

IMPACT OF OUTSOURCING ON THE ORGANISATIONS OPTING FOR IT

MS SHILPY MALHOTRA

ABSTRACT

The research paper concentrates on whether outsourcing is a good option for the companies going in for expansion or not. It discusses why companies generally opt for outsourcing in the manufacturing function and tells about the main benefits that these companies get when they opt for outsourcing. Benefits with respect to outsourcing are:

- Benefit in terms of Labour Costs
- Benefit in terms of Overhead Cost
- Benefit as it gives more flexibility
- Company is able to focus on other important areas

The paper discusses about how Titan opted for outsourcing and what reasons forced it to opt for the same. It gave Titan competitive advantage over others as it was able to get its watches and jewellery manufactured in a cost effective manner and also it was able to concentrate on other important areas rather than the ones that are considered lesser important.

Therefore, as a conclusion on whether outsourcing is viable option or not, it was concluded that while it can be true that bigger risks bring bigger rewards, at the same time, if things go wrong, the fallout can be costly. This is especially the case when it comes to large, multi-partner supply chains, where the number and potential impact of risks multiplies. Therefore, companies should equally evaluate the positive and the negative aspects of outsourcing relating to their specific business and then only reach a conclusion.

KEYWORDS

Outsourcing, Pros & Cons of Outsourcing, Titan's outsourcing

INTRODUCTION

Outsourcing is the process of delegating a company's business process to third parties or external agencies, leveraging benefits ranging from low cost labour, improved quality to product and service innovation. When outsourcing transgresses national boundaries and is managed by companies located in other countries, outsourcing takes the form of offshoring.

Outsourcing of the manufacturing function has become quite common now a days, as we keep on hearing every now & then that this company outsourced their manufacturing function or that company did the same. There are certain reasons why outsourcing is considered to be a very beneficial option for the companies as they provide benefit with respect to costs involved in the same. A few of them are discussed below:

Benefit in terms of Labour Costs

Part of any analysis for a manufacturing company deciding to outsource any of its operations includes the cost of labour. Whenever prime cost is calculated, labour cost forms a major percentage of the expenditure. Companies have to pay them a competitive wage and, for most of the companies, it also means providing some form of employee health benefits. But outsourcing labour costs doesn't always mean moving the production to another country. Companies can outsource labour simply by using workers from temporary agencies instead of having employees on the payroll. Whenever a company outsource, there comes a flexibility on how you can increase or decrease the number of people employed by you, a lower hourly wage paid to a temporary worker than that of a comparably skilled fulltime employee and less employee healthcare benefits expenses.

Benefit in terms of Overhead Cost

Outsourcing helps in reducing overheads costs that is incurred whenever you set up a production department. These overhead costs include utilities, such as gas, electric and water, and the maintenance required to operate production equipment. Other overhead costs include indirect labour such as quality assurance personnel, equipment technicians, material handlers etc.

Benefit as it gives more flexibility

Whenever production function is outsourced by a Company, production process is given to contract manufacturers who produce goods for two or more companies, and even for competitors within the same industry. Contract manufacturers have more production capacity (the ability to produce more goods) than the original manufacturing company, it can respond to increased production requirements faster than the original manufacturer at times whenever an increased quantity of output is demanded by the consumers. Instead of the original manufacturer making a capital investment in new equipment to increase its production capacity, it informs the contract manufacturer that it requires more goods. Although, placing an order for increased quantity would surely increase the costs involved but it would be significantly lesser than the costs involved in making capital expenditure for machineries relating to production.

Company is able to focus on other important areas

Some companies have experienced extreme paradigm shifts that have prompted them to outsource their manufacturing. From the perspective of a company, what is considered to be more important is strengthening the value for its brand rather than originally manufacturing goods on its own. With the production outsourced, the company is able to focus on other aspects of sales and other resources that it possibly has to maximize revenues and profits. As we have seen above, outsourcing reduces the manufacturing costs and if the company is able to increase revenues, it becomes highly beneficial for the company.

Now, when we talk about outsourcing, it has been one of the most common topics of discussion in the recent times, we come across with both sides i.e. the good as well as the bad points related to the same. Pros and cons of outsourcing are discussed below:

The pros of outsourcing

The pros of outsourcing often positively reflected by enterprises across industries include:

- Increased return on investment with better revenue realisation.
- Labour cost reduces and economies of scale increase.
- Helps in capturing wide knowledge base which leads to increased innovation.

- Allows management to concentrate on other important topics like marketing and sales of their products to increase the brand value for their products.
- Helps in improving the quality of services and speed at which they are delivered also increases.
- Leads to proper resource allocation.

The cons of outsourcing

Often weighed with the advantages before any decision on outsourcing is undertaken, the following represents some of the possible disadvantages often dwelled upon:

- There is a possibility of the company losing control over its business processes.
- It might adversely affect the quality of the product delivered.
- Issues solving and response time slows down.
- There might be a difference between the actual performance and the expectations of the consumers.
- As a result profits might suffer and it might lead to a reduction of profits.
- There might be a difference in the way communication takes place between the companies and if ever miscommunication happens, performance might suffer on an overall basis.
- If the employees are not happy with the way things are being carried out or if employees had to be laid off due to the outsourcing of the function that was being performed by them, then they might be dissatisfied which lead to problems with the trade unions.

LITERATURE REVIEW

Now, in order to support the above observations, we would have a look at how Titan started its outsourcing journey and find out whether it was beneficial for the company or not. What improvement could have been made for it to be successful?

We all have seen how successful Titan has been all through these years, but without being satisfied with its growth and having an ambitious approach, Titan in the last decade has gone on to become the number one player in jewellery also, with a 40 per cent share of the branded jewellery market. It has in the last four years successively entered the sunglasses and prescription glasses market and has become the first in the former and the second in the latter.

