OUTSOURCING: WHY AND WHY NOT?

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ABSTRACT
The objective of this work is to provide the basic vocabulary for understanding the outsourcing concepts and to emphasize the main advantages and disadvantages of this strategy, that were highlighted in the literature by researchers, in the last decade. These characteristcs are analysed and then grouped under certain categories for a better understanding of the outsourcing implications. The result will be an organized framework that describes outsourcing from different perspectives and could be used as a milestone for a in-depth research in the field.

KEYWORDS: *advantage outsourcing, core competency, disadvantage outsourcing, outsourcing definition*

JEL CLASSIFICATION *M16*

1. INTRODUCTION

The success in business depends on a variety of elements, some of them visible by the clients, like the quality of the products or the after sale services, but the ones that really make the difference are the structures under which a company is organized. To be able to offer products and services at the highest standards, the company must focus on those activities that it knows how to handle best, which bring value and represent the differentiation factor among the competitors.
The first objective of the paper is to emphasize the importance of discovering which the core competencies of a company are. Furthermore, observing the fact that organizations tend to perceive outsourcing as a mean of achieving performance improvements in many areas of the business, the second objective is to present also the collateral effects that can arise on the long term.

2. WHAT IS OUTSOURCING?

Nowadays the business environment is really challenging in order to stay competitive in the global market. The companies are striving to find and develop the best strategies to achieve efficiency and leverage their capabilities. One viable solution for them is outsourcing, which currently is considered to be one of the best ways of reshaping management.
The concept of outsourcing is not new, because for decades the companies collaborated with external providers for some services like cleaning or catering. What is new is the scale of the departments outsourced, that now include everything that is not considered value added, from IT and accounting to HR functions.
In order to define what outsourcing means, some of the findings of the researchers are the following:

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- Predetermined means of externally obtaining goods or services previously provided by the organization itself (Kakabadse and Kakabadse, 2000)
- Contractual relationship for the provision of business services by an external provider (Belcourt, 2006)

Based on these affirmations, the outsourcing strategy supposes contracting another company to do some of the activities that were done in house in the first place.
A clarification of the terms for outsourcing was provided by the researchers (Dolgui and Proth, 2013), who noticed that occurs some confusion between the concepts ‘outsourcing’, ‘offshore outsourcing’, ‘off-shoring’ and ‘subcontracting’.

Table 1. Outsourcing terminology

	Term	Explanation
1	Outsourcing	- the act of obtaining semi-finished products, finished products or services from an outside company if these activities were traditionally performed internally. The company that outsources is called ‘buyer’, whereas the company that provides the service is known as the ‘vendor’.
2	Offshore Outsourcing	- the vendor is located in a country different from that of the buyer
3	Off-shoring	- the company is fully relocated to a country other than his home country
4	Subcontracting	- part of the work is transferred to another company that has special skills or resources that allow it to perform tasks clearly specified in better conditions

Source: adapted from Dolgui and Proth, 2013, p.3

3. WHAT TO OUTSOURCE?

In today’s context, when the external environment is characterized by competition pressure, the companies focus on what they do best, on their core competencies and capabilities. These are considered to be the source of the competitive advantage they have in the market; so consequently, the decision will be to outsource all the other activities that do not have such an advantage (Prahalad and Hamel, 1990). By externalizing activities that are not of a strategic nature, they stimulate the essential competencies of their organizations (Doh, 2005, Nordin, 2008 and Zhang and Dhaliwal, 2009).
The toughest decision in outsourcing is what to outsource and what not. The best strategy is to establish which the core competencies of the business are, what makes it different from the competition and what brings the value added. According to Prahalad and Hamel, who created the concept of core competencies, not the products are creating the competitive advantage, but the management’s ability to adapt to the change and to identify the best opportunities in changing environment circumstances (Prahalad and Hamel, 1990).
After establishing which the core competencies are, all the other activities could be subject for the outsourcing process. The core competencies could be identified based on the following characteristics highlighted by the researchers:
Quinn and Hilmer, 1994:

- Have a range of expertise that crosses traditional functions horizontally.
- Have the capacity to adapt to changes in long-term demands of clients.
- ‘Core competencies’ must be limited in number (as a matter of effective management).
- Dominate the competitors with regard to these skills.

- Being close to customers in order to be recognized as a leader.
- Be able to continue and even improve the domination of the competitors.

Alexander and Young, 1996:

- Activities traditionally performed internally.
- Activities critical to business success. Core work contributes directly to the bottom line; non-core work doesn't.
- Activities creating current or potential competitive advantage.
- Activities that will influence future growth or rejuvenation.

