OUTSOURCING IN ORGANISATIONS: A NEW MANAGEMENT REALITY

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ABSTRACT

Outsourcing has become a major component of globalization and information technology strategy in many companies around the world. From the early 1990s to the present, the reality of sourcing has varied significantly, an example being the services that organizations typically choose to transfer to external providers, which are now different from those of one or two decades ago. This paper explores outsourcing in organizations: a new management reality. It explores this proposition using an exploratory analysis. The paper formulates the modes of outsourcing and the drivers of outsourcing which could contribute to better organizational performance. It demonstrates that when used correctly outsourcing can deliver benefits such as cost reductions, enhanced skills capabilities, shifting technology risks, ability to focus on core business competencies, improved quality and competitive advantages. However, while outsourcing partnerships offer many benefits, there are also concerns and potential challenges which include among others; employees reacting badly to outsourcing, data theft and security concerns, cultural differences between client and vendor organizations – all of which must be taking into cognizance by managers and must adapt to new realities. Based on these challenges some recommendations were made; communication should be established with fearful employees to ensure they understood their roles and are properly compensated to stay through the outsourcing initiative, and that outsourcing vendor candidates must have a proven track record of maintaining strong security programmes at their locations and should have procedures to protect intellectual property.

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INTRODUCTION

The Independent National Electoral Commission (INEC) in Nigeria is now outsourcing the production of some of its electoral materials to firms in South Africa. Even the Central Bank of Nigeria (CBN) is now outsourcing the mintage of some of the Naira denominations to firms overseas. In addition, most Nigerian businesses are also not left out in this trend of outsourcing as a new management reality. This is how a global economy works. Thus, the rules and realities of business have changed. Organizations don't need to own all of their products, services, and infrastructures, they simply need to be able to access these capabilities and achieve their business goals (Crawford, 2000:1).

Therefore, the corporate and industrial landscape has changed tremendously in the last decade. A series of geopolitical, macroeconomic, and technological trends have influenced the way businesses operate. Globalization has created opportunities by enabling access to new production facilities and product markets. At the same time, easy accessibility to inexpensive telecommunications infrastructure has greatly increased the speed and variety of work possible. Organizations are more interested than ever in breaking down barriers, both internal as well as external, to gain increasing flexibility in a dynamic business environment. There is now a trend by firms to reorganize their structures to penetrate new markets and to create more spatial and temporal flexibility. One such business model that has gained increasing prominence in the last decade is outsourcing of various value-chain activities to reduce costs and enhance product quality and customer service. Outsourcing is thus fastly becoming a new management reality.

Although outsourcing has been defined from various perspectives all researchers agree that outsourcing involves going outside the firm to acquire activities that are not conducted internally. In other words, it is the delegation of production processes or services to an external vendor who owns and manages these processes, based upon defined performance metrics.

The historical view of outsourcing is based on the fact that even the Romans were known to outsource their tax collection and highway maintenance (Kakabadse and Kakabadse, 2006: 49-64). What has changed is the nature and focus of outsourcing, and its implications for competitive success. While historically, most outsourcing took place in manufacturing industries, now it has spread rapidly within service industries too. It is also becoming increasingly global in its reach. Outsourcing is now a new management reality. Today, outsourcing involves delivery of capabilities from various locations, for example, on-site delivery, onshore delivery within the same country, nearshore delivery from nearby countries, or farshore delivery from various continents. Infact, it is often a blend of these alternatives and is ultimately tailored according to specific buisness/organizational goals (Kelly and Poole, 2006: 43-48).

The nature of outsourcing has also become more diverse. Most firms outsource a range of secondary value-chain activities such as information technology, accounting systems, human resource management, and research and development (Johnson and Schneider, 1995:40-49). Some firms outsource inbound and outbound logistics too. Further, there are firms such as Nike, IBM, Mattel, who outsource core production activities so extensively that they no longer engage in production, as it is traditionally understood (Barrar and Gervais, 2006).

The result is that while outsourcing was initially seen as a cost reduction tool with a clearly defined and limited scope, today it is increasingly regarded as a means of achieving a marked change in organizational performance, agility and customer service (Barrar and Gervais, 2006); in other words, as a source of competitive advantage. The increased acceptance of outsourcing is reflected in the fact that 82% of large firms in Europe, Asia and North America have outsourcing arrangements of some kind, and almost 51% use offshore outsourcers. It is therefore, against this background, that this paper explores outsourcing in organizations: a new management reality.

