THE OUTSOURCING STRATEGIES FOR ORGANIZATIONAL EFFECTIVENESS AND EFFICIENCY

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ABSTRACT

Outsourcing is a management strategy by which an organization delegate major, non-core functions to specialized and efficient service providers. Outsourcing represents a significant shift in the way organizations manage and staff business support activities. This paper discusses the need for effective business process outsourcing, and starts by identifying overview of outsourcing, core and non-core activities, advantages and disadvantages of outsourcing. To get the organizational effectiveness and efficiency, this paper also discusses about managing and monitoring the effect of outsourcing and its implications for human resource development.

A. INTRODUCTION

One of the strongest and most sustained trends over the last ten years has been the move towards outsourcing. With increased fervor and conviction, organizations have sought to restructure, build flexibility and reduce costs by contracting out services and activities traditionally provided in-house. The rationale for this movement is simple and compelling. If contracting out parts of the operation is cheaper than doing it yourself, it is a clear case for outsourcing. This enables organizations to not only make efficiency gains but also allows them to focus more clearly on those activities that it can better perform in-house (Fill and Visser, 2000). Organizations have hires outside providers to help them with a variety of activities, such as information technology in particular for a long time. What's different is first the range of services organizations are now asking outsourcers to provide and second, the extent to which outsourcing has become the politically correct response to changing market and corporate conditions.

Outsourcing has been viewed as a form of predetermined external provision with another enterprise (company) for the delivery of goods and/or services that would previously have been offered in-house (Domberger, 1998). Economic analysis has its limitations as it does not account for the leadership and management capabilities to structure and manage co-operative relationship crucial to effective working of out arrangements (Kakabadse and Kakabadse, 1999). In keeping with the twin themes of economics analysis and the leadership requirement for the effective running of out arrangement, this paper provides a literatur review of the impact of outsourcing strategies on human resources development and organizational effectiveness. There are two reasons for outsourcing are identified: scale economics and strategic outsourcing.

A major influence impacting on the outsourcing of products and/or service is consideration of scale and costs (Finlay and King, 1999). The Boston Consulting Group studied more than 100 key companies with extensive outsourcing practices and concluded that most Western companies outsource primarily to save on overhead or induce short-term cost savings (Kakabadse and Kakabadse, 2000). Others argue that the growth in indirect overhead cost, which represent "non core competencies", are increasingly being outsourced (Branda, 1999). During the 1990s, scholars and practitioners argued that global competitive pressures have positioned large companies to adopt greater market dicipline, reducing their product range and loosening their vertical links in the production process. As a result, corporations have "divested" peripheral or suplementary businesses in order to focus upon their core business and, in turn, have vertically de-integrated by increasingly outsourcing their requirement for components and business services. The search for greater efficiency, in turn, has led to increased specialisation outsourcing is seen by certain writers as a manifestation of this trend (Domberger, 1998).

In contrast, the strategic sourcing literature positions that outsourcing of goods and services should be integral to an organization's overall strategy formulation process. The organization needs to determine the scope of its internal activities by reference to its objectives, in contrast to outsourcing when there is pressing need to apply cost disciplines or find ways round difficult industrial relations disputes (Domberger, 1998) argue that firms use outsourcing in order to satisfy any one or more of three strategic intents, namely strategic improvement (cost reduction and enhancement of efficiency), strategic business impact (improving contribution to companies' performance within existing lines of business) and strategic commercial exploitations (focus on leveraging technology-related assets).

Although the strategic literature suggest that reason for outsourcing has changed from primarily cost disciplines to strategic re-positioning, core competencies enhancement, greater service integration and/or higher value creation (Quinn, 1999). More efficient transactions help firms reduce the cost of co-ordination, which are defined as the transaction cost of all the information processing necessary to co-ordinate the work of people and machines that perform primary processes take into account the costs of gathering information, negotiating contracts and protecting against the risks of opportunistic bargaining. Reduced co-coordination costs imply an unbounding of functions, making it easier and more efficient to enter into value chains than maintain in-house ownership (Kakabadse and Kakabadse, 1999). In addition to the costs, other considerations that also should be addressed in the business plan include: the impact outsourcing a particular business function may have on customer service, the impact it may have on the community where the company operates, the impact on employee benefits after the implementation of sourcing plan, as well as the potential political consequences of employ reduction (Zhu *et al*, 2001).