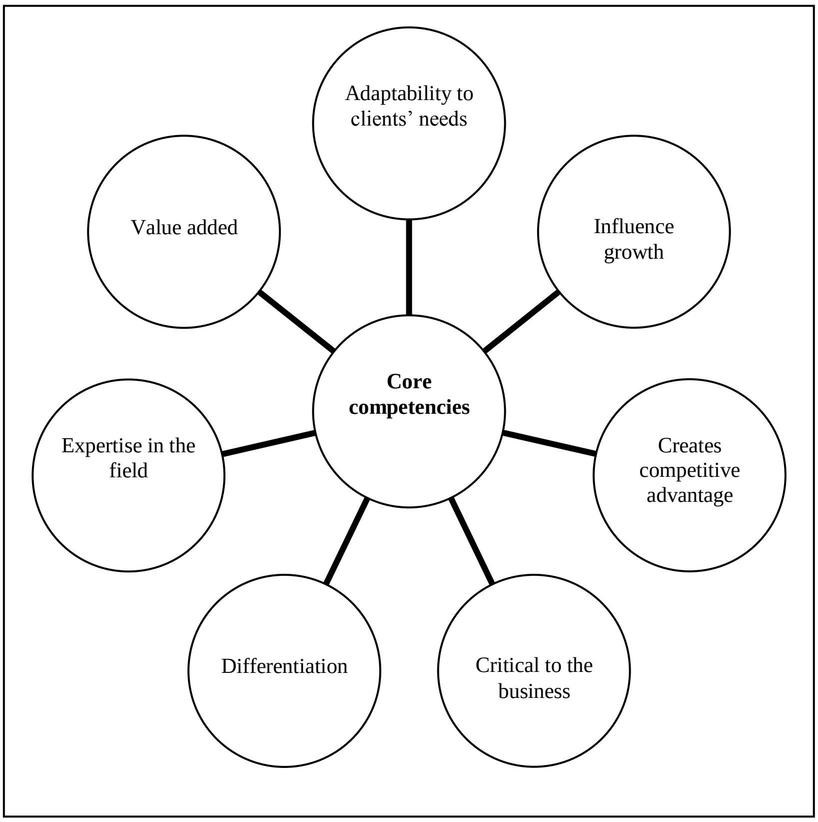

Figure 1. Core competencies characteristics
Source: Own editing based on structured literature review

The theory says that the benefits that result after a right outsourcing decisions, are helping in strengthening the company's internal resources (Nordin, 2008), due to the fact that by outsourcing, the company can focus on the activities that create greater competitive advantages (Javidan 1998 and Pinjala et al. 2006).

Some examples of core functions that are not supposed to be outsourced are orientation, leadership development, employee relations, final selection, confidential information (Belcourt, 2006). On the other hand, Aron and Singh (Aron and Singh, 2005) proved that the companies that outsourced to specialists in the field sensitive functions like design, engineering, manufacturing and marketing had a lot of benefits in return.

When outsourcing, a company is leaving in professional hands the activities for which does not have sufficient resources or knowledge. By adopting this strategy is taking advantage of the capabilities that make it better than the competitors and is putting all the efforts in order to develop those core capabilities and the performance level at which they are done.

Having in mind these elements, it results the importance of making some in-depth analysis before outsourcing, because this strategy won't function if is not correctly implemented. The best decision can be taken after a rigorous plan which contains a structured view of the company's end to end process. Only then it will be possible to identify and eliminate the non-value added and non-strategically areas, which will be subject of outsourcing.

4. WHY TO OUTSOURCE?

The main reason why outsourcing has become an important component of the organizational strategy is the fact that the companies begin to recognize that they cannot perform with excellence in all areas, therefor they decide to make a fundamental change in the way they do business (Prahalad and Hamel, 1990) by restructuring the activities in order to stimulate growth of its core business.

The main reason for outsourcing is cost saving. Outsourcing Institute wanted to determine other reasons for choosing this way of organizing the company, so in 1998 surveyed their business members, discovering ten different advantages. The results were clustered by the researchers David and Amy Chou, into the following categories:

- Transaction costs
    - Reduce and control operating costs
- Re-engineering and innovation processes
    - Accelerate re-engineering processes
- Resources management
    - Free internal resources for other purposes
    - Resources are not available internally
- Market competitiveness
    - Improve company focus
    - Gain access to world class capabilities
- Risk management and quality issues
    - Function difficult to manage/out of control
    - Share risk
- Financial resources
    - Make capital funds available
    - Cash infusion

The advantages that rise when outsourcing can be clustered in many categories and can affect in a positive manner also the following areas: technology, quality, productivity.

