

How Outsourcing Can Help the Organizations for Capturing Sustainable Development?

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Abstract: Outsourcing in its essence is a very dynamic and diverse topic and there are many different outsourcing options. In this paper, we would try to discuss basics on outsourcing aimed for a client and an outsourcing provider. It is argued that outsourcing has its benefits and disadvantages. It is on a company to do due diligence of itself prior to undertake outsourcing process. However, statistical data shown that outsourcing is rapidly growing and it has more its benefits over downsides. As globalization spreading out in untouched areas of the world, outsourcing does so. In this article we try to give the definitions, types and benefits of outsourcing for the organizations in order to give a broad understanding of its effects on sustainable development.

Key Words: outsourcing, contracting, core-components, globalization

Introduction

Globalization is rapidly linking the world's major economies. Today's standard of excellence is not just best in class, in fact, it is best in world. In this global economy every company must compete against customer choices coming from everywhere and anywhere. Barriers to the marketplace are dropping quickly, with new competitors just a mouse-click away from any customer. Core competencies are the crown jewels of a company and, therefore, should be carefully nurtured and developed. Companies can determine their future business directions based on the strengths of competencies. However, because generalized terms such as resource, asset, capability, and competence are not clearly explained in connection with competence theory, these posing difficulties in understanding many contemporary management concepts (Hafeez, K. YanBing Zhang Malak, N. 2002).

The phenomenon of outsourcing has become a global issue in this modern world. Seems that is a new trend for some countries, but in fact it had started in early fifteen centuries. There are many books written on this topic. However, although authors suggest outsourcing as a future perspective following up newest technology, they also argue that there are downsides of outsourcing. They say that failures in outsourcing should be expected if proper analysis and preparation were not undertaken. Others argue that is better to in-source than outsource. Accordingly, this paper tends to discuss some current issues in outsourcing, its benefits, and disadvantages and how it helps the development of the organizations in terms of sustainability.

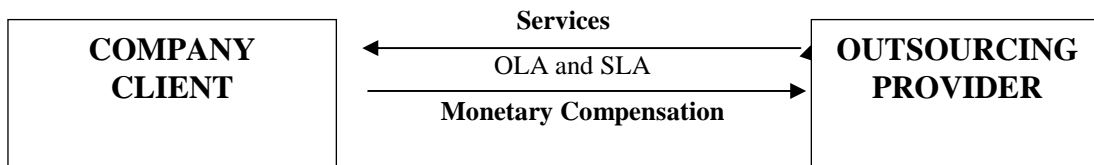
Definitions of Outsourcing

There can many definitions of outsourcing be derived although its essence is the same, so we would provide a few definitions that best describes in brief almost all parts of outsourcing process. Outsourcing at its simplest is when a company or individual delegate some of its specific tasks to another individual who is not their direct employee, or another company. The individual or the company receives monetary compensation in exchange for the services rendered. In other words, outsourcing takes place when a company has recruited another company or an individual to perform agreed business activities for them and that company or individual receive financial benefits (in most cases they get paid). This way, we can see that

outsourcing does not necessarily mean only situations where large corporations are involved. In fact, it can also apply to small companies and entrepreneurs who get some of their work done by people who are not their employees.

Outsourcing is finding areas and responsibilities within an organization that are *not core competencies* and finding someone else to do the work for the company. It involves transferring or sharing management control and/or decision-making of a business function to an outside supplier, which involves a degree of two-way information exchange, coordination and trust between the outsourcer and its client. So, outsourcing is contracting with another company or person to do a particular function. Usually a function being outsourced is considered as *non-core* to the company's business.

Graphically these definitions can be summarized as Figure 2:



OLA – Organization Level Agreement

SLA – Service Level Agreement

Figure 2 - Definitions of outsourcing

Types of Outsourcing

The most common types of outsourcing being implemented are the following:

- BPO – business process outsourcing
- ITO – information technology outsourcing

1. In short, *BPO* refers to the process of hiring another company to handle business activities for a company. A formal definition of BPO is set out as “the delegation of one or more IT-intensive business processes to an external provider who, in turn, administrates and manages the selected processes based upon defined and measurable performance metrics (Havley J.K, B.M.Melby, 2007, pg.21).

