



Outsourcing vis-à-vis organizational performance

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Abstract

The purpose of this study is to examine the relationship between outsourcing and organizational performance in the services sector. The population of the study is made up of 50 firms operating in the banking and insurance sectors of the economy of Ghana. The paper used purposive sampling for the selection of the respondents. Questionnaires were distributed to the respondents for statistical analysis. The study utilized Statistical Package for the Social Sciences (SPSS) to analyze the data collected. The study revealed a number of findings including: there is no statistically significant correlation between outsourcing and organizational productivity, there is statistically significant correlation between outsourcing and quality, there is statistically significant correlation between outsourcing and competitive advantage. Based on the findings, some recommendations were made most importantly: there must be thorough background check before outsourcing, and organizations must also have a back-up system to avoid losing vital data as a result of incompetence on the part of the external supplier.

Keywords: outsourcing, organizational performance, competitive advantage, resources, productivity, quality, off shoring

Introduction

Most firms are in business for the purpose of making profit. These firms then put measures in place to reduce costs in order to increase profits. A common strategy that is commonly used for this purpose which has brought some debate in both academia and professional practice is outsourcing; a common trait of business-to-business firms. Outsourcing is the process whereby firms purchase products and services from other companies than to make the products or perform the services internally (Bearden, Ingram, Lafarge, 2007) [3]. Some companies believe that this is more cost effective; as it allows them to concentrate on their core competencies and to purchase the products or services from expert companies than to produce in-house. For example, TV3 Ghana Limited outsources its internet services from UCOM Ghana Limited. The television giant does this to cut down on the costs it would incur in creating an internet service and managing it themselves as well as remaining competitive. Some other firms also outsource because they need to improve their quality and speed of software maintenance and development. Others also believe that outsourcing is now offering much value than it previously did.

Initially, the concept of outsourcing was more popular among the companies found in the manufacturing sector. Companies such as Boeing, BMW, General Motors and Siemens, who are in the manufacturing industry, source from smaller companies in Bulgaria. However, it has now permeated into other sectors of the economy including services and the government. In the services, telephone answering systems, customer services, technical support, among others are also being outsourced. The business functions that are commonly outsourced are information technology (IT) and human resources.

Problem Statement

Some companies consider it more profitable to produce their

products and services in-house while others see it more profitable to source from other expert companies. As noted earlier, outsourcing is a strategy that has become very crucial in most firms' corporate decisions. As far as corporate strategy is concerned, the final decision may always have a positive or negative impact on the organization's financial position in the long run. Some firms, after considering some financial benefits with regards to outsourcing, likely decide to go for it. On the other hand, some hold back due to certain misgivings about the entire outsourcing strategy. They are of the view that the organization's ability to quickly respond to the marketplace will be deeply affected when outsourced. While others say outsourcing is the best way to enhance the financial performance of an organization, others say in-house production is the best option. This has created some academic degree of uncertainty and the need to conduct a study into the relationship between outsourcing and organizational performance.

Objectives of the research

The general objective of this study is to find out the relationship between outsourcing and organizational performance of firms in Ghana. The specific objectives are; to

- Determine the relationship between outsourcing and organizational profitability.
- Find out whether outsourcing leads to increased productivity or not.
- Determine the relationship between outsourcing and product/service quality.
- Ascertain whether outsourcing leads to competitive advantage or not.

Literature review

This literature intends to explore the themes in the research topic; Outsourcing, and impact on organization financial

performance. The elements of concepts in this chapter do not intend to be complete. In order to enable easy comprehension of this discussion, this chapter seeks to explain the key elements of the research topic. The underlining motive for outsourcing is cost reduction. Companies contract external suppliers that can produce products and services at a lower cost than the company can produce in-house. Companies' ability to get a good outsourcing deal will have a positive impact on profitability and vice versa, which is a major determinant of a company's financial performance.

Marketing and outsourcing

Managing marketing performance prioritizes the optimum use of resources (financial and human) to current market requirements. Planning for today focuses on shaping up the business to meet the needs of today's customers with excellence. Planning for today requires an organization that mirrors current business opportunities. Abell (1999) [1]. Organizations now strive to be lean and fast-moving. Handy (1989) predicted shamrock organizations, with small numbers of full-time employees in core roles, and increasing proportions of activities being contracted out, as a means of dealing with a changing environment. Now organizations are outsourcing central functions to their business success, as well as routine activities where there is advantage in doing so (Linder, 2004) [13]. For example, pharmaceutical companies outsource R&D to Contract Research Organizations (CROs). This market was worth \$9.3 billion in 2001(Reuters Business

Insight, 2002).

