

# Outsourcing: A Non-Competent Area of Organization or an Internal Strategy?

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## 1. Background

Outsourcing has been done in the industry from the time manufacturing and services started in the businesses. Every minute thing cannot be produced at the same place and at the same time. Even if in the light of resources, it is done then it takes a toll on the costs as well as on time of manufacturing of material in the organization. This phenomenon of getting the things done from an outside vendor has been practiced and is being continued in all industry and is not tied to specific industry like manufacturing. With globalization, outsourcing industry saw a big jump because the manufacturing contracts became a common phenomenon. With surge in globalization more and more organizations outsource not only their production processes, but also their service processes. Thus, the outsourcing industry did not get confined to only the manufacturing sector but also expanded into the services sector.

Generally, outsourcing may be defined as “the act of transferring work, responsibilities and decision rights to another entity”. Outsourcing is normally conducted with an external party; hence, the word “out.” While an organization can offload work to another organization, or to an external person, a group within an organization can delegate work to another group. Different reason persists from organization to organization for the outsourcing decisions. But mainly, the firms rely upon outsourcing due to issues like cost, availability of resources, time scheduling and co-ordination. Despite the variability in outsourcing, Franceschini et al. (2003) have identified three broad categories of outsourcing: 1) Traditional outsourcing with the primary aim of reducing overall cost. 2) Strategic outsourcing with focus on a joint value creation; the relationship more of a partnership. 3) Futuristic outsourcing, also a form of partnership, with the aim to have a long term co-operation in which there could be a joint company vision.

Each company has different objectives and scenarios based on which the type of outsourcing is selected. For small organizations cost cutting is primary since these firms want to grow and for bigger firms, strategic and futuristic outsourcing is vital to maintain or to grow at their position. McIvor (2002) by identifying suitable outsourcing strategies, proposed a practical structure for use in industries irrespective of their size and capacity. The framework provides a mechanism for understanding and deciding which processes should be kept internal and which should be outsourced based on relative capability position and contribution of the process to competitive advantage. This helps them to find the better portfolio of outsource and in-house manufacturing activities, which helps them to a greater extent. Such type of framework includes the evaluation criteria's based upon cost, capabilities of the firm, time management, etc.

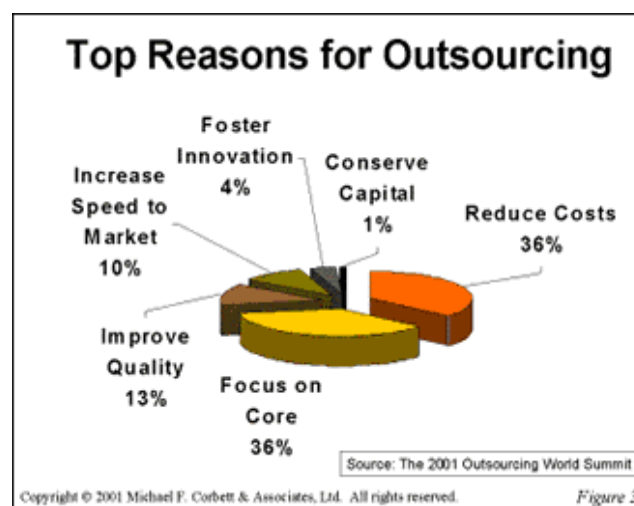


Figure 1 Top Reasons for Outsourcing

Some of the main reasons of outsourcing that has been sighted at many areas are common. One such example of main reasons given during Outsourcing World Summit (2001) is at Figure-1. This however, has not helped the firms fully to maximize their revenue because the outsourcing decisions have not helped them out because they have not fully utilized their potential or neither could benefit from their strategic outsourcing to a greater extent.

In this paper, we have tried to relate the given reasons or any other (if comes during research) with the firms if applicable and then have tried to show the outsourcing pattern of firms and how it makes them decide the outsourcing portfolio.

