

Time to Outsource ERP ?

Here are the two sides of the outsourcing debate

By Barbara DePompa

ERP systems aren't much fun to buy, install, deploy or maintain. In fact, some of the biggest horror stories in corporate IT have involved ERP systems. And since they're widely used in large corporations, they hardly provide much competitive advantage anymore.

Meanwhile, some midsize companies are just starting to consider investing in (or upgrading) ERP systems, and they're wondering whether they want to go through the hassle by themselves. The benefits and trade-offs of outsourcing ERP were hot topics at Gartner Inc.'s recent Midsize Enterprise Summit, says Gartner analyst Robert Anderson.

Typically, an outsourcer charges a monthly fee to host an ERP application and deliver it as a service via a secure network link. The fee can range from \$300 to more than \$1,000 per user, depending on the vendor, configuration and level of services, Anderson says.

The sluggish economy, IT talent shortages, the complexity of ERP and executive skepticism about the value of in-house IT are all contributing to the interest in ERP outsourcing. "Increasingly, business executives ask, 'Is there an intrinsic value to the ownership of technology? Or can an equivalent value be obtained via a packaged or outsourced approach?'" says Jeff Kaplan, managing director of ThinkStrategies, a consultancy in Wellesley, Mass.

On the other hand, CIOs at large companies often say ERP is at the core of the business and is too mission-critical to farm out. They variously describe it as the backbone, central nervous system or brains of the company.

Should you outsource ERP? The decision varies by company, of course. Here's a look at the debate and factors to consider.

YES!

The biggest advantage of outsourcing ERP is that doing so gives you the ability to focus on the company's core mission rather than fiddling with ERP software.

In mid-2001, Mission Linen Supply Inc. in Santa Barbara, Calif., faced a major technology overhaul because its aging mainframe couldn't provide the flexible reporting the business increasingly needed.

A privately held company that provides linen and uniform services, Mission Linen had grown into an operation with more 3,000 employees in 50 locations. But the business hadn't kept pace

technologically. After examining the options -- including the purchase of a new server system and ERP software -- it became clear that the training, additional personnel and capital expenditures required for new ERP software were unattractive. "With the amount of work involved in hiring and bringing our data center up to speed, it seemed much riskier to buy an ERP solution than outsourcing the entire project," says Robert Szerwo, chief financial officer at Mission Linen.

A thorough investigation of outsourcing alternatives led the company to choose SAP AG software hosted by BlueStar Solutions Inc., an application service provider (ASP) in Cupertino, Calif. The selection process even included meeting BlueStar's investors and CEO Tom Kelly to make sure that the company would be in the ERP outsourcing business for the long term, Szerwo says.

The upside of the arrangement is that Mission Linen doesn't have to worry about managing its ERP software, Szerwo says. The downside is that -- as with all outsourcing deals -- any "gray areas" in the contract can cause headaches, says Tony Mancuso, SAP project manager at Mission Linen.

For example, when company growth exceeded expectations, Mission Linen was forced to upgrade to a new server -- something that wasn't contemplated in the original contract, so it cost more, Mancuso says. He advises other businesses to estimate growth potential over the life of the contract to avoid any additional costs.

For some companies, especially midsize ones, it often seems impossible to compete with the big companies for the IT talent needed to install an ERP system and keep it humming. San Jose-based Lumileds Lighting, a joint venture of Agilent Technologies Inc. and Philips Lighting, was launched in late 1999 without a budget for an IT staff, though it got one later. "That's how we came to consider outsourcing. We had chosen J.D. Edwards for our ERP software platform, but weren't sure how to source and run it," says Neil Bostock, CFO at Lumileds.

Because Lumileds didn't have the money, or the desire, to gain expertise in running a data center, Bostock turned to BlueStar to handle all of Lumileds' ERP operations. "ERP is clearly mission-critical. If those applications went down, we would be dead. But we also know we surely couldn't do better on our own," he says.

Bostock says BlueStar has a far greater ability to manage daily ERP operations and a greater depth of resources to handle situations as they arise than Lumileds would if it ran an in-house system. In June, Lumileds signed on for another three years with the outsourcer. Bostock says he's not sure his company could run ERP in-house for less money than what it has paid BlueStar so far.

For both customers, the only real concern about their choice of outsourcing supplier was a general fear about BlueStar's longevity, given the past two years of economic and IT market troubles. But both say their concerns have subsided and they're pleased with the services received.

No!

The biggest disadvantages to outsourcing ERP are the risks involved in not controlling daily ERP operations in-house -- risks that include devastating downtime and the loss of valuable operational data.

Informatica Corp. in Redwood City, Calif., considered such risks to be too great.

Informatica currently uses PeopleSoft Inc.'s ERP software. Three years ago, the company outsourced the human resources portion of the suite, because "if HR goes down, the business will still continue to run," says Tony Young, senior director of IT applications. But Informatica draws the line there.

Two things keep Informatica from moving more of its ERP applications to an ASP. First, because Informatica is in the data analytics business, Young says it already has a "world-class data center." Second, some senior executives perceive outsourcing as simply too risky. "We have no plans to outsource any other ERP-related applications at this time," says Young.

Mike Gaynor, the CIO at Federal-Mogul Corp. in Southfield, Mich., is also in that camp. An automotive parts company, Federal-Mogul is facing a monstrous ERP integration challenge: It has grown quickly via acquisitions and needs to consolidate at least some of its 27 ERP implementations.

Gaynor says there's no way an outsourcing contractor could possibly do what needs to be done to consolidate, manage and maintain those critical applications. It comes down to trust and control.

"We feel no outsider could gain enough of our trust to know what it takes to run our business and understand why things need to be done a certain way. We must control the business operations, the business-process development, project management and change management. We can't hand that off," he explains.

So far, Federal-Mogul has managed to integrate three SAP ERP systems into one, and it plans to consolidate nine SAP ERP systems in Europe into one in about a year. "We would never consider [outsourcing ERP applications], because we have always been taught you never hand off the

brains of your operation, though you may want to farm out for extra arms and legs," says Gaynor.

One thing Gaynor would consider offloading to an outside service provider is programming in SAP's programming language. "You can keep the brains in-house and work with a partner to streamline processes, or come up with a more efficient means of system support," he says.

DePompa is an independent writer and editor in Germantown, Md.