MAXIMIZATION THE BENEFITS OF OUTSOURCING

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I. INTRODUCTION

Business circumstances required a best performance of a company in order to keep its existence in the market. The best performance is needed to strengthen company competitiveness to capture the market. In its operation, one of the factors that can influence the company performance is supplier as well as customers. Since supply can determine operation process, many companies have tried to build a mutual benefit relationship with supplier. Relationship with supplier can keep production or operation process can run well. If this process is disturbed, the companies would lose financial benefit as they could not produce goods or services which are demanded by the market. In some cases, product availability will determine customers purchasing decision. If a particular product does not exist in the market when it is needed, there is a possibility that customers will switch their choice to another product which was produced by another company. Relationship with customers can keep their loyalty to company's
products or services. Customer can determine existence of a company since company can gain sales and profit from its customer. Therefore, if a company does not have a sufficient number of sales from its customer, in a relative period, that company can not fund its operation and it can generate a possibility that the company will close its operation soon.

Business relationship is a partnership of companies which characterized by a long term exchange of goods, financial resources, ideas, product and market information (Klocke, Gemunden & Ritter 2002). Hunt, Lambe & Wittmann (2002, p.18), defined partnership or alliance in broad perspective as "collaborative efforts between two or more companies that pool their resources in an effort to achieve mutually compatible goals." Ford et al, (2003, p.38) explained the relationship as "the pattern of interactions and the mutual conditioning of behavior over time, between company and a customer, a supplier or another organization." There are several reasons which encourage companies to develop a partnership such as: innovation improvement, market capturing, co-opting and creating constraint for competitors, access to complementary assets, organizational learning and reduce risk and cost (Narula and Dubbing 1998). Noteboom (1999) also highlighted several reasons for develop alliance such as: need to focus on core competencies, outsource activities, access to knowledge and competencies, spreading fixed cost, build a barrier for new entries, increase competitiveness and access to market, and access to material, components, labor, and technology.

II. EVALUATION BOOK

In order to develop a collaboration, there are several types of partnership could be built by companies. One of the forms of partnership is outsourcing. Outsourcing is defined as "the transfer of responsibility to a third party used of activities, which used to be performed internally" Maltz & Ellram (1999, p.4). Ellram & Billington (2001, p.15) defined as "the transfer of the production of goods or services that had been performed internally to an externally party." Similar to their definitions, Bailey, Masson & Raeside (2002) described that outsourcing occurs "when an organization uses an external company to carry out activities which previously carried out within the organization." Kinnula & Juntunen (2005, p.2) defined outsourcing partnership occurs when …"
company transfers parts of its business to another company and after that the companies continue collaboration in a partnership mode.”

2.1. Advantages and Disadvantages of Outsourcing

Outsourcing can be used to improve company performance. Several benefits from outsourcing activities are: cost reduction, quality of service improvement, flexibility and allow organization focus on its core competencies (Bailey, Masson & Raeside 2002). Outsourcing can improve company performance to enhance efficiency and effectiveness (Gadle et al. 2002). Brandes, Lilliecreutz & Brege (1997) described three most reasons for outsourcing activities, namely: focusing on core competencies, increasing cost efficiency and financial problems. Their research found that a combination of focusing on core competencies and saving cost, high pace and commitment are the success factor of outsourcing. McIvor (2003) argued that focus on core business, increase flexibility, reduce risk, cost saving and supplier management are the reasons why a company occupies outsourcing. In addition, Shefi (1990) found that outsourcing of logistic activities for a shipper provides many advantages for a company such as: better transport system, reducing cost, obtain professional logistic services, access to technology development, flexible process, and simplification of administration. Bailey, Masson & Raeside (2002) highlighted that several main reasons for companies to outsource their activities are: increase services quality, access to resources such as: skilled human resources and up to date technology, and increase flexibility associated with fluctuating demand. They also found that cost saving was the most important factor to encourage outsourcing.

Despite potential benefits, outsourcing can create problem for company, such as: loss control, risk of exploited by supplier and difficulty to take outsource activity to inhouse (Bailey, Masson & Raeside 2002). Maltz & Elram (1999) acknowledged several contra opinions to outsource company activities such as: can not control supplier performance, difficulty to measure the third party supplier performance and less attention for improvement of the third party supplier. Hendry (1995) argued that there are social and cultural cost associated with outsourcing. It also can increase insecurity and decrease creativities. Khalfan (2004) also found that the most serious problem with
outsourcing in information technology is security. A survey by Greco (1997) showed that more than a half of respondents of his research had pulled the outsourced activities and done it in-house. One of the major reasons why it happened is there is no strategic attention to support such activities (Gadde et al 2002). Greco (1997) acknowledged that it occurred due to the outsourcing activities were chosen to reduce the company expenditure tremendously in short time. Ellram & Billington (2001) argued that companies outsource their activities on short term cost.