Beside that, global outsourcing has also received considerable attention in the popular and business. Global outsourcing is a strategy of redesigning, redefining, reshaping, and energizing organizations all over the world. The global outsourcing is strategic use of outside resources to perform activities that are traditionally handled by internal staff and resources. It is a management strategy by which an organization delegates major, non-core functions to specialized and efficient service providers, a leading consultant on global outsourcing assert. The traditionally global outsourcing emphasis on tactical benefits like cost reduction –cheaper labor cost in low-cost countries have more recently been replaced by productivity, flexibility, speed and innovation in developing business applications, and access to new technologies and skills. The potential of global outsourcing is enormous. If implemented correctly, it can dramatically improve an organization's effectiveness. By understanding and managing the major risk factors, developing a comprehensive plan outlining detailed objectives, expectations, requirements, and expected benefits of global outsourcing projects, selecting global outsourcing partners based on their expertise in the operation and their cultural fit with the firm, and by communication channels with the right components, managers can view global outsourcing as a useful tool to enhance their competitive positions in global market place (Elmulti and Kathawala, 2000)

B. CORE AND NON-CORE ACTIVITIES

Every organization has core activities where the organization has a competence for satisfying specific customer needs which other organizations do not possess. While companies are faced with increasing opportunity to outsource activities there remains a need to develop guidelines for making the outsourcing decision. Outsourcing as a strategic decision concerning near-core activities that presents both the opportunity to achieve significant benefits and also potential problems (Jennings, 2002). Beside that, A core competency lies in an ability to differentiate output so that they match a market segment very precisely. In the retail sector, for example (May, 1998), Marks & Spencer and Georgio Armani both sell clothes but their market segments are quite different, as are their core competencies. Mark & Spencer is a retailer selling clothes to a largely middle-income customer base. They contract design and manufacturing to others, and they core competencies lie in buying promotion and retail management. In the other hand, Georgio Armani is satisfying a very different market segment as his clothes are for a customer base who buy exclusivity. His core competencies are innovatory design, production and public relations; and retail management skill account for little added value.

Many organizations spend a disproportionate amount of management time managing non-core business process activities. For example, in investment banking, attention was diverted from risk management and new product development and spent on information technology (May, 1998). In consequence, the UK banks have been swallowed up by US and European competitors, or have collapsed through management failure to exercise proper control. If the management effort spent on developing technology had been focused on banking, the UK would today be better represented among the world's leading financial institutions.

To identify the core competencies requires assessment of the contribution of every activity undertaken in an organization, to decide whether:

* It has a direct effect on satisfying customers' needs,
* Outsourcing would achieve comparable quality more cheaply
* Re-allocation of resource to other activities would earn a superior return,
* Other benefits might arise from outsourcing such as; lower inventory cost, reduced management time, and improved production flow.

C. ADVANTAGES AND DISADVANTAGES OF OUTSOURCING

Up until very recently, general conventional wisdom among corporate executives was to provide as many functions, tasks, and activities as possible through internal personnel. The rational behind this mode of thinking was that internal operations, particularly through centralized management, could provide the greatest amount of management control over efficiency and productivity. However, new competitive pressures and a troubled world economy have forced a number of organizations to re-think theirs strategies of building up internal organizations. According to management guru, Drucker, in house service and support activities are defective monopolies, which have little incentive to improve their productivity. For example, in-house staff may respond to service problem by hiring more people or an outsource vendor, or respond by ensuring that customers get what they need without extra high costs (Blumberg, 1998).

