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AN EXAMINATION AND CRITIQUE OF THE OUTSOURCING CONCEPT AND PRAXIS

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Abstract:
The contemporary relevance of outsourcing as a process that involves the strategic use of outside resources to perform activities that can be usually handled by internal staff of a firm cannot be overemphasized. To this end, studies have shown that, by adopting outsourcing as a strategy numerous benefits abound. This article describes a theoretical investigation and review into what outsourcing really entails. It also highlights strategic benefits of outsourcing as have been promoted by some researchers. The article seeks to unravel and bring to the fore the other side of outsourcing—the challenges, which may have been neglected by individuals and organisations, so as to proffer a control measure which may in turn cushion its effects on business activities especially in emerging market economies and countries of the global south. Furthermore, the article provides a basis for reorganizing the theoretical application and practice of outsourcing in the business world.

Keywords: outsourcing, supply chain, challenges, strategy, organisations, competitive advantage.

1. Introduction

The unanticipated and unimaginable rate of growth of information technology which is aiding globalization has given rise to the present hyper-competitiveness that cut across organisations operating at the domestic, international and global fronts. Consequently, this hyper-competitiveness and other globalisation related dynamics create a dilemma for firms that relate to three performance pivots. In form of questions they are: How to strategize for continuous reinvention of the firm? What direction for expansion should a firm take? And, how to develop and sustain competitive advantage? Global hyper-competition has therefore, necessitated organisations strategic approaches to this tri-dimensional dilemma. This necessity becomes very much imperative, especially in view of the fact that, heated competitive rivalry across global industries and markets has made it remarkably common for competitive advantage held by companies for decades to erode very fast. As such, companies need to borrow McGrath (2012) advice to constantly launch strategic initiatives so that they can exploit “transient” advantage before they disappear. We suggest and explore in this paper one of such strategies developed overtime to create sustainable competitive advantage and/or elsewhere for competing in a “transient-advantage economy”, which is, the outsourcing strategy.

In view of the above, Quinn (2000) asserted that strategic management of outsourcing is perhaps the most powerful tool in business management today, and outsourcing of innovation is its frontier. Meanwhile, research evidences have also shown that the global market space for outsourced services has developed immensely. For instance, statistical note gave the estimate of over $100 billion has the total money spent on outsourced business activities by most American firms in 1996 (Casale and Overton 1997). Furthermore, research reports have shown that outsourcing usage world-wide has grown to 35 percent in 1997 and the total market for outsourced services was expected to increase to $200 billion by the year 2001 (Greer, Youngblood *et al,* 1999). By 2015, almost a decade and half later, it is expected that this figure would have doubled. In the same vein, a research study conducted by Yankelovih Partners as reported in Bender (1999) has also shown that two-third of the world organisations have already outsourced at least one of their business process to an external third party. Consequently, these submissions have shown clearly that the business world has embraced the concept of outsourcing with organisations adopting its principles to help them expand into other markets. This practice, however, appears to be common both in less developed and developed countries, but whatever the case maybe, the fact remains that outsourcing has taken over the business game.

The purpose of this paper, however, is to achieve a synoptic view of the concept “outsourcing” with more attention on how it all started, its meaning, the benefits associated with it, and some of the emerging challenges pertinent to outsourcing strategy which must be understood and properly handled. The paper concludes with policy recommendations necessary for mitigating against these challenges and for optimizing the outsourcing strategy.

2. Historical Perspective of the Evolution of Outsourcing Concept

The concept of outsourcing has been widely acclaimed to have its roots in the 'Comparative Advantage' theory propounded by Adam Smith in his book 'The Wealth of Nations' published in 1776. This theory gained acceptance during the industrial revolution as many organisations became mechanized and kept labour costs low in order to gain competitive advantage. Presently, this thought still remains the business case and basis for the increased practice of outsourcing and this view is reinforced by Mankiw and Swagel (2012) when they asserted that, “Outsourcing is the latest manifestation of gain from trade that economists have talked about at least since Adam Smith” (p.8). Conversely, Handfield (2006) argued that outsourcing began to be conceptualised and put into formal practice between 1970 and 1980. Handfield (2006) further argued that, “Since the industrial revolution, organisations were grappled on how they could exploit their competitive advantage in order to increase their markets and profits”. The trajectory on the evolution of the outsourcing concept as opined by Handfield (2006) indicated that, “In the 1950s and 1960s, the rallying cry by organisations and their management was just to use diversification to broaden corporate bases and take advantage of economies of scale. By diversifying, organisations were expected to expand their business frontiers and protect profits, though expansion as it required multiple layers of management. Subsequently, organizations attempting to compete globally in the 1970s and 1980s were handicapped by a lack of agility that resulted from bloated management structures".

