

Farm it Out

Time is money. Intelligent outsourcing can save your business a bundle of both.

By Nate Hardcastle

You didn't go into business to spend hours administering payrolls, wading through changing tax rules and maintaining fickle computer systems but when your server went down one Thursday morning there was no one else to fix it and, before you knew it, you had spent the entire day getting the problem solved. With a critical business meeting scheduled for nine the next morning, you had no choice but to stay up all night preparing work that you should have been doing earlier that day. And when the meeting finally did roll around, you were so exhausted that you could barely focus on the issues at hand. Is this any way to run a business? Does it make sense to spend so much time on relatively minor operational tasks that have little or no bearing on your real, long term goals? And while you could hire and train full time employees to manage those tasks, wouldn't that be both expensive and time consuming?

To combat all these issues, you might consider the benefits of outsourcing. Increased numbers of small businesses are freeing up time and saving money by farming out non core functions such as information technology, payroll, human resources, and accounting. According to the Outsourcing Institute, based in Jericho, New York, small businesses have been outpacing larger companies in their use of outsourcing recently. And by 2009, industry analysts estimate that outsourcing by small and mid-size companies will exceed \$25 billion annually.

"Outsourcing can be especially helpful for small firms," says John McClendon, a professor at Temple University's Fox School of Business in Philadelphia. "It can provide them with some of the advantages larger firms enjoy, such as economies of scale and specialized expertise."

Outsourcing does pose some potential risks, however. Pitfalls, including vendor incompetence, poor communication, culture conflicts, and misuse of your firm's proprietary information, sometimes make outsourcing less productive. Fortunately, you can avoid most of those problems with a methodical, carefully planned approach to the outsourcing process.

The Promise Of Outsourcing

The term "outsourcing" is often misinterpreted. Politicians and pundits typically use the word as shorthand for the practice of hiring cheap labor in developing countries a practice more accurately called "off-shoring." The true definition of outsourcing is both more mundane, and, to small businesses, more useful. "The bottom line is that outsourcing involves using an outside vendor to do something you've traditionally done in house," says McClendon. Outsourcing often makes intuitive sense. You hire an accountant to do your taxes, because it's not worth your time to familiarize yourself with the tax laws. Likewise, a technology consultant can upgrade your computer systems far more quickly and efficiently than you could. What's more, there is considerable empirical data suggesting that outsourcing can help small businesses. Robert Brown, small business outsourcing analyst for consulting firm Gartner Group in Stamford, Connecticut, has done extensive research into the benefits of outsourcing. Brown and other experts report the following benefits:

Access to expertise. Outsourcing allows small businesses to draw upon skill sets that would be far too expensive to develop and maintain in house. This know how can also provide a host of other benefits as well, such as the ability to spot developing opportunities or keep your businesses compliant with changing laws. For example, a technology consultant might help make your business more efficient by identifying ways to automate your supply chain. Similarly, a payroll vendor might keep you on the right side of new payroll tax regulations.

Time to focus on your core business. When you outsource time consuming but peripheral tasks, you and your employees can focus on what business experts like to call "core competencies." A doctor can spend more time with patients; a consultant can devote more hours to working with new and old clients; a designer can save his energy for his designs. The extra hours you and your employees devote to your firm's core business could make a real difference to the bottom line even after you take into account the money you spend on outsourcing. Perhaps it's no surprise, then, that "improving company focus" was the number one reason given for outsourcing business functions in a recent survey by The Outsourcing Institute, barely beating out "reducing operating costs." And among small businesses, this trend was even more pronounced, with 58 percent choosing "improved focus" as their primary reason for outsourcing compared with 41 percent

who listed "cutting costs."

Improved morale. Employees generally are happiest doing what they do best. They often hate being distracted by tasks that have nothing to do with their essential functions. Just ask William Dailey, an accountant and comptroller for Trans-County Title Agency, a 25-employee title insurance firm in New Brunswick, New Jersey. He handled the firm's human resources for years he estimates HR duties took up 20% of his time before the company's owners finally hired a dedicated HR firm. "I wasn't qualified for that job," he says. "I never went to school for HR, and I don't have the personality for it. The company hired me for my ability to count money, and now I have the time to do that properly."

