CHAPTER 1

INTRODUCTION TO

OUTSOURCING

1.1 Introduction

In the wake of globalization, we have witnessed the economies of the world become interdependent to one another to maximize productivity and profitability. Staying competitive in the global market place has become increasingly challenging and many organizations are looking at various ways to gain a competitive advantage by recreating and restructuring their value chain activities. These continuous efforts to gain efficiency and sustainable competitive advantage paved way for the emergence of outsourcing. Sourcing refers to identifying which production units will serve which markets, and where will they get the components or processes required for production (Kotabe and Murray, 2004; Davidson, 1982; Kotabe, 1993; Swamidass and Kotabe, 1993). Outsourcing which has now predominantly become part of an organization's business value chain, involves producing services and products effectively and economically through outside suppliers (Kotabe et al., 2008a,b; McCarthy and Anagnostou, 2004). Simply put, outsourcing is commonly defined as the transfer of activities and processes which was previously conducted internally, to an external party (Ellram and Billington, 2001). Viewed as one of the most sustained concurrent business strategy (Fill and Visser, 2000), outsourcing have witnessed a revolution in many industries such as automobiles, aerospace, telecommunications, computers, pharmaceuticals, chemicals, healthcare, financial services, energy systems and software (Carson, 2007; Dahan and Hauser, 2002; Quinn, 2000). Although previously outsourcing primarily focused on the procurement of non-core activities and services of an organization, it is undeniable that today it has expanded to include almost every activity of an organization including core and non-core components, business processes, information technology processes, manufacturing and distribution activities, and customer support activities (Chamberland, 2003; Gottfredson et al., 2005; Venkatraman, 2004). The constantly changing and competitive environment, unpredictable market, globalization, the pressure to seek cost efficiency and profitability to stay ahead of competition are among some of the reasons which had encouraged the growth of outsourcing. Not only has it become a key component in supply chain management strategies (Chase et al., 2004; Lankford and Parsa,1999) but the growth of outsourcing has also made outsourcing strategies to be an important component of an organization's success (Kakabadse and Kakabadse, 2000; Talluri and Narasimhan, 2004).

It is common to see outsourcing being done both domestically and internationally. The term used to describe international outsourcing is offshore outsourcing or commonly known as offshoring. Offshore outsourcing basically involves transferring activities across borders which is done through outsourcing (using external resources) or through foreign direct investment (using internal sources) (Hagel and Brown, 2005). While the term outsourcing and offshoring has been used interchangeably and have been subject to plenty of confusion as to what it really means, its goal has always been to derive competitive advantage although it is unclear if these outsourcing decisions are always strategically aligned with an organization's overall competitive strategy (Garaventa and Tellefsen, 2001). Previous research advocates that outsourcing decisions must be made in alignment with the competitive priorities of an organization (Chamberland, 2003) in order to realize its competitive benefits. Recent operations management literature had also established that an organization's competitive priority can be defined along the dimensions of cost, flexibility, innovativeness, quality and time (Skinner,1966; Ward et al., 1998; Watts et al., 1992).

Undoubtedly there are many advantages and efficiencies to be gained from outsourcing such as increased focus on core competencies, reducing costs, improving speed and responsiveness, reducing cycle times, improving innovativeness, increasing flexibility and agility, and improving overall competitiveness (Chamberland, 2003; Jiang et al., 2006, 2007; Venkatraman, 2004). Other related benefits are achieving economies of scale, better documentation of internal processes and spreading risk to vendors (Gilley & Rasheed, 2000). Having said that, there are many factors which determine the efficiencies derived from outsourcing. Not all outsourcing efforts have provided positive results for organization nor proved fruitful. Surprisingly many organizations have experienced failure in their attempts of adopting outsourcing as a competitive strategy. Based on study conducted by Deloitte Consulting (Landis et al., 2005), 64% of respondents had brought back in-house the services which they had outsourced initially while 44% indicated that they did not realize any cost savings or efficiencies. Another study by Dunn and Bradstreet found that 20%-25% of all outsourcing relationships fail within 2 years and half fail within 5 years (Doig et al., 2001). In addition to this, outsourcing certainly is not risk free. Reduced flexibility in amending contracts, unrealised benefits, hidden costs, loss of innovation and control over the outsourced process are among some of the common risk associated with outsourcing. Some researchers have argued that the primary risk is the effect of outsourcing on employee morale and performance (Elmuti & Kathawala, 2000).

