Outsourcing

Session 4 – The Project Team

Outsourcing in Project Management

Contracting an external party (PMC) to complete a contracted task in a specific manner until an agreed time and within a certain budget.

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Motivation:

- Faster
- Cheaper
- Expertise
- Resource Shortage

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Problems:

- Control/ Dependency
- Risk
- Conflict
- Security
- Cost

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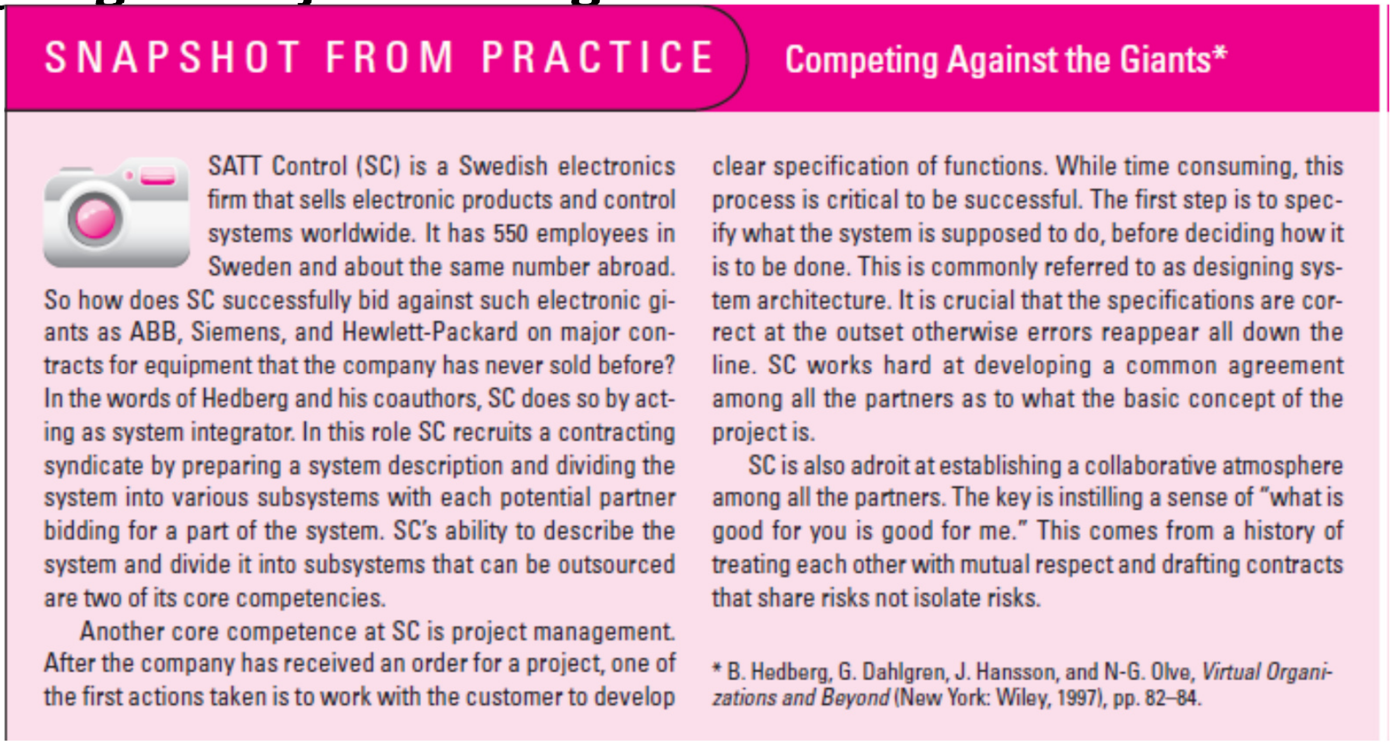

SNAPSHOT FROM PRACTICE

Competing Against the Giants*

SATT Control (SC) is a Swedish electronics firm that sells electronic products and control systems worldwide. It has 550 employees in Sweden and about the same number abroad. So how does SC successfully bid against such electronic giants as ABB, Siemens, and Hewlett-Packard on major contracts for equipment that the company has never sold before? In the words of Hedberg and his coauthors, SC does so by acting as system integrator. In this role SC recruits a contracting syndicate by preparing a system description and dividing the system into various subsystems with each potential partner bidding for a part of the system. SC's ability to describe the system and divide it into subsystems that can be outsourced are two of its core competencies.

