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CHAPTER 9

Outsourcing

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“The common point of all successful entrepreneurs is not a specific personality but their commitment to systemic innovation.”

Peter Drucker

The Housekeeping Test of a Hotel

Our holiday adventure, which we started with my family with great enthusiasm last year, turned into disappointment when we entered the hotel room we had booked. There was a pervading odour of cleaning detergent in the hotel room on entry which was disturbing. The cot that had been put in our room for our child sagged in the middle and the pillowcases had traces of stains which could not be removed completely. There was no toilet paper or foot towels in the bathrooms. A cleaning detergent forgotten by the housekeeping staff in the bathroom contained quite high levels of phosphate and chlorine. These negativities that we encountered were indications that cleaning and hygiene services were not carried out professionally.

We shared all the negativities we had observed in the hotel room with the receptionists before we settled into the room and asked to change our rooms. However, we were convinced that changing room would not incur any benefit because the housekeeping department operated within the same structure and logic in all the rooms. The receptionist noted that complaints about cleaning and hygiene were made by most of the guests but that no administrative decision had been taken so far. Shortly afterwards, the officer requested that we share these complaints on the complaint sites over the Internet and that these sites were followed by the managers on a daily basis and jokingly added that we should write a positive comment about the reception unit. We communicated that they could rest assured that we would write realistic comments.

The friendly dialogue we had with the receptionists enabled us to discover a reality towards the end of our holiday. A university graduate receptionist told us that all the managers and employees in the housekeeping department were chosen from local residents living in rural areas to provide affordable labor. We could not hide our surprise in this matter. In our opinion employing individuals who have no expertise and are not trained in an important issue like human health was a surprisingly upsetting practice.

As soon as our holiday was over, I shared all the negative aspects I had noted on the internet sites of the agencies that market the hotel as well as the information that the receptionist had told us. I saw many similar complaints about the same issues on the site. We made a reservation for a different hotel for the following year hoping to avoid similar inconveniences. Just a week later I made the reservation, I received an email from the manager of the hotel, involving a response to our negative experience. The message indicated that we were absolutely right in our criticism and complaints. The message also informed that during the next tourism season, they had agreed with a service provider that trained specialists in the field and assigned them in hotels to reorganise the housekeeping department. At the end of the season not a single complaint about the hotel's

housekeeping department was entered on the Internet. This means that in terms of quality it is an important step to ask an expert and procure external service in areas that cannot be carried out professionally.

1. Introduction

In the early 1990s, intense and fundamental changes took place in the field of management and organization in order to enable companies that were influenced by rapid developments and globalization in technology to survive in a competitive environment. As a reflection of this radical process of change, the concept of outsourcing emerged as a new management technique. This concept has been used by many sectors in a short time because it creates advantages in many respects such as gaining competitive advantage with regard to enterprises, more efficient and productive use of resources, and easier access to other sectors and regions.

The concept of outsourcing has been applied since the earliest periods that human beings practiced agricultural activities in the history of the world. However, with the emergence of social sciences and its development in various stages over time, just like many other issues, outsourcing has been taken under the scrutiny of certain scientific rules.

The aim of this chapter is to examine the concept of outsourcing within the framework of management knowledge and evaluate the multidimensional aspects of the concept. For this purpose, the conceptual and historical dimension of the concept of outsourcing will be covered first, followed by the theories that underlie the emergence of the concept. Once the motivations for business outsourcing are examined, the types and processes of outsourcing of enterprises will be included. The areas the outsourcing is implemented in, what potential benefits and obstacles it generates and what it means in terms of restructuring will also be discussed in this chapter. Towards the end of the chapter, the studies related to outsourcing in management literature will be briefly summarised.

