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CHAPTER 4

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4 OUTSOURCING TO A THIRD PARTY

4.1 Introduction

When looking to break away from old business paradigms and move to a more streamlined and ultimately more profitable business alignment, modern companies can investigate the viability of outsourcing their non-core business activities to strategic third-party business partners (Lynch 2000: 1 – 6). Businesses that are open to this change must then adapt their current business paradigms and evolve in order to become more effective in their traditional operations – this can be achieved by opting out of the race to produce, manage and control everything in-house and rather outsource some non-core business activities to the above-mentioned third-party logistical business partners.

Chapters 2 and 3 of this thesis examined the players and processes of the local South African recording industry. Forming part of the literature study, Chapter 4 researches and documents two main aspects related to supply chain management (SCM):

(a) How outsourcing can add value to a company and to a chain, while collaborating with strategic business partners. Third party logistics and the key success factors of the process are also discussed.

(b) Integrated SCM and collaboration of the supply chain, present channel inefficiencies and possible success factors for the future are also researched.

These two aspects serve as background information supporting the hypothesis statement researched under the researched methodology of Chapter 5 and reads as follows:

"Record Companies in the South African Recording Industry should outsource all their non-core business activities to one strategic business partner."

Performing all business functions in-house have become so complex and expensive to maintain, that outsourcing has become a viable option and in some cases, a sure means of gaining a competitive advantage. Previously companies would outsource for tactical reasons, such as a lack of technical or other skills and know-how. As will be seen in this chapter, the reasons for outsourcing now tend to be more strategic and driven by senior management (Nowicki in Language 2000: 2).

4.2 Adding value through outsourcing

4.2.1 Outsourcing methodology

Outsourcing is the practise of handing over the planning, management and operation of certain functions to an independent third party. Outsourcing methodology is essentially the embodiment of good practise in taking management decisions. The decision to outsource a business function needs to be the subject of a proper management process and not simply made on financial or technical grounds.

Many authors have defined the word 'outsourcing' or the outsourcing concept (Greaver 1999: 1 – 5; Linder, Cole & Jacobson 2002: 23 – 24). Rothery and Robertson (1995: 4 – 6) offer the following simple but clear definition on the process of outsourcing:

> 'The *outsource* could be defined as a service outside the company acting as an extension of the company's business but responsible for its own management, while *outsourcing* could be defined as employing an outside agency to manage a function formerly carried on inside a company.'

If a company wants to invite bidders to tender for the management and execution of one of the proposed outsourced processes, Rothery *et al* (1995: 39 – 40) suggest that the decision to outsource, as well as the implementation thereof, can successfully be reached by utilising a set of six business tools. These tools should help traditional record companies that are still integrated both backward and forward (*i.e.* still performing all

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operational processes discussed in Chapter 3 in-house), to change their business paradigms and adapt the outsourced logistics model detailed in Chapter 6.

Phase One: Initiation

This phase identifies the scope of what is being considered for outsourcing, *i.e.* which one of the functions in the logistics chain will be outsourced. It sets criteria, initial milestones and other factors for initial decisions. It also allocates initial resources to start the project. According to secondary research, as well as several personal interviews (primary research), this phase can take between two and four weeks and since it is a strategic company decision, it should be initiated by senior management.

Phase Two: Assessment

This phase examines the feasibility of outsourcing, it defines the scope and boundaries of the project and reports on the extent to which the project will meet the criteria laid down above. This phase generally lasts between four to six weeks and can be executed by a functional manager who should deliver a feasibility study at the end of the assessment phase. This report should include, amongst other things:

- A summary on the current situation, *i.e.* current levels of service and current costs with regards to people, capital and overheads
- Information on the gaps between the current and the expected or desired service levels
- Any other relevant influences, be it internal (*e.g.* internal company changes) or external influences (*e.g.* market, industry or legislative changes)

Phase Three: Detailed planning

In this phase the criteria are set for the expected bids, whilst requirements are defined in detail. A shortlist for invitations to tender is

drawn up. This process can last up to ten weeks, where after a plan for the bidding process is developed, including tendering documentation, service descriptions, a strategy for supplier negotiations and the drafting of the SLA's (service level agreements). Refer to the proposed content and main elements of a SLA in Annexure F at the end of the thesis. Good preparation in this third phase will improve the quality of the received responses.

