# IS OUTSOURCING A STRATEGIC TOOL TO ENHANCE THE COMPETITIVE ADVANTAGE?

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***Abstract:*** *The most important target of the strategic management is to find the best ways to maintain or increase the competitive advantage via the lower costs or the differentiation by comparing with the competitors on the market. One of the multiple ways to reach out this target is the outsourcing. The aim of this paper is to review the main aspects of the outsourcing as a strategic management tool, to enumerate the types of outsourcing, to underline its advantages and disadvantages in increasing the company's competitive advantage and to propose a model based on six factors that are influencing the outsourcing for the decison making. The documentation regarding the opinions of different authors about the state-of-the art in this field, the own judgment and the narative presentation are used as research methodology.*

***Keywords:*** outsourcing, strategic management, competitive advantage, model of decision making on outsourcing

***JEL Classification:*** L14, L24, M19

## *1. Introduction*

As part of strategic management, the outsourcing is becoming more and more popular in the field of business, being a way to reduce costs and to create competitive advantage and increase organizations' performance.

Some companies planned to externalize as much as possible in order to get business performance, for example, Coca-Cola (Elmore, 2014), but others failed in competition, creating new competitors, for example, Samsung and Foxconn by Apple outsourcing (Griffin, 2015).

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Today the IT outsourcing is the most used. Companies from all continents are actively competing in the cyber space and many clients are in their third and fourth generation of outsourcing relationships (Willcocks & Lacity, 2012).

When discussing outsourcing the managers refer to a strategy or a strategic tool or to a business practice.

Outsourcing is defined as being ‘a practice used by different companies to reduce costs by transferring portions of work to outside suppliers rather than completing it internally’ (Investopedia). This definition underlines the cost-reduction way to increase the competitive advantage, rather than the differentiation.

Outsourcing can be also defined as ‘the strategic use of outside resources to perform activities traditionally handled by internal staff and resources’. Sometimes known also as ‘facilities management’, outsourcing is a strategy by which an organization contracts out major functions to specialized and efficient service providers, who become valued business partners (Handfield, 2006).

The reason of the strategic decision is that ‘most companies can substantially leverage their resources through strategic outsourcing by: (1) developing a few well-selected core competencies of significance to customers and in which the company can be best-in-world; (2) focusing investment and management attention on them, and (3) strategically outsourcing many other activities where it cannot be or need not be best. There are always some inherent risks in outsourcing, but there are also risks and costs of insourcing’ (Quinn & Hilmer, 1994). Nevertheless, the best way to make the decision is to balance between the opportunities and risks of outsourcing (Leavy, 2004). Other reasons for using the outsourcing are considered to be: the superior competency, asset transfer, utilization improvement, economy of scale and business risk mitigation (Chung et al., 2002).

## *2. Types of outsourcing*

A group of terms regarding outsourcing includes the transactional, contractual and relational governance of outsourcing arrangements along with its underlying characteristics (Chaudhary & Kishore, 2010).

The IT communication devices facilitate the understanding of the outsourcing practices. One of the websites is posting clarifications on different terms used for outsourcing, such as professional outsourcing, manufacturer outsourcing, multisourcing, process-specific outsourcing, business process outsourcing and project outsourcing (www.nearshore-technology.com/).

*Professional Outsourcing* facilitates the access to high-quality resources, which significantly reduces overhead costs. It includes accounting, legal, purchasing, information technology (IT), or administrative support and other specialized services.

*Manufacturer Out sourcing* or *industry-specific out sourcing* involves the transferring of blue collar jobs to a third party for various reasons such as expertise, human capital, time to market and cost factors.

*Multi-sourcing* is a term that can apply to any business area but is most commonly used when referring to IT outsourcing and IT services. It operates in a 'partner' relationship manner and requires a strategy, a network of relationships and governance as well. This method promotes competitive pricing and eliminates the dependency on 'one' company for the product (WordPress.com).

*Process-Specific Outsourcing* has specific operation-related aspects, mostly to other companies or units that specialize in that specific service to reducing costs and time, such as delivery.

*Business Process Outsourcing* is mostly specific to manufacturing companies for specialized activities such as machine maintenance and equipment repair, landscaping, cleaning services, and facilities maintenance or property management.

*Project Outsourcing* facilitates the function of project management or the entire project development to replace the lack of the inside skills or available people.

*Self-employed workers* is a form of outsourcing the labour force, as, for example, in the insurance industry. The contracting worker is formally self-employed but the conditions of work are similar to those of employees (Muehlberger, 2007). The author argues that firms (in the insurance industry) have established governance structures based on markets, hierarchies *and* self-enforcing relational contracts so that they are able to keep a substantial amount of control despite sourcing out of labour.