BPO encompasses call center outsourcing, human resources outsourcing (HRO), finance and accounting outsourcing, and claims processing outsourcing. When BPO is concerned we can say that the BPO has its own sub-business processes such as *KPO* – *knowledge process outsourcing* and *BTO* – *business transformation outsourcing*.

KPO includes those activities that require greater skill, knowledge, education and expertise to handle. The current definition of KPO encompasses R&D, product development and legal e-discovery, as well as a number of other business functions.

Similarly, *BTO* refers to the idea of having service providers contribute to the effort of transforming a business into a leaner, more dynamic, agile and flexible operation.

2. *ITO* focuses on IT-related activities, such as application management and application development, data center operations, or testing and quality assurance.

As a remark, we must bear in our mind that any kind of outsourcing would not be successful without IT technology. Rather it is an integrated part of every BPO.

Also, the outsourcing could be distinguished according to the region or area where outsourcing is being performed as On-shore/Near-shore and offshore outsourcing.

On-shore or near-shore outsourcing is outsourcing within nearby region or the same country.

Offshore outsourcing is outsourcing beyond a country borders.

Traditionally, organizations have a home base of operations-a region or country, where they began and where their first customers are located.

In going *offshore*, the company has the opportunity to change its business in two primary ways: its net costs and its net capabilities. *Net costs* refer to all of the aspects of its costs that might be impacted by the change, such as labor, support, technology, communications, infrastructure, legal, insurance, and taxes. The resulting cost differential can be positive (it can produce a lower net cost for the organization) or negative (it can produce a higher net cost). At the same time, *offshoring* will also affect the organization's net capabilities. *Capability* means all of the operating characteristics of the business, including the volume of work that can be processed, its quality, speed, and flexibility

It is known that among the cheapest labor in the world are labors in India and China so today most business are offshored to these countries.

Outsourcing Places in the World

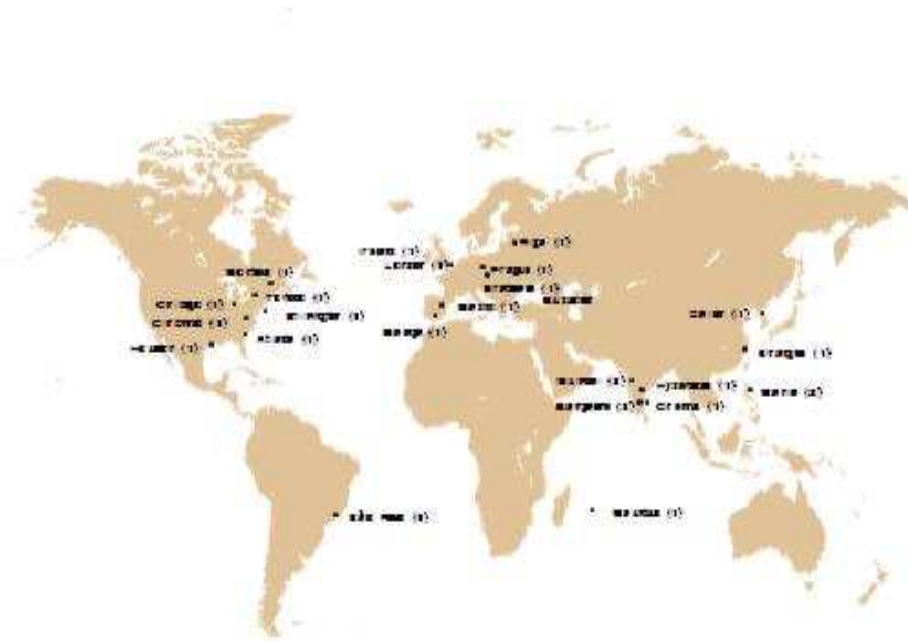


Figure 3 – Outsourcing around the world (<http://www.ulb.ac.be/> 15 December 2008)

To note: since the outsourcing is in fact BPO, and all main functions are actually BPO functions, we will use it as outsourcing term in further discussion. So it is important to extent this discussion to BPO categories.

