

INNOVATIONS IN OUTSOURCING

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Abstract

One of the possibilities how the company may built its competitive advantages is focusing on core business activities and other supporting (non-core) activities procures by external providers. This is the main principle of the specific kind of managerial approach, to which many organizations have turned – outsourcing. Outsourcing means that the company allocates specified activities and entrusts their implementation to a third party (another company) that is specialized in the required area. It is considered as a business decision that leads to cost savings and many other positive effects by concentrating on core business activities. This article is interested in the theoretical scope of outsourcing, describes how significant outsourcing is and points out its advantages, which may vary by outsourcing situation. There is also mentioned what kinds of restrictions can be identified in the process of outsourcing, points at trends in outsourcing and briefly describes current situation in the analyzed area in condition of the Slovak Republic.

Key words: Outsourcing, Business Process Outsourcing, Innovation

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Introduction

Outsourcing has become one of the most popular and worldwide managerial approaches for last two decades and the results from practice have pointed out its advantages and relevance in process of business activities optimization. Especially, it has been facilitated by the considerable changes not only in national economies and business environment, but also in the global economy.

Outsourcing is, in itself, a factitious term of British origin. This term appeared in 1989, when *E. Kodak* drew industry and media attention by outsourcing to three outside companies the management and support of its data centers, its desktop computing and its related network needs (Sharpe, 1997). Before this term appeared, previously it was termed as *contracting out*. Specialist literature offers many different interpretations of outsourcing. For example, *Greaver* defines outsourcing as a long-term, results-oriented relationship of the company with

an external provider of activities, which would otherwise have been performed in-house. Outsourcing thus involves a “make-or-buy” decision by the organization (Greaver, 1999).

In case of Slovakia, there is no Slovak (or similar Czech) equivalent of the term outsourcing and specialists as well as wide society use the British one. *Gros* considers the outsourcing as a tool that helps a company to transfer selected internal activities to an external supplier including the responsibility for sourced activities (Gros, 2010). In this regards *Majerčák* emphasizes the importance of the analysis and systematic planning, which business activities regarded as being non-core are suitable candidates for outsourcing. He sees its substance in possibility to transfer chosen business activities on an external provider that allows the company to focus on main so-called core business activities. In generally *Majerčák* considers the outsourcing as a rent service that offers a care/maintenance of chosen activities. (Majerčák & Majerčáková, 2012).

In the early stages of outsourcing, outsourcing activities were used in cases that the company was not able to perform due to lack of incompetence, capacity, financial sources, and technical failures. *Bourdin* distinguishes three stages of outsourcing development (Bourdin, 2003). The first stage, *traditional outsourcing*, appeared in 1970s and activities such as maintenance, security, catering, cleaning were mainly outsourced. The second stage, *near-core traditional outsourcing*, expanded in the 1990s and developed basic principles of outsourcing – most companies focus on their core activities, the others non-core but critical are outsourced. The last stage – *strategic outsourcing* has been expanding for last 10 – 15 years. It represents a radical focus on core business activities and outsourcing of all the lowest value-added activities.

With the increasing importance of outsourcing and big moves towards outsourcing of various business activities, *Král'* emphasizes that outsourcing is needed to seen as a part of strategic management of the company. Because at the strategic level it allows to managers to focus on core activities and their improving to gain or intensify a competitive advantages and others non-core activities are objects that could be outsourced. Consecutively he talks about a key element in the whole process of outsourcing – about the rational decision that involves determining which business activities are suitable to be outsourced and on which activities the company should concentrate. In this connection, he has mentioned functional areas of the management such as IT activities, logistics, and distribution activities including transportation activities, security services, marketing activities with the emphasis on promotion activities, and accounting services etc., which are suitable for outsourcing (Král', 2012). In generally, a certain product, information, capital, activity, or project, personal sources, or functional area

of management can be viewed as the potential object for outsourcing and external providers can carry on services/needs in these areas. According to the survey of ColemanParkers agency (carried out on the request LogicaCMG) the optimal proportion between the activities carried out by the company itself and outsourced activities is approximately 30:70 (Kaláb, 2004). The survey was realized in Great Britain, France, Germany, Netherlands, Belgium, and Australia and the questions about the level of outsourced activities were asked 191 managers. Results of the survey have also confirmed that only 20% of business activities in the interviewed European countries are fully outsourced, that is under the optimum level.