2. The Concept and Development of Outsourcing

Outsourcing is a term used as an abbreviation for “outside resourcing.”¹ Outsourcing is provided by specialists or external companies that are experts in a field.²

Benefiting from external sources is the efficient countering of a whole or part of a function with the physical or human resources of external suppliers. It can also be expressed as the foundation of production activities and other value-added activities on external sources.³

Outsourcing is used as a management strategy when enterprises focus on activities that provide competitive advantage, while activities that are not directly related to their expertise are carried out through enterprises outside the specialized organization. In the broadest sense, outsourcing means that the parts and services that are produced by a company can be used by other companies and this is included in the literature as “outsourcing”.⁴

Outsourcing can be traced to the Roman era. Outsourcing was implemented in the Roman era when tax collection work was allocated to a source outside management in order to be executed efficiently and systematically. The use of outsourcing has been initiated in many production areas with industrialization. For example, metal production for firearms in the 18th and 19th centuries

were given to outside enterprises. In the United Kingdom, prison administration, road works, collection of waste materials, and public services were also outsourced. In the same period in France, the construction of railways as well as water storage and distribution also benefited from external sources.⁵

The trend of outsourcing has gained momentum with the signing of NAFTA (North American Free Trade Agreement) in 1992. After World Trade Organization (WTO) was established in 1995, a global outsourcing system was established and gained momentum. The most important reason why such a system exists or emerged again is the downsizing and deceleration that took place, especially in the US economy, in the 1990s. This slowdown also affected other countries. Outsourcing increased tremendously in the early 2000s due to economic downswings.

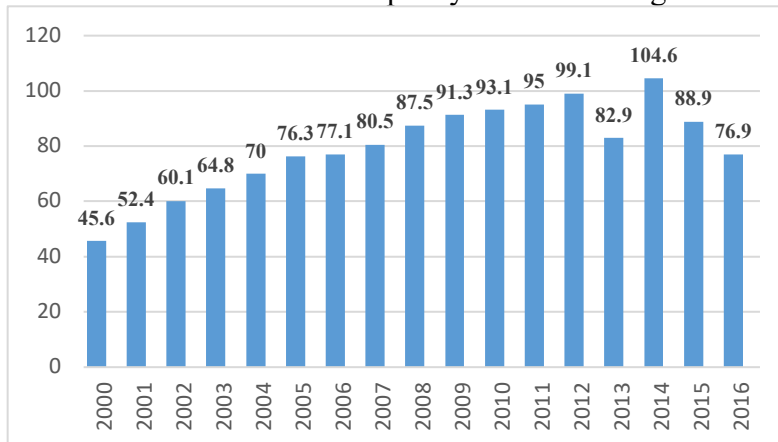
The most common form of outsourcing is subcontracting. Subcontractors have emerged in order to allow companies to focus on their core competencies, use external sources for other activities that do not fall into their areas of expertise, and take advantage of enterprises with more competence in this regard. Subcontractors are focused on helping enterprises steer their real energy to their core competencies, while ensuring that the resources which the enterprises allocate to a selected portion of activities are used in a more disciplined and planned manner.

Until now, the literature on subcontracting companies and outsourcing has suggested that there is no significant difference between subcontracting and outsourcing, whereas there are many differences between these two concepts. These differences can be listed as follows:⁶

- a) Supply is a more comprehensive decision and involves outsourcing operations. That is, each outsourcing is a supply, but each supply is not necessarily an outsourcing.
- b) Outsourcing includes an alternative such as in-house production whereas supply procedures have no alternative.
- c) Cooperation in supply processes, although not legal, continues to operate with a commercial trend. Whereas a written agreement is made for each outsourcing initiative.
- d) Outsourcing is defined as giving out work. Supply is expressed as procurement from the outside.
- e) Supply procedure is done for production purposes, outsourcing is done for reasons such as cost reduction, productivity increase.