Phase Four: Contracting

In this phase a preferred contractor is selected as a result of the tendering process. It is important that a back-up supplier should also be identified. When complex processes or aspects are outsourced, the contracting phase can last up to three months. If however, only one third party outsourced partner is selected to manage all outsourced processes, this phase can be concluded in a much shorter time period. The above-mentioned SLA's should be discussed, the companies should reach agreements over all relevant aspects and should negotiate the final contract. A detailed plan must be drawn up for the transition of the outsourced processes to the new outsourced supplier.

Phase Five: Transition to the new service

The fifth phase establishes the procedures for the management of the newly outsourced function. It transfers formal responsibility for operations and also transfers staff and other assets if and where agreed. A detailed transition plan must be drawn up in which all management- and review procedures are documented. This is the phase where the handover of responsibility formally moves to the new outsourced supplier or service provider.

Phase Six: Management and review

The contract needs to be reviewed on a regular basis against the agreed levels of service (as per the established SLA). Any changes or additional requirements can be negotiated and implemented if and where necessary.

4.2.2 Collaborating with strategic business partners

Record companies operating in recording industries around the world are extremely suitable candidates for following the route of outsourcing. The core function of these companies is to record music and manage their artists - not to manage their entire supply chain and ultimately get their product to the market. Many record companies are also increasingly wary of the accelerated obsolescence associated with their industry. Time to market and customer service levels should be outstanding and managed and controlled by a dedicated team. The reality of these and other corporate management challenges is what is driving outsourcing trends in the world and this bodes well for supply chain management service providers and other logistics companies.

Important elements can be identified which should be seen as prerequisites to successful outsourcing agreements. There exists a definite need for accelerated delivery of relevant information to management in order for them to execute timeous and cost-effective decisions. There are many ways in which information can be used, manipulated and delivered. New technologies are constantly emerging that can offer substantially improved cost-to-benefit characteristics. Also refer to the discussion on information technology and management information systems in Chapter 3. South African companies are only now catching-up to their worldwide counterparts in realising the importance of information as a vital company asset and a core economic enabler of the new millennium.

Outsourcing has many benefits and various authors have listed them in their works (Rothery 1995: 3 – 10; Dash 2000: 8; Language 2000: 1 – 5; Lynch 2000: 7 – 16; Linder, Cole & Jacobson 2002: 24). Summed up below are some of the main

advantages that can be derived from outsourcing non-core activities to strategic business partners:

(a) A stable budget in the form of a negotiated fee structure

When, for instance, a record company outsources the manufacturing of its end-item (*i.e.* the duplication of its recorded master CD), it will receive a fixed quote based on quantities and lead-times, from the chosen business partner. This will allow the record company to include this variable cost into a stable budget.

(b) Service levels can be guaranteed

The company that spends more time developing the important relationships with its market – rather than performing repetitive administrative or other non-core tasks – is the one that will eventually enhance its long-term value in the eyes of the customer.

(c) Access to scarce resources and specialised skills can be obtained

A company that possesses the skills to record music, may not necessarily possess the resources or know-how to distribute the records into the market. By outsourcing this non-core business activity, both business partners can concentrate on doing what they do best.

(d) Increased flexibility to accommodate business changes and expansion

When needed, it is easier to change outsourcing partners than changing one's own internal operations.

(e) Focus on the core competency

Most importantly, the ability to concentrate on the business' core functions will be obtained.

However, Dittberner (2000: 1 – 2) warns that outsourcing does not guarantee success. Although outsourcing brings innovation and a fresh approach to all business activities, the need for a cultural fit must not be underestimated. The delivery capability of the

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service provider needs to be assessed meticulously. Companies will do well to ensure that the outsourcers they select become more than mere solution providers – they must in fact be seen as critical links in the products and services delivered to clients.

4.2.3 Third-party logistics

Integration of functions and the development of process management will guide many organisations to decisions about internal and external sourcing. As was explained in Chapter 1 (refer to point 1.3), company philosophies and paradigms influence many decisions of this nature.

If distribution for example, is truly seen as a part of the marketing function, the control of distribution activities may be integrated into the marketing function, while only the physical distribution functions are then outsourced to a third party service provider.

