

OUTSOURCING BENEFITS AND COMPLICATIONS

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ABSTRACT

This research is theoretical, and its purpose was to explore literatures on the relationship between outsourcing benefits and complications. The paper offers a detailed assessment of outsourcing as a concept and its benefits and implications to organizations. This study was conducted adopting a qualitative secondary data from newspapers, journals, articles, textbooks, dissertations and internet. The core-competency theory, resource-based theory and transaction theory were adopted as the theoretical foundation for the study, and it offered a strong position in support of the importance of focusing on core competency as basis for outsourcing decision, this research also posit that assets or resources that give the organization competitive advantage should be kept in-house. The position reached based are on the harmony of views, identify clearly outsourcing as commendable and required for the efficient functioning of organizations today. On this note, it was concluded that the features of cost and organizational operations are efficiently addressed through the adoption of outsourcing practices and behaviour which are strategic and which allow for the organizations to focus on its own key and primary functions. The study recommended that the practice of outsourcing should be such that emphasis is focused more on the additional functions and areas identified as weak or overly costly to the organization. Such features can be addressed through a shift in responsibilities to other organizations which are more proficient and structured for that purpose.

Keyword: Outsourcing, Benefits, Complications, Core Competency, Cost, Control, Competitive Advantage.

INTRODUCTION

In the recent time, outsourcing has become one of the most effective practices by business organizations. The competitive nature of business activities has necessitated the adoption of outsourcing by business organizations to enable them provide required goods and services in order to satisfy the customers' needs, make profits as well as remain relevant.

With globalization, many companies do not have to produce everything they need on their own. Outsourcing is one of the best ideas that allow many companies to focus on what they do best and outsourcing what others can do better, faster, cheaper, and higher quality. Outsourcing is one of the successful business concepts has become an increasingly popular organization management strategy (Koszewska, 2004).

Outsourcing is a popular strategic management tool that is being used by firms throughout the world, it has become a major operational tactics in today's downsizing-oriented firms. Outsourcing is based on the notion that strategies should be built around core competencies which add the most value in the value chain, also, that functions or activities that add little value or that cannot be done cost effectively should be given to outsiders via outsourcing. Outsourcing is simply obtaining work previously done by employees inside the companies from sources outside the company. Outsourcing is the business practice of hiring a party outside a company to perform services or create goods that were traditionally performed in-house by the company's own employees and staff. Outsourcing is a practice usually undertaken by companies as a cost-cutting measure.

Previously, outsourcing was generally known as off shoring. Outsourcing is said to have originated from America, which then spread to other parts of the world. Presently, large trading partners such as US and China have adopted outsourcing policy in lot of their business units in their industries, this legitimizes that outsourcing is paramount to increased organizational competitiveness and competency as well as reduction in production costs. Outsourcing avails organizations the opportunity to concentrate her core competencies on definable preeminence business area and provides a unique value for customers, Dominguez (2006; Großler, Laugen, Laugen and Fleury, 2012). It is imperative to know that, outsourcing is no more limited to peripheral activities such as cleaning, catering and security. As noted by Jennings (1997) and Dominguez (2006), outsourcing also includes essential areas such as design, manufacturing, marketing, distribution, information system etc.

The importance of outsourcing has made organizations, both large and small, to embrace the practice. Several companies are outsourcing many of their core processes to reduce costs and improve efficiency. Within this spectrum, a trend that has emerged last few years is one in which companies in developed economies are outsourcing technology and business processes to less developed economies. Though outsourcing in many ways benefit many businesses economically, there are still many arguments that outsourcing causes some setbacks such as loss of control, privacy and security concerns, hidden costs and decline in employee morale. Thus, this research work intends to explore the concept of outsourcing as well as its benefits and implications.

