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Outsourcing: a way to Improve the Responsiveness and Agility within the Organisation

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OUTSOURCING – A WAY TO IMPROVE THE RESPONSIVENESS AND AGILITY WITHIN THE ORGANISATION

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Abstract

Outsourcing or offshoring as it is now known has been around for many decades. In the beginning it was only very peripheral activities that were outsourced, blue collar (lower skilled) work but this is now all changing with the outsourcing of white-collar jobs. Historically, outsourcing was used when organisation could not perform to world-class excellence in all sectors of the organisation due to incompetence of staff and/or management, lack of capacity, financial pressures, and/or technological pressure.

The research currently underway is initially focusing on a literature review of current outsourcing applications in the market place. From the literature review, a questionnaire has been developed to assess the impact outsourcing has on business performance. This research focuses on the Irish Market place. The paper will present the findings of the initial literature review, it will examine the main reasons companies outsource and the benefits they could accrue if gone about systematically and the associated problems. It will also discuss the methodology being followed to explore the Irish Industrial Sector. This is a working paper and as such, it is hoped that initial results from the survey will be available for presentation at the conference in September.

Keywords: Outsourcing, responsiveness, agility, benefits, problems, Ireland

Introduction

Ireland, as with other Western European manufacturing countries, is currently experiencing a change in the way that customers and suppliers relate. Manufacturing has become increasingly demand driven since the late 1970's, where the customer specifies their need and suppliers do their best to deliver a satisfactory solution. Increasingly firms that traditionally manufactured their own products are outsourcing production, and instead focusing on the companys' core competency. Core competencies are one of the keys to customer satisfaction and superior performance. To hand over to a third party supplier core functions is to hand over the things that make a company what it is and what differentiates it from others, in essence what makes the company profits. Non-core competencies take up time, energy and workspace and help management to lose sight of what is most important in the organisation (Greaver 1999). Non-core activities can be farmed out to specialists if they conduct them more cheaply or better or both. However, something that can be core activity to the company like customers may be kept happy easier by outsourcing than to keep them in-house, specifically, operating process and management positions and highly skilled services such as some banking and accounting firms and functions in the pharmaceuticals and biotechnology and in other areas of the economy. Most importantly, do not outsource the functions/processes that gain the company competitive advantage. Thus, the use of outsourcing is becoming more important, and is growing significantly in a range of industries, including, electronics, pharmaceutical, medical devices, automotive, and food and beverage production.

Growing international competition has forced manufacturers in many industries to guarantee fast and reliable deliveries of an increasing variety of high quality products. This has resulted in placing pressure on established companies in the industrialised nations, and to create opportunities for the new companies, and the nations, which have taken the path to industry more recently. "This effect has been very pronounced in the West, with industry in Europe and America suffering particularly severely" (Sweeney 2005). In recent years, the elimination of restrictive practises and the increased levels of shop floor productivity have resulted in some improvement in competitiveness in the West, but these have only affected the direct manufacturing costs. Although according to Sweeney (2005), the direct manufacturing costs were not competitive the indirect costs were causing the most problems. However, efforts to increase productivity were concentrated on the direct costs.

Consequently, organisations are focusing on areas where they have or can gain a competitive advantage, and strengths that will enable them to participate successfully in an advancing global market place.

Outsourcing

In the simplest of forms, outsourcing takes place when an organisation transfers the ownership of service or function that used to be done in-house to a supplier. The degree of transfer of control is the defining characteristic of outsourcing. Outsourcing can be applied to most functions and services within an organisation, but what an individual company outsources depends on the core competencies[1], core activities[2] and critical functions within the organisation. Outsourced jobs should have no face-to-face customer servicing requirement, high information content, a work process that is telecommutable and Internet enabled, and finally a high wage differential with a similar occupation in the destination company.

Outsourcing in its most basic of forms started from the basis of a single service such as canteen management, buildings management, or computing. In the 1960's and 1970's, organisation diversification was "all the rage", organisations were trying to spread their options and hedge their bets against downturns in their core activities (Oates 1998). Diversification also involved the "outsourcing" of slightly more complex functions like facilities management. This fad died out as organisations found many problems including that it spread organisational resources too thinly. However, as this was going on the problems in the organisation were escalating and now extended to: inflexibility, unresponsiveness, the absence of a customer focus, an obsession with activity rather than the ultimate result of a process, "bureaucratic paralysis" (Hammer & Champy 1992), lack of innovation, and the most challenging problem, high overheads.