In order to determine the viability and profitability of the outsourcing concept, many internal issues need to be considered. Pienaar (2000: 1 – 2) highlights the importance of evaluating the following six critical areas:

(a) Evaluate the company's core competency, in order to determine characteristics such as what the company specialises in, where and how it makes its profits and where its human resource strengths lie.

(b) Evaluate the company's primary products and whether it is possible to outsource its manufacture, warehousing, sales or distribution.

(c) Evaluate and quantify the possible future growth prospects of the company which will aid in the outsourcing decision, for example capital expenditure and others.

(d) Review any and all current collaborations with suppliers and clients.

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(e) Evaluate the company and employee flexibility (with regards to management structures, company paradigms and others).

(f) Decide on timeframes that need to be worked towards (with regards to the implementation process, as well as the accompanying changes in the working processes and procedures).

Third-party logistics have recently gained popularity as a broad-based contemporary issue. Recent demand of market forces are causing considerable attention to be focused on logistical functions and revitalising interest in outsourcing them. The need to efficiently and economically adjust logistics support to meet rapidly changing market demands is growing significantly. Outsourcing to third parties has become a strategic issue demanding greater attention in corporate boardrooms of small, medium and large organisations that want to remain competitive and cost-effective in the future.

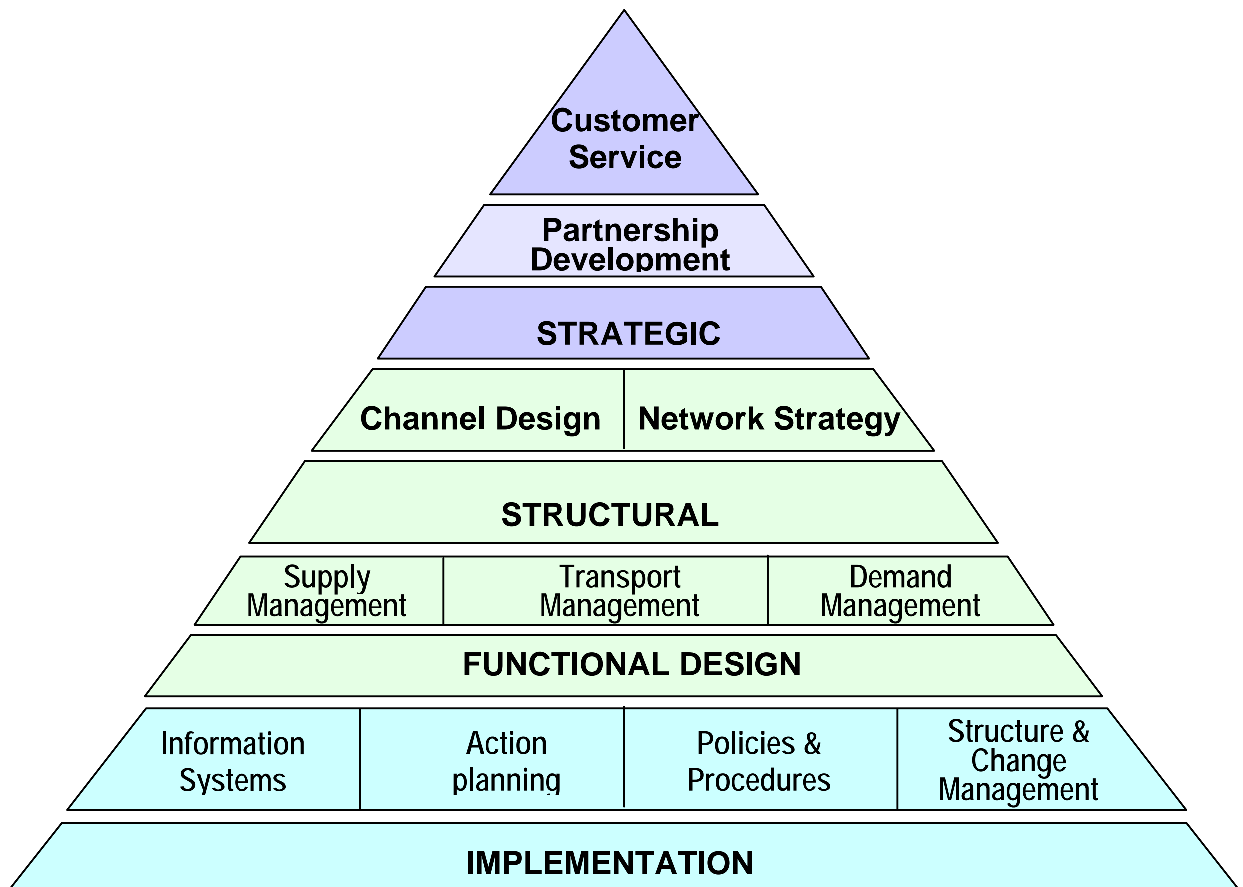
According to Robeson *et al* (1994: 835), the term ‘third-party logistics’ first became widely used in the mid- to late 1980’s as a descriptor for the outsourcing or sub-contracting of elements of the logistics process, and further states that ‘leading edge firms have a greater tendency to manage logistics as a value-added process, reflect a stronger commitment to achieving and maintaining customer satisfaction and place a premium on flexibility.’ Refer to figure 4.1 on the following page for a popular schematic breakdown of the logistical process. A common profile of these leading-edge companies that implement integrated logistics management include the following three main characteristics:

(a) Leading-edge organisations seek to use logistical competency to gain and maintain competitive superiority.

(b) These companies seek to add value to the products and services they market, supporting this goal by operating a cost-effective logistical system.

(c) They leverage their assets by forming strategic alliances with service suppliers. These alliances help the companies achieve preferred-supplier status with key customers.

Figure 4.1 Approach to managing logistics



Sources: a) Franz, Cilliers, & Andrews. 1994. *Logistics excellence in South Africa.*

b) Robeson and Copacino. 1994. *The Logistics Handbook.*

Companies primarily concerned with exploiting their market opportunities through customer satisfaction, often work with these specialists and third-party suppliers to ensure the ultimate competence in meeting customer demands. It is interesting to note that many companies that outsource their non-core business activities, chose to either identify single-source suppliers for particular disciplines within logistics or, at the very

least, use only limited sources. In this way, administration of the process is simplified and economies of scale become possible by concentrating the viable business on a limited number of resources. These logistics alliances are by nature 'win-win' endeavours creating greater efficiencies for the system as a whole.

Through personal interviews with managers at various record companies and SCM companies (refer to the sources of knowledge in Chapter 5 under point 5.4.3.2), it was revealed that these managers believe that the organisation of the future will be 'knowledge-based and information-based'. With the increased emphasis on down-sizing or right-sizing leading to the outsourcing of many labour-intensive functions, many authors and academics believe that third-party logistical activities will increasingly grow.

4.2.4 Outsourcing integration driven by management

Mechanical principles dictate that any chain is only as strong as its weakest link. Many supply chain participants are still focused mainly on products and markets (and other static elements), meanwhile neglecting aggressive management of the supply chain itself as a strategic source of added value. In many cases, significant value is being overlooked or simply not being captured. Others are limiting their integration efforts to quick, tactical solutions, rather than launching more far-reaching strategic initiatives. Also refer to the discussion on static and strategic strategy components discussed in Chapter 1 under point 1.4.3.

Supply chain management (SCM) is one of the latest buzzword in many industries around the world and is said to be saving these industries millions of rands. Through primary research (refer to the Primary sources of knowledge under point 5.4.3.2. and to the Questionnaire in Annexure I on page 198), it has become clear that the local South African recording industry has not yet entered into the world of outsourcing – most local record companies still keep all or most of their business processes tightly in-house.

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4.2.4.1 Management capabilities

A company cannot manage its way in or out of a changing environment, but needs to lead it through innovations and the development of new technologies. However, Behrmann (2000: 1 – 2) offers a note of caution to companies that wish to implement tools which will help them in managing discontinuous change: a sure recipe for failure is hiring only IT (Information Technology) specialists to facilitate the adaptation. The process must be business-driven and not technology-driven. Technology on its own does not create wealth or growth or a new mindset, but rather the intelligent use of technology applied to business objectives. Business leadership must thus drive the process and only then allow the technologists to get on with the job of making it work.