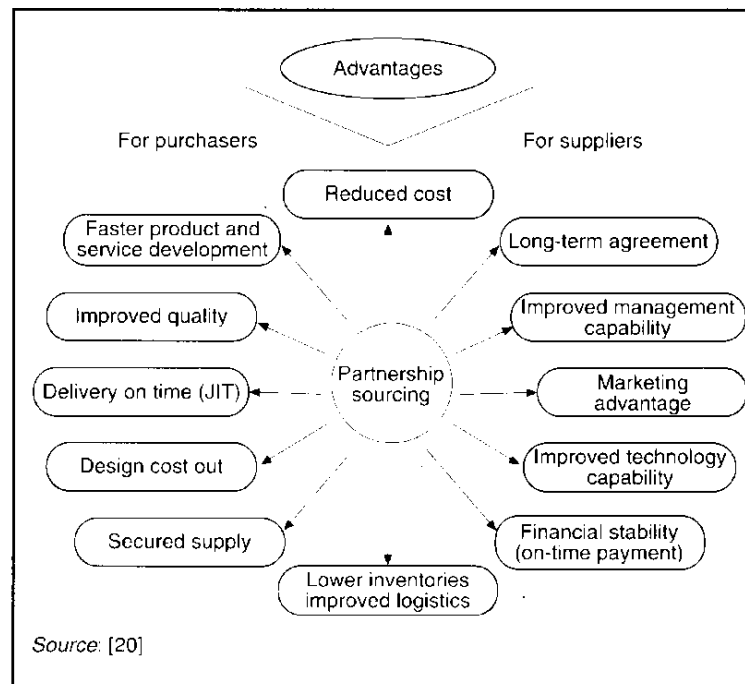
## 2. Literature Review

Clear organizational focus is usually missing whenever outsourcing decisions are to be taken because there is no clear method that could help the organizations to decide the outsourcing portfolio. However, firms consider many factors to outsource a part of their business to the external party. The outcome of their decisions is affected by many other factors which can change their decisions during the course. Thus, with the information available firms decide about the outsourcing. With increasing competitive pressures and progressing globalization, firms have to reduce their costs and build new opportunities via optimized using of internal and external resources (Mahmoodzadeh et al., 2009). This optimized use of resources depends upon various decisions. All these decisions of the firms are then the key factors that decide about how to go for the outsourcing projects.

Again, there are number of factors involved once firms decide to go for the outsourcing decisions based upon few set of key factors that become the basis of such decisions. Some of the important criteria or the key questions for better management of outsourcing include:

1. *Right relationship with the vendors:* Before evaluating the vendors, firms study the vendors history of vendors like have they been on good terms with the other companies or have they maintained a healthy relationship with other firms which are new customers for them. This helps both the parties to go with the future business which may be long term and thus may be of high benefit for both the parties.
2. *Supplier evaluation:* This is one of the major criteria that decide the success of any project for the firm. If the supplier is right, then everything goes well for the firm but if the evaluation is not right, it will land the firm into trouble both in terms of business and time.
3. *Outsource to one or more vendors (how many?):* Usually, smaller firms outsource a limited set of their activities (May be higher depending upon industry to industry) but the medium and bigger firms have more vendors and they need to see if they should get the work done with limited vendors having all the resources or should allocate work to many vendors to avoid higher dependency.
4. *Where to outsource (Includes vendor based geographic division):* Companies do outsource to the vendors who are nearby the manufacturing unit just to minimize the time and transactional costs but at times they compromise on the capabilities or the facilities of the vendors. This should be kept in mind before awarding any contract to nearby vendor.
5. *Contract terms:* Transparency and full information of the contract must be made available and should be clearly stated in the contract terms to avoid any conflict during the later stages.
6. *The right time to outsource the activities:* Time consideration is very important before awarding any contract to the vendor. The right time should be found out by the firms to outsource the activity because if the outsourcing is done at wrong time, then it will incur costs which would eliminate the required need of outsourcing the activity or project.
7. *Which type of activities to outsource?:* All the firms need to evaluate their core competent activities and then other activities in which they feel that they are not very good at. After that, the later activities should be outsourced by the firms in order to fully benefit themselves.
8. *To find the right drivers:* What are the drivers that ask the firms to go for an outsourcing project is very important point to be considered. If the right drivers are found only then the firm's outsourcing decision would be validated otherwise it will create a heck of trouble for the firm in terms of cost as well as time.
9. *Is the activity core competency of the firm?:* This should be carefully evaluated that the activity that firm is trying to outsource is the core competency of the firm or not. If the activity is core competency then no one can do it better in terms of cost and, time and efficiency than the firm itself.
10. *Understanding the price and cost factor for both i.e. firm and vendor:* These factors are the negotiable parts and are very crucial for both the parties and thus need to be carefully evaluated and should be specified clearly by the firms. These are one of the main reasons for both the parties to go for the business strategic alliance.