The company, which began as a manufacturer, has over the years become the country's number one speciality retailer with nearly 500 exclusive outlets taking up 600,000 square feet of floor space and doing an annual business of over Rs 3,000 crore (in terms of what the customer pays) through its own or exclusive franchise outlets.

Titan still remains an integrated manufacturer — the way it began in watches — but now outsourcing plays an important role in Tanishq jewellery, and the entire fast track range of accessories is outsourced.

Outsourcing at Titan

Titan began with outsourcing in 1999 with the changes in the trade policy. Manufacturing was proving to be costly at that time such that, it had no option but to outsource in order to make its production cost effective.

Titan's entry into the clock segment in the mid-1990s failed badly because its clocks could not face the competition from cheaper imports from China.

Titan's multibillion investments in manufacturing facilities were proving to be a real drain on its profitability in the changed industry. Though the company had consistently posted yearly profits, in the first quarter of 1999-00, it reported a loss of Rs 52 million.

By opting for outsourcing, the company could launch the watches for just Rs 250-395. If it had to manufacture the range, it would have had to invest at least Rs 2.5 million just for the machinery to make the moulds for the watches. Similarly, the Fast track range of digital watches

was also priced in the range of Rs 650 to Rs 1500, keeping in mind the target segment - youth in the 15-24 age groups. Titan could price the range so attractively because the watches were completely sourced from Hong Kong and Taiwan.

In December 2001, while the income from the watch division increased by 4%, the figure was 10% for the company as a whole. This was because Tanishq, the jewellery division had posted a 32% growth.

Outsourcing was a viable option for TITAN?

By outsourcing non-essential work, the corporation can free valuable resources and focus on its areas of competitive advantage. To achieve that result, the corporation must know its core competencies, the type of work within the organization, and manage the outsourcing process.

Moreover, since the company relied heavily on its marketing finesse than operational excellence, these investments were deemed to be too high. Though the company had consistently posted yearly profits, in the first quarter of 1999-00, it reported a loss of Rs 52 million. This loss was due to the high overheads, excise duties and marketing spending in 1999-00, which increased expenditure by Rs 1.5 billion. Moreover, net profits had come down by 47% to Rs 146.4 million in 1998 from Rs 275.7 million in 1996.

Company watchers partly attributed this to the heavy investments in the manufacturing setup.

Taking into account the above factors, Titan had no other option but to settle for outsourcing.

Another reason why Titan wanted to reduce its focus on manufacturing was the high employee costs -11.2% of its revenues in 2000. This was because in the days when the company had no other option but to manufacture, the Hosur factory had a huge worker base.

However, the biggest factor that swung the decision in favour of outsourcing was the fact that Titan was not being able to meet the onslaught of the unorganized sector for the first time. Since the company decided to focus on generating volumes from low-end mass products, it had come in direct competition with players in the unorganized market.

Outsourcing gave Titan a competitive advantage

Outsourcing, once used mainly for downsizing and cost reductions at major corporations, should be used as a strategic tool to deliver a forceful impact on corporate growth and financial stability. By outsourcing non-essential work, the corporation can free valuable resources and focus on its areas of competitive advantage. To achieve that result, the corporation must know its core competencies, the type of work within the organization, and manage the outsourcing process.

Therefore, we see that outsourcing provided Titan with a competitive advantage such that it was able to operate in a successful manner as compared to others.

CONCLUSION

As we have seen above the various aspects of outsourcing, we see that it is a favourable and beneficial method for companies so that they can concentrate on the much more important aspects of a business and get their work done in a cost effective manner.

For outsourcing to be successful, right amount of skills are needed with the right capacity to succeed and thereafter, the process must be continuously monitored to make sure that the right results are generated. Many contracts are also long-term in their nature with little in-built flexibility to adapt to short-term shifts in regulation or changes in community expectations. To be effective these arrangements require a certain degree of future forecasting by local authorities and, unfortunately, this is a luxury many local authorities do not have.

There is a fine line between "pure cost" savings and exposure if something goes wrong. In tough times, the most effective option may be to partner with an organisation that shares a similar attitude, appetite and capacity for risk.

Factors to consider in choosing a service provider include:

- Costs involved
- Location of the service provider
- Financial stability of service provider so as to know about financial security
- Client references that provide a feedback on how it performs
- Technology transfer capability
- Current performance metrics to know how it would perform

- Flexibility of being able to produce increased quantity of goods
- Responsiveness to customer demands to increase customer satisfaction
- Cultural fit helps in understanding needs of the customers well

Is outsourcing a good or bad thing?

Outsourcing can be considered to be good as well as bad. It makes jobs available for people that may live in high poverty areas, while also being more cost effective for the business owner. For these reasons, outsourcing is generally a good thing. However, it also means that some people will lose their jobs and it can negatively affect people already working for a company that has been decided to be outsourced as it leads to a reduction in the workload by transferring it to the company to whom it has been outsourced.

REFERENCES

<http://www.theguardian.com/society/2013/jan/08/local-authority-services-outsourcing-partnerships>

<http://www.forbes.com/sites/modeledbehavior/2013/01/16/is-outsourcing-american-jobs-wrong/>

<http://www.athenaintl.com/news/articles/outsourcing-the-good-bad-ugly/>

http://articles.economictimes.indiatimes.com/2002-09-20/news/27354858_1_titan-plans-titan-brand-titan-eye

<http://www.ask.com/question/is-outsourcing-a-good-or-bad-thing>

<http://www.thehindubusinessline.in/2006/10/06/stories/2006100601321200.htm>

<http://forbesindia.com/printcontent/15412>

<http://en.wikipedia.org/wiki/Outsourcing>

<http://www.investopedia.com/terms/o/outsourcing.asp>