BPO Categories

Business processes that have come under close examination as potential candidates for outsourcing typically fall within one of seven categories:

1. Finance and accounting
2. Investment and asset management
3. Human resources
4. Procurement
5. Logistics
6. Real estate management
7. Miscellaneous (energy services, customer service, mailroom, food processing), [Halvey K. John, Melby M. Barbara, 2007, pg.134,]

These categories have been established to facilitate the discussion of the general types of business processes that are the subject of consideration for outsourcing. Because in many cases a business process touches different areas within an organization, customers and vendors may categorize certain business processes under different headings depending on the organization's internal structure. For example, in some companies, payroll is considered a human resource function, while in others it is considered a finance function.

As the BPO market evolves, customers and vendors will undoubtedly identify more business processes than can and will be outsourced. The potential reach of BPO is evidenced by the scope of what is even now being considered for outsourcing. Business processes targeted for outsourcing are expanding beyond the traditional corporate support functions into the supply chain.

Reasons for Outsourcing

Over 90% of all companies around the world outsource certain business activities, whether it is HR benefits administration, payroll, technical support or many other services. Each of these areas is specialized and

resource intensive. Working with a knowledgeable vendor ensures that the tasks will be done well, and most importantly allows your organization to stay focused on its *core business*.

For the past five years, vendors have been marketing BPO as an alternative to the typical IT outsourcing deal, encouraging customers to identify noncore processes that are inefficient, too costly, or difficult to manage. The entire process (except, in most cases, a high-level management position or positions) is then turned over to the vendor, who, in turn, typically agrees to productivity, customer satisfaction, and cost savings commitments.

As the IT outsourcing marketplace becomes more standardized, BPO customers are looking for innovative ways to increase the efficiency and quality of an entire business process through value-added services, customer satisfaction, and, ideally, a direct, quantifiable impact on cost.

Some of the *key business drivers* for customers considering BPO include:

- Transferring the entire function (not just the IT component) to a qualified supplier
- Enhancing/improving methodologies
- Benefiting from industry knowledge or experience
- Streamlining or standardizing processes across the organization
- Sharing resources or technologies
- Committing less up-front investment to new methodologies or technologies
- Obtaining flexibility with respect to the roll-out of methodologies or technologies
- Increasing productivity
- Quantifying savings or benefits
- Tracking customer satisfaction
- Enhancing shareholder value

Obviously, objectives for outsourcing one or more business processes will vary on a deal-to-deal basis. The objectives are typically shaped by management’s overarching goal in outsourcing (e.g., transition to new methodology or technology, reduction in costs or expenses).

In addition, the Table 1 shows other benefits of outsourcing which best describe why a company tends to outsource its *non-core business activities*.

Table1: It indicates what activities are reduced when a company is outsourcing its business activities

<i>Outsourcing</i>	
Client	Service Provider
No need for a new infrastructure	Existing infrastructure
No extra staff needed	Existing staff
Perceived needs	After a client describes their specific needs, a group of people, whose job it is to do those things, does them
No new equipment needed	Already possesses necessary equipment
Does not hire new people	Hires staff
Provides no support or training	Trains and supports staff
No need to fire people	Fire people in case of not working out
No need for learning for outsourced activities	Track the learning curve
Better service quality	The client is guaranteed a certain quality level of service
No effort needed for extra project analysis and investment	They see better results, in less time, with very little ongoing investment of time and effort

The following figure summarizes already introduced reasons for outsourcing business competencies.