All of these are the key areas that need to be looked out by the firms before any outsourcing decisions. Some of the other grey areas come into the picture once firms are through with the outsourcing and thus, to avoid such things during the outsourcing all of these criteria need to be understood and applied well by the firms. Some other factors and advantages for supplier and vendors are shown in the Figure-2.



**Figure 2** Source: Berry at al. (1994)

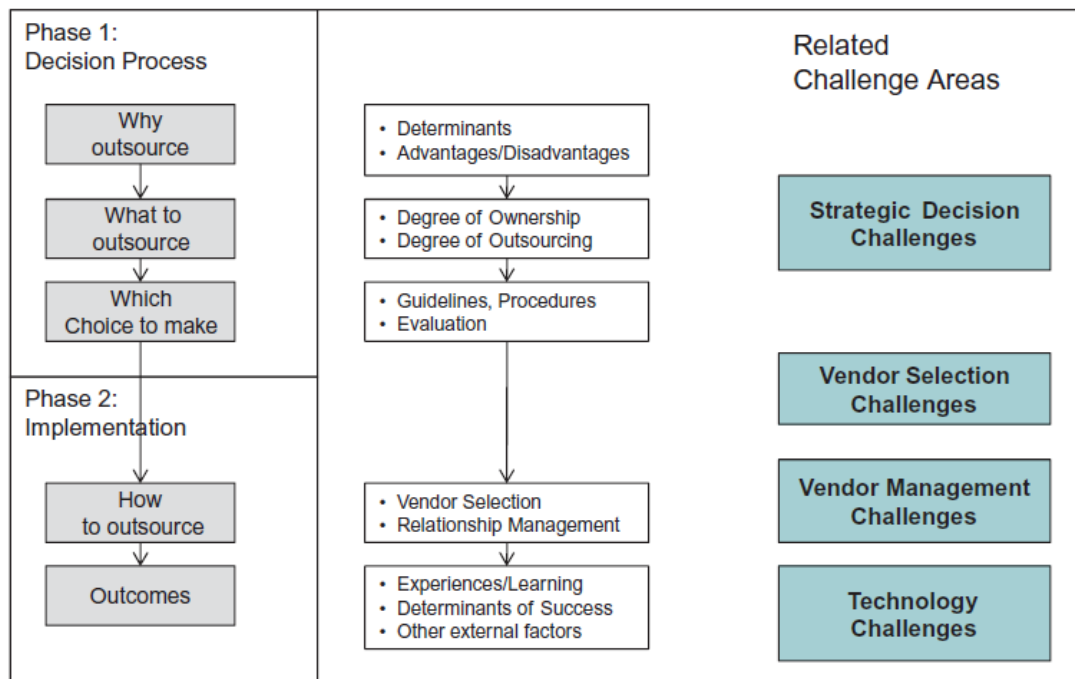
As per Berry at al. (1994) these advantages indicate that outsourcing helps for supplier as well as its customer i.e. industries which do outsourcing. Out of all these advantages, just in time delivery and faster delivery are very important. Just in time delivery has its own implications which may not be beneficial as it involves risk of supplying material just on time when required but also, it has many advantages such that it helps in reducing inventory holding costs to a great extent which costs companies very high depending upon their size especially large companies. Also, product developments through vendor developments can be made faster which helps companies to become more profitable by outsourcing the tasks which are cost cutting tools for them. Apart from these advantages discussed, other advantages of technological and management advances can be achieved even by the vendors or supplier to whom the outsourcing task has been given. This all works in a 2-way direction and helps both the parties. To obtain synergy for both the parties, it is very important for both of them to find their respective partners who can prove to be an asset for each other. Usually, this has not been attained as it involves a complex process of selection and management.