1 The main reasons for outsourcing

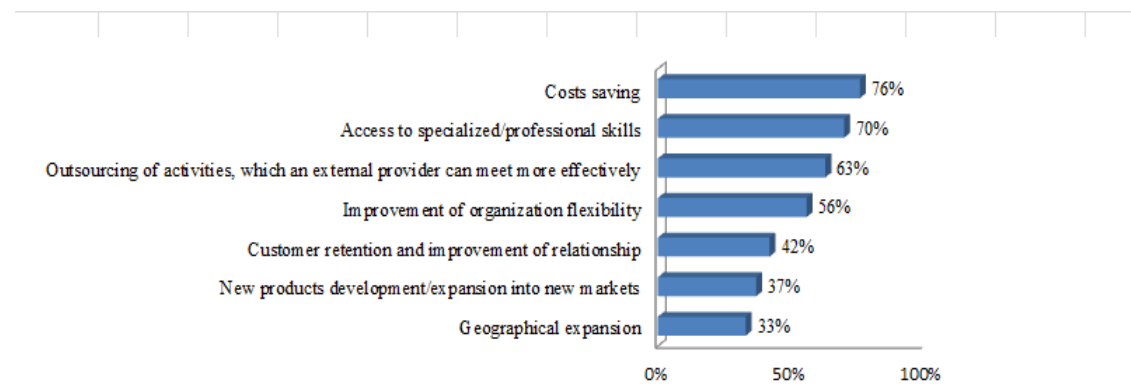
There are many reasons why the company should go for outsourcing. However, regardless of the stated reasons, outsourcing should help the company to become more efficient. In the beginning, outsourcing was simply viewed as a tool for costs optimization and reduction. As the national and global markets have fundamentally changed, the perception of outsourcing has extended. Nowadays outsourcing as one of the latest trend in managerial approach allows the company to flexibly react on customers' needs, track national as well global market competitors, build own competitiveness, minimize skills gap and already mentioned costs, especially operational ones.

From the theoretical point of view, four main reasons for outsourcing are identified, namely competitive, factual, financial, and organizational. Mentioned reasons can penetrate more or less each other and it is difficult to restrict their impact strictly in the practice. The *competitive reasons* emphasize the possibility to gain a competitive advantage by applying a suitable outsourcing strategy. These reasons are seen as strategic (long-term) oriented targets related to innovation technologies and know-how. The *factual reasons* relate to the main principle of outsourcing – focusing on company's core business activities, while the others non-core activities are transferred to an external provider. Subsequently the company can get a better access to sources, which are important for its next development of core activities. The factual reason can be also an effort to reduce risk of leakage of internal information – this risk is transferred on an external provider of outsourced activities. The *financial reasons* relate to the cost reductions, costs, and cash flow clarification. Finally, the *organizational reasons* allow the company to simplify managerial works, organization structure, to increase flexibility in managerial decisions and reduce salary costs as the results of outsourcing of needed personal sources.

Usually experts define following reasons why outsourcing should be placed in the company - possibility to focus on the business activities (core activities), possibility to increase or at least maintain the company's competitiveness, possibility to reduce own skills gap by using services of local, national or global experts (outsourcing provider's industry expertise), reducing of operational costs; in some cases also investment cost and release financial sources for other purposes, costs predictability of chosen area, simplification of work organization, reducing or sharing business risks, creation of mutual activities between the company and a provider of outsourcing services.

In 2010 PricewaterhouseCoopers carried out a survey, which dealt with outsourcing. More concretely, the main aim of this survey was to find out and compare experience and opinions both main parties involved in the process of outsourcing: organizations and providers of outsourcing services (outsourcing partners). Totally 300 respondents were interviewed from 19 countries. Their reasons for outsourcing of selected activities are presented in the following figure. As you can see, reducing costs remains the number-one reason for implementation of outsourcing principles into practice. Approximately 76% of all respondents named cost-cutting as the main reason why they decided to cooperate with outsourcing companies. As the second fact indicated that, outsourcing had been a way to get an access to specialized skills. As the less important, respondents named geographical expansion, new products development or expansion into new markets (with a new product).

Fig. 1: Main reasons for outsourcing



Source: Own collaboration based on the information accessible at web side <http://www.pwc.com/en_GX/gx/operations-consulting-services/pdf/outsourcingcomesofage.pdf>.

2 Main areas for outsourcing implementation

Before outsourcing methodologies are applied into organization, all business activities have to be defined and divided into primary and support activities, nowadays in other words into core

business and non-core business activities. Porter's classification of business activities depends on the added value of each activity to the final output. This theory is known as Porter's Value Chain approach.

