IST 600

ERP Implementation Issues

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WHETHER OR NOT TO OUTSOURCE

ERP?

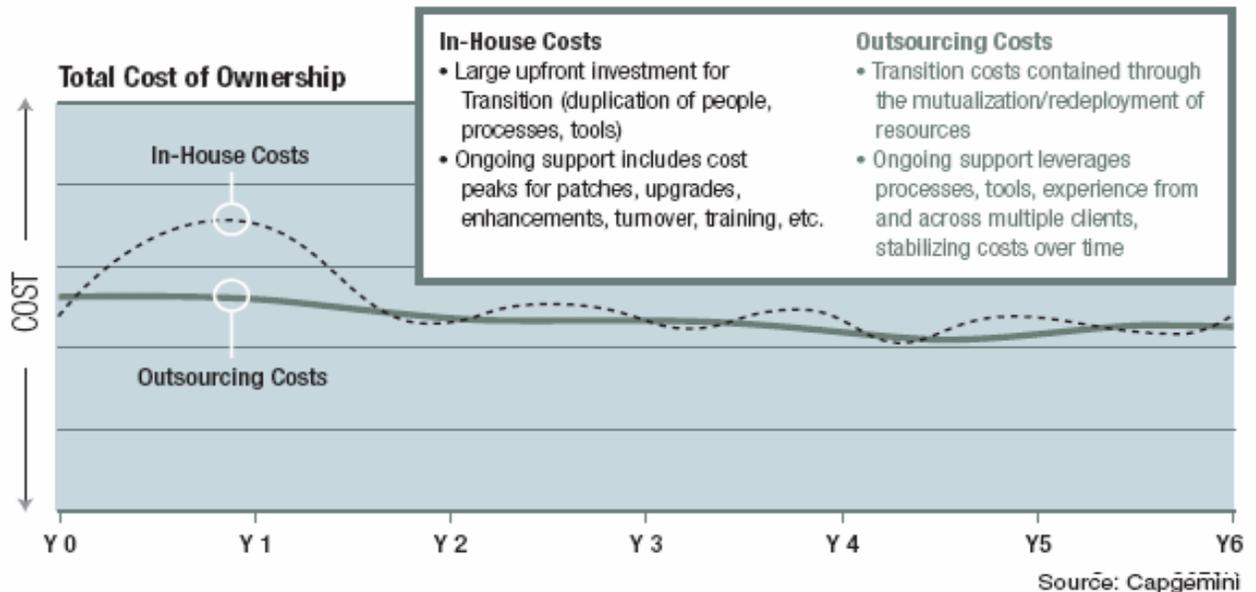Prepared by:

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Introduction

With technology advancing at an insurmountable pace, the current enterprise resource planning application software packages are becoming more enveloping, envisioning greater broader benefits with enhanced connectivity and superior performance. But this is accompanied by a host of proliferating challenges as well. The most recent versions of enterprise application software extend beyond the typical "back-office" functions, featuring complicated Customer Relationship Management (CRM) systems, fully integrated Supply Chain Management, Product Lifecycle Management and other comprehensive collaborative applications [1]. ERP solutions, such as SAP and PeopleSoft, and others enable companies to develop their business processes into opportunistic, real-time collaborations with business partners. In the current scenario of an unpredictable environment, many chief executives agree that eventually, applications solutions help build shareholder value.

In 1998, three of the four largest ERP (Enterprise Resource Management) vendors brought forth outsourcing proposals. J.D. Edwards announced its Network Application Services, Oracle launched its Business On-Line service, Baan released its Midmarket Outsourcing, and by the end of 1999 SAP introduced its Business Process Outsourcing Support services[2]. Now the question arises, should ERP be outsourced? What are the benefits and detriments of outsourcing such an extensive operation?

