

Berlind: Outsourcing Key to Competitiveness

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With David Berlind, the executive editor of ZDNet. He also serves as principal and chief content officer of Mass Events Labs, Inc. Prior to becoming a tech journalist in 1991, Berlind was an IT manager responsible for the design and deployment of custom developed software, local and wide area networks, PC-mainframe connectivity, corporate technology standard-setting and end-user training programs.

Question: Do SMBs risk losing any competitive edge, perhaps in their ability to innovate, in outsourcing their IT to a third party?

Berlind: By some estimates, roughly 70 percent of business operating costs have to do with IT. When you look at that 70 percent, you say "that must encompass a lot of functionality." But ultimately you have to look at that and determine what amount of that functionality actually leads to competitive advantage. It's extremely important, particularly with small businesses where you have constrained resources, that people focus on what makes their business different and focus on winning. The more effort spent on IT, particularly IT that offers very little in the way of differentiation from your competition, is very much a waste. A lot of times, people may say it's cheaper to do it that way. In many cases, that is true when you do a quick back-of-the-envelope calculation. But sooner or later, those investments come back to haunt you, in not only hard dollars but in soft dollars. You will at some point down the line be required to do something with that technology. You may have to upgrade it, may have to fix it, may have to integrate it with something else. You may find that it becomes a black hole of a project to deal with, taking you away from the things that are most important to your business.

When you think about basic boilerplate technology — servers, Web hosting technology, e-mail systems — they in no way, shape or form really contribute to competitive advantage. To have to support that on your own, it just makes no sense. Take, for example, servers. Once you set up your servers, you have to spend time backing them up and then you have to maintain a tape library, and then what happens when those servers go down or crash? Why take on all of that yourself? Why not have the help of an external hosting outfit that can manage a lot of that for you. There are so many little costs that nickel-and-dime you to death, whether it's hard or soft dollars, and you have to decide at some point whether it's worth the headaches.

Question: Are there any elements of IT that you don't think it makes sense for SMBs to insource?

Berlind: There may be a technological component to an SMB that they can't outsource. The very thrust of the business is based on some unique technology that [a company] itself has built; it's the basis of your competitive advantage. You've built some product that only you know how to operate, and it is impossible to outsource because there is no one who can take it on. In that case, you need to bring that component of IT in-house. In many cases, though, the technologies that go into building and maintaining that product are ones that can be outsourced. With the small business I am involved in, which is an events production company, we are putting together a platform that doesn't exist out there today. We think it will provide some degree of unique competitive advantage to our company. But that doesn't mean we have to insource the entire thing. It requires Web servers and hardware servers, and we outsource all of that.

[Outsourcing] frees up resources. A lot of people will do a quick calculation and may find it costs more money to outsource. For us to outsource the component of our business we are outsourcing, it costs \$700 to \$800 a month. But if you look at the math over a period of a year, for us to acquire that same hardware that all of that stuff is running on, there's a break-even point in terms of numbers of months. At some point, it would be cheaper to own the hardware and the software ourselves. But that doesn't take into account the costs of running all that stuff. One thing you cannot change is the number of hours in a day. Time is one of the most precious resources to any business. Your success is directly related to how much time you can spend on your revenue-generating initiatives. If your people can spend more time generating revenue for your company and less time worrying about where your hardware is, chances are the net result is going to be a positive. You are going to recover whatever extra money you spent on outsourcing. For any business where that wouldn't be the case, I'd say they'd have to look closely at what business they are in. When you look at the fairly incremental costs of outsourcing and say, "we cannot recover that if our resources are focused on generating revenue," I would argue that you're in a business that's not generating enough revenue. It's largely a question of scalability. How do you scale your business? How do you make incremental investments in your

technology, and leverage that into large revenue streams? The more time you are using resources to focus on IT, the more you are taking away from your ability to focus on revenue-generating activities.

Question: Does your stance on outsourcing IT change in the case of larger companies?

Berlind: I think larger businesses have a harder time making the conversion. There are a lot of reasons for that. Sometimes people feel like the nature of the data they are dealing with is extremely sensitive and private, and that they cannot fully trust outsourcing that to an external organization. Take, for example, Salesforce.com. A lot of Fortune 500 companies are using it for salesforce automation. What are the advantages? Even the largest organizations can do a lot of collaborating around the sales process using a browser-based application. If you insourced that, you'd have to have a whole team of people focused on that. There are people who think, "Wait a minute, that's our bread and butter. It's our sales data and our customer lists," and they are not comfortable outsourcing that. Meanwhile, we have yet to hear of a security transgression at Salesforce.com where the data that is being stored there has been compromised. So there needs to be a culture change.

It depends on who you are talking to at a large corporation. Large corporations have larger hierarchies. The person making these decisions may be on the IT staff. Organizing what is essentially something that could end up costing you your job is not in your best interest. But if it's driven by the CFO or even the CIO, there's a stronger likelihood that they are going to do a more honest assessment of the pros and cons of moving to an outsourced solution for certain parts of the business.

Another question you hear about is integration. A lot of times, under the hood, there is a lot of customized integration. Yet the largest cost in terms of IT is cost of maintaining integration. When Oracle releases a new version of its database and you go to upgrade, a lot of things could end up breaking that you have to go back and fix. That's where the majority of the IT costs in companies where a lot of integration has been done exist. So you want to stay away from the integration you can stay away from. A lot of people say, "We have to do that for our business." But say it's a human resource application: What haven't the people who provide human resource applications thought of? What have you done with your human resource application that makes your business more competitive? It almost sounds ridiculous when you step back and think about it.

Even if you have to do some integration — and here's the great part about outsourcing — integration is available. [Providers] offer component-level integration, so if you need to tie the outsourced solution to the insourced solution, you can do it. When you feel like you have to integrate, the capability is there or it will be there soon.

A lot of these outfits that people outsource to use multi-tenant solutions. To run that same salesforce automation application requires a lot of infrastructure, a lot of people, a lot of effort. What these companies have figured out how to do is build one infrastructure that they can leverage across a lot of customers simultaneously in a way that drives down the cost of that infrastructure on a per-customer basis. If you have to have that same infrastructure just to yourself, meanwhile some other company has the same infrastructure and is running it for 500 customers. Their business is in figuring out how to drive costs out of the equation to make it more economical to turn to them rather than doing it on your own. Even large organizations can benefit from that.