The digital revolution which included the introduction of the Internet, and Broadband, accompanied by the falling costs of transport, and telecommunication, all of which played a part in opening up the global economy played a part in the growth of outsourcing. Fig. 1 illustrates the fall in costs of transportation and telecommunication from the 1990's to now:
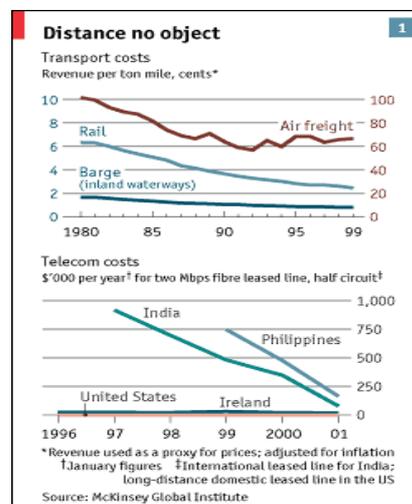

Fig. 1 Trends in Transport and Telecom Costs
Source: The Economist (2004)

Reasons for Outsourcing

According to the literature the main reason organisations outsource is to take the advantages of lower wages. Clinton (2004), claims that ninety percent of organisations say that cost saving is the primary reason to outsource. Stakeholders are increasingly demanding cost-effective business practises to improve productivity and profitability. Savings are cited by professionals to be forty-four percent,

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[1] "The central things organisations do well" (Oates 1998).
[2] "Things that are central to what organisations do" (Oates 1998).

however, organisations that have outsourced maintain that the actual figure is closer to twenty percent. Tyson (2004) claims that service costs can fall by a dramatic fifty to sixty percent and Diana Farrell, the head of research in, the McKinsey Global Institute claims that by reorganising production intelligently, multinational organisations can hope to lower its costs by as much as 50-70%. While, the Gartner Research Group estimates that saving of offshore outsourcing of IT can save the company as much as forty to fifty percent.

Improvements in efficiency are also required if an organisation is to reduce costs. The Western hemisphere is declining in competitiveness and in engineering skills, and with the widespread use of IT, productivity has never been greater and outsourcing can also aid in this where staff cannot provide adequate service or do not have the appropriate expertise to carry it out. Cost reduction can also come as a result of superior supplier performance and the provider's lower cost structure – the provider can do this by doing things faster and more efficiently.

Free (2002) states that the organisational drivers are, the financial impact of shared services and their resulting economies of scale, speed to market, and the leveraging of scarce or expensive IT resources. On the other hand, Chohan (2004) claims that organisations outsource to benefit from, greater financial resources, greater technological resources, and increased economies of scale. Brown & Browning (2003) claim that outsourcing is to "ensure that critical technology service delivery is achieved and can grow overtime without directly investing in costly skills, hardware, and software" and to access technology they otherwise could not afford to keep up with the every increasing pace of new technologies in the market place.

Cohen (2003) maintains that economic downturn and the climate of uncertainty that surrounds us are the two main factors that are forcing organisations to move towards outsourcing in order to reduce costs and improve efficiencies. In this day and age companies need to move from the functional organisation of the past to the process orientation of now, thus companies need to improve their business processes and outsourcing is one of the ways that can be used to do this.

Nowadays, outsourcing can also be used to improve and strengthen relationships and to gain technologies and economies of scale that may not be attainable to the organisation. With improving relationships organisations will have the opportunity to give more responsibility and trust to the outsource supplier thus creating more time in the organisation. Furthermore, outsourcing allows companies to become more agile to deal with situation more easily as they occur.

Outsourcing is "*an easy way to achieve more functionality for less money, with less aggression*" (Perkins 2003).

Benefits of Outsourcing

There are many benefits that can be obtained to the organisation as a result of outsourcing, however, these depend on whether the company goes about the outsourcing project in the appropriate manner and if they are willing to put the time and effort into helping their staff overcome the problems they may encounter as their jobs change and evolve. In addition, outsourcing has helped to open up the global market as outsourcing organisations take advantage of regional labour markets and reduce operating costs.

