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Edward Sweeney
Technological University Dublin, edward.sweeney@tudublin.ie

Aoife O'Riordan

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Outsourcing and its Role in the Supply Chain

AOIFE O'RIORDAN AND
EDWARD SWEENEY

INTRODUCTION

As noted earlier (see in particular Chapters 2 to 4), companies are increasingly focusing on what they regard as their core activities or competencies. Oates (1998) defines core competencies as 'the central things that organisations do well.' The corollary of this is that activities regarded as 'non-core' are being outsourced. Greaver (1999) states that 'non-core competencies take up time, energy and workspace and help management lose sight of what is important in an organisation'. Furthermore, the trend towards economic and business globalisation (see Chapter 2) has facilitated the outsourcing of various activities to overseas locations (offshoring). Key supply chain activities are increasingly being outsourced to third-party organisations. Furthermore, in the increasingly knowledge-based economies of developed countries, shared knowledge – which one can acquire by outsourcing – is a potentially important element of competitive capability. What was once known as **power is knowledge** is now known as **shared power is knowledge** (Connolly *et al.* 2004). This chapter provides an overview of outsourcing in the context of wider developments in the supply chain.

BACKGROUND AND DEVELOPMENT

Traditionally, outsourcing is an abbreviation for 'outside resource using' (Arnold 2000). Currently, in the simplest of forms, outsourcing takes place when an organisation transfers the ownership of a service or function that used to be done in-house to a supplier. The degree of transfer of control is the defining characteristic of outsourcing. It concerns 'the transfer of routine and repetitive tasks to an outside source'; 'having an outside vendor

provide a service that you usually perform in-house'; and 'paying other firms to perform all or parts of the work' (Zineldin and Bredenlow 2003).

Outsourcing, or offshoring as it is now known in many circles,[1] has been around for many decades. In the beginning, outsourcing was a relatively peripheral activity and related mainly to the blue collar or lower-skilled operations of organisations. However, with rising labour costs and the increasing use of robots for automation purposes, those jobs would have been lost anyway. Now, the fear of many skilled workers or managers is that their jobs are going to be outsourced as the global economy has opened up and the cost of communication is cheap. Organisations can now outsource virtually anything they wish within the organisation.

Historically, outsourcing was used when an organisation could not perform to world-class standards in all aspects of its work due to many factors, including: incompetence of staff and/or management; lack of capacity within the organisation; financial pressures and/or technological pressures. In its most basic of forms it started from the outsourcing of a single service such as canteen management, buildings management, or computing. In addition, outsourcing was applied in overhead functions or activities with no potential for competitive advantage and business processes where an end user could create a competitive advantage through partnerships with vendors specialising in a particular area (Dole 1998). Now, outsourcing is used to build on core competencies and organisations recognise that serving the customer is critical: 'Anything that distracts us from this focus will be considered for outsourcing' (Greaver 1999).

Outsourcing is not simple or easy to create, develop and support, and it can have both positive and negative effects on key areas of the supply chain (Mason *et al.* 2002). There are many implementation problems and the failure rate is often quoted to be as high as 70 per cent (Zineldin and Bredenlow 2003). In addition, it can adversely affect employees and many transitions have been unsuccessful. Even with these problems recent studies have indicated that 85 per cent of all companies outsource at least one function or service (Logan 2000).

So, why outsource? According to Dole (1998):

> To compete in today's information age companies must re-evaluate the way they do business in the light of rapid, unrelenting change in the marketplace. The need to improve productivity, quality and flexibility has led companies to examine their organisational structures and to realise that

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[1]The terms 'offshoring', as the name suggests, is usually used in the context of the outsourcing of activity to an overseas-based provider.

creating the greatest value does not require them to own, manage, and directly control all of their assets and resources. Rather, strategic alliances and partnerships with those who provide expertise in a particular area may be the most effective way to gain results.

It permits organisations to enhance effectiveness by focusing on their core competencies while using specialist suppliers for non-core activities, and as a result they should have better overall performance.

Furthermore, it can be applied to most functions and services (see Figure 9.1) within an organisation. Today, what an individual company outsources depends on the core competencies,[2] core activities[3] and critical functions (see Figure 9.2) within the organisation.

