.
- Expertise: Choose a provider that has expertise in the specific area you want to outsource. For example, if you want to outsource your IT services, look for a provider that specializes in IT outsourcing.
- Location: Consider the location of the outsourcing provider. If the provider is located in a different time zone or speaks a different language, communication can be challenging.
- Price: While price should not be the only factor you consider, it's important to choose a provider that offers competitive pricing.

Communication barriers

Communication can be challenging when outsourcing to a company that is located in a different time zone or speaks a different language. This can lead to misunderstandings, delays, and errors. To mitigate this issue, it's important to establish clear lines of communication and set expectations from the outset.

Solution

- Use video conferencing: Video conferencing can help to bridge the communication gap when working with an outsourcing provider in a different location.
- Establish clear communication channels: Set up regular meetings with the outsourcing provider to discuss progress, address concerns, and provide feedback.
- Use written communication: Use written communication, such as email or messaging apps, to ensure that important information is documented and can be easily referenced later.
- Provide clear instructions: Provide clear instructions and expectations to the outsourcing provider to ensure that they understand what is required.

Cultural differences

Cultural differences can also create challenges when working with an outsourcing partner. Different cultural norms and business practices can affect the way work is done and can cause misunderstandings. To mitigate this issue, it's important to be aware of cultural differences and to establish clear guidelines for working together.

Solution

- Understand the culture: Take the time to learn about the culture of the outsourcing provider to understand their business practices and communication style.
- Be patient: Be patient when working with the outsourcing provider and be willing to adapt your communication style to accommodate cultural differences.
- Establish clear guidelines: Establish clear guidelines for working together, including expectations for communication, deadlines, and quality standards.

Loss of control

Outsourcing involves giving up control of certain business processes or tasks to an external provider. This can be difficult for some businesses, especially those that are used to having complete control over all aspects of their operations. To mitigate this issue, it's important to establish clear expectations and to monitor the outsourcing provider's performance closely.

Solution

- Define clear expectations: Define clear expectations for the outsourcing provider, including performance metrics and quality standards.
- Monitor performance: Monitor the outsourcing provider's performance closely and provide feedback regularly.
- Build trust: Build a relationship of trust with the outsourcing provider to ensure that they are involved in the business with right intentions.

Security risks

Outsourcing can also pose security risks, especially when sensitive data or confidential information is involved. Since first-time outsourcers often tend to focus on low costs or cheaper labour, they may neglect to inquire about the data security or safety protocols

Solution

- It's important to carefully vet potential outsourcing partners and put in place appropriate security measures to protect your business.
- Inquire about the company's data security protocols before hiring them.
- Company should have prevention systems to protect sensitive data against malicious traffic over the internet

Prioritizing cheaper labour over quality

One of the primary reasons people outsource their business processes is to save costs. However, it's important to note that the lowest price won't always benefit in the long term. Hiring the right outsourced or offshore team is just as important. When you outsource with the sole intention of cutting costs, you may compromise on the quality, defeating the whole purpose of outsourcing.

Solution

- Instead of being guided just by the vendor prices, company can focus on the other important benefits of outsourcing.

- This includes specialized talent, increased flexibility to meet your goals, more capacity for core competencies, ability to scale rapidly, etc.

Disputes due to lack of detailed service agreement

Every business transaction requires a solid contract (in case of any service quality issues). However, first-time outsourcers (especially small businesses) can be unaware of this and proceed to work with companies without signing a contract. In such a case, it can be difficult to clarify expectations and set quality work standards. It could also lead to miscommunication and eventually impact your business process.

Solution

- Company should draw up a rough outline of the kind of services they are looking for. If they have already hired a outsourcer without written agreement, company should speak to them and negotiate a new outsourcing contract at earliest.

- This agreement should include – service to be rendered, project milestones with time frames, technical resources required, modes of communication and collaboration, contract duration, payment, ownership, etc.

Inadequate information on Outsourcing Pricing Models

The entity that is planning to outsource its activity for the very first time, is very often not aware of the various outsourcing pricing models that operate in the industry.

Below are the various outsourcing Pricing Model that the entity should be aware of:

Solution

- Variable Rate Pricing Model: The entity can opt for a variable rate pricing structure, where it can pay a fixed basic rate, and also have the flexibility to pay more for additional/ higher services or pay less when the market price goes down.

- Fixed Rate Pricing Model: The entity pays a fixed charge throughout the course of the outsourcing contract.

- Performance based Pricing Model: The entity will pay the firm based on their performance. If the entity is satisfied with service provided, they will have to reward the firm with incentives. If they find the services unsatisfactory, the firm will pay a penalty.

- Cost plus Profit Pricing Model: The entity will have to pay the firm the actual cost along with a fixed percentage.

- Bundling Pricing Model: This type of payment structure is usually opted for in the outsourcing of IT services. As an outsourcing client, the entity will pay a fixed price for two or more IT services/products which are bundled together.

- Profit and Risk Sharing Pricing Model: When the business objectives in the project are met, both the entity and the outsourcing firm will be able to enjoy the profits. Likewise, loss will be equally shared.

Conclusion

- Overall, outsourcing can be a great way to reduce costs, increase efficiency, and access specialized expertise. However, it's important to be aware of the potential challenges and take steps to mitigate them.

- If outsourcing is new to the entity, it probably will face some challenges first, which is why it is so important to choose an outsourcing firm that you can trust. A reliable outsourcing firm is a company with enough cases that prove their expertise, positive feedback from their clients, and a devoted team of professionals who will be there to walk you through each step.

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Overview of Kirtane & Pandit

Kirtane & Pandit LLP, Chartered Accountants (KPCA) is an Accounting, Auditing & Consulting firm with a widespread established network of financial experts across India. With the "Step ahead, Always" motto, we partner your growth journey with the delivery of sound financial solutions & value added approach.

With an extensive experience of 65+ years, we deliver a wide range of professional services in the areas of Assurance, Accounting & Advisory to listed & reputed companies from varied industries across the globe.

We are a registered member of PCAOB, SEC, USA & feature as an A category firm of RBI and C&AG.

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700+ Employee Strength

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