Globally inclined firms had to make strategic moves to attain strategic competiveness and flexibility. As a result, Handfield (2006) submits that, "To increase their flexibility and creativity, many large companies developed a new strategy of focusing on their core business, which required identifying critical processes and deciding which could be outsourced". This led to the formal birth of outsourcing.

Mullin (1996) cited by Handfleid (2006) argued that "Outsourcing was not formally identified as a business strategy until 1989". However, Verumeulen (2010) while in pursuit of a variation of expressive terminology adopted the term "off-shoring" which is similar to outsourcing strategy to give his own account on the development of outsourcing concept. According to him, business operations were not just conducted within the limited boundaries of an economy but also involved transnational and continental dealings, which he termed as off-shoring. In this regard, he explained that during the early 90s, organisations were looking for new business models to adopt for the purpose of gaining competitive advantage. Consequently, upon the looming financial difficulties that abounded then, multinational companies for example, resorted to low-cost locations where they would conduct their operations. These destinations include India and the Philippines. This idea of setting up businesses in distant locations is also aimed at achieving the same purpose as outsourcing, which is ultimately the reduction of cost of doing business by using external hands. He thus opined that in the end, off-shoring also significantly reduced the operating costs of these companies with a corresponding increase in profits. Verumeulen (2010) further reported that the outsourcing and off-shoring phenomena quickly took flight as many companies realized the advantages, as well as the need to resort to them in view of the impending global financial crisis. Furthermore, as companies tried to enhance their competitive positions in an increasingly hypercompetitive global market place, they discovered that they can cut costs and maintain quality by relying more on outside service providers for activities viewed as supplementary to their core businesses (Mullin, 1996; Grant, 1996).

However, in many parts of the world today, outsourcing has become one of major business strategies used by managers to ensure the survival, growth, and profitability of their organisations. For example, India has been rated as the largest destination of outsourcing in the world. The reason for this according to Vermeulen (2010) was as a result of the huge amount spent on wages and salaries. This however, has made most of multinational companies as well as some of the indigenous firms operating within Indian territory to adopt the outsourcing strategy as means of achieving above average performance. Subsequently, the outsourced jobs and tasks given out by these firms in India are mostly outsourced to Philippines which is now the second largest destination of outsourcing in the world.

Meanwhile, in United States and Europe, research evidences have also shown that outsourcing strategy has not only made perfect business sense to many organisations within these continents, but there is a sudden realization that without it, the day-to-day business life may turn upside down. This assertion has become so critical, that, if outsourcing as a business strategy cease to exist, the business world may come to a grinding halt. For instance, let us image the cost of blackouts in communication, banking transactions, transportation and other business functions which businesses have been built around outsourcing (Mullin, 1996). Consequently, it is suffices to say that, outsourcing has come to stay and it will continue to be considered as a strategic option for organisations in the face of competition and dynamic business environment. This is largely because of the some advantages which it sets to offer. In support of this position, Amaral, Billington *et al,* (2006) in Knudsen (2010) emphasised that, "Outsourcing is not an optional strategy, and the question is therefore not whether to outsource, but what to outsource, where to outsource and how to capture the expected and promise gains".

3. Outsourcing- A Brief Overview of Definitions

According to Kazma (2010) the word "outsourcing" is composed out of two words 'out' and 'source', 'out' refers to 'away from' and 'source' as simply 'supply'. He maintained that it is one of the methods that organisations have relied on when they need help outside their business functions, in such areas as employment, management, and development. A more continuous and interactive definition of outsourcing is required. Handfield (2006) defined outsourcing as "the strategic use of outside resources to perform activities traditionally handled by internal staff and resources". Handfield (2006) goes on to contend further that, "*Outsourcing* is sometimes also known as facilities management". Handfield (2006) also maintained that, "*Outsourcing* is a strategy by which an organization contracts out major functions to specialized and efficient service providers, who become valued business partners".

Furthermore, Handfield (2006) opined that, "Organisations before now have always levelled-off peaks and troughs in their workload by subcontracting, and have formed long-term relationships with firms whose capabilities complement or supplement their own". However, Handfield (2006) noted that, "The difference between supplementing resources by subcontracting and actual outsourcing, is that the latter involves substantial restructuring of particular business activities including, the often, transfer of staff from a host company to a specialist, usually smaller, company with the required core competencies. However, this opinion of Handfield is likely to raise some arguments and criticisms. For Vermeulen (2010) outsourcing can be viewed as a management strategy by which an organization delegates major, non-core functions to specialized and efficient service providers. Omar (2010) explained outsourcing as the management or day to day execution of business functions by a third-party service provider. Omar (2010) also maintained that outsourcing enables a company to focus on its core business rather than having to be concerned with what he referred to as "marginal activities". The above definitions seem to be content and context oriented. The literature reviewed indicated that most definitions fall under this category, while a few are process oriented. Bearden, Ingram and Lafarge (2007) defined outsourcing as, "A process whereby firms purchase products and services from other companies than to make the products or perform the services internally". Thompson and Strickland (2001) see outsourcing as an organisation-building function which involves, "launching initiatives to identify the most attractive providers and to establish collaborative relationships" (p.358).