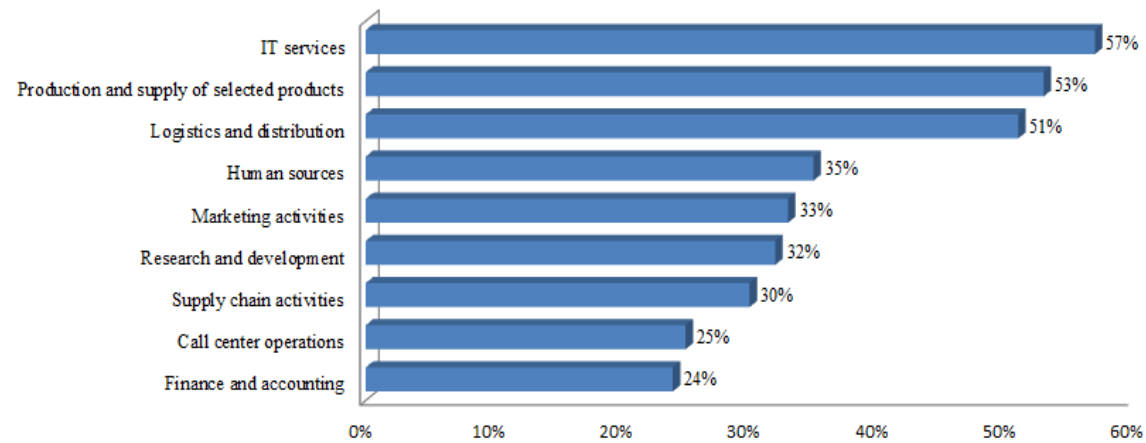
Support activities are usually potential candidates for outsourcing. Based on Porter, we talk about firm infrastructure, human sources, technology development, and procurement activities. On the other hand, we must emphasize that current situation in the business environment disallows the company to follow strictly this theoretical approach and the company may thereby identify as the potential candidates for outsourcing also activities within primary activities. Due this fact, a modified classification of business activities into core and non-core is preferable. Simply said, before the company makes a final decision if to outsource or not to outsource, it must realize the strategic analysis of core competencies. Subsequently activities identified as core competencies (in generally sources or drivers of company's long-term competitiveness), remain in company's in-house business, others activities regarded as being non-core are suitable for outsourcing.

Focusing on core business activities and transferring the others to outsourcing provider has undeniable advantages. This decision primarily reflects in higher quality of product or services, leads to more operational management style and overall more efficient production management. As we have mentioned above, many companies consider outsourcing of chosen activities mainly as a tool how to lower overall costs, especially operational. Costs can be reduced for example by applying sophisticated know-how, when the company, which specializes in a particular business area, will get an access to high-skilled employees, experts and technologies. Thereby fixed costs can be reduced by transferring certain activities and competencies to external suppliers. They are transferred outside the company and subsequently purchased back as intermediate inputs (goods or services) in the form of variable costs. In term of economic theory, variable costs compared to fixed costs have the advantage, that they occur at time and in the volume, which is necessary to ensure operations within the transformation process and then saving funds can be used in another way.

For example, the results of already mentioned research carried out by PricewaterhouseCoopers point out that the most preferable business activities, where an outsourcing strategy is employed are IT technologies (IT supports services). More than 57% of all respondents indicated this activity. The others are production, or supply of selected products/semiproducts, logistics and distribution services, employees (replacement of full time employees with less expensive contractors), marketing activities, call center operations, finance and accounting. Detailed information is presented in the following

figure. It is interesting to emphasize undeniable fact, that more and more companies outsource their own primary activities (if we take into consideration the Porter's breakdown of business activities).

Fig. 2: The most outsourced business activities



Source: Own collaboration based on the information accessible at web side <http://www.pwc.com/en_GX/gx/operations-consulting-services/pdf/outsourcingcomesofage.pdf>.

3 Reasons to outsource or not to outsource business activities

Like any other managerial approach, also outsourcing has own advantages and disadvantages identified on the side of the organization and on the side of outsourcing provider. In general, within the practitioners the opinion prevails, that the advantages of outsourcing far outweigh its disadvantages. They emphasize especially the fact that outsourcing and outsourcing providers, no matter what kind of activities they provide, can help the company to achieve its business goals. But they also state, that almost of all disadvantages of outsourcing the company can avoid by partnering with the right outsourcing provider. Few of them have been already mentioned in the previous text and here we present their basic rundown.