1.2 Problem Statements

Despite the massive growth and a positive trend towards offshore outsourcing in the global arena, there seem to be underlying problems that predominantly dampens the success of such initiatives which is evident by the failures faced by many businesses across the globe. In the Malaysian context, while our country has established itself as an attractive hub and successfully secured a comfortable position, how long we are able to sustain ourselves before lagging behind competitors is definitely a cause for concern. This study is driven by the need to seek answers to the following problem statements:-

1. There are several key determinants which highly influences whether organizations are able to derive operational efficiencies from outsourcing strategies

2. Organization must be able to control and manage risk effectively and efficiently in order to reap the various operational benefits of outsourcing

3. Malaysia's position as an attractive outsourcing hub is highly dependent on its ability to derive operational efficiencies and its sustainability measures to remain competitive against other established hubs and emerging markets.

1.3 Research Purpose

The purpose of this study is twofold and the focus will be specifically on offshore outsourcing. The research attempts to investigate the critical aspects of operational efficiencies and the factors which determine that these efficiencies are realized. It will be viewed from the perspective of transactional cost economic (TCE) and resource-based view (RBV) theories. This study also looks at risks involved in offshore outsourcing and the impact of ineffective risk control and management on realizing the benefits of outsourcing.

The study would also will look at Malaysia in the context of these determining factors and establish if it has the ability to emerge and/or sustain as an attractive outsourcing hub. It takes a holistic view of Malaysia's positioning as an attractive hub in comparison to other established countries such as India, China, Philippines and Vietnam.

It attempts to answer the following questions:

(1) What are the factors determining the operational efficiencies derived from offshore outsourcing?

(2) To what extent does risk control and management influences the operational efficiencies derived from offshore outsourcing?

(3) Based on the factors that determines operational efficiencies, is Malaysia an attractive outsourcing hub with the ability to provide such advantages?

(4) Can Malaysia sustain its position in comparison to other established outsourcing hubs and emerging markets?

1.4 Organization of the Study

This study is organized to begin with introduction to outsourcing practices followed by various dimensions to outsourcing and operational efficiencies, Malaysia's attractiveness as a hub as well as it's sustainability in the long run in comparison to established and emerging markets. The study then moves on to the research methodology and design, data analysis and findings. It finally concludes with the implications, the way forward for Malaysia and future research extensions. The details of the layout are as follows:

i. **Chapter 1** consists of the introduction to outsourcing, the purpose of this research and the layout of this study.

ii. **Chapter 2** follows with the literature review discussing the definition and dimensions of offshore outsourcing, evolution of the outsourcing practice, drivers of outsourcing from theoretical perspectives, the efficiencies derived from outsourcing from a transactional cost economic (TCE) view as well as resource (RBV) and knowledge-based view theories among others, a peek at why some outsourcing practices fail, a critical view of outsourcing as a double edge sword and the types of risks involved in offshore outsourcing.

iii. **Chapter 3** critically examines Malaysia's positioning as an attractive outsourcing hub and it also takes a look at Malaysia's sustainability in the long run as a hub in comparison to other established outsourcing hubs and emerging markets within Asia

iv. **Chapter 4** begins with the development of the conceptual framework and hypotheses. It is then followed by the research design, methodology, analyses used to test the hypotheses.

v. **Chapter 5** discusses the results of the analyses and findings

vi. **Chapter 6** presents the conclusion, managerial implications of the findings, limitations of this research, the way forward for Malaysia and finally the possible research extensions.