Meaning of Outsourcing

Outsourcing as a concept is not a recent phenomenon, outsourcing came from “outside resourcing,” an American terminology, which means to obtain resources from outside. Later on, the term was used in economic terminology to refer to the use of external resources instead of internal, as was typical in the process of developing the business (Troacă & Bodislav, 2012). Outsourcing as a concept can be traced as early as 1776 when Adam Smith wrote in *The Wealth of Nations*, “If a foreign country can supply us with a commodity or service cheaper than we can ourselves make or provide it” (Smith, 2007). Organizations have been outsourcing since the early 1900s, although under a variety of labels (Cappelli, 1995; Chandler, 2004).

Outsourcing according to Yalokwu (2006), as the process of subcontracting operations and services to other firms that specialize in such operations and services that can do them cheaper or better (or both). Also, Dominguez (2006) views outsourcing as the practice of hiring functional experts to handle business units that are outside of a firm’s core business. She describes it as a method of staff augmentation without adding to headcount. Usually, in an outsourcing business venture, there are three major parties; the service provider, the user, and the adviser. The advisers act as agents and are mostly lawyers and related professionals that acquire experience in the outsourcing business practice and help draw mutual beneficial agreements (Service Level Agreements) on behalf of the two parties.

For Nigeria organizations to recognize and embrace the emergence of outsourcing in Nigeria, some associations were set up, some of which are; the Association of Outsourcing Practitioners of Nigeria (AOPN), the Nigeria Association of Information Technology Enabled Outsourcing Companies (NATIEOC), the Outsourcing Development Initiative of Nigeria (ODIN) in conjunction with the World Bank and Interra Networks Limited, Assessment of Core Competencies for Employability in the Service Sector (ACCESS Nigeria) there has been considerable enlightenment on outsourcing through their activities.

Popular foreign companies which have outsourced are among others Kodak Company who subcontracted its computing operations to International Business Machines (IBM); which resulted to higher quality computing system and operation at Kodak for less money than it was spending (Sev 2009). Also as noted by Hill (1997), Boeing as at 1997, was world’s largest manufacturer of

commercial jet aircraft with a 60% share of the global market. Despite being the market leader, Boeing was faced with competitors like Europe's Airbus industries. The stiff competition between these big two resulted to high operating cost which forced Boeing to think outside the box and came out with ways to beat down cost. In 1993 Boeing undertook a companywide internal analysis whether to make or buy. The outcome of this analysis made Boeing to outsource certain components to China. Worthy of note is the fact that Boeing avoided outsourcing the production of wings because it believed that doing so might give away valuable technology to potential competitors.

In Nigeria, Sev (2009) noted some examples of companies who have outsourced their operations. Some of these; examples are Ashaka Cement Plc, which outsourced its operations and services to Blue Circle industries of United Kingdom; Dangote Cement, Gboko (Benue plant which acquired the expertise of Pakistani who have managerial know-how and expertise to give quality services and operations. Also, because of the keen competition in Nigeria banking industry outsourcing became really prominent in Nigeria banking industry when, in a bid to reduce cost, banks started outsourcing for staff. Major banks in Nigeria outsourced their operations and services to "Experts" to keep them competitive in the international financial markets. Some of these major Nigerian banks are; First Bank of Nigeria Plc, United Bank for Africa (UBA) plc, Zenith Bank plc, Access Bank plc, Ecobank plc, Guaranty Trust Bank (GTB) plc, and Union Bank Plc etc. These banks outsourced their Automated Teller Machines (ATM) to a company called Inter-Switch. Similarly, these commercial banks outsourced their human resource operations to agencies like Dragnet, Workforce consulting, Lington & Bernie Consulting, Vic Laurence and Philips consulting etc. Banks, Oil & Gas companies, FMCG companies including Nigeria government outsourced their account auditing to audit consulting firms like KPNG, PWC, Delliotte and Akintola Williams.

Types of Outsourcing

There are three main types of outsourcing which are local outsourcing, offshore outsourcing and near-shore outsourcing. These various types of outsourcing are further explained below.

Local outsourcing

Local outsourcing is also known as onshore outsourcing or domestic outsourcing, is a type of outsourcing that has to do with the obtaining of services from someone or company outside a company but within the same country.