According to Harward (2010), there are four types of outsourcing strategies: two business process outsourcing (BPO), i.e. comprehensive and selective, and two out-tasking models, i.e. licensing and contracting.

*Comprehensive BPO* is the most complex, strategic, long term, and demanding relationship a company can have with a supplier, engaging with a partner for a multi-year period to strategically manage a comprehensive set of processes across all four functional process areas of the organization.

*Selective BPO* is also a very complex engagement, but somewhat less than a comprehensive deal because of the reduced integration of functional processes, but engaging a partner in managing multiple processes within one functional area of activity (administration, content, delivery, or technology) but not processes across functional areas.

*Licensing Agreement* is an engagement of out-tasking and it is used when sourcing a tangible asset, such as a technology or real estate for training. When the cost of implementation and set-up are high, these deals are often times multi-year. This allows the client to amortize costs over longer periods of time. When these costs are low, deals often take the shape of a month.

*Contracting* is the second form of out-tasking engagements, and the most common form of outsourcing in the training industry. The project can be consulting, instructional design, delivery of a course, etc.

In addition, when a company is willing to use the cheaper labour from another country the outsourcing is usually called *offshoring*. Willcocks & Lacity (2014) are stressing that ‘offshoring and outsourcing often retain their scale through recessionary as well as growth periods, making them attractive businesses for growing economies. A highly competitive global services market presents opportunities and revenues for countries able to offer the right mix of strong cost, reliable service, and secure location’. The authors also underline the importance of near shoring into the non-BRIC developing countries, giving some examples, such as the USA in Mexico and Germany in the Czech Republic. ‘Among the top contenders are Romania, Bulgaria, Poland, Slovakia and other 10 countries’.

## *3. Advantages and disadvantages of outsourcing*

### The advantages of outsourcing

The main advantages of the outsourcing may be concentrated into four directions: cost reduction, increased productivity, jobs balance and the management flexibility and risk avoidance.

*Cost reduction*

In order to enhance their competitive advantage many companies outsource to decrease the costs. “Outsourcing lets organizations pay for only the services they need when they need them. It also reduces the need to hire and train specialized staff, brings in fresh engineering expertise, and reduces capital and operating expenses" (Olive, 2004).

*Increased productivity*

Being focused on the core activities the companies are making decisions to invest in the know-how and technologies that are increasing the overall productivity. The 'outsourcing helps an enterprise concentrate on its strategic tasks and goals in the core activity' (Koszewska, 2004).

*Job balance*

In order to avoid cost increasing the companies are looking for outsource some of their support activities and are focusing on the core activities people's training.

*Flexibility and risk avoidance*

The outsourcing provides the use of the resources to a high degree and flexibility in avoiding the fixed costs (Merk et al., 2014). It also provides the sharing the risks with a partner company (Handfield, 2006).

**The disadvantages of outsourcing**

Regarding the companies running their business out of their home countries, the most important disadvantages of outsourcing are the downsizing with the consequence the unemployment rate increasing in these countries and the business uncertainty and risk threat in the host country.

*Downsizing and the unemployment rate increase*

In the global market, the outsourcing might have a different connotation. While the emerging countries offer cheaper labour force, the companies from the developed countries are willing to outsource some of their tasks to increase their profit on the basics of cutting the expenses with the wages. But, the transfer of many activities overseas might increase the downsizing and the unemployment rate, as well, in the home countries. As a consequence, the legal framework is discouraging the outsourcing, by increasing taxes on the revenues or profits obtained or by offering incentives to the businesses returned back to the home countries.

*Business uncertainty and risk threat*

Outsourcing some important tasks of the business in other geographical sites, especially in countries with different culture and education, might affect the products' quality and the pace of the delivery, even parts or full production contracts. Some other environmental factors of risk, such as the lack of governmental support, the poor development of the transportation infrastructure, the fiscal regulation instability and the political corruption may cause the management decision to reconsider the outsourcing strategy.

Nevertheless, the domestic companies are also facing some risks by outsourcing: hidden costs, inflexible contracts, dependency on one or two suppliers and maybe the time loss to find new suppliers. However, the potential benefits of outsourcing for small businesses are often indeed significant (Sonfield, 2014).

Despite its disadvantages, the outsourcing is used not only in the international businesses but also in the businesses that are not run internationally. A survey carried out, which 'had representation from 22 industry sectors, and geographical diversity, with respondents from 30 countries' (Deloit, 2014), shows that 'despite a political environment that can dampen the appeal of outsourcing, for the foreseeable future, we expect to see a continued growth of the [outsourcing] industry'.