From the productivity point of view, when dealing with an external provider, all the activities must be measured, set the expectations and analyze if what was done equals, exceeds or is under what was agreed. The activities that are being outsourced are repetitive ones that bring low or non-value added. It is necessary to create a procedure manual where all the processes are registered step by step. If is easy to codify the steps, than the transition to the supplier will be smooth. Processes with a high proportion of explicit knowledge are easier to be codified than those with high proportion of tacit knowledge and therefore can be transferred more readily to a supplier (Aron and Singh, 2005). By taking this burden from the internal employees, they have the opportunity to stay focus on the strategic activities, on the development of the company and on value added roles. In his research, Oshima (Oshima et al, 2005), observed that companies that did outsource had diminished their administrative tasks with more than 50% and increased their strategic focus by 40%. Having all the performance standards and targets agreed in a contract, the quality of the activities will increase both for the internal employees and for the vendors' employees.

An increase of performance and quality could be obtained also due to the greater depth of knowledge that the external provider has in the field. Specialized vendors offer a higher degree of efficiency because they can spread the costs to more users (human resources coordinator, for example). Studies that evaluated the results of outsourcing after 2 years of contract, demonstrated a cost saving of 15% in average and the perception of the buyer that the objectives have been met and the labour productivity was improved (Oshima et al, 2005). Collective learning is the effect of the perfect match between the employees of the buyer and the vendor, engaged in the outsourcing process. All in all, this will help in the reinforcement of the core competencies of the firm. (Prahalad and Hamel, 1990)

Another advantage of outsourcing is the technology. At a certain point, organizations decide to improve the technical service, or they cannot find technical talent, or they need quick and reliable access to new technologies so they contract an external provider (LaCity and Hirshheim, 1995). The vendor that is entitled to perform the activities is continuously looking forward to be up to date from the technological point of view because the purpose is to reduce the time an activity is done, to be able to perform more. In outsourcing, the contract is done from the perspective of the activities and is not taking into account the number of human resources necessary to do that.

An outsourcing decision for a specific department of the firm could be taken not only based on the value added, but also on the low productivity. Offering these tasks to someone that could perform them better reduce the head count, the payroll amount and the taxes. Organizations which outsource achieve a ratio of 1:231 (one HR person to 231 employees) compared to the tradition 1:100 (Oshima et al, 2005). Once again the cost saving advantage of outsourcing is proved.

Other outsourcing advantages that are common in the literature are summarized also by Dulgoi and Proth (2010):

- *Cost saving*- a lower cost is obtained by choosing a vendor that can perform the activities to be outsourced at a higher performance level of accuracy and efficiency than the buyer could
- *Reduce staff*- not only there will be less persons on the pay roll, but the buyer will not concern any more in facing the fluctuations in staffing due to changes in demands because he pays for the amount of work that needs to be done and not for the persons needed to perform it. The hiring of the resources, training and efficient knowledge transfer is the responsibility of the vendor.
- *Free employees from tedious tasks in order to allow them to concentrate on core activities.* It was noticed that a company outsources in the first place the repetitive activities, that require a lot of time invested but do not bring back that much financial benefits
- *Gain benefit by taking advantage of external expertise or outsourcing non-core activities.*
- *Achieve greater financial flexibility by selling assets that were formerly used in the outsourced activity in order to improve company's cash flow.*
- *Gain access to external skills and technologies.* This advantage is applicable only if the 'vendor' do not provide only the workforce, but takes the responsibility to improve the process through innovative procedures or technology
- *Vendors are assumed to provide quality activities: paying for service creates the expectation of performance (in costs, quality, flexibility, etc.)*

Even if at a first glance, this management strategy of outsourcing seems to fit only for the large companies, was proved that the same advantages can be obtained also by small-medium size enterprises. Paresha Sinha et. al (2011) conducted a qualitative study in China in order to find out the motivations for offshore outsourcing encountered by manufacturing small medium size enterprises and their suppliers. The first pro- argument that resulted from the research was the increasing efficiency and labor cost reduction while holding quality constant. The second main reason was the possibility to enter new markets both for manufacturing firms and their suppliers due to the flexibility in resource allocation. From the perspective of the buyer, it is highlighted that the key to success in an offshoring outsourcing is to maintain a good relationships with the supplier of the activities outsourced. This is the first step in order to secure the quality that is delivered. From vendor's perspective, the way they deliver the services for which were hired, helps them improve their international image and can gain additional exposure by supplying international clients.