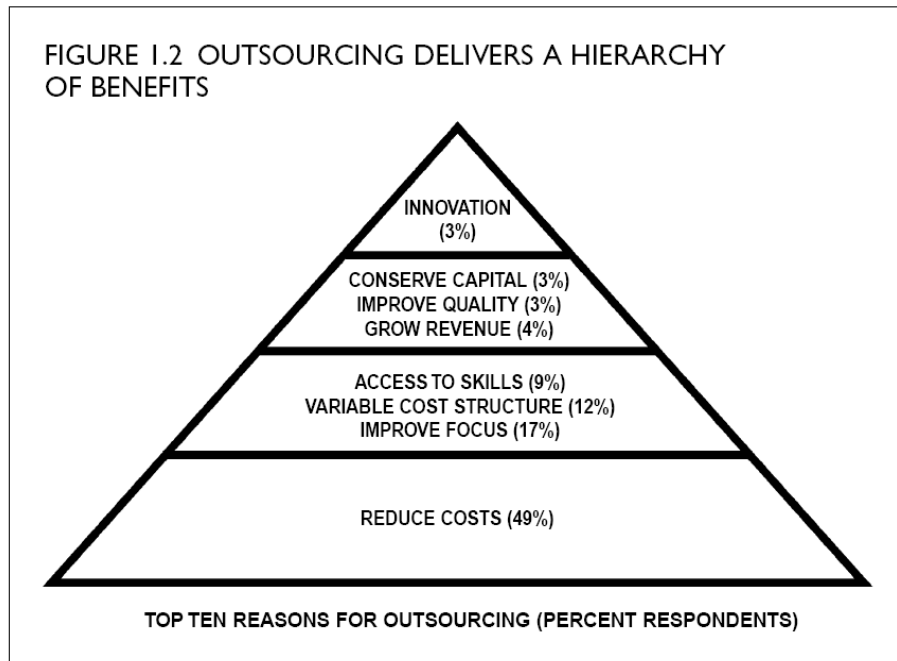


Figure 4: Source (Corbett F. Michael, 2004, pg 31)

Analysis, Preparation and Stages of Outsourcing

Prior to outsource, a company needs to define its internal SWOT Analysis. It should determine points where sustainable advantage lies and could those weaknesses be eliminated if company find outsourcing vendor in order to follow and continue its competitiveness.

This should be made at Business process and IT level.

If the company perceives the following, it should go for outsourcing.

Business concerns:

- Perceived low availability of services
- Perceived a low level of service quality (accessibility, turn-around time etc.)
- No clear service reporting and service management
- Roles & Responsibilities not clear.
- Processes unclear, too slow, too many hand-offs
- Slow and error-prone service introduction
- Unsatisfactory support of remote sites & subsidiaries
- No service culture
- Cost allocation & charges unclear and cannot be influenced by business decisions, etc.

IT concerns:

- Unreasonable service level expectations from business
- No cost & resource awareness
- Large number of non-standard work requests
- Overlarge project portfolio, paired with spaghetti development infrastructure
- High-level of business applications
- Inefficient-underutilized server platform,
- Aging central technology platforms and complex networks
- Large and diverse skill pool required to support infrastructure

Similarly, a company should take into account its other internal constraints prior to outsource, namely:

- *Availability of Seed Money* – a company needs to reduce cost, this requires efficiency gains, and efficiency gains require investment
- *Structural Inflexibility* – company's current business and application architecture may not allow for simple and low cost ICT changes
- *Time to Benefit* – Most "quick-wins" have already been explored over recent years. Major initiatives have pay-backs seldom shorter than 24 – 36 months

- *Business vs. IT Projects* – Most projects are invisible to the normal business users and do not directly contribute to business revenue generation
- *Capacity and Know-How* – Are there sufficient internal resources available to drive the change in a timely fashion? Will heavy external resource usage kill the business case?
- *Change Capacity* – Can the internal organization absorb this change now (ex. Overall moral, unions, etc.)
- *Sustainability* – Can initiatives be maintained in light of business development?

Statistics Facts

Since globalization took place, outsourcing has increased enormously. It is a fact that every year outsourcing getting its part in every business. Another factor that fosters its growth is rapid development of IT technologies.