Outsourcing offers several advantages, such as enabling existing staff concentrate on core activities on organizational specializations, focusing on achieving key strategic objectives, lowering or stabilizing overhead costs, and thereby gaining cost advantage over the competition, providing flexibility in response to changing market conditions, and reducing investment in high technology (Quinn, 1999). The obvious reason behind outsourcing is that it provides very effective means reducing costs by contracting with a third-party who can provide better service and high quality at a lower cot. By reducing costs through outsourcing, we gain the ability to improve operating efficiency, increase return on assets, and improve profitability. Outsourcing is also an effective means of generating new revenues. For example, the firm which outsource can contract with a third party to provide products and services which can not offer on a profitable basis. This form of outsourcing enables a client firm to test market demand for service or product in a less risky, more cost-effective way than creating the service internally with scarce resources. Outsourcing can also occur in the form of collaborations or alliance with two or more like parties in the same business line for offer complementary products or service. These hybrid situations enable the two organizations supporting the same market to share resources and increase revenue through synergetic relationships. Benefit of these hybrid situations also include the ability to increase capacity utilization, improve return on investment, and create economic of scale (Blumberg, 1998). Perhaps the greatest advantage of outsourcing is the full utilization of external suppliers' investment, innovations, and specialized professional capabilities than otherwise would have been the case, which for any one organization would be prohibitively expensive to replicate. However, transferring fixed cost into variable costs by selling assets to an outsourcing vendor is considered and advantage for many organizations. The company receives cash payment and transfers fixed costs into variable overheads (Currie and Willcocks, 1997). The main outsourcing motives quoted by managers: focus resources on core activities, cost reduction, convert fixed cost to variable, benefit from a supplier's investment and innovation, and improve time to market (Lonsdale and Cox, 2000).

On the other hand, there exist several disadvantages to adopting outsourcing strategies. The concept of outsourcing is not for everyone. These disadvantages are mostly of a psychological nature and if managed effectively, do not lead to financial losses. Outsourcing can generate new risks, such as the loss of critical skills or developing the wrong skills, the loss of cross-functional skills, and the loss of control over suppliers (Domberger, 1998). Therefore, systems must be put in place to monitor and evaluate the performance of vendors. However, developing these systems can be a difficult task for some.

The biggest obstacle to outsourcing is that it requires a change in management mind set. Many managers fear the loss of control or conflict of interest and fail to compare the cost and benefit of using outside human resources with the cost and benefit of using internal support organizations. Managers faced with an outsourcing decision often construe the financial cost and loss of control over individuals as their justification for not outsourcing, but fail to consider the long-term and short-term improvements and results, and the indirect financial benefits and long-term saving to the organization. Unfortunately, motivating employees and effecting change within internal support organizations is not as easy. In essence, the risk associated with outsourcing can be offset and controlled if managed properly (Blumberg, 1998).

D. MANAGING OUTSOURCING

The achievement of a sustainable competitive advantage has long been the goal of companies and organizations. Management teams require an expertise in outsourcing management. The principal tasks of outsourcing management vary between organizations, but there are common ones (May, 1998): identifying activities to be outsourced; specifying standards of performance to be achieved; sourcing and appraising suppliers/providers; negotiating services provision levels of price, quality and delivery; co-ordinating outsourced activities with the organization's core activities; monitoring the effects of outsourcing; and assessing risk and contingency planning. The competencies needed for outsourcing management are similar in many respects to project management, but extend beyond it. There is continuing need to review the synergy of outsourced and in-house activities.

Negotiating with a chosen supplier is the first step in a relationship that should be built to last the course. All successful negotiation is predicted on the fact that both parties must gain from the resultant agreement. Understanding the business aims of the proposed supplier, and what part your business will play in fulfilling those aims, is essential to creating a sound lasting relationship. The outsourcing organization will specify exactly what is needed from the supplier. The supplier will know the standards to be achieved in terms of output. In any negotiation, there will be negotiating points fundamental to both parties, others will allow for some flexibility. During negotiation for an outsourcing relationship, thought needs to be given as to how the relationship will be integrated into the organization. Managing the relationship well is the key to successful outsourcing, and achieve the benefits sought from moving away from in-house provision.

Managing outsourced relationships needs to be pro-active, enhancing the working relationship and transferring best-practice to achieve economies in both supplier and purchaser organizations. It is important, however, that the purchaser organization does not attempt to take over management of the supplier. This distracts management's attention from focusing on core activities, which necessitated the move to outsourcing in the first place. Negotiating, whilst a technical skill, has behavioral overtones and relates closely to relationships management. A key skill of negotiating is an understanding of the technology of the outsourced processes. Communication, inter-personal and analytical skill are prime behavioral competencies in an outsourcing relationship. Management are involved in dealing with managers from other organizations and must be adaptive to their cultures.