MEANING AND NATURE OF OUTSOURCING

There is no clear, unambiguous definition of outsourcing. Although most definitions are very closely linked, some small but essential differences remain. Bryce and Useem (1998: 635-643) are of the view that outsourcing is an outside company's provision of the product or services associated with a major function or activity of a user organization. In other words, outsourcing is having an external vendor provide, on a recurring basis, a service that would normally be performed within the organization. Simply put, outsourcing is the decision made by a company to pay another firm to do something that, theoretically, it could do itself. To Kazmi (2002:408) outsourcing is a variation of the traditional make-or-buy concept where portions of value-chain activities are commissioned to external suppliers on the basis of economic analysis, so that the firm's own focus remains on its core competence. This definition has found prodigious research cum intellectual support in Espino Rodriguez and Padron-Robaina (2006:49-70) whose views emphasized that outsourcing firms are higher capability firms that provide determined non-strategic activities or business processes or human resources, necessary for the manufacture of goods or provision of services, by means of agreements or contracts with client organizations, with the aim of improving the clients' competitive advantage.

Furthermore, this view/assertion lends credence to Gupta's (2006:60) conclusion that outsourcing is to engage the services of an external provider to manage and deliver services in respect of one or more business activities of non-core nature to the client. Thus, in an outsourcing agreement, there are two parties- the client company or the outsourced which wants a business activity to be externally performed; and the vendor or the external provider or the outsourcer which manages and delivers the service to the client company. In this sense, the external providers use their expertise in their core competency to provide services to other organizations. In other words, the idea behind outsourcing is that of specialization, i.e. a business enterprise must concentrate its attention only on its core-activities like manufacturing, marketing, etc and get non-core activities done through external agency.

Outsourcing has its origin in the core competency theory, propounded by Prahalad and Hamel (1990:79-91). These famous management consultants advised business enterprises to identify their core competencies and focus only on them, and getting everything else done through outside agencies. The idea propounded by Prahalad and Hamel, and many others, is that organizations should define the areas critical to their success, devote maximum resources to those areas, and outsource everything else. It could be seen that the main activities that are outsourced are non-core activities, but however core activities are now being increasingly outsourced. This view is supported by Gottfredson, Puryear and Philip's (2005: 132-139) assertion that outsourcers are more qualified partners who provide critical functions which allows companies to enhance the core capabilities that drive competitive advantage in their industries.

Nevertheless, to Landford and Parsa (1999:310-316) outsourcing is the procurement of products or services from sources that are external to the organization. It is about ongoing outside procurement with respect to services or products which the firm is capable of doing as well, or has done in the past. It is seen as a strategic management tool and part of the corporate strategy.

Based on this definition, joint ventures and strategic alliances are not seen as outsourcing because outsourcing consists of more or less one-way resource flows (Bryce and Useem, 1998). The outside firm is paid to deliver a service or product and although there might be some sort of information exchange, there is no real mutual development. After all, the outsourcing firm usually procures the product outside the firm because the provider is more knowledgeable and because the provider has a competitive advantage in producing the product (Quelin and Duhamel, 2003:647-661). Furthermore, management and implementation are transferred to the provider, unlike with joint ventures/strategic alliances.

MODES OF OUTSOURCING:

Literature does not discern much different modes of outsourcing. One commonly used pair is peripheral and core outsourcing (Gilley and Rasheed, 2000:763-790). Peripheral outsourcing entails the outsourcing of activities that are not of highly strategic importance, whereas the later concerns activities that are critical to the long term success of the firm. What constitutes these core activities is highly contingent on the situation of the firm and can differ even between firms within the same industry.

Two different modes are given in a research by Accenture (2004), in which the author distinguishes between conventional outsourcing and transformational outsourcing. Conventional outsourcing mainly applies to less relevant activities and small improvements with a focus on cost reduction (Accenture, 2004). Transformational outsourcing is used to bring about rapid and sustainable improvements of the firm's performance. It often concerns activities that are critical to the success of the business. In essence, both typologies make the distinction between core and non-core outsourcing, yet their approach differs. Quelin and Duhamel (2003) created a similar moderator and make distinction between strategic and non-strategic outsourcing. Strategic outsourcing deals with outsourcing beyond peripheral tasks. It also focuses on functions that add significant value to the firm and uses outsourcing as a strategic choice to generate a strategic advantage over competitors (Quelin and Duhamel, 2003). Cost reduction is not considered to be the main driver of strategic outsourcing but other, more qualitative factors are of importance (Quelin and Duhamael, 2003).

Another often mentioned mode of outsourcing is offshoring (Bhagwati, Panagariya and Srinivasan, 2004: 93-114). Offsoring, as mode of outsourcing, is nothing more than procurement of the product or service from an external supplier from abroad (as compared to domestic, local outsourcing). It is however, important to keep in mind that offshoring is not always a mode of outsourcing. For example, if a firm moves a production facility abroad while retaining control it is also called (captive) offshoring but it is not a mode of outsourcing (Lewin and Peters, 2006:221-239). Hence offshoring can be interpreted differently in different situations.