The major challenge that companies have been going through in terms of their processes is of the in-house and outsourcing management. Maximizing the profits has become a challenging task because there is high mismanagement of the tasks that are carried in as well as out of the organization. While outsourcing is associated with several important benefits, it also entails a number of risks (Earl (1996), Leavy (2004)). Also, acquisition of resources from outside the firm, by itself, does not guarantee competitive advantage. This takes the risk of outsourcing to a different level because what may be seemed as a cost cutting technique, may lead to losses as well due to the risks involved. Thus there is a need to resolve this problem from company's perspective. This problem resolving includes the understanding of certain factors that have been discussed above. Also, the challenges during outsourcing occur at many stages of the process which should be sorted out at the time of inception only. Some of the outsourcing stages and the associated challenge area with them are discussed in section 3.

### 3. Map of Outsourcing Stages and Challenge Area

Figure-2 shows the different phases and the related problems which are associated to such processes. There are two processes in any project which talks about the decision and implementation. Each process has some challenges that need to be looked upon while making any decision. Outsourcing the processes which are not good at the company's level is evaluated in these stages only. Determinants of such tasks and processes vary

from company to company and from size of company. Based upon these determinants, companies take outsourcing decisions and the outcomes decide that companies had been taking right decisions or not. Thus, at every stage of the process, challenges have to be looked and resolved to the best to attain maximum efficient outputs.



**Figure 3** Source: Herath et al. (2009)

Challenges may be of any form as stated above and may come at every stage of outsourcing be it the decision stage or the implementation stage. These challenges have to be resolved with such effectiveness that the outsourcing decisions or the outsourcing portfolio is a success for the firm and is on the line of strategies planned. For the SME's, they may not rely upon high level of outsourcing because the risk factor is high for them for their given limited resources and thus, it becomes a difficult task for them to maintain an efficient level of outsourcing. Similarly, for the bigger firms, at every step factors to be considered become high and thus complexities increases. Based upon the decision set, execution of outsourcing is done by the companies. Complexities at every stage increases due to unforeseen problems at each stage. This makes firms to review their decisions that where did they went wrong with the strategic planning of their outsourcing.

These types of problems become a huge loss for the firms because during the implementation stage, main focus is on the problem solving and there is a trade-off for the firms to find the easy way out that is cost effective as well as efficient. These types of scenarios are common for any firm in any industry and thus need to be resolved with utmost important decisions. This paper is an attempt to find such reasons of outsourcing which are the reasons for firms to outsource and later will discuss about the problems during implementation and then will suggest few solutions to those problems which are encountered by firms.

#### 4. Research Work

To fully understand and to see whether the normal outsourcing issues that have been cited go with the sample firms also, we have taken the qualitative survey from a sample of industries. We have taken a structured questionnaire based interview from the managerial employees of different SME's and few big firms. The survey sample taken has helped us to find the outsourcing reasons and other different problems that they have been facing in past and also have been encountering usually during the procuring of products and services from the vendors. Structured questionnaire has helped us to get the unbiased results from managers who are employed into services as well as manufacturing sector. Also, we have ensured that the sample taken covers most of the manufacturing and services sectors for which we have surveyed single manager per firm to broaden our research. Third party firms are the ones who outsource a part of their business as well as get some business as a part of outsourcing by some other firm. So, to understand their perspective, it was quite essential to survey them and thus they have also been surveyed. However, not a large number of third party industries have been surveyed due to certain limitations but a significant outcome has been achieved from the surveyed firms.