Tab. 1: List of advantages and disadvantages of outsourcing

	ADVANTAGES	DISADVANTAGES
ORGANIZATION	<ul style="list-style-type: none"> • Create a time-space for core business activities and streamline business operation • Increasing of production, productivity and efficiency in core as well as non-core activities • Access to expert solutions, skilled workforce, professional services in high quality • Increase the flexibility of organizational and management structure • Cater to the new and potentially profitable customers' needs • Improvement of operational management • Reduction of operating costs • Reduction of investing costs because the latest technologies, software, infrastructure and know-how are in competence of outsourcing provider • Transformation some kinds of fixed costs into variable costs • Free up the company's cash flow • Risk reducing from long-term perspectives by sharing it with the provider 	<ul style="list-style-type: none"> • Cost savings may not meet company's expectation • Outsourcing contract and level service agreement are kinds of unnamed contracts and thereby the satisfaction with outsourcing services depends on concrete specifications • Process of preparing an outsourcing contract may take longer time • Contract costs and overall costs of outsourcing • Reduction in the quality of products or services, delayed supplies • Outsourcing provider may not be innovative enough and may not understand the industry, where the company operates in • Lack of customer focus • Fragmentation of the corporate image and identity • Risk which is determined by the switch of suppliers • Risk of leakage of sensitive and confidential information
OUTSOURCING PROVIDER (OUTSOURCING AGENCY)	<ul style="list-style-type: none"> • Revenues from services provided are more predictable • Close cooperation may promote the development of both parties • Close cooperation may help the provider to expand its portfolio of outsourcing services and promote in new markets 	<ul style="list-style-type: none"> • Specificity of required services may not be meet • Maintain of operational efficiency could be difficult and may be affected by external and uncontrollable circumstances • Demanding requirements on financial capital, human sources and technologies • Risk sharing

Source: authors

4 Innovations in outsourcing

Innovation is essential to human and business progress and it is reflected also in outsourcing methodologies, or in outsourcing process in generally. Innovation in this area is usually seen as result of globalization process of national economies, trade liberalization, IT and communication development. In this context, terminology such as offshore outsourcing, multisourcing, business process outsourcing and cloud has become more popular.

Offshore outsourcing is considered as a relatively new tool for costs optimalization in international environment. Thereby it is called as international outsourcing and can be defined as a type of practice of hiring an external organization to perform some or all selected business functions in a country other than the one where products or services will be sold or consumed. Usually it is a delegation of administrative, engineering, research and development, or technical support activities to a third-party provider in a lower-cost location (Robinson & Kalokota, 2004). Other definition of offshore outsourcing that it represents outsourcing over long distances (Dvořáček & Tyll, 2010). It is useful because of its ability to use cheaper labour, rents, lower taxes and contribution rates etc. and thereby achieves operational costs savings. In this connection, if the company hires outsourcing services within the same country, we talk about onshore outsourcing.

Multisourcing has arisen as reaction to the chaotic, impulsive and in many cases unreasonable outsourcing actions. It is a specific approach to outsourcing (new outsourcing discipline) in which none-core business activities are contracted to a number of providers, usually in combination with some internally provided activities or technologies. It allows the company to get beyond the traditional fixed costs reduction, contributes to the development of next capabilities, global expansion, higher level of organizational flexibility, profitability, and creates competitive advantages.

On the other side, it requires overall changes in the company's thinking referring to the outsourcing, modification ways of communication and information sharing to promote better cooperation between the involved parties and more seamless delivery of services across organizational lines. The multisourcing is seen as a contrast to fully in-house provisioning and sole-source outsourcing approach. To be successful, a common sourcing strategy that is closely linked with the overall corporate strategy is needed to apply into practice. In order to the company to shift from outsourcing to multisourcing, it is important: to have common and clear outsourcing strategy for all outsourced services, to create an executive framework for outsourcing and integrate outsourcing strategy into overall corporate strategy, to not forget

that the relationship between involved parties in outsourcing is needed to be developed, to make sure, that in a process of provider appraisal all relevant key features, which products or services depend on, will be taken into account.

Simply said, the main aim of multisourcing is to maximize the effectiveness of the company business activities by ensuring that various elements are sourced from the best possible outsourcing providers, while allowing the company to maintain its focus on core business activities. The company can profit from diversifying risk in provider operation, from competition among various outsourcing providers, cost savings related to repetitive service contracts etc.

Business Process Outsourcing (BPO) it is a specific approach, when not only non-core competencies are outsourced, but all business processes are viewed as potential candidates for outsourcing. In this connection, it is assumed that a specific business process should be performed there, where is possible to gain the highest economic effect and long-term development. This kind of outsourcing represents so-called transformational or dynamic outsourcing. It is viewed as the highest level of outsourcing (pick of outsourcing pyramid). It is based on a wide range of methods, knowledge and sources which should be applied especially in a situation when the company must pass through the transformation in short-time period and all potential risks involved in this process should be eliminated. Almost all business processes can be outsourced, but it is recommended to keep in-house such processes that present a core of company's existence and operation in the market (protection of core business know-how). In generally, principles of BPO outsourcing are suggested such way, that they are able to run in each organization, without considering its size. Next, they prefer to maximize efficiency and productivity of business processes in contrast to cost savings in traditional outsourcing approach.