According to Useem, professor in Management at the University of Pennsylvania (in Kunz 2000b: 1 – 2), the new outsource manager will require at least four important capabilities:

(a) Strategic thinking

He will need to think strategically in order to determine what to outsource and how to add competitive advantage to the business through the outsource deal. As outsourcing develops and changes, both the customer and the supplier or service provider's management will need the skills to facilitate new trends such as risk and reward programmes, contract interpretation and implementation as well as the constant strategic realignment of the service and the contract.

(b) Negotiating skills

The outsource manager must posses the ability to continually negotiate the right deal for the company while ensuring that the deal is in line with internal requirements. The management team needs the necessary experience, leadership skills and theoretical exposure to outsourcing in order to be aware of internal needs and requirements as well as external opportunities and availabilities.

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(c) Partnership governing

This management capability is essential to ensure that the outsourcing deal works for both the outsourcer and his partners. These days, leading companies are outsourcing for strategic reasons and not simply as a 'quick fix'. This means that the customer's management must be fully informed and the supplier's strategy understood. On the other hand, the supplier's management structure must in turn understand the customer's strategy in order to be able to interpret it correctly. This will cause both the management teams of the partners in the relationship to work together towards achieving the same goals and objectives.

(d) Change management skills

Management will need change management skills not only to counter employee resistance but also to continuously align and re-align the outsource transaction to the business requirements (refer to the discussion on managing business change in Chapter 1 under point 1.3). Initially, business paradigms may have to be changed to allow the acceptance of the outsourcing agreement by management and employees alike.

4.2.4.2 Key success factors

The reality of corporate management challenges is thus what should be driving supply chain and outsourcing trends in the recording industry (Kemp 2000: 1 – 2) and this bodes well for SCM and other logistics service providers. The caveat is that the sourcing company must find service providers who clearly understand their role and are strong enough to meet all demands. Much has been documented recently about the opportunity of new supply chain execution technologies to provide noticeable cost- and time-savings. Most of these technologies are targeted at reducing the cost of transactions and / or improving the visibility of supply chain transactions and costs. Inventory Carrying Cost (ICC) is the most obvious tangible goal of a project. (ICC is defined as cost of capital plus variable costs such as shrinkage, damage and obsolescence.) On the other hand, there exists less tangible, but far more strategic project objectives, of which the influence can be just as great. A good example of an

intangible goal is service level improvement, in the form of maintaining gross profit by improving customer loyalty. The problem at hand is that it is very difficult to separate the strategic from the tactical (or static) in supply chain optimisation. Many experts believe that failed projects often have their root cause in management's inability to dynamically link strategy and execution (Buys 2000a: 1 – 3).

Below are listed five important key factors which should receive attention in the management of the outsource relationship:

(a) Due diligence

Time must be taken to ensure due diligence is performed between the parties. This must include open and honest declarations regarding expectations, goals, targets, costs and service parameters.

(b) Matched needs and capabilities

The outsourcing record company and its chosen supplier or service provider must ensure that their needs and capabilities are matched. Suppliers of goods and services vary widely in their competencies. Care must be taken that the service offering fits the requirements.

(c) Risk determination

Risks need to be determined early on. Some service providers will procure and warehouse their clients' components at their own risk. This means that, according to the outsource agreement, they will ensure that sufficient quantities of their clients' stock are available at all times. In order to maintain safety stock levels, they will manufacture or procure components even before an order is placed. Especially with the high rate of obsolescence in the recording industry, this can lead to a situation where large amounts of capital will have to be written-off when music albums become unpopular, outdated and un-sellable.

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(d) Control measures

Some measure of control needs to be maintained, especially if the service provider is not manufacturing all components in-house, but is in turn employing additional sub-contractors to fulfil the outsourcing company's orders (*e.g.* outsourcing the CD manufacture to specialists like *Sonopress* or *Compact Disc Warehouse* – as discussed in Chapter 3 under point 3.2.3).

(e) Confidentiality

Confidentiality must be a prerequisite to the signing of any outsourcing agreement. Companies operating as supply chain or logistic managers in the recording industry will have clients that are competitors (the different record companies). The intellectual property of each need to be guarded and protected unconditionally.