Apart from some of the common reasons and challenges of outsourcing, there are many other reasons which vary from industry to industry, it has been ensured that the survey gives them an unstructured information sharing tool so as to ensure a good research and its outcome for the firms and topic. Thus, many of the factors have been considered while researching and to obtain significant outputs.

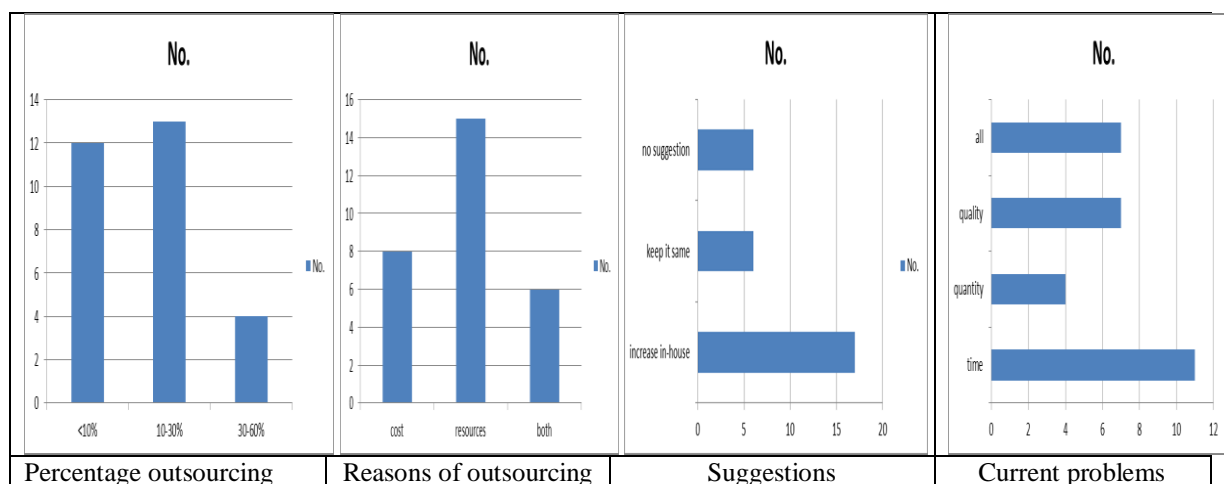
### 5. Result/Analysis

Survey conducted has been primarily focused on the people employed in manufacturing sector. Most of the respondents from the survey have discussed that there has been a need of outsourcing in their organizations and also many shortcomings including the given have been coming for the firm regularly. Another significant point to be noted is that most of the respondents belong to the mother plant or office which actually outsource more as compared to a third party company. All the respondents belong to different industry but have cited many similarities in terms of their outsourcing processes and requirements.

Outsourcing requirements vary from small to bigger firms and the variability in terms of the company size has also been maintained during the survey to again making the research unbiased. Some of the important outcomes of the survey have showed that irrespective of the company size, outsourcing being done by the company is very low. Almost, half of the respondents have admitted of their companies doing nearly 10% outsourcing for their processes. Also, due to many outsourcing problems more than half of the respondents have suggested to increase the in-house production for the company. Dependency on outsourcing has seen a negative trend because of many problems which are almost common in any industry. According to the survey also, major issues that have come up in case of the current outsourcing projects of companies include time issues more as compared to any other issues like quantity or quality issues etc.

However, before these implications, main reasons which drive the companies to go for the outsourcing projects include absence of resource or costs etc. equally. However, limit of outsourcing and in-house production recommendations clearly suggest that companies have been outsourcing due to cited reasons but are not happy with the supplier’s performance. From the framework discussed, it can be clearly seen that most important criteria that drives the outsourcing projects is of supplier evaluation which has not been done well by the companies. Due to this reason, companies want their in-house production to expand as against outsourcing the projects to any third party. Numbers of companies which are facing same problem are high in numbers and thus the real problem that has been coming talks about the insufficiency of companies in carrying the outsourcing projects rightly. As discussed in the beginning, same reasons about the outsourcing challenges have come up and the most common problems which do not allow companies to carry a good outsourcing project have been clearly seen in the survey results.