Lower costs. Economies of scale allow outside vendors to perform many business tasks far more efficiently than small businesses could do themselves and that translates into cost savings. "Small businesses can get access to experts for a much lower cost by outsourcing than by hiring," says Brian Klaas, professor of management at the University of South Carolina's Moore College of Business. "Essentially, outsourcing means that a number of businesses can share the cost of an expert's training and resources."

New perspectives. Outsourcing can provide ongoing input from an outside expert to help you improve your business. For example, an outside accountant or financial consulting firm will provide regular financial reports, produced and examined by an advisor with years of experience working with companies similar to yours. Gene Polley, a business advisor with small business consulting firm Fiducial, recently showed a client who owns an auto parts store that the prices he charged hadn't kept up with the industry average. "The next month, the client made an extra \$5,000 in profit just from marking those items up to the going rates," he says.

Improved recruiting. Outsourcing certain functions also can help you attract and retain high-quality employees. "The marketplace for good people is very competitive," says Darren Dupriest, owner of background checking firm Clarence M. Kelley and Associates in Shawnee, Kansas. "Outsourcing HR and payroll allows us to offer a well designed package of benefits, and our employees know their paychecks will be handled professionally. We can make our employees happy without having to sweat the details."

Making The Most Of Outsourcing Opportunities

Outsourcing doesn't always work as planned, though. A recent study by consulting firm Dun & Bradstreet found that between 20 and 25 percent of outsourcing relationships fail in any given two year period, and half fail within five years. Likewise, a recent Gartner study predicts that 80 percent of organizations that have outsourced their customer service operations in order to cut costs will see no savings in the long run. Reasons for these failures are varied and can include hidden expenses, poor service, culture conflicts, and a lack of flexibility to address changes. But the following tips can help you reap outsourcing's benefits while avoiding its potential pitfalls:

Common sense check. Outsourcing works best for jobs and systems that are common to most businesses, such as IT, payroll, accounting, and human resources. An outside vendor may have trouble with processes that are unique to your firm. For example, many airlines save money by outsourcing new employee training but Southwest Airlines keeps that process in house. "Southwest views employee training as a crucial, unique element of its corporate culture so the company doesn't believe in using outside vendors for that task," notes John McClendon. "They spend more resources on training than their competitors, but they feel that it's worth it."

Compare cost. Calculate how much the job costs you now and how much it is likely to cost going forward. Include the costs of labor and materials, as well as the opportunity cost associated with diverting employees' time from their primary duties. That information will help you decide whether to keep doing it yourself or look for someone to take it off your hands.

Define your goals. Before shopping for vendors, figure out exactly what you want them to accomplish: whether it is to implement a particular technology, handle administrative functions to free up employees, provide a package of affordable benefits, or meet other goals. Also consider whether you're looking only for a vendor to administer a given business function, such as payroll, or if you want to consult the vendor about a wider range of business practices.

Start small. "Don't outsource everything, especially at first," says Gartner analyst Robert Brown. "Some companies overdo it, and run into trouble managing all their vendor relationships." Start by farming out one or two relatively simple, discreet tasks. Use references to find the right vendors. Get out and talk to other businesspeople. Referrals offer the best way to discover effective outsourcing partners. Look for a firm with a reputation for integrity and experience serving companies similar to yours. Interview several candidates before hiring a firm.

Evaluate prices. Brown notes that small businesses often pay proportionately much more than larger firms for similar services, in part because they are less vigilant about negotiating cost. Remember that economies of scale should allow vendors to perform the relevant tasks more cheaply than you can yourself. And don't allow vendors to sell you services

you don't need.

Don't be afraid to trust your gut. Avoid vendors who make you feel uncomfortable, no matter how good their reputation. Consider whether you really want to work with a person, and whether you trust the vendor with sensitive information. "The relationship is number one," says Kelly and Associates' Dupriest. "Can you relate to the people you deal with, and do they understand you and your business?"

Demand flexibility. Consider the ways your relationship with the vendor might change in the future perhaps based on your firm's potential for growth. If you expect revenues to double during the coming year, will the vendor be able to keep up? If you expect flat or declining business, make sure your contract won't force you to pay for a higher level of service than you're receiving.