DRIVERS OF OUTSOURCING:

The trend towards outsourcing has been driven by a number of factors in the business environment. The most important drivers have been developments in information and communication technology (ICT), globalization, more demanding customers and governmental support (Barrar and Gervais, 2006). These drivers have had an important impact on the growth of outsourcing, singularly as well as in interrelated manner, as discussed below:

(i) Developments in Information and Communication Technology (ICT)

Advances in ICTs have facilitated organizations to enter into outsourcing arrangements with greater ease. This is because information technology has helped reduce the cost as well as time required to transmit information. It has eliminated geographical constraints associated with physical information mechanisms (Melvor, 2006:49-64). At the same time it has increased the complexity and amount of information that can be sent across its global locations and to its outsourcing suppliers. Hence, most organizations today rely on information technology to create efficiencies and reduce costs in their business operations.

(ii) Globalisation

In recent years, the business environment has become increasingly global for many industries. While globalization has created opportunities by enabling access to new product markets and production facilities, it has also presented many challenges.

Globalization has increased the intensity of competition in many industries. In the past, organizations operated in a national market with three or four established companies and a contained level of competition. Nowadays, as organisations extend their boundaries globally they face competitors in both home and international markets (Melvor, 2006). The increased intensity of competition has put pressure on companies to reduce costs, enhance product quality and improve customer responsiveness. Many organizations have been forced to also accelerate the development of new products and services and restructure business processes in order to reduce costs and eliminate inefficiencies.

These changes have led to the creation of outsourcing organizations that help firms achieve greater economics of scale, share investments in research and development, sell in a wider range of markets, and access lower-cost labour sources for both the manufacture of their products and delivery of their services (Barar and Gervais, 2006).

(iii) More Demanding Consumers:

Customers today have become more knowledgeable on issues such as prices, reliablity and availability of customer service. As a result they are demanding more customised products and services at lower prices. They are also more informed about alternate service providers, which has diminished customer loyalty. Hence in order to retain customers, organizations have to provide greater accessibility to their products and services. Organizations now use innovative methods to interface with customers in order to create more efficiency and convenience; an example could be through call centres and customer care centres.

(iv) Government Support and Policies:

The success of the outsourcing industry has been critically dependent on governmental policies. This is especially true in the Nigerian business environment. Successive governments at both the central and state levels have liberalized policies, introduced tax exemptions, funded world-class satellite telecommunications projects and provided incentives for quality certifications. This has created a conducive business environment for the outsourcing industry to thrive in.

THE BENEFITS OF OUTSOURCING TO ORGANISATIONS:

There are many reasons that companies outsource various jobs, services and production processes, but the most prominent advantage seems to be the fact that it often saves money. Many of the companies that provide outsourcing services are able to do the work for considerably less money, as they don't have to provide benefits to their workers and have fewer overhead expenses to worry about. In other words, outsourcers operate on a large scale. Thus, the cost of services provided by them is much less than the cost the client company would have incurred had it performed the same services in the organization itself. In terms of IT outsourcing, outsourcing relieves the business of the need to recruit and maintain expensive, skilled IT staff (Kakabadse and Kakabadse, 2000: 670-728). However, although outsourcing will provide cost savings for some organizations (mostly those that are very largely inefficient), in most cases, it is naira-for-naira cost neutral.

In the current climate of globalization and escalating competition, outsourcing also can aid a buisness in keeping abreast of technological change and provide opportunities to improve efficiency through application of technology from its outsourcing partner. In this sense, businesses expect that by outsourcing IT services to a specialized IT organization they will gain access to that organisation's technology skills rather than have to develop these resources in-house. Outsourcing therefore gives a business access to the resources it needs to be able to use technology to improve business efficiency. In other words, outsourcing offer access to expertise. Organizations that outsource gain access to know-how they probably do not possess; the broad network of experienced people and best practices. These benefits are however, strategic and unfortunately difficult to quantify.

In addition, outsourcing allows a business to leverage off the economies of scale of the service provider and can be used to shift a component of technology risk onto the service provider (Kakabadse and Kakabadse, 2000: 670-728). Furthermore, partnering with an outsourcing organization can allow a business to improve its buisness focus by concentrating more on its core competencies, certainly in terms of allocation of capital; and thus obtain advantages of specialized performance in those areas. Outsourcing therefore frees up a business resources to concentrate on more important business objectives. As a result, organizational functioning is at its optimum performance level.

Nevertheless, the outsourcer or service provider provides service at a fee. Therefore, he is more responsible for the quality of services provided than the internal staff of the client company and this augurs well for better accountability. Outsourcing also enables both the client company and the external provider to perform according to the best of their abilities. This type of performance, all though the economy, is a boost to the economic development of the economy.