Majority companies have not been able to retrieve the Total Cost of Ownership (TCO) of their packaged applications, due to the ever mounting demands of their supporting ERP solutions that have become increasingly complex, consume considerable

time, money and other valuable resources[1]. It is hence not cost-effective for such companies to retain the level of specialization required to maintain and optimize their ERP systems. With applications becoming more complex and interrelated, synchronizing technology with organizational needs is becoming increasingly complicated. To add to the challenges, companies also need to keep pace with new technology or would end up losing potentially intended benefits. Majority of the installed ERP applications that went live in the late 1990s, were typically to prepare for Y2K[1]. Ever since, most software vendors have released sophisticated upgrades of their core products. According to Gartner analyst Brian Zrimsek, many customers have not kept current with these consequent upgrades[1]. Gartner's review of the larger- vendor installed database reveals that a staggering half to three-quarters (50% to 75%) of ERP customers are operating with older versions of their vendor's product[1]. Gartner estimates approximately 52% of the R/3 installed base are using releases prior to 4.6, so many users must decide between continuing with their migration to 4.6C or migrating directly to R/3 Enterprise[1].

Total Cost of Ownership

In-House Costs
- Large upfront investment for Transition (duplication of people, processes, tools)
- Ongoing support includes cost peaks for patches, upgrades, enhancements, turnover, training, etc.

Outsourcing Costs
- Transition costs contained through the mutualization/redeployment of resources
- Ongoing support leverages processes, tools, experience from and across multiple clients, stabilizing costs over time

In-House Costs

COST

Outsourcing Costs

Y 0   Y 1   Y 2   Y 3   Y 4   Y5   Y6

Source: Capgemini

Reasons why to outsource

Companies that decide to outsource ERP implementation could stand to benefit from a greater simplified operational efficiency and perhaps a more manageable budget[2]. With the ERP products becoming more complex, ERP vendors have begun further enhancing their technologies, making IT training more indispensable. Shifting the entire implementation of an ERP through outsourcing would imply shifting all the involved day-to-day operations, and the extensive learning durations that would be required to the vendor[2]. This would essentially leave the organization free to center its activities on just the core business aspects of ERP. With the ERP outsourcers pricing their services on a monthly fixed basis, this facilitates organizations to better administer and control their cash flows and eliminate large expenditures that are typically associated with general ERP implementations and subsequent upgrades[2]. Such an outsourced infrastructure and hence a lower cost of entry would make industrial financial, manufacturing, human resources and accounting software packages more affordable. ERP outsourcing's new wave thus targets the high software ownership and maintenance costs; as it essentially simplifies the conventional complexities in implementation and evades the crisis of hiring, retaining and training IT staff to run the concerned applications[3]. Such potential also exists beyond a sheer cost-diminishing measure; outsourcing could offer a highly strategic and competitive advantage edge[3]. For example, outsourcing could lead to major cost cutting advantages and free up resources and personnel in the organization to focus on the core business aspects within. Another key factor would be the benefits that would be accrued by the technical assistance provided by such vendor application service

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provider partnerships, and as a result, improved chances of obtaining enhanced predictable and assured results[3]. Some other reasons why organizations opt to outsource ERP, are due to inadequate IT personnel skills set and resistance from within to learning new skills and adapting to a new atmosphere, realized midway through the implementation[4]. Also, finding the right employees to perform such tasks with the necessary expertise would end up costing a lot more of the company resources, in terms of both financial and human resources[4]. Other reasons yet include, avoiding laborious upgrades, and not being able to keep pace with the rapidly advancing technologies which especially concerns mid-sized organizations.