Onshore or local outsourcing is the outsourcing to service providers located in the same country or region. With this outsourcing model, you'll be likely speaking the same language and the team will be working on the same time zone and these factors make communication with an onshore outsourcing company quite seamless. The team is easily accessible, as there are no cultural differences between you and the business process outsourcing services company, you will be sharing the same holidays and this makes the work run efficient. There are many disadvantages as well. The cost will obviously be higher, compared to the offshore model. Also, you may not find a great pool of experts in the world with onshore outsourcing. Example of local outsourcing are; Union bank outsourcing its human resources operations to Lington & Bernie Consulting, Procter & Gamble outsourcing its products distribution and sales to Prince Mega. Indomie Nigeria outsourcing its sales and distribution to Multipro.

Offshore outsourcing

Offshore Outsourcing is a type of outsourcing where an organization recruits a third-party supplier to conduct operations from an outside country. Offshore outsourcing is the opposite of Onshore outsourcing, which is the obtaining of services from people or companies within the country. While similar but not the same, nearshore outsourcing is the practice of getting work done or services

performed by skilled workers in neighboring countries rather than in the same country. Examples of offshore outsourcing are, some IT companies in Nigeria outsource work to United State of America and United Kingdom. Offshore outsourcing companies provide service from low-cost regions around the globe to reduce costs and tap into seasoned experts. LG outsourcing its sales to Fuan Nigeria, Dangote Cement (a Nigerian multinational) setting up its manufacturing plants in Algeria are examples of offshore outsourcing.

Near-shore outsourcing

Nearshore outsourcing is the practice of getting work done or services performed by people in neighboring countries rather than an organization's own country. While nearshore outsourcing involves hiring for services in nearby countries, offshoring involves employing or contracting services in countries that are further away. These options provide a stark contrast from onshore outsourcing, which is simply employing or contracting services from someone outside the organization, but still within the same country. For example, for companies in the Nigeria, outsourcing nearshore might be to countries like Ghana and Benin Republic. Dangote Cement (a Nigerian multinational) setting up its manufacturing plants in Ghana. The Ford Motor Company has factories in Mexico.

Theoretical Framework

This research was guided by various school of thoughts, this research was guided by three theories: Core-Competence theory, Resource – Based theory and Transaction Cost Theory.

Core Competence -Based Theory

In 1990 core competency as a concept in management theory was propounded by C. K. Prahalad and Gary Hamel. Core competence is the knowledge set that distinguishes a firm and provides a competitive advantage over others (Leonard-Barton, 1992). Leonard-Barton (1992) identifies four dimensions of core competencies: employee knowledge and skill; technical systems; managerial systems and values and norms. The emphasis for organizations to outsource their non-core activities has been welcome by lots of organizations as a way of improving performance of the organization through organizational efficiency. The concept 'core competence' has been popularly used to develop and also test decision frameworks whether to outsource to a third party or keep it in house.

Outsourcing is also seen to be related to 'make or buy decision'. Organizations makes decisions on to internally make and what to buy from outside with the aim to maximize the profit margins. With 'make or buy decision', the firm is defined as the buyer organization and the 'supplier' is the outside organization. There is a trend for the suppliers to bundle the firm's maintenance into integrated solutions (Ulaga and Reinartz, 2011), which incorporate the entire maintenance cycle, including the combination of equipment from competitors and performance guarantees for entire production systems (e.g. Windahl and Lakemond, 2010).

Resource-based View

Barney in his 1991 article "Firm Resources and Sustained Competitive Advantage" is popularly seen as the pivotal work in the emergence of the resource-based view. The resource-based view (RBV) is a managerial framework used to determine the strategic resources a firm can exploit to achieve sustainable competitive advantage. The core idea behind the resource-based view is that of competitive advantages which comes from a firm's effective use of its tangible and intangible resources or assets. Tangible assets include plants, equipment and even human resources, whereas intangible assets include things like trade secrets and corporate reputation.