Another core competence at SC is project management. After the company has received an order for a project, one of the first actions taken is to work with the customer to develop clear specification of functions. While time consuming, this process is critical to be successful. The first step is to specify what the system is supposed to do, before deciding how it is to be done. This is commonly referred to as designing system architecture. It is crucial that the specifications are correct at the outset otherwise errors reappear all down the line. SC works hard at developing a common agreement among all the partners as to what the basic concept of the project is.

SC is also adroit at establishing a collaborative atmosphere among all the partners. The key is instilling a sense of "what is good for you is good for me." This comes from a history of treating each other with mutual respect and drafting contracts that share risks not isolate risks.

* B. Hedberg, G. Dahlgren, J. Hansson, and N-G. Olve, *Virtual Organizations and Beyond* (New York: Wiley, 1997), pp. 82–84.

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Case Study: Outsourcing

Question:

What are the major differences in the two incidents?

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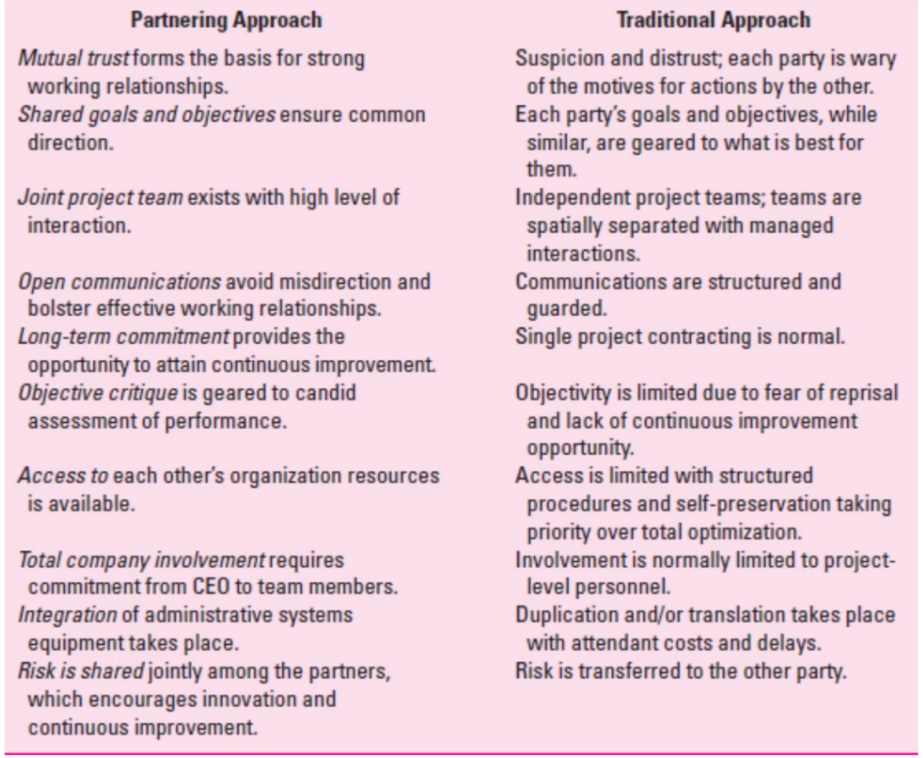