Above remarks have been made for the survey (Annexure – page 7) based upon the chart analysis done for the responses given by respondents.



From the above charts, it can be analyzed that outsourcing by companies has been restricted to less than 30 percent overall. Also, cost and resources both are a significant reason for companies doing outsourcing. For sampled companies, higher number of them has said to accept time as the most important reason whereas other reasons also have been significantly cited by them. Based upon the reasons given by the managers, most of them have suggested increasing in-house production. Increasing the outsourcing methods have not been taken well from the respondents. This came up as a variation from the usual study or the usual notion of companies wanting more outsourcing now-a-days.

## 6. Conclusion and Recommendations

From the research work carried out, it can be concluded that most common reasons that have been discussed for the outsourcing projects have been applicable on the firms taken for the survey. All common reasons are applicable directly or indirectly with any firm involved in the outsourcing. Also much to our surprise, outsourced business has been found very low at these times when actually it has been increasing around the industries of the world due to given factors. But there are obvious reasons for such an off-track measure as discussed. Since, companies have been not much successful in implementing the outsourcing project, therefore high percent of the responses indicates that companies should rather build on their capabilities and thus can avoid problems which they are currently facing with outsourcing projects due to their in-capabilities or due to any other reasons which may not have come up in the survey conducted. Although, any company if do not see any advantage with outsourcing will suggest that and there may be many reasons which vary from geographic regions as well as from environmental factors as well. From the survey conducted, it can be found that these reasons have taken a toll on the outsourcing as sampled firms do not want outsourcing. However, few firms do want to rely on outsourcing as they see benefits in them as against in-house productions. Thus, outsourcing replacements cannot be neglected even for the surveyed firms as well as from other industries.

Some of the recommendations that can be made based upon the research are:

1. If companies' evaluation for the vendor selection and management is good or is done correctly, outsourcing can be beneficial for both the parties and synergy can be obtained.
2. Also, companies should look for alternatives at every stage of challenging be it strategic or technical.
3. Outsourcing the processes decrease the lead time and can benefit the organizations as then organizations need not to focus on their many process and thus can focus on process in which they are competent.
4. Outsourcing is not specific to any particular industry and from surveying many industries, it can be stated that they need to focus on the three major factors of outsourcing more which include cost, time and quality.
5. Companies do not rely much on outsourcing but they need to evaluate their factors as well as of suppliers only after then, they can rely on outsourcing methods and techniques.
6. Evaluation criteria for the firms have been a bottleneck as many firms fail to do it properly or many vendors fail in the evaluations. Both need to work in this direction.

## 7. References

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## 8. Annexure

Outsourcing management survey [Survey link: <http://bit.ly/1f39h0s>]

\* Required

1. In which type of sector are you working? \*
  - \* Manufacturing
  - \* Services
2. You are working with? \*
  - \* Mother plant/office
  - \* With third party outsourced company
3. What is the core business of your company? \*
4. Your company is a \*
  - \* Small scale company

- \* Medium scale company
- \* Large scale company
- 5. What percent of your business is being outsourced? \*
  - \* <10%
  - \* 10-30%
  - \* 30-60%
  - \* >60%
- 6. Main reasons of outsourcing by your firm? \*
  - \* Absence of enough resources
  - \* Cost of outsourcing is less than cost of in-house production
  - \* Both of the above
  - \* Other:
- 7. Major issues being faced with current outsourcing projects? \*
  - \* Quantity or poor service issue
  - \* Time issues
  - \* product/service quality issues
  - \* all of the above
  - \* Other:
- 8. You would prefer your company to \*
  - \* increase the outsourcing projects
  - \* increase in-house production or services
  - \* be as it is with outsourcing
  - \* no specific suggestion as of now