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Outsourcing Information Services in the Hospitality Industry

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Abstract
Outsourcing of informational services, a growing trend outside the hospitality industry for several years, is the process of contracting with an outside vendor to take over all or part of a company's information processing needs. The author examines the pros and cons of outscourcing to help the hospitality industry determine if this si a business practice to be considered.

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Outsourcing information services is the process of turning over some or all of the information processing functions of a company to an outside vendor, sometimes called an outsourcer. There are a number of forms which outsourcing contracts can take.

Complete systems management is where all of a company's information needs are performed by the outsourcing vendor. This can include the acquisition and support of any data processing equipment required for the business. The range of services can extend from implementing and maintaining sophisticated telecommunications equipment to the processing of mail. A company's information processing employees are usually transitioned to the outsourcing vendor in a systems management contract.

In specialized outsourcing, a company will outsource one or many pieces of their information needs to an outsourcing vendor. The most common information needs that are outsourced are general data processing operations and networks. For example, the banking industry generally tends to contract out the general data processing part of their operation while maintaining "mission critical" systems such as check processing in-house. One reason data networks are outsourced is because a company lacks the expertise in remote areas of the world to support them. A good example of this is Holiday Inn which signed a contract in January 1993 to turn over the responsibility of their Pacific Rim data network to British Telecom (BT) North America.

Integrating is similar to specialized outsourcing except a company will hire an integrator who acts like a general contractor in

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the construction industry. The integrator may subcontract the work to other vendors.

Outsourcing is a Growing Trend

In the past, the decision to outsource information processing functions was viewed as an admission by a company that it could not run its own data processing system. However, several large companies have signed outsourcing contracts which have helped remove the negative image of the function. A highly visible contract between a large company and an outsourcing vendor occurred in 1989 when Eastman Kodak and IBM announced a systems management arrangement in which IBM would consolidate the operations of Kodak's five data centers into one. Although one estimate indicated this outsourcing arrangement would save Kodak $130 million in the next decade, the key to Kodak's decision to turn to outsourcing hinged on the issue of strategic value.[1]

By stripping down to its essential business, Kodak was positioning itself to deliver the greatest possible value from its core business to its customers. Kodak management wanted to avoid any distractions from its non-core activities so it could leverage its managerial, organizational, and financial strengths more effectively. Although Kodak knew how to run a data center, it had decided that the strength of its data processing department was not a reason why customers bought their film.

Now, an increasing number of companies are following Kodak's lead, including some large companies such as National Car Rental, Security Pacific Bank, Enron, and Continental Airlines.

The outsourcing trend is expected to continue for some time. U.S. businesses spent $7.2 billion on the outsourcing of computer operations in 1990; by 1995 the annual amount will more than double, to $15.2 billion, according to Input, a computer market research firm in Mountain View, California.[2]

What Are The Advantages of Outsourcing?

What is fueling this trend toward outsourcing? Probably the most significant advantage to outsourcing is that it allows a company to focus on those activities that provide a competitive advantage.

- **Helps a company achieve strategic focus**: This is one of the main reasons that Kodak stated when it decided to outsource its data processing operation. Many successful companies realize that by limiting or shedding activities that provide no strategic advantage, a company can increase the value it delivers to both customers and shareholders and, in the process, lower its costs and investments. Conversely, if a company performs activities that it could buy more effectively, costs tend to balloon, and it loses competitive advantage.[3] One example of a company focusing on its core business is General Motors, which is now in the process of selling some of its non-core businesses. For example, it sold its 3,000-member security operation in 1992 and is looking for buyers for its Allison Transmission and Allison Gas Turbine divisions, among others. GM has decided that its profitability will be driven by a clear focus on the business of manufacturing automobiles.

• **A company can realize cost savings**: Another advantage of outsourcing is the cost savings potential. The banking industry is leaving the data processing business to outsourcing vendors because new capital outlays for the latest hardware and software innovations, which banks are compelled to buy in order to keep up with other banks and non-bank competitors, are taxing the budget of many institutions. In addition to capital expenditures, operation costs are spiraling out of control at many institutions. Bank managers are often frustrated by the fact that the funds they allocated for automation, which operations people promised would save banks money, do not seem to be returning what bankers had hoped. Costs keep going up.[4] Outsourcing vendors can achieve economies of scale that a company may not be able to because they can spread fixed costs over a higher volume. For example, a vendor can process several companies' data on the same mainframe. This gives an outsourcing vendor the ability to generate a unit of computing for less than if each of the companies had its own hardware and operating staff.

