

# Chapter 1.1

## Why, When, and What to Outsource

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### ABSTRACT

This chapter presents an overview of the outsourcing phenomenon, focusing on the question of why, when, and what to outsource. It provides an extensive set of guidelines for a business student to understand the nature of outsourcing. Drawing extensively on recent scholarly literature, the chapter presents a wide range of concepts. There are many causes that might lead a company to a decision to outsource. Similarly, there are many factors that contribute to an environment that is conducive to outsourcing. The question of what to outsource is answered by examining core competencies and critical success factors. The chapter also presents trends in outsourcing in specific countries and industries to help the reader understand what is possible.

### INTRODUCTION

Today's business environmental, organizational, and technological factors require businesses to operate efficiently and effectively in order to be competitive. Toward those goals, managers employ many strategies to improve productivity, including standardization, automation, and business process reengineering. Additionally, they restructure the business organizations to be lean and flat so that they can become flexible in responding quickly to changes in environment and customers' needs.

*Outsourcing* is another valuable strategy managers use to achieve the above goals. Whenever a business procures resources purely from an external source to accomplish business objectives, it engages in outsourcing (Gartner, 1997).

Hence, the term “outsourcing” is one that can be used to describe any external up-line function in a supply chain. When a manufacturer acquires raw materials from a supplier, it engages in outsourcing. When a wholesale company contracts with an external delivery firm, it engages in outsourcing. When a firm hires a computer consultant, it engages in outsourcing.

Outsourcing has taken on a new emphasis in today’s business environment. In the interest of either efficiency or effectiveness, a modern organization often contracts out entire business functions to other companies that are specialists in their specific fields. A firm might turn over to external suppliers its human resource functions, its information technology functions, its shipping functions, or any other functions for which an external supplier is more efficient and effective than is the host company. While such outsourcing is not a new strategy — businesses have used outside consultants for as long as there have been businesses — it has gained more attention and usage in recent years.

Outsourcing has also received unprecedented attention from politicians and the press in recent elections. Some candidates and journalists have painted outsourcing as an evil to be avoided as economically undesirable to a country’s economy. Those reports often confuse outsourcing with one or two of its logical extensions, namely *near-shore outsourcing* and *off-shore outsourcing*, also known as *off-shoring*. A distinction between those two is that the former typically refers to outsourcing to a country that is on the country of origin’s same continent, for example, a U.S. company outsourcing to one in Mexico; the latter refers to outsourcing to a country across an ocean, for example, a U.S. company outsourcing to a supplier in India. Collectively, both are known as off-shore outsourcing and off-shoring and will be referred to in this chapter as such.

Business managers see off-shore outsourcing to lower-wage countries such as China, India, Ireland, and the Philippines in the same light as

reducing labor cost by automation or technology. Conversely, politicians, the press, and a large proportion of the general population view off-shoring as a threat to local economies. Regardless of one’s perspective, in the absence of government regulation to the contrary, outsourcing and off-shoring, in particular, will grow steadily (Robinson & Kalakota, 2005, p. 16)

## **HISTORICAL PERSPECTIVE**

The predominant supply chain model for several decades was vertically integrated. Each member of a supply chain was considered to be part of the same industry. Automobile manufacturers purchased parts from automotive parts manufacturers, and then sold completed cars to automobile dealers. All the ancillary activities that support the supply chain directly or indirectly were included within the automobile manufacturer. Steadily, products became complex and the scale of operations increased and management of entire operations within one corporation became less feasible. This resulted in the increasingly popular use of outsourcing and has resulted in vertical disintegration of corporations and supply chains. As travel and communication became easier in the 1970s and 1980s, as trade restrictions increased, and as the gap in wages between developed and developing countries increased, outsourcing began to move off-shore.

Arguably, the advanced industrialized economies of the United States, Japan, and Europe are the principal candidates for origination of outsourcing transactions (Koveos & Tang, 2004, p. 52). For decades, U.S. industry has outsourced blue-collar jobs to the lower wage countries. That trend now includes white-collar jobs as well. Economic development in Japan and Europe in the past couple decades has generated an environment that has fostered outsourcing practices. In addition, some developed Asian economies have both the experience and the location advantage in outsourcing

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