Nick Wreden, a US management consultant, whose works has appeared in the Harvard Business School Press, specializes in how supply chain issues affect brands. He believes marketing will be the 'next wave of outsourcing.' His supporting reasons include that marketing is 'rarely a core competency', and that marketers have been buying in their expertise in functional areas for years. He believes that the quality of internationally based external suppliers is now so high that it is inevitable that they will attract a greater share of marketing work, citing the quality of different suppliers, such as Philippines' Team Asia, which works with Microsoft; and Jack Yan & Associates in New Zealand who continue to innovate.

Initially, marketers survived the threat of outsourcing because they added intellectual expertise. Now, they need to add more 'intellectual capital'. It is critical that they understand the role of distribution, data integration, forecasting and branding, and have strong customer communications. Marketers now need to use knowledge for competitive advantage. The core marketing knowledge exists throughout the developing nations, but currently few understand management of marketing performance.

Wreden advocates that marketers use overseas resources for efficiency where appropriate, passing the savings to clients. It is clear that most compelling reasons for international outsourcing are that outsourcing providers charge less than the fees of US agencies, without reducing value. So, this tells marketers that they must deliver value.

Table 1: Criteria for initial Outsourcing Evaluation

| Issue | Organization undertake in-house when | Organization outsource when |
|--------------------|--|--|
| Capacity | Internal capacity is non-existent, limited or flexible | They need rapid access to additional capacity or resource |
| Capability | Quality is a key concern for the outsourced work | They wish to improve business performance |
| Cost | Cost will be higher than doing the work in-house | Cost will be lower than doing the work in-house |
| Customer | Customer reaction to outsourcing is negative | Customer value outsourcing |
| Control | There is concern over loss of control over the process | The external party guarantees the service |
| Credibility | Company credibility will be damaged through poor performance from the outsourcer | They gain credibility by using a reputable supplier |
| Compatibility | Outsourced organization has goals that are inconsistent with those of suppliers | Outsourced organization has goals that fit and add to those of suppliers |
| Competitive Issues | They think competitors will take over their business | Outsourcer can add value to Commissioning organizations or competitors |

Organizations are becoming more value and cost oriented and the need to optimize resources for the desired result. Non-core marketing functions such as advertising, database management, etc., are therefore contracted out to specialist external suppliers to undertake. This is more cost effective than undertaking such activities in-house.

Generic View of the Merits and Demerits of Outsourcing

There is no single model for deciding whether or not to employ the service of external suppliers in existence. This decision is normally made based on the analysis of business process and assessment of the reasons for seeking external suppliers. However, evaluation always includes subjective assessment.

The cost benefit is also often unclear here. Marketers are often unaware of the costs of undertaking work internally or

because of budgeting methods and uncertainty over evaluating the activities, especially creative processes. (Traditional measures of success for some suppliers do not measure the commercial outcomes required, for the award winning agencies are not always those which have the best result against campaign objectives.) However, these need a revision, especially in light of the organization's responsibility to its shareholders or the key stakeholders.

Initial Evaluation Overview

An initial evaluation overview will thus look at factors to guide the decision on what to outsource and whether to outsource. Some key factors are summarized below. There are other areas of evaluation and the relative importance of these areas varies depending on the organization, industry and the task to be undertaken.

Legal Requirement

Another major factor that influences outsourcing decision is legal or regulatory requirement. This influence can be seen through:

Contract conditions

These conditions imposed by insurers or conditions related to security or privacy may restrict the use of external suppliers.

Statute

Some public organizations, for example, are restricted by law from contractors (for security reasons). The restricted areas are reducing and governments are increasingly operating Compulsory Competitive Tendering (CCT) policies, thus requiring public sector providers to face competition from the commercial sector.

Regulatory Body

Professional bodies require work to be undertaken by people with approved level of qualification and supervision.

Detailed evaluation

Assuming the outcome to the first stage in the process identifies the potential for using external suppliers, this process can move to the second stage which involves;

- An audit of internal resources, cost, skills and competencies.
- An external provision review, to identify suppliers and cost.

A clear identification of the activity or process to be undertaken by staff or external providers to focus the investigation is required. These processes need to be broken down into resource categories, such as expertise, equipment, people and money. These internal and external evaluations can be done simultaneously, or in an iterative process. They are not sequential.