Partnering Approach	Traditional Approach
Mutual trust forms the basis for strong working relationships.	Suspicion and distrust; each party is wary of the motives for actions by the other.
Shared goals and objectives ensure common direction.	Each party's goals and objectives, while similar, are geared to what is best for them.
Joint project team exists with high level of interaction.	Independent project teams; teams are spatially separated with managed interactions.
Open communications avoid misdirection and bolster effective working relationships.	Communications are structured and guarded.
Long-term commitment provides the opportunity to attain continuous improvement.	Single project contracting is normal.
Objective critique is geared to candid assessment of performance.	Objectivity is limited due to fear of reprisal and lack of continuous improvement opportunity.
Access to each other's organization resources is available.	Access is limited with structured procedures and self-preservation taking priority over total optimization.
Total company involvement requires commitment from CEO to team members.	Involvement is normally limited to project-level personnel.
Integration of administrative systems equipment takes place.	Duplication and/or translation takes place with attendant costs and delays.
Risk is shared jointly among the partners, which encourages innovation and continuous improvement.	Risk is transferred to the other party.

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Best practices:

- Clear Specifications
- Extensive teambuilding and training
- Established conflict and resolution procedures
- Frequent and open communication
- Colocation
- Fair contracts
- Long term relationships

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Possible contracts:

- Fixed Price Contract
- Cost-Plus Contracts
- Time and Material Contracts (T&M)

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1. Firm Fixed Price Contract (FFP)

Any cost increase is born by contractor. Requires precise specifications. No changes unless buyer pays.

2. Fixed Price Incentive Fee Contract (FPIF)

Adds some flexibility to deviate from specifications. Final price determined afterwards and depends on seller performance.

3. Fixed Price with Economic Adjustment Contract (FPEPA)

Adds agreed cost provisions for e.g. Inglation, cost alteration of inputs. Needs a reliable index to adjust final price. Protects both seller and buyer from cost changes.

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4. Cost Plus Fixed Fee (CPFF)

Seller is reimbursed for the specified cost and receives a fixed fee for their services.

5. Cost Plus Incentive Fee (CPIF)

Incentive fee depends on achieving certain criteria set in the contract. Cost divergences above/under budget are split according to an agreed formula.

6. Cost Plus Award Fee (CPAF)

Seller is reimbursed for cost but fee depends on subjective buyer satisfaction as based in contract.

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7. Time and Material (T&A)

Hybrid Contract. Buyer and Seller agree on augmentations on a case by case basis. This can happen ad hoc or apriori. Cost can go up significantly for buyer. It is important to read the agreement.

All information PMBOK 6th Edition.

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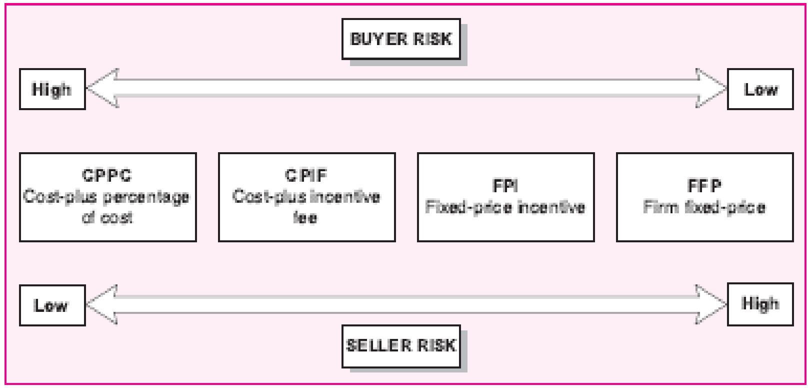
- Different Options
- Different Risk (Cost)



BUYER RISK

High

Low

CPPC
Cost-plus percentage of cost

CPIF
Cost-plus incentive fee

FPI
Fixed-price incentive

FFP
Firm fixed-price

Low

High

SELLER RISK

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Increasingly Strategic Decision and Issue

Increasing integration of Externals into Interna

Trust?

Expertise, Experience and Knowledge?

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Outsourcing becomes (temporary) Insourcing

[...] from control to collaboration [...] (Sloan, 2009)