Bank Trust Wealth Management

Build versus Buy

CANADIAN WESTERN BANK

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Created by Business Plans Canada

Table of Contents

Build or buy?

Deciding whether to "build" your business internally or "buy" outside services is a strategic business decision that requires careful consideration.

When you do a cost-benefit analysis of outsourcing, it should measure a lot more than how much you pay staff versus how much you would pay a contractor. It should examine what it will cost to make and administer the changes, and estimate the real benefits of the change.

What can be outsourced?

The most common areas for outsourcing are:

- Website development and marketing
- Technology services
- Human resources (hiring, training, evaluating, payroll management)
- Legal and accounting services
- Product production or assembly
- Distribution planning (logistics)
- Leasing, buying or building facilities

Outsourcing should improve your operations by:

- Giving you access to expertise or equipment that is beyond your current capabilities.
- Changing functions that are non-productive and time-consuming or out of control.
- Freeing up internal resources—cash or people—for other purposes.

Cost-benefit analysis

You can use a cost-benefit analysis to help:

- decide whether to outsource;
- decide whether to hire new team members;
- evaluate a new project or initiative, and;
- determine the feasibility of a capital purchase.

A cost-benefit analysis is best for making quick and simple financial decisions.

How to do a cost-benefit analysis

Step one: Identify all the financial and non-financial considerations

Financial:

- Direct staffing costs including benefits and training
- Space requirements and equipment purchases
- Indirect staffing costs such as managing contractors, administering process changes and shifting workloads in other business areas
- Direct contract costs, including benchmarking time and penalties for service changes
- Potential costs to your business if supplier services are interrupted

Non-financial:

- Gaining access to the outsource provider's expertise and technology
- The ability to re-direct internal resources to other business areas
- Service and production improvements due to streamlined processes
- The readiness and ability of other areas of the business to manage changes

Step two: Assign a dollar value to the financial and non-financial costs

Step three: Assign a dollar value to the financial and non-financial benefits

Step four: Compare costs and benefits

Calculate your total costs and your total benefits, and compare the two values to determine whether your benefits outweigh costs. You also need to decide whether your business processes will improve.

Cost-benefit example

Your business is growing and your accounts receivable/payable services are falling behind. You've been bringing in temporary staff to manage the extra work. Would it be better for you to hire more accounting staff, or to move your payroll staff to billing and hire an external payroll company?

Costs

Outsource cost considerations	Cost-benefit
Full service payroll outsourced (based on number of employees)	Direct cost increase
Payroll staff move to AR. Manager does contract oversight.	Management time increase costs
Expert knowledge and system upgrades and changes.	None
In house costs to administer payroll.	Department head time to submit information
Additional software licenses for added users in AR.	Cost of software licences x number of additional users

Keep in-house cost considerations	Cost-benefit
Expand office to accommodate 2 new staff	Costs per square feet
Hire two more accounting staff	Salary, including benefits Recruitment costs Orientation and Training
Two additional workstations	Furniture and hardware Software licenses
Construction downtime	Two weeks of revenue loss

Benefits

Outsource benefit considerations	Cost-benefit
Dedicated staff	20% revenue increase from timely AR management
Savings from not hiring temps	Hourly wage for approximate hours per month
Increase in productivity due to work load satisfaction	Number of staff X $ per hour
Savings from not having staff do payroll or submit government payments. Fewer errors in payroll and remittances due to expertise of outsource company.	No new staff cost, Manager review time reduced

Keep in-house benefit considerations	Cost-benefit
Timely AR management	20% revenue increases
Decreased salary costs	In-house staff salaries per hour Hourly outsourcing costs (at so many hours per month)
Workload satisfaction	10% improved productivity per person
Improved customer service and retention as a result of 100 % in-house accounting processes	Increase in retention percentage

Calculating the cost and benefits

Now you have clearly identified the costs and benefits of each option you can compare the results. Your break-even point is part of your calculations. You calculate this by dividing the projected total cost of the project by the projected total revenues:

$$\frac{\text{Total Cost}}{\text{Total Revenue (or Benefits)}} = \text{Length of Time (Payback Period)}$$

Making your decision

Some of your numbers are likely to be "a best guess." Moreover, your decision to build instead of buying shouldn't be based solely on cost. Outsourcing should improve processes and help grow your business. If outsourcing is more cost effective, measure that decision against your strategic growth goals to ensure that you have the resources to support your core business processes.

Post-implementation

Your cost-benefits analysis gave you a clear picture of your direct and indirect costs and benefits. Use that information as the benchmark to measure performance changes on a monthly or quarterly basis.

Risks of building and buying

Generally, it is not a good idea to split a business function. The risk of gaps and overlaps is very high, and the accountability and benchmarking processes are difficult to manage. For example, if you outsource your staff payroll to a payroll company but keep management payroll in house, you have increased your costs and reduced accountability.

There may be some business areas where building your capacity and buying services could work. For example, computer systems are crucial and you need on-site IT staff to manage your system and respond immediately to problems. But IT staff turnover is high. You can outsource the IT services, while providing the on-site workspace. You get updated expertise without the HR costs associated with high turnover.

Now what?

You've run your cost-benefit analysis and decided your business processes would be improved if you buy the solution rather than building it in-house. Your next step is to very carefully review the companies providing the service.

- Check their references with more than one source and ask a series of questions that let you know how they will manage the risks, challenges and changes that may be needed.
- Set very clear goals and establish benchmarks to measure their performance.
- Look at establishing bonuses for innovations that improve your business processes, instead of setting penalties for errors.
- Develop an implementation plan.
- Identify key people to manage and meet the change timelines.
- Develop an exit strategy. You need to know how to bring the function back in house if needed, including the costs and potential losses.

The purpose of outsourcing is to improve business functions. The outsourced function is still part of your business and it needs to be included in your strategic planning and performance measures processes.

Depending on your business, and what you have outsourced, this arrangement could eventually become a part of future growth through a joint venture or purchasing agreement. Outsourcing can do more than improve your results—it might provide new business opportunities.