Outsourcing statistics show that the largest percentage of jobs being outsourced is in Information Technology, by around 28%. The next largest field is human resources taking 15% of the outsourcing market, followed closely by sales and marketing outsourcing with 14% and financial services outsourcing at 11%. The remaining 32% is made up of other different processes such as administrative outsourcing. (<http://www.manpower.com>, 12 December 2008)

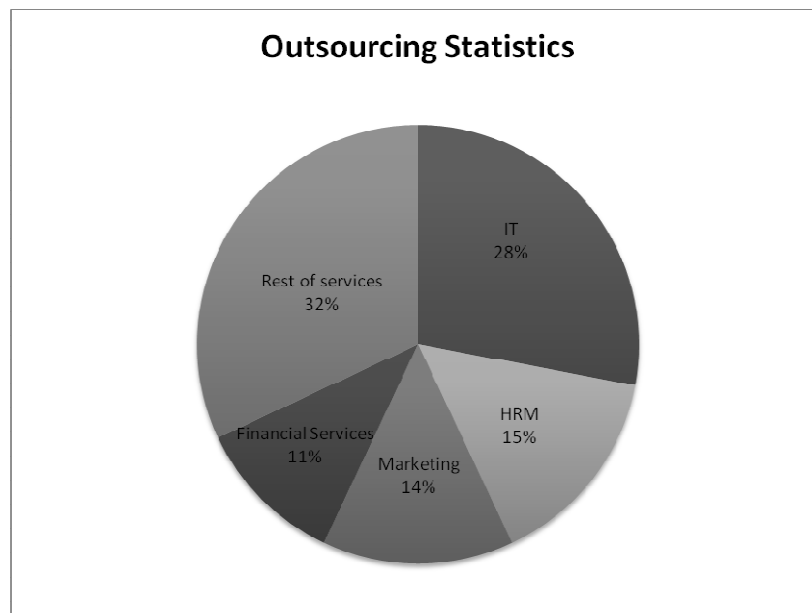


Figure 5 - Outsourcing statistics on IT, HRM, financial services, marketing and the rest of services

Most of the outsourcing is done by multinational companies and the most popular destinations are India, China and the Philippines. Of course these figures slightly differ depending on the study and the point of view, but this division gives an idea of the outsourcing market. (<http://www.manpower.com>, 12 December 2008)

Forrester Research estimates that 3.3 million U.S. jobs and \$136 billion in wages could be moved to such countries as India, China, and Russia by 2015. (<http://www.manpower.com>, 12 December 2008)

Nasscom, a lobby form for Indian software and service companies, has reported that India could earn \$60 billion a year by 2010 from information technology and outsourcing. Most of the new business is expected to be outsourced by insurance, retail, banking and travel companies. (<http://www.manpower.com>, 12 December 2008)

The McKinsey Global Institute estimates that the volume of offshore outsourcing will increase by 30 to 40 percent a year for the next 5 years. (<http://www.manpower.com>, 12 December 2008)

According to an article in Business Week magazine, the most commonly outsourced functions in terms of global spending include the following (listed in order of global spending):

1. Logistics and procurement—\$179 billion
2. Manufacturing—\$170 billion
3. InfoTech—\$90 billion
4. Customer care—\$41 billion
5. Engineering—\$27 billion

- 6. Finance & accounting—\$14 billion
- 7. Human resources—\$13 billion
- 8. Analytics—\$14 billion

(<http://hosteddocs.toolbox.com/ceo-succession-management-consultants.pdf>, 12 December 2008)