Outsourcing management requires a framework of both technical and behavioral competencies. A review of several organizations with successful outsourced business processes has identified competencies common to outsourcing management. Common technical competencies include (May, 1998): costing; contract law; Organization and management analysis; purchasing; systems design; probabilistic forecasting; loss evaluation; benchmarking; market and economic research; decision taking; and negotiating. In organizations, they are most closely associated with strategic planning and, to a narrower extent, production planning. However, skill learnt early in a career are outdated by the time individuals reach senior management. Failing a rigorous continuing professional development, or a company management development program, a structured development experience will be needed so that managers with outsource management functions can work effectively. Specific technical knowledge of business processes is gained through planned work experience. Management development should give candidates for senior outsourcing management roles and exposure to the main business process activities.

Common behavioral competencies include (May, 1998): listening skills; communication skills; lateral-thinking; persuasiveness; cultural awareness; and team working. Common behavioral competencies pose a great challenge for development specialist. Re-focusing mind set is not straight forward, but is essential to enable managers to become receptive to new ideas and cope with cultural diversity. Training can be effective, but behavioral change requires planned interventions often extending across the organization. Unless the move to concentrate on core activities and outsourcing is accompanied by a through organizational change program, changing managers' attitudes is a long-term exercise.

E. MONITORING THE EFFECT OF OUTSOURCING

Reviewing the synergies of outsourcing in an organization relies on depth of analysis. The impact of outsourcing on the purchaser spreads widely across an organization, affecting cash flow, management accounting, production and, ultimately, sales. If in-house arrangements give way to outsourcing, there are bound to be ripple effects within the organization. Close monitoring will detect unanticipated costs arising, for instance, in quality control, customer service or expenditure of management time (May, 1998). If not controlled, relationship management in particular, can become a significant cost. Assessing the performance of the contract is straightforward if the performance standards are clear. However, monitoring performance extends by other suppliers are not more advantageous; and that benefits of technical innovation which the supplier introduces is made available to the organization.

Monitoring the outsourcing risk is commonplace in most organization. Risk assessment plays an important part in the management of outsourcing. Moving business processes out of the organization raises exposure to a risk of loss from failure in the supplier's systems or organization. Risk management stars with assessing whether a business process can be outsourced, and whether the organization can afford to lose direct control over an activity. Security, research and public relations are examples of activities that might always be kept in-house to minimize risk. Many of the criteria for judging potential suppliers have bearing on risk. Their supply capability, reputation in the market and financial soundness all directly relate to risk. The checks made will approximate the due diligence a bank conducts before extending credit facilities to a corporate borrower.

Risk can also be managed by monitoring suppliers' markets and designing information systems that give early warning of foreseeable failure (May, 1998). The risk management of outsourcing depends on managers, ability to interpret the information that they receive. A company will be not protected if manager cannot make sense of financial or marketing data. In part, it is a resource for management to identify opportunities or competitive threat and is supplied through market research and by benchmarking specialist. Monitoring key indicators enables forecasting of economic events; for example, change in industry structure through mergers and take-over may impact on a supplier's cost base or access to technology, and affect the future pricing strategy of the purchasing organization.

Outsourcing adds value if management plans ahead, forecast their business requirements accurately, and takes steps to minimize risk impact. However, the unexpected does happen and contingency planning is required to cope with the situation and limit loss. Contingency planning raises cost; allowance must be made for the probability that disasters will occur, at the stage when outsourcing is first evaluated as an option. For example, where there are few supply alternatives, the cost of a supplier default may threaten the organization's survival. Risk management may require bonding against contract default, which will again raise the cost of an outsourced activity to the purchaser.