The concept of SCM should thus extend an organisation's value chain forward to its clients' clients as well as backwards to its suppliers' suppliers (Theron 2000: 1). By linking to these value chains and planning in conjunction and within the context of the supply chain, inventories and work in progress can be driven down, lead times can be optimised and the entire supply chain can be made more responsive to changes in demand or supply. As mentioned before, any chain can only be as strong as its weakest link. If the operations of one or more companies in the chain are not executed properly, it will negatively influence the entire supply chain. The onus therefore lies with management to ensure that the chain has no weak links. Managers need to execute the optimised supply chain plan, manage deviations and make decisions in real time. A goal of companies operating in supply chains, must be to achieve negative working capital (*i.e.* sell and get paid before you pay), together with adhering to service levels that exceed customer expectations.

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4.3 Integrated supply chain management

4.3.1 Collaborating the supply chain

Collaboration in the supply chain and seamless integration between the various functions and processes are prerequisites for success. Certain inefficiencies were discovered in the management of the supply chains of the local recording industry. These four problems will be discussed below, where after certain success factors that should be implemented in the channel will be documented.

4.3.1.1 Present channel inefficiencies

Before examining the best ways in which to manage a company's integrated supply chain, it is advisable to first be aware of the problems that currently characterise the channel. Through primary as well as extensive secondary research of the local recording industry's current channel, four major problems or inefficiencies were discovered:

(a) Unpredictable demand

The signing, recording and marketing of titles in the music industry is a very risky business. It is nearly impossible to accurately forecast the demand for any title or future release. Demand for a title can pick-up, slow down or completely stop without any apparent reason. This puts a great amount of stress on all the participants in the channel, from the initial supplier or manufacturer, right through to the record company, its supply chain management partners and the music trade.

(b) Poor integration

Unlike industries such as food service, automobiles and apparel, the local recording industry has not implemented any significant integration in its supply chain. Inefficiencies are emerging that are preventing potential channel growth. Supply chain inefficiencies in particular, have led to chronically delayed new

products, demand distortions, scarcity and allocation problems, inventory obsolescence risks and unpredictable service levels.

(c) Insufficient channel relationships

With the constant pace of change in the end-user's music tastes, participants in the recording industry are under increasing pressure to identify and exploit new value sources and then add this value to the channel. Relationships among supply chain participants are currently insufficient to provide the necessary solutions to many of the problems relating to the integration mentioned above.

(d) Technological growth

The pressures and tension amongst recording industry supply chain participants stem from several sources, some of them by-products of rapid growth that is being fuelled by the current advances in technology. Moreover, consumers are increasingly demanding hi-tech products with better sound and visual quality. Competitors have become increasingly able to emulate one another within ever-shorter time frames. The result of these trends has been a decline in average selling prices and profit margins.

4.3.1.2 Possible success factors

In order to deal with technological, commercial and even social change, organisations are being forced to rethink their current business development strategies. Radical adjustments in focus, positioning, product or service development and relational links with trading partners are required to keep the business on course and meet the ever-greater demands of customers. Hughes, Ralf and Michels (1999: 210) have identified a number of critical success factors that will all, to a greater or lesser extent, influence the way in which companies eliminate present channel inefficiencies:

(a) Top management involvement

Top management needs to give direction and be actively involved in orchestrating the overall change program. As discussed above, it is management

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that needs to strategically drive the move towards outsourcing and supply chain management.

(b) Setting goals and strategies

Management needs to develop strategic purpose by setting explicit goals and priorities across all business activities, as well as in dealings with suppliers across the supply chain. An appropriate strategy needs to be determined that will balance the need for business development led by change, together with narrower operational process design.

(c) Critical success areas

It is necessary to define mission critical areas such as market management, redesign of supply chains, supplier responsiveness, product development and strategic target costing. Cross-functional and cross-supply chain integration of effort and expertise is then necessary to address these various target areas.

(d) Segmentation

The various supply chains and supply processes must be segmented (for better understanding, delegation and management) and then resources must be allocated accordingly.

(e) Continuous change management

The required change management capabilities, such as project management and process measurement, must be strengthened in order for change to occur. This is especially important in companies with deeply ingrained traditional paradigms.