5. WHY NOT OUTSOURCE?

All the arguments presented above are theoretically in favor of outsourcing. However, was noted that some of them can have in certain circumstances, negative effects on the company that outsources or in the country from which the activity is taken away.
As stated before, the main reason for outsourcing is cost cutting and the first restructuring decision that a company takes into account is the labor costs reduction. Based on this, from employee point of view was observed a huge decline in the moral and the performance of the daily activities (Elmuti & Kathawala, 2000). Having a permanent job creates a feeling of security, but the possibility of losing it, will put a lot of tension in the relation employee - company. The reason is that, no matter how smooth the transition is planned there will always be employees that will be dismissed or replaced when switching processes to a new vendor.
According to A.Dolgui & JM.Proth (2013), the company that outsources can face four different types of risks:

- Dilemma of competitor
- Loss of initiative by the buyer,
- Migration of products and services to vendor's country
- The harmful aspect of offshore outsourcing strategy.

In outsourcing, over the time, the buyer-vendor relation develops and the flow of information and know-how will became more and more complex. This side effect could be emphasized if the vendor has a hidden interest to gain insights to the core competencies of the buyer and became a competitor in the medium-long term.
The second minus noted by A.Dolgui & JM.Proth (2013) in outsourcing, is the low level of flexibility and freedom of actions. Every change of procedure must be negotiated with the vendor and might include extra costs, depending on the complexity. Organizations often outsource processes without fully understanding the connections of that part with other departments of the business and this can lead to poorly specified requirements in the contract the parts agreed.
From the location point of view, the buyer is usually located in a developed country and the vendor in a developing one, in order to afford to offer low salaries to the employees for the same job. The changes of scale at which companies outsource, (that now includes also IT, top services, aviation, automobiles etc) give the opportunity to host countries to create the skills and the tools to compete with developed countries. The concern is that this approach of some investors that want to make money at any price might end up in destroying the industry, research and development in developed countries.
Offshore outsourcing can have harmful effects both on the employees and on the country. From employees' perspective, if they remain without a job because their employment has been outsourced, it is difficult to find an equivalent job opportunity from the point of view of responsibilities and salary offered. On the other side, in the host country, many jobs opportunities will be created and the unemployment rate in a region will be greatly diminished. With the regard to the harmful effect on the countries, a valid example is the French company Renault that decided to develop a low-cost brand in Romania. After this decision, the sales for Dacia, exploded in Western Europe, causing a significant decline in the sales of the other brands (including Renault). Having the above examples, we can came to the conclusion, that if outsourcing effects are not seriously analyzed on the short term and on the long term, can lead to consequences like unemployment, declining living standards and deindustrialization.
In order to make a comparison of the benefits and the consequences that outsourcing offers, the below table could be a valuable support:

Tabel 2. Objectives and related consequences in outsourcing

Objective	Consequence
Vendor with low prices	- Unemployment in the country of the buyer
Reduce staff in the country of the buyer	- Unemployment in the country of the buyer
Free employee from tedious tasks	- Unemployment in the country of the buyer
Taking advantage of external expertize	- Possible only if the vendor has a high technological level, but in this situation the prices will be higher
Improve financial flexibility by selling assets that became unnecessary due to outsourcing	- The sale of assets reduce the possibility of future extension of the buyer
Gain access to external technology	- If the need for technology is permanent than the buyer become dependent on the vendor

Source: adapted from Alexandre Dolgui & Jean-Marie Proth (2013)

6. CONCLUSIONS

To achieve the competitive advantage in a continuous changing environment it is necessary to reshape the boundaries of the organization by making the right decision on what to keep in-house and what to outsource. Nowadays, outsourcing is promoted as one of the most powerful trend. It is not only a cost saving exercise, but a strategic movement that allow managers to limit the firms functions for which they are responsible and focus on the core competencies.

Almost all the autors on the subject come to the conclusion that the organization should focus on activities in which it possesses a sustainable competitive advantage and externalize those that do not bring value added. In a nutshell, outsourcing offers the following advantages: enables companies to focus on their core capabilities, balances the number of employees, reduce costs, offers access to new technology and improves the productivity and the quality. On the top of this, through outsourcing is encouraged the development of resources that enable the achievement of sustainable competitive advantage.

The problem is that many organizations often rush into outsourcing without fully understanding the consequences. After a while they realize that there are important side effects and the process is not so cost effective on the long term, and neighter problem free. The negative effects can impact not only the company internaly, but also the contry where it was located initially by creating an increasing unemployment rate.

All in all, the right outsourcing strategy depends on the ability of the managers to understand their businesses and to make the right decision, balancing all the risks. A good transition from in house to a third party vendor can be done only through detailed analysis.

The general opinion after the literature review is that many researchers tried to present in full detail the positive and the negative implications of outsourcing, but do not concentrate that much on giving guidelines to managers in order to make the best decision. The limit of this research is that it does not present any tools that can offer support in the decision making process, consequently this represent the direction for the future research in the field.

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