F. OUTSOURCING AND THE IMPLICATIONS FOR HUMAN RESOURCE DEVELOPMENT

As stated, whenever organizations decide to transfer ownership and responsibility for activities traditionally carried out internally to external providers, they simultaneously redraw organizational boundaries and change organizational structures and shape. These changes often involve reductions in personnel in order to improve the efficiency of the firm in terms of cost disciplines and to maintain competitiveness in the market. The resultant organizational forms provide positive and negative consequences. Organizational performance can improve in three areas through introducing new skills and working practices, reduc-

ing staff numbers, and by modifying individual incentives, employment terms and attitudes in the workplace. As management is more able to predict future costs than predict future revenues, reducing costs by decreasing the size of the workforce is often practiced (Mishra et al., *1998). Hence, the expected economic benefit of a smaller work force include reduced expenses, increased returns on investment, higher profits and improved stock prices (De Vries and Balazs, 1997). However, such initiatives also generate internal fears and employee resistance (Domberger, 1998). Past experience suggest that many outsourcing initiatives have not yielded the desired results because organizational and staff issues were neglected.*

The impact of outsourcing depends on how well it has been planned, how positively it has been communicated to employees and how effectively it has been implemented within the organization. Overall, it is acknowledged that whether the need for change in the company is due to a re-engineering of business processes, and/or a focus on core competences, an attempt to restructure in order to become more globally competitive, and whether restructuring or outsourcing strategies are utilized, the resultant effect is downsizing (Burke and Nelson, 1997). Redundancies and layoffs are common place in outsourcing situations despite the transfer of personnel to service provider, the redeployment of staff within the organization, outplacements and voluntary early retirements (Domberger, 1998).

In order not to deal with the unpleasantness of redundancies, negative publicity and legality of employee rights, organizations are increasingly undertaking outsourcing deals which include the transfer of staff to service providers. In certain cases, service providers take over the entire workforce of outsourced activity as a condition of contract. Such conditions usually carry higher contract prices, as the service provider has to service short-term constrains on efficiency gains because of the cost of carrying surplus labor. In the long-term, the service provider relies more on natural attrition and redeployment as a means of aligning manpower to the contract (Domberger, 1998). Even the transfer arrangements may have an impact on employment within the organization, on wages, and on working conditions and the duration of the contract being sold-off, often with capital equipment. Although many employees understand economic reality, that is outsourcing efforts are undertaken for the improvement of organizational efficiency and to increase value to shareholders, question are increasingly being asked concerning the emphasis on shareholder value to the detriment of organizational stakeholders, namely employees (Cascio et al., *1997). In effect, loyalty to organization is disappearing (Kakabadse and Kakabadse, 2000).*

Some managers have argued that the negative effect on people can be mitigated by the way outsourcing is managed. Others indicated that the impact on employees is likely to be related to the specific, technical differences of the mode of outsourcing, exemplified by the tightness of the contract specifications affecting the harshness of the employment regime that my follow. Moreover, in organizations where in-house bids have been made for a contract, making outsourcing but one potential outcome of the tendering process may have a positive influence on employees, especially in the case of new activities which have not been previously performed in-house (Domberger, 1998). Furthermore, in certain case, outsourcing can be perceived by employees as an opportunity *for career enhancement and development, provided it involves a move to a desired specialist organization. For example, when an organization with a small Information Technology (IT) department outsourcers its IT activities and employee to a large IT service provider, employees usually face an enhanced chance for career development within a specialized IT organization than was the case in the previous small IT department.*

G. CONCLUSION

In conclusion, most organizations are now engaged in an in-depth analysis and evaluation of the opportunities for cost reduction and productivity improvement through outsourcing and downsizing (Blumberg, 1998). However, it is essential for organization which is considering outsourcing to fully understand the need for a quantitative, in-depth, professional and objectively conducted consultative evaluation process, in order to arrive at the optimum decision and solution with respect to cost reduction and efficiency and productivity improvement, relating to: 1) growing the organization to achieve significant economies of scale; 2) outsourcing and/or subcontracting of key function and processes to reduce cost, and 3) forming a partnership with another service organization to gain both economies of scale, and the ability to increase in the direct business. The main motives of outsourcing (Lonsdale and Cox, 2000) quoted by managers are focus resources on core activities; cost reduction; convert fixed cost to variable; benefit a supplier's investment and innovation; and improve time to market.

Outsourcing has been prescribed as an important tool for attaining a competitive advantage (Elmulti and Kathawala, 2000). Sourcing is nothing less than the whole sale restructuring of the corporation around core competencies and outside relationship. The composite outsourcing decision framework was used as a means to encourage managers to appraise the range and complexity of the issues that need to be considered when making decisions about outsourcing (Fill and Visser, 2000).

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