Barney, 1991 opined that, a resource must fulfill the VRIN (V-Valuable, R-Rare, I-Imperfect Imitability and N-Non-substitutability). Resources that are valuable, rare, and difficult to imitate or substitute are considered to be sources of sustainable competitive advantage. With resource-based theory an organization is able to identify those resources that are core to its operations which gives competitive advantage from those that are non-core, this information equips the organization to take 'make or buy' decision.

Transaction Cost Theory

The term "transaction cost" is frequently thought to have been coined by Ronald Coase in the 1930s. Transaction cost is a cost in making any economic trade when participating in a market. Transaction costs will occur when dealing with another external party, these costs include; *Search and information costs* this cost describe the work of determining the availability of inputs and identifying the most affordable source of inputs in a market, or finding the best partner for an exchange (Williamson, 1975). *Bargaining costs* describes the work of negotiating prices and agreements, such as contracts. Solid contracts may require considerable negotiation and the employment of lawyers with skill and experience with contract development. *Policing costs* describes the effort needed to enforce agreements or to ensure that exchange terms are being met (Dahiman, 1979).

Transaction cost theory is in tandem with outsourcing in organization because, their services or products can be outsourced only if the strategy leads to cost benefits for the organization. Cost reduction is the pivotal point of outsourcing. Because of the differences in wage level in different countries, organization can leverage the overhead cost of the company and the company can also benefit from the expertise available across the globe. For example, many of the US based companies have outsourced their IT operations to India to cut the cost.

Benefits of Outsourcing

Organizations outsource with the aim to trickle in some benefits into their organization. There are a lot of benefits of outsourcing, the main benefits are as follows;

Focus on core business activities

The term Core Business refers to the main activity of the company, which must generate profitability and position itself in advantageous positions within the competition. As a company grows, administrative functions also grow. Managing back-office operations and administrative functions takes the time and energy out of any organization. Outsourcing frees companies from having to manage non-core functions, and offers the possibility to put the focus back on their core competencies. It is necessary to focus on the central activity of the company.

Expertise and fast delivery

Usually, tasks are outsourced to vendors who are the best in their field. The outsourced vendors also have specific equipment and are expertise connoisseurs. Similarly, an organization core team might be fantastic at a few things, but no organization is perfect at everything. By outsourcing particular tasks, companies are often able to substantially improve performance by drawing on the niche skills of experts in certain fields.

Also, when an organization hire an expert to handle some of its business operations, such organization will be working with masters of managing time-sensitive deliveries as a result speed will be greatly improved because the outsourcer or expert firm probably have better resources at its disposal than the organization in-house team might.

Cost Efficiency

Cost efficiencies are business strategies that strive to reduce the cost of creating a product or performing an activity without compromising quality. Outsourcing allows an organization to get the work done at a very low cost and in a much more efficient way.

With outsourcing a company does not need to spend extra on developing infrastructure. When a task is outsourced, the partner who takes over the outsourced task, make necessary infrastructural changes, as per the requirement of the task.

Lastly, when an organization outsource a specialized type of work, then the company or organization does not require hiring skilled people for it. There will also be no need for arranging for training programs for the same. The work will be handed over to people who are already experts in that trade.

Quality improvement

One of the most cited reasons for an organization's decision to shift to outsourcing is quality improvement (Lacity et al., 2009). There exists a belief that outsourcing may contribute to an increase in the processes' efficiency and effectiveness that such application services support (Lacity & Willcocks, 2009).

Although the main goal of outsourcing is usually to cut costs, it also leads to an increase in Direct Foreign Investments (FDI) most especially in IT. Jobs are outsourced to Nigeria from around the world thereby increasing the nation's Gross Domestic Product (GDP).

Complications of Outsourcing to an Organization

Even though outsourcing is used by many organizations in Nigeria, it is still a new business strategy with its potentials yet to be fully annexed and has been faced with some complications.

Loss of Control

There have been numerous complaints from organizations about loss of control over their own process technologies and quality standards when specific processes or services are being outsourced. Quality may suffer, production may be disrupted, or contractual disagreements may develop when a company outsource to outsiders' tasks that were previously performed by the company personnel. When outsourcing contract is inappropriate or the work specifications are incorrect it may be opportunistically tempting to the outsourcers.