Ketler & Wastrom (1993) acknowledged some variables which could be advantages and disadvantages simultaneously relate to outsourcing in information system business, namely: personnel, economic, risk versus control, characteristics of outsourced data or segment, and organizational. Some advantages of outsourcing for personal are: knowledge improvement and expertise, and sufficient number of staffs when company needs them for temporary bases. On the other hand outsourcing reduces in-house expertise and increase cost for transfer or leaving staff. From economic point of view, outsourcing can reduce cost as a result of economic scale and increase return on equity. On contrary, outsourcing might reduce profit as company should pay outsourcing fee, cover hidden cost and increasing in the number of tax liability. Some advantages relate control such as risk sharing between companies and increase of management information system performance as problem is shared or transferred. On balance, company would lose control of quality, disaster recovery and confidentiality. Outsourcing of non strategic area, allow company to focus on its strategic business area as advantage in outsourcing segment. On the other hand if company outsources the wrong area, it will be disadvantage for company as it is needed more attention. In organizational term, company can outsource the weakness of management information system and retain the strength internally. Disadvantages for organizational variable such as: loss control of vertical integration, requirement of outsourcing in dynamic company difficult to contract and ability to satisfy many customers by outsourced company.

2.2. What Activities should be Outsourced

Company should consider what kind of activities that could not be outsourced or be outsourced. Maltz & Ellarm (1999) highlighted some criteria that can be used to determine what activities should not be outsourced by a company. According to them,
the circumstances for not using outsourcing companies if a company has resources, competencies or capabilities which:

- allow company to create better customer value added or more economically than competitors
- can not be easily imitated or substituted by competitors
- allow firm to dominate competition in the market
- are used in multiple activities or business units and can be occupied to access many markets.

If a company has above characteristics, it is better to do it internally and never outsourced the activities because it can be done more effective or efficient by internal company. Another important factor is if outsourcing could no reduce cost, the activity could probably do internally. Collins (1999) highlighted that outsourcing should be done when it increase a sustainable competitive advantage. In addition, Prahalad & Hamel (1990) acknowledged that core competencies and the secret activities which influence company successful should not be outsourced.

2.3. Outsourcing Design

Outsourcing should be designed properly in order to take targeted benefits. McIvor (2003) described a framework of outsourcing process which consists of four stages.

- Stage one: Define the Core Business Activities
  At this stage, company should define its core activities. The core activities should be done internally and the non core activities should be outsourced.
- Stage two: Evaluate relevant value chains activities
  At this stage, company evaluates outsourcing partner capabilities.
- Stage three: Total cost analyses
  This analysis evaluates the cost relate to either if activities is outsourced or in-house. Activity should not be outsourced if company has more capabilities than outsourcing partner. On the other hand company should outsource an activity when a partner could do it more efficient.
- Stage four: Relationship Analyses
If company decides to perform externally, then it can develop relationship with a partner. Bailey, Masson & Raeside (2002) acknowledged that the most common method to assess a potential outsourcing candidate is evaluation of reputation and previous experience with a partner. The most important criteria of vendor are: quality, cost, technical capabilities, and commitment.

Design of outsourcing activities should concern company position within relationship. Imbalance position will create a chance to exploit a partner. Therefore equal position could be used to anticipate an opportunistic behavior. A study by Lonsdale (2001) compared total outsourcing activities to total insourcing and selective sourcing. The study conducted in information technology field. He found that only 14% of companies which employed total outsourcing succeeded reducing the cost. On the other hand, 67% companies which employed total insourcing achieved cost saving. Meanwhile, cost reduction was achieved by 85% of company which segmented their information technology. The total outsourcing deals with a huge financial resource. It leads the relationship within buyer and supplier is set up in long term. Lonsdale argued that opportunistic behavior in total outsourcing long term contract lead buyers became locked in. On the other hand, suppliers get advantage by exploited the lack of contractual detail. Therefore, the risk sharing benefit can not be achieved in this case. Lonsdale found only 40 percent of long terms arrangement achieved success. On contrary, 89 percent successful rate was achieved in short term contract. Altinkemer, Chaturvedi & Gulati (1994), highlighted that most outsourcing contract in information technology business, can not be specified as the rapid change of technology as well as environment. It could lead vendor dominates the relationship. In order to choose a qualified vendor, Ketler & Walstrom (1993) proposed some criteria which should be to evaluate a potential vendor. The factors are: vendor experience and capabilities, long range planning, technology and human resources, flexibility to enter or exit the contract, communication, flexibility to transfer personnel and financial stability.