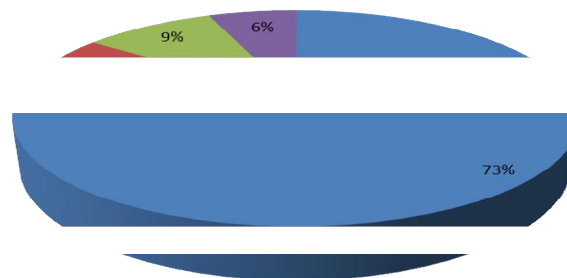
Cloud Outsourcing or cloud computing represents a relatively new way to outsource IT activities, sources, processes, or information. Mainly, it is considered as an extension of current outsourcing of IT activities based on external data storage. Although this term has been becoming widely known, its exact definition does not exist. The common features of definitions are that cloud computing is perceived as a specific model for delivering information technology services in which resources are retrieved from the virtual network through web-based tools and application, rather than a direct connection to a server. It provides an access to stored information as well as to store new information. The cloud computing simply means, that information is stored in the clouds and allows the company to gain access to this information anytime and without requirement to be in a specific physical

place. This kind of outsourcing IT services allows the company to reduce IT costs, since it is not required to own its own servers. The company profits from outsourcing of server capacity from the provider. In addition, the reduction in labour costs it is important to mention, because the company does not need employees who will be responsible for all activities linked with server managing and database placed on it. Additionally, the cloud computing allows also the company to profit from more quickly software upgrades. On the other side, this kind of outsourced services is more sensitive to protect all stored information. Thereby it is needed to make and sign such outsourcing agreement that will not protect only the company, which is interested in outsourcing, but also information about its customers. In the agreement, it should be precisely defined what kind of information will go to the cloud, especially information on firm know-how, price lists, all business processes as well information about its customers (in this case it is important to solve the issue of the protection of personal data).

In condition of Slovakia, cloud computing is not very expanded kind of outsourced IT services, no matter how huge its potential is (in the private as well in public sector). Based on survey conducted in 2011, Slovak companies have already discovered benefits from outsourcing of chosen IT services and processes. But on the other side, they are still not willing to fully outsource IT infrastructure. This is a paradoxical finding of the survey, because more than 63% of interviewed companies have already outsourced more than half of their servers, while operating systems have outsourced only 6% of them. The findings next confirm that almost 73% of companies refusing cloud computing solutions and on the other side only 6% of companies plan to invest financial sources into own IT infrastructure.

Fig. 4: Do you apply cloud computing services in your business?

- No, cloud is not our priority.
- No, we do not outsource such kind of IT solutions, but this kind of services we consider as very interesting. We are interested in how this area has been development



Source: Own collaboration based on the information accessible at web side: <http://www.zive.sk/firmy-sa-cloudu-boja-aj-kvoli-bezpecnosti/sc-3-a-307161/default.aspx>

Fig. 5: What are the obstacles in implementing cloud computing solutions in case of your company?



Source: Own collaboration based on the information accessible at web side: <http://www.zive.sk/firmy-sa-cloudu-boja-aj-kvoli-bezpecnosti/sc-3-a-307161/default.aspx>

Conclusion

Today, in order to gain critical competitive advantage and get ahead of competitors, many companies have turned to outsourcing. Outsourcing of non-core or less valuable activities allows the company to focus on its core or key competencies. As the results, the company can increase its production capacity and efficiency, reduce transaction costs, capital costs, production costs, free up firm's cash flow and enhance capability for research and development and other investment possibilities, profit from full skilled workforce and access to the newest technologies etc. All of these factors can be seen as potential sources of competitive advantage, which existence is the basal element for company's long-time perspectives. Whatever the motivation for outsourcing is, each company interested in it must take into consideration all potential risks involved in outsourcing activities. Outsourcing can not be regarded as a magic solution that is able to solve all problems defined by the company. It requires detailed analysis of overall company's process, activities, and sources. As the result, the company will be able to answer if outsourcing is an appropriate tool for solving its problems, which processes, activities, and sources are available to be outsourced and what kind of agreement with a provider of outsourcing services the best fits its requirements. In addition, the company should pay an attention to new possibilities and trends in outsourcing, because they could create new market challenges.

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