Organizations pass through a common phase when they outsource tasks that were previously done in-house. Because an external partner is not your in-house team, the level of control is dependent on communication and the location of your vendor. Geographic distance in outsourcing result to inability to take full control of a project most especially when the vendor is offshore due to the challenge of monitoring performance and productivity, including coordination and communication between the vendor and the outsourcing firm. The inability to engage in face-to-face discussions, brainstorm, or explore nuances of obstacles could cripple a project's flow. The transfer of control means an organization need to rely highly on his vendor, so, it is paramount while choosing a reliable partner, appropriate research should be done about client's experience and the tracking strategy.

Privacy and Security Concerns

An organization partially or completely expose their business asserts when they outsource their operations to another organization. That is why keen attention to privacy, intellectual property, and data protection is very important. This involves copyrights, patents, trade secrets, and more are very important. This may not be the case if the organization hire a reputable vendor, however, there is still the likelihood that the third-party organization might steal/leak valuable confidential

information or business secrets. This concern is likely applicable to an organization outsourcing its operations to an organization from another country who is not obliged by the laws of the principal organization country. For example, if a member of the outsourced software development team steals the code from your company, it can become quite troubling. How will you take legal action across borders?

Hidden Costs

As the name implies, hidden costs are those that are involved in the production or management of a business and are difficult to identify. Since the primary motive of an organization wanting to outsource is to gain a competitive edge in comparison to having its in-house team handle non-core business tasks, it becomes imperative to an organization before choosing a service provider, to compare the cost of your in-house team to the price estimated by the vendor.

Decline In Employee Morale

Employee morale could be affected by outsourcing because if employees don't understand the need for outsourcing in an organization, they will feel they could be replaced and this will affect their morale and productivity. Also, in a situation whereby attrition or layoff is inevitable due to outsourcing it sends a negative signal to the remaining staff and if not properly managed it may be counterproductive. In-house fighting can occur among employees as there will be confusion as to which activities would remain in-house and which to give to a third party.

Although not always the case, some employees may find themselves carrying out activities that they deem menial and not so interesting, and their morale may fall. They may conclude that they should be carrying out the outsourced work and, most especially if they find out the fees the outsourcing company is charging, they may feel they should have a pay rise or leave and find jobs elsewhere (including outsourcing themselves).

Limitations and Future Studies

In research works, limitations are inevitable including this research which is not without limitations. A major limitation of this research is that the researcher only used secondary data. Also, another limitation is that, here are situations where organizations may have the needed resources in-house but still go ahead to outsource, this casts doubt on resource-base theory. Organizations even go to extent of subcontracting in areas of their core competence. This therefore brings the fore the insufficiency of the core competency theory in explaining the outsourcing decision in terms of strategic choice and implementation.

There is a strong possibility that there may be some additional expenses that may not be included in the initial cost estimate. These may end up adding to the initial outsourcing budget of the organization, and in the long run this will end up becoming a problem. Cost can be effectively minimized through effective communication with the service provider as well as transparent cost estimate while making the deal. For the vendor to provide the organization with an accurate cost estimate for the outsourcing process, the organization is required to unambiguously identify the requirements of the outsourced project.

CONCLUSION

There is an increasing need for organizations to leverage on its core competencies or distinctive capabilities which gives them competitive advantage by keeping in house those activities that are core and cost effective to its operations and outsource non-core and cost ineffective activities. The core competences of the organization need to be identified to enable the organization to know

what to outsource. Also, if the organization have sufficient resources to take care of its activities there will be no need for outsourcing. The opinion expressed on this research explore the key attributes and relationships between outsourcing benefits and complications. The various theories discussed explicitly described the features, antecedents and possible outcomes of each of the variables. Going by the generalization of the literature there is a strong relationship between outsourcing benefits and complications making outsourcing a double edge sword.

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