Kinula & Juntunen (2005) argued that successful of outsourcing partnership relates to the business, structural and relationship. Business issue relates to hard factor which can be calculated in term of money. Structural issue relates to structures,
processes and techniques that can be assessed and evaluated. Relationship associate with value based and people dependant which can not be easily measured or evaluated. One of the relationship factors that can be employed to determine a good partnership is commitment. In addition, in the broad perspective, Kinula & Juntunen (2005) acknowledged that trust is the most important factors to achieve successful in relationship.

III. DISCUSSION

There are many advantages as well as disadvantages when company decides to outsource its activities. Company should attempt to reduce the disadvantages and increase the advantages. Decision to outsource part of business activities should be supported by strategic analysis. The analysis encompass several steps such as: determine what of core and non core company’s competencies, evaluate partner capabilities, cost analyses and relationship development. These step is used to answer several questions such as: what kind of activities could be outsourced, for how long the outsourcing activities should be done, how to choose a qualified partner, how to ensure that companies would not be exploited by vendor, and how to bring back outsourcing activities if a vendor can not produce a desired performance.

3.1. Resources, Competencies and Capabilities

Researchers argued that outsource should not be done if company has resources, competencies or capabilities which can not be easily imitated or substituted, that allow to create better customer value added, and can lead to access and dominate the market. Indeed, company benefit from this circumstances. It can run well as long as company keeps its effort to increase creativity and add more value for customers. To some extent, this situation would encourage its competitors to more creative and innovative.

3.2. Selection of Outsourcing Partner

In order to maximize benefit and minimize risk, outsourcing strategy should be supported by best strategy to choose outsourcing partner. Many researchers found that many companies prefer to develop a new partnership within its established network (Klocke, Gemunden & Ritter 2002). For industrial market, companies tend to keep long term relationship with supplier (Luthardt 2002). The established relationship could keep
companies to retain or take much effort if a partner wants to switch to another company. Indeed, long term relationship can easily create a good relationship, since all of the companies that agree to develop a strategic alliance have known each other and have experience with previous project or activities. However, outsourcing activities could be classified base on investment and the degree of critical of activities. If a relationship requires allocation of much investment, company will be tied by relationship and hard to switch to another partner. It usually occurs in long term and strategic relationship. However, in order to benefit long term relationship, buyer and supplier should get mutual benefit and have equal position. Commitment and trust are the main factors influence the relationship successful. For short term and lack of resources outsourcing activities, company should have flexibility to choose its partner. This flexibility can encourage improvement of creativity its supplier.

3.3. Outsourcing Assessment

Evaluation of vendor performance can determine whether outsourcing could achieve target or not. The motives of outsourcing could be used as base line for benchmarking of outsourcing performance. To make it easy, the motives could be detailed become items which could be measurable. For example, if a company wants to reduce cost, it should be detailed in company plan, how much the number of cost saving. To ensure mutual benefit for both parties, contract should be detailed. In the other words, responsibilities and liabilities of both parties should be clear in the agreement. However, uncertainty in business and environment lead of lack of detail in outsourcing contract. Therefore, companies’ position in relationship should be equal to guarantee that there is no opportunistic behavior or exploitation by one party. When the agreement could not be fulfilled by a vendor, company can evaluate why it happened. Then, company can communicate to vendor in order to solve the problem. Company should always monitor vendor performance and compare to agreement in the contract. Other important factors are trust and commitment of a partner. These factors are crucial since company can not control its partner performance. Lack of trust or commitment in a relationship lead an outsourcing activity can not achieve a particular target. If it happened, company should consider bringing back the activity in-house.
IV. CONCLUSION

Business relationship contains benefit and risk at the same time. Likewise, outsourcing produce advantages as well as disadvantages simultaneously. To maximize advantage and minimize disadvantage, outsourcing activities should be supported by strategic plan. This plan ranges from decision of what activities which could be outsourced to assessment of performance of outsourcing relationship. There are several motives which encouraged company to outsource their activities. Researcher found that the motives are: cost reduction, risk reduction, improvement quality of service, flexibility that allow organization focusing on its core competencies, enhance efficiency and effectiveness, and financial problems. However, research also found that sometimes the expectation could not be reached by companies when they outsource their business. Lack of strategic decision was the main problem when it happened.

In order to get benefit from outsourcing, company should determine what is the core and non core business. Only the non core business could be outsourced. Company should evaluate the potential candidate before decide to choose the vendor. Many companies tend to create new relationship within its established partnership. The main reason is they have had experience and known their performances each other. While a company was choosing partner, the main criteria which they evaluated were trust and commitment.

An outsourcing as well as other types of relationship should provide mutual benefit for buyers and suppliers. Company should have relative flexibility to asses and control vendor performance. Both parties should have a balance position in network to prevent one party exploited another party. If an outsourcing could not provide targeted benefit, company should consider to chose another partner or even bring the activities back in-house.
REFERENCES

Book


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