However, from the myriad definitions stated above, this paper therefore, offered the following formal conceptual definition of "outsourcing" as a process whereby an organisation tends to produce a final output using necessary inputs or services obtained outside the firm. It is a process strategy which involves a firm contracting out the production or service delivery activity within its value and supply chain induced with the benefits of reduced production process and transaction economics costs. This strategy encourages organisations to concentrate on the strategic roles that will enable the continuity of their businesses and play much of decision making and supervisory roles, while letting identified professionals handle some other functions according to their different areas of competencies. In addition, outsourcing can be local (an external supplier in the domestic market) or international (a leading example is the outsourcing by firms in developed countries to firms located in low-waged countries) (Alberto, 2009). Given this context, Amaral *et al* (2006) aforementioned emphasis should be reiterated. Outsourcing is not an optional strategy. And if this point is valid, outsourcing should therefore, be considered as a strategic prerequisite for the success of globally-minded firms in the 21st century.

4. Types of Activities Outsourced

What kind of supply and value chain activities come under the purview of outsourcing? Elmuti (2003) identified the following as the top activities or functions that most organisations outsourced most: Information technology (such as application development, contract programming, data entry and simple processing), management services, manufacturing of components for the final product or the whole product, product design, engineering projects, distribution, and sales of products or services. For Armstrong (2009) organisations are often seen outsourcing such functions that are more of staff functions, for example, human resource functions such as training, recruitment, executive search, occupational health and safety services, employee welfare and counselling activities, payroll administration and legal advisory services, catering, car fleet management, facilities management and security. As asserted by Vermeulen (2010) majority of the workload outsourced by organizations include: customer support, telemarketing and technical support, content writing, web design, programming and software development. Others include: accounting, human resources, data processing, internal mail distribution, security, plant maintenance, etc. (Mullin, 1999).

It is important to note all of these activities could be associated at different points in time and space with the multiple dimensions associated with the outsourcing concept. Those dimensions which have coloured the face of many empirical and theoretical studies are: offshoring, service sourcing, technology outsourcing, in-sourcing, global sourcing and international sourcing, just to mention a few.

5. Benefits and Reasons for Outsourcing

Outsourcing plays a pivotal role in the process of modern business. According to Stanko, Bohlmann *et al,* (2009) outsourcing as business strategy can help organisations to reduce cost of production, lead to organisational efficiency and also aids organisations to tap into talents outside their organisations. In the same vein, Bowers (1990) asserts that successful implementation of outsourcing strategy will help organisations to reduce cost of production. It increases and improves capacity as well as the quality of organisatonal products and services (Lau & Hurley, 1997). It leads to increase in profitability and productivity (Casale & Overton, 1997), as well as, improved financial performance (Crane, 1999), lower innovation costs and risks (Quinn, 2000), and improves organizational competitiveness (Lever 1997). Similarly, Armstrong (2009) opined that, “Outsourcing is accrued with benefits such as reduced cost, access to expertise not available within the human resources, increase flexibility and speed of response, and freeing-up human resources and other units of the organisation to focus more on value adding activities”.

But the benefits of outsourcing can only be best appreciated by asking the question: *When does outsourcing make strategic sense?* (See, Thompson, Gamble *et al,* 2004). This question must be put in front burner of all strategic intentions of a firm bearing in mind the role that outsourcing plays in global strategy formulation and implementation. Marcus (2005) captures this role in the equation (GS=GE+OS), where GS represents global strategy, GE represents global expansion and OS represents outsourcing. However, Thompson, Gamble *et al,* (2004, p. 183) have provided a set of answers to this question. According to them, outsourcing pieces of the value chain formerly performed in-house to narrow the boundaries of a firm business makes strategic sense whenever:

(i) An activity can be performed better or more cheaply by outside specialists.

(ii) The activity is not crucial to a firm’s ability to achieve sustainable competitive advantage and wont hollow out its core competencies, capabilities or technical know-how.

(iii) It reduces the company’s risk exposure to changing technology and/or changing buyer preferences.

(iv) It streamlines company operations in ways that improve organisational flexibility, cut cycle time, speed decision-making, and reduce coordination costs.

(v) Finally, it allows a company to concentrate on its core business and do what it does best.

6. Pitfalls and Risks of Outsourcing

As earlier mentioned in this paper, outsourcing strategy has several benefits if its processes are well integrated into the strategic management processes of interested organisations. Conversely, there are also a number of pitfalls and risks