## *4. A model to make decisions on outsourcing*

The outsourcing decision matrix (Manktelow, 2016) takes into account two dimensions of the outsourcing: the strategic importance and the contribution to the operational performance. The author also considers four possibilities of the decision making: (1) keeping the core competencies in house; (2) outsourcing; (3) strategic alliances; and (4) auxiliary activities elimination.

The literature, creativity and databases are conclusive factors in the decision-making process (Negulescu, 2014). However, the rapid pace of the occurrence of new information leads to the need of the professional adaptation to new knowledge and competencies that support obtaining and increasing the managerial performance (Dragomir & Panzaru, 2014). Moreover, the most of the management decisions are taken under the influence of external and internal environmental constraints" (Negulescu, 2014).

Considering the factors facilitating outsourcing for enhancing the company's competitive advantage and the types of the outsourcing, a model based on six factors is proposed, as a tool to make decisions on outsourcing (fig. 1).

As the figure 1 is illustrating, there are six factors that may facilitate the decision making regarding the use of different types of outsourcing, i.e. geography, competition, IT development, organizational structure, fiscal regulation and the cost of human resources.

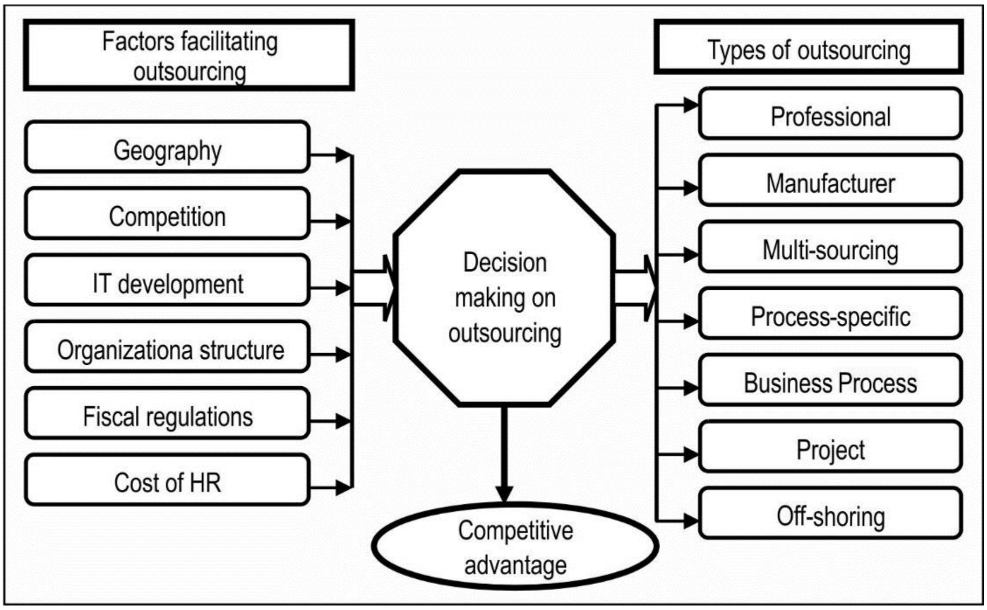


*Figure 1. The model of the decision making on outsourcing based on six factors*

*The geographical distance* between the headquarters, the subsidiaries and the outsourcing partners may be a factor for the decision for outsourcing, depending on the level of the costs.

*The competition* in the country of origin market may constitute the factor for outsourcing on a market with less competition that is decreasing the costs.

The continuing *development of the IT systems* is a factor for the outsourcing that influence the time effectiveness and costs decrease, as well.

A flexible with few levels *organizational structure* may influence the decisions for outsourcing aiming to decrease the overhead costs.

The *fiscal regulation* is a decisional factor for outsourcing in countries with tax breaks.

The *cost of the human resources* may be the most important factor for outsourcing taking into account that, depending on the industry, the cost of the labour may vary from middle to high level out of the total expenditures.

The type of the outsourcing that may be chosen is linked to the organization's strategy and the type of industry is which the organization is running its business.

## *5. Conclusions*

On a high competitive market and an IT developing environment, the companies are looking to reduce or to save costs by balancing their strategies between insourcing and outsourcing. When there is too much integration, the costs, and especially the overheads, have the tendency to increase too much and then, the outsourcing becomes necessary.

The outsourcing may be considered an important tool for the strategic management or a strategy. The bunch of the outsourcing enumerated in this paper and defined by different authors could be used for the decision making in correlation with the factors that are facilitating the outsourcing.

The model proposed may be a useful tool for the managers that are willing to sustain or to increase the companies competitive advantage by lowering the costs of the products or services provided on the market. This model may be developed by considering specific criteria to select the best type of the outsourcing according to the company's vision and its strategic objectives.

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