Internal Appraisal

The Internal Resource Audit may be present in some form in the organization; otherwise, management must detail the staff by level, workload, skills and competencies in the area under the review. Another component here is costs and hours worked (including the overall cover). In addition, the review must measure the flexibility of staff to move to a different role if required. Any misfit between existing and required skills and abilities are identified and the cost of any overcoming these in an in-house provision calculated. The effects of using external suppliers such as the costs of redundancy payments, retaining or other support must be identified.

An Equipment Audit should also be undertaken. Equipment may be a requirement of the outsourced task, and indeed sometimes equipment is transferred as part of an outsourcing agreement. For instance if the outsourcing need relates to a database management activity, existing equipment can be compared to the equipment required to get the full work done. Lastly, management must estimate the available budgets and determine the desirable expenditure, as a basis for discussion with the review of external suppliers.

External Appraisal

Requirement for undertaking the task, detailing the required characteristics, experience, resource and cost of external suppliers, forms the basis for the external review. The process does not emphasize on the choice of providers at this stage.

This appraisal involves information on the number and size of competitive suppliers, their reliability, range of service, past projects (including case history), example of work achievements and performance outcomes, their quality processes and staffing levels. Payment structures also form part of the review.

The decision to outsource

The above assessment will reinforce the decision to outsource, what not to outsource or even which outsource organization to use. Evaluation includes measures to ensure that the decision is consistent at all levels.

Strategic

Strategies must answer; what is the impact on the organization’s competitive position? What is the impact on the organization’s brand position? Is the core competence under threat by this? Are our weakness reduced by this? Does this helps or hinder the long term development of asserts or expertise?

Operational

What supervision and guidance is necessary for control and consistency with organizational requirements? What actions are required from the organization and the external supplier? What are the performance targets? How will these be measure? What are time-cost trade-off points?

Organizational

How is the implementation linked to marketing strategy? How will it ensure result? Will this create conflict or loss of morale within the organization? Will this improve the organization’s cost structure and profitability? Will this improve overall operational effectiveness?

Why outsourcing

Table 2: Top ten reasons for outsourcing

| S. No | Reason for outsourcing |
|-------|--|
| 1 | Reduces and control operating costs |
| 2 | Free internal resources for other purposes |
| 3 | Improves company’s focus |
| 4 | Resources are not available internally |
| 5 | Accelerates reengineering benefits |
| 6 | Gain access to world-class capabilities |
| 7 | Difficult to manage or control function |
| 8 | Make capital funds available |
| 9 | Share risks |
| 10 | Cash infusion |

Problems or challenges with outsourcing

Outsourcing and off shoring are not without problems. Many companies discover that their cost savings are less than the vendors sometimes promise. Also, companies that sign

multiyear contracts may find that their savings drop after a year of two. When propriety technology is an issue, outsourcing raises security concerns. Similarly, companies that are protective of their customer data and relationships may think twice about entrusting functions like customer service to outside sources (Kurtz *et al*, 2006)^[8].

Outsourcing may not always deliver. Managers are poorly prepared for outsourcing. Bain's research shows that 82 percent of large companies in developed markets use outsourcing, but approximately half of these think that outsourcing does not meet their expectations. The cost savings only satisfy 10 percent of these respondents. However, outsourcing causes problems as well as having the potentials to solve those (Gottfredson *et al.*).

In some cases, outsourcing and off shoring can reduce a company's ability to respond quickly to the marketplace, or it can slow efforts in bringing new products to the market. Suppliers who fail to bring goods promptly or provide quality services can adversely affect a company's reputation with its customers. General Electronic had to delay the introduction of a new washing machine because of a contractor's production problems.

Another danger of outsourcing is the risk of losing touch with customers. When telecom giant Sprint realized that the customer data to its outsourced technology providers was not being put to work fast enough, the company decided to pull the plug on the external supplier. In their place, Customer Relationship Management (CRM) software was able to pull data on more than 10 million business accounts, saving Sprint \$1 million in the first year.

Outsourcing and Off shoring are controversial topics with unions, especially in the Auto industry, as the percentage of component parts made in-house has steadily dropped. These practices can create conflicts between non-union outside workers and in-house employees, who fear job loss. Management initiatives to outsource jobs can lead to strikes and plant shutdowns. Even if it does not lead to destruction in the workplace, outsourcing and off shoring can have a negative impact on employee morale and loyalty.