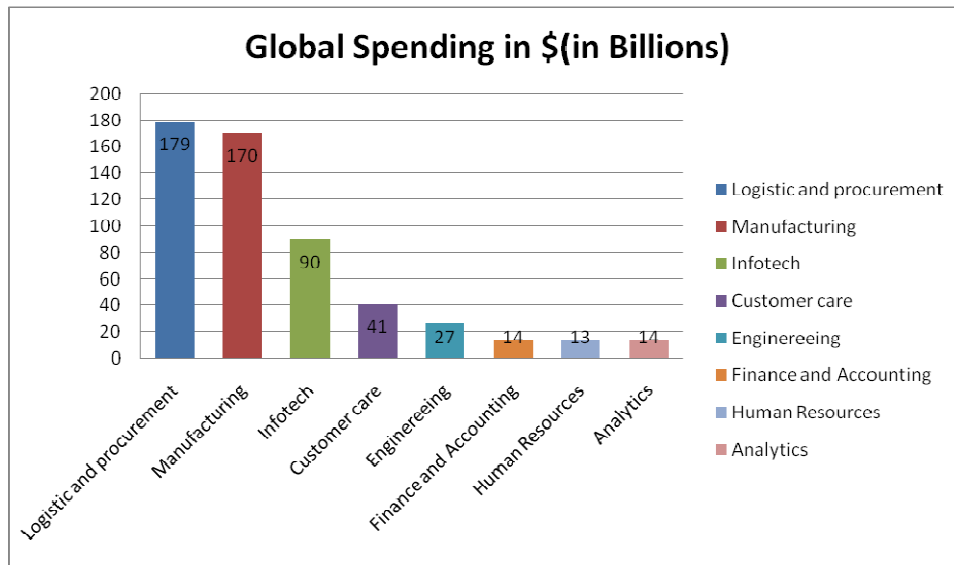


Figure 6 – Commonly Outsourced Functions and Processes

Problems and Barriers in Outsourcing

Although outsourcing's ability to create these benefits for companies and their customers and shareholders is well documented, challenges and problems do exist. These are highly complex, sophisticated relationships that require care in their planning, execution, and management.

There are also a number of barriers inside the organization that must be brought down if outsourcing is to work well. For example, managers fear a loss of control. They often believe that although an activity may not be core, it may still be too critical to be outsourced. Also, they are concerned about losing flexibility by getting locked into a long-term contract with a service provider.

In addition, managers are concerned about how their customers may react and they are concerned about employee, and especially union, reactions. Also, managers are worried, particularly when it comes to offshore outsourcing, about community and political reaction over lost jobs.

Concerning problems and barriers, the following should not be neglected:

- Longer for vendor to setup than expected
- Outsourcing vendor unable to hire and train staff fast enough
- Outsourcing vendor can't handle volume of activities
- Unable to obtain and maintain telecommunications equipment
- Different work ethics between organization and outsourcing vendor
- Outsourcing vendor unable to perform on a timely basis
- Outsourcing vendor unable to produce contractual results
- Contract performance measures and penalties poorly written
- Contract exit language inadequate
- Failure to consider time necessary to major outsourcing vendor

Conclusion

No organization can stay competitive in today's rapidly changing global economy by relying solely on its own resources. Outsourcing is a necessary response to today's rapidly-competitive environment. In this environment, no organization can afford the level investment required to be best-in-world across its entire operation, yet none can afford to be anything less. Through outsourcing, organizations solve this dilemma by focusing their internal resources on the activities that provide them a unique competitive advantage.

At the same time, each outsourcing transaction adds to the organization's overall performance and competitiveness. It saves money, redirects resources to more valuable activities, achieves a more variable cost

structure, gains access to much needed skills, reduces the internal competition for capital, becomes faster and more responsive, and even increases its level of innovation. Managers and executives themselves are able to better focus their energies externally, on customers, as opposed to internally, on day-to-day operations.

On the contrary, outsourcing has its barriers and problems such as loss of control, to critical to be outsourced, loss of flexibility, negative customer reaction, employee, lack of clarity in costs, lower service quality and similar.

Therefore, we can conclude that if a company perceives such that functions are non-core and/or not a competitive niche, significant cost advantages from outsourcing, limited/no opportunity for learning transfer, skill competencies not available in organization, cost of monitoring/administering outsourcing partner is low, comparable or better service levels from outsourcing, the company should go for outsourcing. On the other hand if the company sees issues that are: critical to the business, no cost advantages from outsourcing, potential competitive advantages through knowledge transfer, skill capabilities readily available in organization, high cost of monitoring/administering outsourcing partner and service levels better within organization, the company should insource its business processes.

Finally, concerning Bosnian business environment, we can fairly argue that this region lacks of many kinds of outsourcing (although there are some companies involved in outsourcing activities) and there should be a leveraging instrument or factor that could foster this new era business activity. Yet, outsourcing business activities would definitely boost the economy of Bosnia towards its prosperity and its faster integration into European Union. Outsourcing would be one of many steps to implement the country mission as a future EU member.

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