Reasons why not to outsource

Deciding whether or not to outsource ERP is a major and critical decision to make due to many reasons. Outsourcing ERP essentially means, that all of the organization's strategic and confidential customer data would be maintained at the outsourcer's site, this causes grave security concerns to especially the corporate managers of the organization; how will the outsourcers structure information in a database with the proper access controls and partitioning so it cannot be accessed by an unauthorized person using the application within the company?[5] It is one thing to have the technology to host a network[5]. It's another to build an application and an infrastructure that will scale to thousands of customers; the biggest issue hence essentially concerns the security model[5]. Some of the other pre-implementation issues to ERP outsourcing, before renting applications over the web are having an integrated operational platform. Hosting companies need an airtight security model to service multiple customers on a single

server and a completely web enabled set of application to bring down the networking costs[5]. Eventually, the cost of outsourcing ERP parallels other product and service leasing options in the long term and could even end up costing far greater than having the product in-house[2]. Also, ERP outsourcers' inflexibility to offer little or no upgrades or modifications could hinder companies from seeking the option of outsourcing their ERP implementation, being unable to implement unique business processes, make product modifications as necessary and suited to their specific business needs and evolving changes[2]. The whole process of ERP implementation involves crucial re-design and re-engineering of the organization's core business processes, procedures and functionalities. Handing such overly critical operation implementation over onto an outsourcer who has little or no clue about the businesses processes, procedures and functionalities in place, could result in an unwanted operational catastrophe. The reality lies in obtaining the necessary working technology and business model required to outsource ERP, which is not only expensive but also time-consuming, and only a few companies are positioned to pull it off[5]. Considering a medium-sized organization outsourcing an application could be in conflict with software-integration issues, due to the inability to accommodate required cross functionalities. Successfully outsourcing such operations would demand managing and controlling the outsourcing staff as good as internal staff, and this could become particularly intricate with diverse locations. ERP being strategically intertwined with all the core business processes of an organization, and hence perceived as the central nervous system and backbone of the company, many would consider keeping such an extreme strategic aspect of the business well within the organization walls.

The ultimate question for outsourcing in any business segment is not how to do it, but whether to do it[5]. A survey of 37 categories of outsourcing activities by the American Management Association (AMA) revealed that 94% of the 619 respondents participate in at least one category with 40% of them naming some aspect of their information systems operation[5]. The study targeted managers in the purchasing, administrative, and financial functions in AMA member firms[5]. Once considered evidence of a quick-fix response to some sort of internal technical or performance lag, the practice has gained respectability because top-performing companies outsource to perform even better[5]. Yet consultants remind companies to consider whether the practice is at least in pursuit of the right objectives[5]. If a case for outsourcing does pass scrutiny, then consider outsourcing providers as suppliers and judge them on the basis of value-added[5].

Hence we see that the ERP implementation challenge simply revolves around the reality that it's too intricate to manage in-house and much too strategic to outsource[2]. CIOs thus have to hit upon the comfortable middle ground appropriate for their companies and business processes[2]; they would have to rely on their own vision and foresight, to take the stand of making such a crucial strategic decision.

Endnotes

[1] Capgemini Consulting Technology Outsourcing. *It's Not Whether to Outsource ERP—It's When*. Capgemini Outsourcing Point of View: Outsourcing ERP, A New Competitive Lever. Retreived 06/13/2005. pp.1-2. <http://web.capgemini.com/outsourcing/media/ERPPoV.pdf>

[2] Maggie Biggs. (1999). *Two views on ERP: Outsourcing pros and cons, and hitching up with e-commerce*. Enterprise Toolbox. IDG.net. Retrieved 06/10/2005. <http://www.infoworld.com/cgi-bin/displayNew.pl?/biggs/990125mb.htm>

[3] John Teresko. (1999). *ERP Outsourcing: Can it meet market demands?* www.industryweek.com. Retrieved 06/12/2005. <http://www.industryweek.com/ReadArticle.aspx?ArticleID=435>

[4] David Pearson. (1998). *Complex Compromises: Outsourcing ERP*. CIO.com. Retrieved 06/12/2005. <http://www.cio.com/archive/060198/erp.html>

[5] Judy Democker. (1999). *Outsourcing -- ERP's Future?* www.internetweek.com. Retrieved 06/10/2005. <http://www.internetweek.com/trends/trends032299.htm>

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<http://web.capgemini.com/outsourcing/media/ERPPoV.pdf>