A company can also save on taxes. "While hardware must be depreciated over three to five years, outsourcing fees are deductible as a current business expense."[5]

• **A company can gain effectiveness quickly**: A company may also want to outsource to gain effectiveness because it realizes that developing a new function in house will take so much time that it will result in a loss of market share.

The banking sector is an example of an industry that has turned to outsourcing to control costs and to gain effectiveness. "Many applications running in banks today were developed 15 years ago and are approaching the point where they are either too old to support or need to be revamped because of increasing competition."[6] Because new technology requires specialized knowledge, many smaller banks and financial institutions would not be able to offer major bank type services such as sophisticated voice response customer service systems or image-based statement processing without turning to an outsourcer. Developing these types of services in house would take much longer than simply hiring an outsourcer to do it.

• **A company can gain data processing expertise**: Often companies decide they lack the resources to keep up with new information processing technology, and an outsourcing vendor can provide them with access to a pool of experienced programmers.[7] Gaining control over the technical environment and getting access to qualified programmers was one reason why National Car Rental decided to turn to an outsourcing vendor to manage its data center. Former Chief Executive Vincent Wasik stated, "We understand what we want from the technology and now we can direct the outsourcer to implement it. Instead of worrying about losing one of our top programmers, we can concentrate on how we can launch a new product."[8]

What Are The Disadvantages of Outsourcing?

Despite the appeals of outsourcing some opponents say that there is a risk of losing control. The issue of control can be broken down into two categories: operational control and future control. In order to avoid losing operational control, "It's important to retain knowledgeable people both to manage the outsourcing vendor and also to mange the needs of users within the firm."[9] By retaining people who can figure out how a company should extend its technology, a company will not have to rely on the outsourcer for direction on how information technology can be applied to gain a competitive advantage.

The other control issue relates to loss of control over the future. Because of this concern, it is important to select an outsourcing vendor who "agrees to specific results, costs, timetables and performance requirements."[10] The key to overcoming the disadvantages of outsourcing is the outsourcing contract between the outsourcer and the company. The contract should clearly define performance requirements and the role of each party so control will remain with the company.

Outsourcing Trends in the Industry Expand

Outsourcing is done with the purpose of achieving one or all of the following goals:

- refocusing attention on the core business
- controlling costs
- obtaining more efficient and effective systems
- gaining technical data processing expertise

A few examples in the hospitality industry support the view that some companies have decided to realize the benefits of outsourcing.

For example, Holiday Inn outsourced its Pacific Rim data network and its support by signing a $5 million contract with British Telecom to build and manage a customized data network to replace their current, less reliable, network. Dick Smith, senior vice president of information technology for Holiday Inn Worldwide, stated, "With the vast fiber network that BT is installing, particularly in rapidly developing countries, we expect greater reliability."[11] By outsourcing its network Holiday Inn will remain focused on its core business, gain the necessary technical expertise to install the new data network, and obtain a more efficient and effective system.

In 1991, Hospitality Franchise Systems signed up EDS as its information outsourcer. The contract called for EDS to consolidate HFS's multiple platform systems onto an IBM mainframe. EDS will also build a new reservation system to replace HFS's aging system, which was developed and written with "old" technology. The new system will be easier to maintain and enhance when needed. This will allow HFS to remain focused on its core business, control data processing costs, gain technical expertise, and obtain a more efficient and effective reservation system.

Taco Bell Corporation and Kentucky Fried Chicken Corporation (KFC) have contracted with SHL Systemhouse, Inc. to develop point of sale (POS) software that will link front counter, kitchens, and back office functions together on a PC-based system. The new system will allow for the remote management of restaurant POS terminals. One of the main advantages of the new system is that menu and price changes will be more quickly downloaded to the POS terminals. Even though KFC has its own information system department, Ken Harris, vice president of worldwide information systems, stated the reason they decided to contract out the development of this system was to obtain "a partner who would bring state of the art technological expertise to the project."

Outsourcing Should Be Considered

The decision to outsource information services in the hospitality industry should be examined to determine the strategic and financial results it could realize for a company. Although there are many possible advantages to the outsourcing of information services, the potential downside is a possible loss of control over the future of a company's information processing operation.

It is the responsibility of hospitality information system managers to anticipate these control issues and develop an outsourcing plan that allows the hospitality firm to cut costs, improve strategic position, and retain control at the critical points. Already, some hospitality firms have decided they can gain a competitive advantage by remaining focused on their core business and leaving the development of computer technology to support this advantage to an outsourcer.

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