THE CHALLENGES FACED BY OUTSOURCING IN CONTEMPORARY ORGANISATIONS:

There are many challenges faced by outsourcing in contemporary organizations, but the most prominent challenge seems to be that employees may react badly to outsourcing and consequently their quality of work may suffer and this may cause the loss of talent generated internally. In other words, outsourcing rumours can impact all levels of the organization, instilling fear and apprehension and creating a negative impact on organizational productivity.

Another challenge faced by outsourcing in contemporary organizations is the data theft and security concerns plaguing the outsourcing industry, including the call centres. Outsourcing is a risky proposition and, in some cases, a leap of faith as organizations move people, functions, applications and processes to external vendors in hopes of improving overall competitiveness without minding the security of their data, applications and processes. A key issue on the minds of executives today is the protection of intellectual property, including confidential business data, trade secrets, copyrights, trademarks and patents. The physical security and protection of intellectual property are critical issues, particularly since countries have differing legal systems. In other words, at the end of the sourcing period outsourcing firms may lose control of the core process.

Additionally, other companies may also be using the same service provider. Therefore, in some cases, the best interests of the service provider may be diluted with other users. Moreover, the costs associated with managing the outsourcing relationship with the supplier are real and often significant. This is another challenge to outsourcing in modern organizations. However, minimizing the costs of managing supplier/outsourcing relationships is one of the many standard mechanisms used by business for controlling costs and the success or otherwise of this process is critical to the success of any outsourcing venture.

Furthermore, one of the most difficult and underestimated challenge facing outsourcing relationships is the impact of cultural differences between the client and vendor organizations. Client organizations scour the world for outsourcing partners, often considering vendors in India, Nigeria, Ireland, Israel, China, Mexico, Canada and the Philippines. Clients tend to believe that the norms, values and ethics of their vendors will be similar to their own. Once into the relationship, they realize that the vendor's views of time management, organizational structure, business approaches, decision-making processes, long term cooperation and teamwork may be much different from their own. Even if the vendor speaks English, it may be a dialect that causes key points to become distorted in the interpretation. Subtle differences in language and the context of words make for distinct semantics. Therefore, many offshore outsourcing relationships get into trouble due to cultural differences where both the client and vendor organizations believe they are fulfilling their obligations, yet both sides end up being disappointed with the results and frustrated with the relationship. Nevertheless, critics have noted the other important risks/challenge of outsourcing, including potential loss of flexibility, qualified personnel, and competitive advantage in information management.

CONCLUSION

It is now obvious that modern economies are now getting more and more global and organizations in this new environment intend to use every way possible to become more competitive in growing industries. Outsourcing has been the part of this change cum new management reality for many years. It may change name or form slightly, but it is clear that it will remain as an important economical fact in today's and future global markets.

Outsourcing is a powerful business strategy that requires a paradigm shift in the way global business is conducted. Used correctly, outsourcing can deliver benefits such as cost reductions, enhanced skills capabilities, shifting of technology risks, ability to focus on core business competencies, improved quality, and competitive advantages. Organizations that make outsourcing a core competency will be well positioned for competitiveness in the global market place.

However, the ultimate gains of outsourcing especially to contemporary organizations may not come without any costs. Governments and organizations around the world must face with the considerable and implicated challenges that outsourcing will bring besides benefits. These challenges which include among others; employees reacting badly to outsourcing, data theft and security concerns, cultural differences between client and vendor organizations, potential loss of flexibility/qualified personal all must be taking into cognizance by managers and must adapt to new realities.

RECOMMENDATIONS

Having reviewed outsourcing in organizations: a new management reality, and offered a number of benefits cum challenges which outsourcing had bequeathed to organizations; the following recommendations if carefully applied should help improve and enhance the process:

1. A formal communication plan that articulates the purpose of the outsourcing initiative, including key milestones, which should describe the organization and processes that are involved, including timelines and descriptions of how communications will flow through out the organization should be established. Thus, communication with fearful employees is essential to ensure they understand their roles and are properly compensated to stay through the outsourcing initiative. Companies that fail to do this are at risk of seeing key employees and intellectual capital leave the organisation during the outsourcing initiative, crippling their chances for success.

2. Outsourcing vendor candidates must have a proven track record of maintaining strong security programmes at their locations and have procedures to protect intellectual property. It should be noted that the best method for ensuring the protection of intellectual property is to limit outsourcing to locations that can guarantee impeccable security.

3. Many offshore outsourcing relationships get into trouble due to cultural differences between the client and vendor organizations. Thus, the client organization must take the time to understand the vendor's cultural milieu and educate the internal organization on these differences. This may entail developing team building workshops with the vendor organization to help identify and bridge the cultural differences.

4. Finally, mature organizations serious about making their outsourcing initiative successful should seek out industry best practices and benchmark successful outsourcing initiatives. They should invest in training their personnel on proven methodologies and codify them relative to their internal processes while collecting and analyzing metrics data to measure their progress.

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