Core competencies are one of the keys to customer satisfaction and superior performance. They combine three features: (1) They differentiate between the company and its competitors; (2) Resources and know-how for the product must be unique over time, (there must be something to prevent

Figure 9.1: Examples of What is Outsourced

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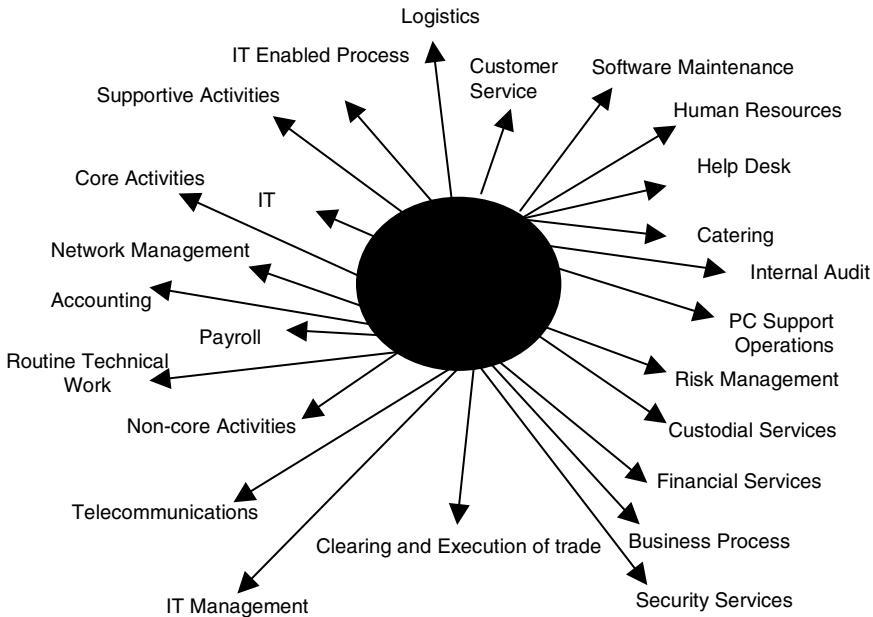
[2]'The central things organisations do well' (Oates 1998).
[3]'Things that are central to what organisations do' (Oates 1998).

Figure 9.2: Examples of Core and Non-core Parts of a Business
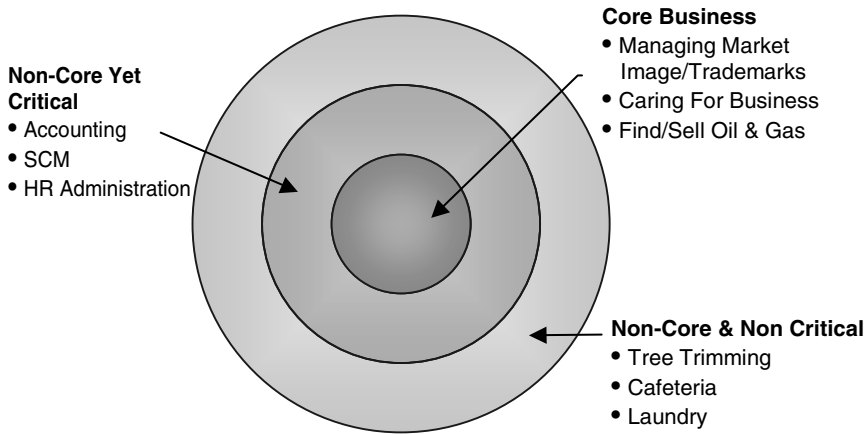
Source: Adapted from Dole, R. (1998), *Business Process Outsourcing: A Case Study*, KPMG Peat Marwick LLP.

it against an influx of imitators); and (3) The core competencies should never be outsourced (Arnold 2000). To hand over core functions to a third-party supplier is to hand over the things that make a company what it is and what differentiates it from others, in essence what makes the company profits.

Non-core competencies take up time, energy and workspace, and help management to lose sight of what is most important in the organisation (Greaver 1999). Non-core activities can be farmed out to specialists if they conduct them better, more cheaply or both.