Measure the results to manage the relationship. Sara Cullen of Australian outsourcing consultant ABIE Source recommends measuring four components: service quality, financial results; the quality of the relationship; and whether the vendor has introduced better business practices. With those measurements in hand, you'll have a sound basis for judging the relationship. Reevaluate every one to three years, and use the opportunity to adjust the arrangement as needed.

Read the fine print. Make sure any outsourcing contract spells out the following: minimum service levels; conflict resolution provisions; an escape clause; who owns the work produced; and any incentives for good performance.

Prime Candidates For Outsourcing

Information technology. Outsourcing IT is a no brainer for many businesses, given its complicated nature and the speed with which it changes. However, it's essential to define precisely what business results you want to achieve before entering an IT outsourcing relationship. Consider whether you're looking to fix specific problems or seize particular opportunities or if you want to determine how new technologies might help in ways you haven't considered. Referrals from other people in your industry are the best way to find a good vendor. Affiliations with professional organizations are good starting points, as are certifications from leading vendors of hardware and software systems, especially for the products your company uses. Ask the consultant for help achieving your business goals, rather than for a particular technology (unless there's a clear, compelling reason to do so). The consultant should be able to propose a plainspoken solution that you can understand. Be wary of technology consultants whose jargon leaves you confused. Be prepared to spend between \$600 and \$1,200 a day or more, depending on the complexity of the work.

Avoid getting stuck in an open ended project. Divide each project into discrete steps, each with a deadline and budget. Ask the consultant for written reports as the job progresses that will make it easier to maintain and upgrade the system in the future.

Accounting. Most small businesses already outsource end of year income tax preparation but experts contend that they shouldn't stop there. The duties your firm might outsource range from bookkeeping to more complex tasks such as business valuation and auditing. A seasoned accountant also can apprise you of the tax implications of business decisions you make throughout the year, helping stave off unpleasant surprises come April 15. What's more, he or she might act as a business owner's point person in crafting financially sound succession strategies or doing other financial planning. Rates depend on the complexity of your books and the tasks you outsource. You might begin your relationship paying an hourly rate, until the accountant understands your business well enough to quote a flat fee.

Keep in mind that outsourcing your firm's books does not mean washing your hands of them. Meet regularly with your accountant and make sure you understand where your business's money is and why you're undertaking particular financial strategies.

Payroll and Human Resources. Outsourcing payroll can remove a gorilla from the back of many small business employees, and can protect firms from costly errors. The IRS reports that 40 percent of small businesses are fined for filing payroll taxes late or incorrectly, to the average tune of \$845 per year; some fines are far worse. "Payroll tax rules change every year," says Fiducial advisor Gene Polley. "If you're not careful you can get into a boatload of trouble."

A number of large firms as well as many major banks now offer payroll processing to small businesses and many offer the convenience of online connections. One potential benefit of this is a simplified accounting process that links directly to your back office accounting functions, eliminating the need for duplicate data entry. Other advantages include uptime guarantees that are typically better than you would get from running your own system as well as protection from penalties. The range of services varies with the price, so it's worth taking the time to compare the offerings to find the provider that offers you the best combination to fit your company.

Businesses looking for more consultative, personalized relationships might want to look into professional employer organizations (PEOs). These firms officially become co-employers of small businesses' employees, making the PEOs legally liable for any errors in payroll tax filings or other mistakes. PEOs also can handle a wide range of human resources

functions, from offering comprehensive benefits packages to writing employee manuals to helping craft strategic compensation plans. Business professors John McClendon, Brian Klaas, and Thomas Gainey conducted a survey designed to gauge client satisfaction with PEOs. They found that 89% of respondents saved time, while 68% saved significant money. They also found that the more firms outsourced to PEOs, the more satisfied they were. "There's no reason why a small business person should have to handle all of their company's HR duties by themselves," concludes Klaas.

You are in business to succeed at doing work that you enjoy. Outsourcing tasks for which your firm is not well suited can help you achieve both of those goals. "Small businesspeople have enough headaches without trying to be the expert at everything," says William Dailey. "If you're overworked or putting important work aside just to keep your firm's basic systems running, you should think about outsourcing."

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