Extensive attention and activity related to improving supply chain integration is becoming a top management priority. The international market seems to have realised the immense value that can be added to their own internal business operations by being an active channel member and working closely together with partners, suppliers and outsourced service providers.

4.3.2 Supply chain integration

Synchronised supply chain planning is no longer a future promise – it is a reality, if not a prerequisite, for competitive performance (Hunter 2000: 1). Rapid technological change, ever-shorter product life cycles and increased supply chain complexity in the recording industry have all compounded the challenge of matching supply to demand. The industry's changing supply chain structure has created further challenges for supply chain value enrichment. A critically under-utilised key to lean inventories and increased market agility is the degree to which supply chain partners collaborate in planning and executing the combination of tasks that bring a product from raw materials to market.

In practical terms, even though music albums often have short lifecycles, these products tend to have similar lifecycle trends over the period from introduction and adoption, to tail-end sales and ultimately very low sales after the announcement of a follow-up album (Buys 2000a: 2 – 3). New albums often tend to replace prior titles and in essence are sold or upgraded into the same customer base as the superseding title. This lifecycle inheritance implies invaluable corporate experience and knowledge: it guarantees a measure of consistency, which massively reduces the workload of product managers when new products are introduced into the market.

Linkages among the participants in a company's supply chain are a key dimension of the organisation's overall supply chain strategy. The foundation of a supply chain integration strategy can be formed by answering questions relating to the degree to which the company should integrate across its supply chain, as well as looking at the alternative types of supply chain integration that are required. Gattorna (1999: 28 – 32) calculated that supply chain integration can fundamentally be divided into four different forms – information, decision, financial and operational integration:

(a) Information integration

Information integration enables companies across the supply chain to share useful information. It is vitally important that companies working together in a chain are aware of what the other are doing regarding any new developments,

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technologies, innovations, marketing campaigns or any other issues that might influence the relationship between the parties, as well as with their external relationships with the market.

(b) Decision integration

Decision integration supports the planning and control functions of management across multiple organisations within the supply chain. Once again, this confirms the need for working together and being transparent in the relationship. Continuous communication will be necessary to achieve decision integration in the channel.

(c) Financial integration

Financial integration changes the terms and conditions of payment across the supply chain. A manufacturer may agree to warehouse goods for a specified period of time and then only demand payment from its client when the goods are actually delivered to the reseller. Some manufacturers only demand payment at the time its products are sold by the market (the wholesalers, dealers or retailer), rather than demand payment at the time the goods are sold into the market.

(d) Operational integration

Operational integration encompasses the sharing of physical and human assets between participants within a supply chain. A SCM company may provide warehouse space to one or more of its suppliers for the purpose of producing components for the assembly line. Beyond the savings in the fixed costs of warehouse space and equipment, such arrangements enable both parties to respond more quickly to production changes and to reduce overall cycle times and costs.

4.4 Outsourcing pitfalls

Through primary literary research (refer to the list of References at the end on the thesis) and by consulting, examining and quantifying primary sources of information

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(refer to the Primary sources of knowledge under point 5.4.3.2. and to the Questionnaire in Annexure I), it was revealed that all outsourcing agreements are not necessarily successful. In these cases, it seems that there is no one single aspect of an outsourcing relationship that can be blamed - outsourcing is a complex business management relationship, which was usually uniquely constructed to satisfy a set of specific circumstances.

An unprepared company can easily fall into the various pitfalls that exist in the outsourcing process and the subsequent management thereof. These pitfalls are grouped under the headings of business, people and technology:

(a) Business-related pitfalls

As has been thoroughly proven throughout this thesis (refer to Chapter 1, point 1.3.1), business is in a constant state of change. When a business is considering outsourcing some of its business processes to a third-party SCM partner, the following business-related possibilities and their effect on the relationship need to be considered:

- A downturn in business or a decrease in business volumes may mean that the outsourcing contract must also decline
- A possible change in the line of business will have to be incorporated into the outsourcing agreement
- Changes in the business direction may mean that a record company has an expensive outsourcing contract for services it may no longer need
- The outsourcing agreement must take the possibility of acquisitions, mergers and de-mergers into account and must be open to re-negotiations
- One of the major and most common business-related pitfalls is choosing the wrong supplier. Pre-qualification of suppliers is extremely important – for long term contracts a record company should choose suppliers that are large and stable. When looking for lower costs, suppliers with economies of scale and many similar customers should be selected

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One way of improving the chances of implementing a successful outsourcing agreement, is to draw up service level agreements (SLA's) between the two parties. Refer to Annexure F at the end of the thesis where some of the main elements of a SLA are listed. It is important to note that a SLA is not a sure recipe for success and may fail for various reasons, most important being a lack of commitment with regards to issues such as resources, finance, monitoring tools, support tools, management, control and direction.