The benefits can be separated into two distinct areas obvious benefits and hidden benefits. The obvious ones are the ones that hit the bottom line of the company's financial sheet at the end of the month. These can include but are not limited to; lower prices, better quality goods and/or services, and a wider selection of products and services. It could also result in a reduction in staffing levels and hence, operating costs may fall. As the function or service is outsourced to a "best in class" provider, there may be greater flexibility in the systems. As a result, companies can become more profitable and more competitive.

Other obvious benefits to companies are the access that can be obtained to highly skilled workforces, energy sources, scare or abundant natural resources, technology excellence, proximity to markers, transport and trade routes, improved responsiveness, and agility. Improved responsiveness and agility come about as a result of the company outsourcing to a service provider that is best in class. The best in class provider should have the skills and expertise in the form of employees and best

practises in order to improve the service/function and consequently make the service/function more transparent and more responsive to changes.

Hidden benefits may include suppliers providing you with technical skills and ideas that might not have been able to develop in-house, and extending the scope of customer services. Probably the most important hidden benefit is that because as companies become more profitable and flexible "this protects many existing jobs and allows companies to invest additional money in the next-generation technologies and business ideas that will create the jobs of the future." It can also help to eliminate the barriers that were created between different departments in within an organisation and allows for the merging of estranged departments.

Problems with Outsourcing

The main problem with outsourcing is that the starting point for every outsourcing project is different as are the country, cultural, business, legal, financial, and taxation requirements are different. "Western Europe, Northern America, and Japan account for approximately 70% of the world's exports of manufactured good in 1995" (WTO 1995) Trade barriers still exist in international business, which make a completely free flow of goods impossible. Furthermore, many companies are outsourcing in the "guise of strategy" in an attempt to rectify larger ills where the underlying problems emerge and the root causes remain unresolved and as a result is a "waste of time" and is "harmful to the productivity of the enterprise and the lives of the people involved" (Cramm 2004).

Torres et al. (2004) found some disadvantages to outsourcing in Southeast Asia, China, India, and Russia. Wages in some parts have risen by up to fifteen percent and these increases have lead to decreases in wages in other sectors of the economy. The high growth in outsourcing has created a shortage of highly skilled workers – predicted to be a 20% excess demand over available labour supply by 2008. Russia is failing to provide the high levels of skilled workers because of the gradual deterioration of their higher education as a result of insufficient funds, China an established powerhouse in the manufacturing sector, but has yet to replicate that success in the services sector.

In addition to all of that companies can lose key members of staff leading to a loss of knowledge, loss of experience and exposure as the company may not know the answers as key personnel are no longer there. They may lose the responsiveness or flexibility within the organisation and lower the morale in an already "jittery" and mistrusting workforce (Johnson 1997). As like any other project, there are many inhibitors to the project. Most of these come from the staff. They fear the uncertainty that surround its and do not know whether they will lose their jobs or not. They fear the loss of control and the unknown situation they are heading into. Managers fear the loss of core competencies within the company and what happens if the project fails and as the outsourcing decision is difficult if not impossible to reverse and reversing the decision means bring the outsourced project in house and will they be able to do it.

Research Design

The research question is: What are the critical success/failure factors in relation to outsourcing from an Irish perspective and what impact do they have on business performance? And, from this the overall hypothesis to be tested was formed which is: "Outsourcing has a positive affect on the overall business performance in an Irish context" with the following objectives:

1. To find out the types of outsourcing Irish companies are involved in.
2. Is there a correlation between what medium to large sized companies are outsourcing as compared to SME's?
3. What were the benefits companies experienced as a result of outsourcing? Were they the same as the benefits companies expected?
4. Were the problems experienced by companies more pronounced for SME's than medium to large sized enterprises?

From these a quantitative survey to gather the practical reality of what happens in companies and following these three case studies in order to get an in-depth insight into the benefits/challenges of outsourcing.

Conclusions

Outsourcing is a powerful strategic tool that can gain an organisation many benefits including responsiveness if gone about in the right way. However, the consequences can be detrimental for the organisation if they do not go about it in the right way. To avoid the pitfalls requires advance planning. Roles, responsibilities, and conflict resolution terms must be outlined clearly along with the performance measures in order to evaluate the service.

In order to improve responsiveness and agility companies must outsource to a best in class provider to take advantage of the best practise they have employed.

The results of the survey are hoped to answer many of the fundamental questions that have arisen in an Irish context and to give an overall viewpoint of outsourcing from an Irish perspective.

Acknowledgements

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