Nowadays there are two main types of outsourcing: total outsourcing and selective outsourcing. *Total outsourcing* happens when companies outsource all the activities within the selected function or service of the company. *Selective outsourcing* on the other hand can be done in four separate and distinct ways. The first is outsourcing on the individual level. It involves moving specific positions out of the organisation, for example the management of a poorly performing function or service. The second type is outsourcing on the functional level. The next type of selective outsourcing is the process level. The final level is outsourcing on the component level, which involves outsourcing the manufacture of component parts or sub-assemblies.

Other types of outsourcing that are used, though not as widely as total outsourcing and selective outsourcing, include *co-sourcing*, whereby the client company keeps responsibility for the management and strategic aspects of the outsourced activity while the outsourced supplier provides a consultancy service and often experienced personnel to help to keep the business streamlined.

Another is *insourcing*. Insourcing is the outsourcing of some work to other countries but, instead of transferring all the responsibility, the company sets up, staffs and runs the business except with much lower costs (King 2003; Arnold 2000). This can help to overcome the problems of skill shortage, particularly in the areas of project management and technical work. A major advantage of the insourcing option is that, because the suppliers are inside the organisation, they are living with their clients and because they are, for example, attending in-house meetings they understand the business, thus allowing the company to retain critical business knowledge and intellectual capital. KPMG (2004) claim that 41 per cent of information technology outsourcing (ITO) users intend to insource some components of their IT systems because they fear a loss of control.

EXAMPLES OF OUTSOURCED SERVICES/FUNCTIONS

Logistics Outsourcing

> Logistics is the process for the efficient and timely flow of goods, services, and information from the point of origin to the point of consumption. (Candler 1994)

Logistics outsourcing has become really important in the supply chain in the past twenty years as it was traditionally handled by firms internally as a support function. At that time logistics activities such as warehousing, distribution, transportation, and inventory management had been given low priority compared with the other business functions within the organisation. However, since the customer has become more demanding, the logistics function has now become a source of competitive advantage (see Table 9.1),

Table 9.1: Types of Logistics Services that can be Outsourced

Warehousing	Outbound Transportation	Freight Bill Auditing/Payment	Inbound Transportation
Freight Consolidation/ Distribution	Cross-Docking	Product Marking/Labeling/ Packaging	Selected Manufacturing Activities
Product Returns and Repair	Inventory Management	Traffic Management/ Fleet Operation	IT
Product Assembly/ Installation	Order Fulfilment	Order Entry/Order Processing	Customer Service

Source: Cap Gemini Ernst & Young (2001), *Third Party Logistics Study – Results and Findings of the 2001 Sixth Annual Study*, <http://www.tli.gatech.edu/downloads/3PLStudy_2001.pdf>.

and there has been a growing emphasis on providing good customer serv-
ice (Razzaque and Sheng 1998).

According to Wilding and Juriado (2004), about 40 per cent of global logis-
tics is outsourced. According to Razzaque and Sheng (1998), the management
of the logistics function in modern organisations involves decision-making for
the complete distribution of goods and services with a view to maximising
value and minimising cost. What has become apparent is that competitive
advantage now comes as much from the delivery process as from the product
being delivered (Razzaque and Sheng 1998), which has transformed logistics
from a traditional back-room function to a front-office function. Consistent
service at appropriate levels is necessary for a well-run and well-designed
logistics system.

However, for an organisation to handle its logistics activities effectively
and efficiently, it must consider the following:

1. Can it provide the service in-house?
2. Can it outsource the function?
3. Can it set up a subsidiary by buying a logistics firm which will provide
    its logistics function?

IT Outsourcing

In the late 1980s and early 1990s senior executives sought ways to use out-
sourcing as a way to control and shape IT costs in conjunction with chang-
ing business requirements (Currie 2000). The 1990s witnessed the growth
and maturing of the IT outsourcing market.

Electronics Outsourcing

Electronic manufacturing comprises the process of 'design, development,
fabrication, assembly, and testing of electronics parts, tools, technology,
components, and systems' (Mason *et al.* 2002). The evolution of electronics
manufacturing started with the development of new and better technolo-
gies to produce smaller and more reliable electronic components at a much
lower cost than previously. But, at the same time, the manufacturing process
has become more complex and costly than ever before. As a result, there is
now a very high cost of entry into the market, which has caused many
start-up electronics manufacturers to outsource.

The effective management of this supply chain is important due to the
existence of short product life-cycles and the resulting cyclical demand.
The outsourcing of electronics typically results in significant reductions in