(b) People-related pitfalls

The following seven important people-issues need to be addressed before a company embarks on an outsourcing project:

- Assessment of the skills inventory (aspects such as what the company currently has, what it should keep and not keep and what the right size is). These are questions which may be answered by utilising the benchmarking tool which was discussed in Chapter 1 under point 1.4.4
- Any people- or employee-related legislation or other government rules and regulations need to be taken into account
- Outsourcing negotiations can rarely be kept quiet. Since there will always be concerns about job security, the record company should inform their staff about what is happening and help the effected people deal with the changes
- The people considerations should also begin at the start of the discussions about outsourcing, which means early liaison between the human resources departments. Assessments of core competencies and skills, company philosophies, cultures and values, human resource practises and all other policies and procedures should be carried out and diligently monitored
- In the beginning, the changes in relationships between people from both sides may not be easily accepted, therefore these changes should be dealt with accordingly and managed properly

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- Outsourcing is about delivering a service and irrespective of what it states in the SLA, the final arbiters of whether the service is good, bad or indifferent are the users. They are the ones who will make it work or fail and it is therefore important that they are satisfied with all or at least most aspects of the agreement
- People who are forced to work together as a result of the new outsourcing contract may experience initial difficulties. The importance of a working relationship between the parties is essential to the stability of the outsourcing contract

(c) Technology-related pitfalls

Worldwide, companies are evolving to give more power to lower management levels, more local autonomy and more accountability. These trends together with emerging technologies, will make users weigh what they are having to pay for an outsourcing deal, against what might be achieved by using their own internal technologies. The result of a poor technological decision could be that the centrally provided function becomes inefficient and the customer (the record company) pays both for a centralised service from the outsource supplier, as well as for allowing the company's own internal users to expand their own internal technology. While an IT company will not outsource its technology development function (*i.e.* a core competency and possible main reason for existence), a record company can certainly outsource its smaller technological needs to an outside service provider.

Two possible technology-related pitfalls to look out for are:

- Different factors will affect the cost profile of an outsource contract during its life. Those that are purely people intensive will have a cost profile that rises with inflation and pay settlements and in turn falls with the improved productivity of those people. IT outsourcing contracts are technology sensitive. The cost of IT is coming down and contracts must

University of Pretoria etd – Steyn, M M (2005)

ensure that both the record company and the outsource supplier share the cost benefits that accrue from exploiting cheaper technologies

- IT is a critical function to a record company. The management information system (MIS) manages its inventory and generates stock, sales and other crucial reports (refer to the functions of a MIS discussed in Chapter 3 under point 3.2.2). The record company must ensure that this business process continues to receive the critical attention it requires form the outsource supplier.

4.5 Summary

If a business' supply chain is optimised through efficient management, it follows that the needs of customers will be successfully met. This success is, however, due as much to the supply chain as it is to the business itself. According to the Sales Director of a major Information Services company (in Edwards 1999: 1 – 2), the degree to which decision-makers buy into the process of collaboration in the supply chain will determine the holistic success of supply chains in the new global economy.

The Operations and Marketing Director of a South African logistics company operating in various IT, software and music supply chain management industries, states that SCM will achieve substantial growth by offering cutting-edge technology and world-class service (Thornhill in Gillingham 2000: 17). Clients of channel management companies are demanding solutions that will add value to their businesses. This can be achieved through a combination of cost-effective and efficient integrated management solutions that are geared to meeting all global operational and logistical requirements. In Chapter 5, by testing the hypothesis statement, the processes of a completely outsourced supply chain of a South African record company are researched and evaluated (MODEL B). The tested model is discussed in Chapter 6 as MODEL C.