Research methodology

The study used a quantitative approach to determine whether or not outsourcing (the independent variable) can impact on organizational performance (the dependent variable) of service industry in Ghana. The study population includes 50 services companies operating in the Banking and Insurance sectors of the economy. The population is divided into two groups; the first group has to do with organizations operating in the banking sector numbering 30, and the second group is the organizations doing business in the insurance sector numbering 20. Questionnaire and interviews were used to collect all the necessary data from the management and employees of the organizations mentioned earlier. With regards to the questionnaire, both open-ended and close-ended questions were used. This question style was adopted because it will facilitate ease understanding on the part of the respondents. It will also enable me to have a direct visual impression of the trend of events. The questionnaires were given to customers personally and they were assisted to fill. To get this respondents (sample- 50), purposive sampling

techniques was used. That is, the selection of the respondents was as a matter of necessity. This technique was used because it helps in saving cost and the cost saving may be used to improve the quality of the research through increasing sample size. Again, the data, when compared to random methods which are perhaps double the cost, has been proved to be acceptable provided that the research is managed effectively. Statistical tools or normal distribution curves and software packages such as SPSS was used to analyze the data.

Data analysis correlations analysis

The coefficient of the correlation analysis which is -0.24 shows that there is weak negative correlation between outsourcing and organizational productivity. This means that changes in outsourcing will not correlated with changes in the organizational performance. Therefore one can conclude that outsourcing and organizational productivity are not strongly correlated.

With regards to Sig (2-Tailed) value which is 0.867, we can conclude that there is no statistically significant correlation between outsourcing and organizational productivity. That means, increases or decreases in outsourcing do not significantly relate to increases or decreases in organizational performance.

Relationship between outsourcing and quality

The coefficient of the correlation analysis which is 0.218 shows that there is weak positive correlation between outsourcing and quality product or service. This means that changes in outsourcing will correlate with changes in the quality. Therefore we could conclude that outsourcing and quality are strongly correlated. In addition, Sig (2-Tailed) 7value which is 0.129, we can conclude that there is statistically significant correlation between outsourcing and quality. That's, increases or decreases in outsourcing do significantly relate to increases or decreases in quality.

Relationship between outsourcing and competitive advantage

The coefficient of the correlation analysis $r = -0.165$ shows that there is weak negative correlation between outsourcing and competitive advantage. This means that as one variable increases (outsourcing) in value, the second variable decreases (competitive advantage) in value. We could conclude that when the organization continues to outsource from other organizations or if there is an increase in outsourcing, competitive advantage of the organization will decrease in value. In addition, Sig (2-Tailed) value which is 0.251, we can conclude that there is statistically significant correlation between outsourcing and competitive advantage. That is, increases or decreases in outsourcing do significantly relate to increases or decreases in competitive advantage

Findings

The objective of this paper is to examine the relationship between outsourcing and organizational performance. This was done in order to ascertain whether carrying about business functions in-house or through external agencies is more profitable. The general assertion is that a well implemented

outsourcing strategy would;

- Reduce and control operating costs
- Improve the firm's focus
- Help the firm gain access to world-class capabilities
- Helps in sharing risks, among others,

This will therefore have a positive impact on the financial performance of the firm. It is therefore obvious from the results that there is weak negative correlation between outsourcing and competitive advantage. This means that as one variable increases (outsourcing) in value, the second variable decreases (competitive advantage) in value. The results again show that there is weak positive correlation between outsourcing and quality product or service. This means that changes in outsourcing will correlate with changes in the quality.

Conclusion and recommendations

Based on the findings from the study, one can conclude that even though outsourcing enables organizations to focus on their core business yet, when the organization continues to outsource from other organizations or if there is an increase in outsourcing, competitive advantage of the organization will decrease in value. With this, the following recommendations could be made:

The firm must make sure that it recruits the services of third party firms that are trustworthy and credible. From the research carried out, most of the workers were assured that information being leaked to other competitors would be quite impossible if the external party comes highly recommended. It is therefore of greater importance that measures are put in place to check that information is protected.

A thorough and an extensive assessment of the firm must also be carried out to see if the firm carries out its functions outside. The commitment of the company would come into play here. It has been observed that outsourcing may not always be the strategic option for a firm in every situation, so, usually the best option would be to carry out the function in-house if they are well equipped to.

In order to avoid losing very vital data due to the incompetence of the external party, the firm must also make back up of all the information that it gives out. This would help the firm to evade losing very pertinent customer information.

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