During the first years that it was initiated, outsourcing was composed of small-scale activities which were outside the main activities of enterprises (maintenance, repair, cleaning, distribution, etc.). The first significant outsourcing applications emerged years ago in the American automotive industry as spare parts production. Subsequently with its positive impact on cost reduction, personnel savings, and freeing personnel to do other work, the use of outsourcing from external companies became more widespread for various activities carried out in the organization in a more conventional way. This prevalence has made so much progress that now enterprises whose sole purpose is to perform outsourcing functions have emerged.⁷

By 2000, the global market capacity of outsourcing services reached quite high figures. The market capacity, which was 45.6 billion dollars in 2000, reached the highest level in 2014 with 104.6 billion dollars. In 2016, total revenue from outsourcing services was 76.9 billion dollars (Exhibit 1).

Exhibit 1. Global Market Capacity of Outsourcing Services During 2000-2016 (Billion Dollars)

Source: <https://www.statista.com/statistics/189788/global-outsourcing-market-size> (07.08.2017)

3. Theoretical Approaches to Outsourcing

There are several approaches that explain the reasons why outsourcing is preferred as a modern management technique by enterprises and how strategic decisions can be made to achieve efficiency in terms of enterprises. These approaches are structural and economy-based and play a supporting role in explaining outsourcing.

3.1. Core (Self) Competency Approach

The determination of which functional units in the enterprise shall benefit from external sources is just as important as the decision to outsource by enterprises. At this stage, the Basic (Self) Skill approach has a guiding characteristic.

Core competency refers to the unique knowledge, skill and ability of an operator which distinguishes it from other operators, plays an essential role in the actualization of an operator's activities, and cannot be easily imitated by competitors. Core competency is the source of developing new business processes. It is also an incentive force to find new markets for enterprises.^{8,9}

Capabilities describe the capacity of the resources that an operator possesses if it is appropriately managed to run a business or achieve a goal. Capabilities explain how two operators can achieve different successes although they have similar targets and absolutely the same resources; or on the contrary, how two operators can achieve similar successes despite having different resources.¹⁰

Enterprises that want to gain competitive advantage by improving their core competencies will transfer activities outside the core business to supplier companies. Therefore:¹¹

- a) They will downsize to a more efficient management.
- b) They will use the cost advantage of the supplier company which focuses on the function that is beyond the basic capabilities of the operator and that it does not want to do.
- c) They will gain competitive advantage.

Basic skills constitute the most strategic point when deciding which activities to outsource. In the process of outsourcing, activities are classified as core and secondary skills, and outsourcing of tasks is applicable to skills other than core competencies which are critical to the business. Within this context, the identification of core competencies is a process within the context of outsourcing.¹²

3.2. Transaction Cost Approach

According to Transaction Cost Approach, companies operating in a specific market structure are formed as institutions that reduce transaction costs. Transaction costs are directly related to production. Because transaction costs are monetary, they represent a cost burden in the actualization of the change process, such as in information and contract costs.¹³

There are three critical factors in transaction costs. These are the authenticity of assets, uncertainty, and frequency. The authenticity of assets refers to investments that enterprises have to undertake when their operations are carried out. It affects the decision of whether these high investments will be carried alone or by entering various partnerships. The transaction cost approach assumes that with the increase of asset authenticity, countering procedures with internal resources (i.e., external resources will not be used) will increase.¹⁴

Uncertainty concerns how an operator adapts itself to unpredictable conditions. Uncertainty can be about the future price and quality of goods and services or about the amount of future supply and demand in any combination of price and quality. Uncertainty and limited rationality lead to increased costs for long-term contracts, negotiation, and implementation. Exchange costs are increased because transactions cannot be done frequently enough. Infrequently done jobs face the risk of outsourcing costs being high.¹⁵

3.3. Resource Dependence Approach/Resource-Based Approach

The Resource Dependence Theory is based on two fundamental hypotheses. The first one is that in the context of the environment, there is the uncertainty of whether the organization has the limited and valuable resources that it needs and whether the organization can obtain the resources it needs.¹⁶ Therefore, organizations need to eliminate environmental uncertainties and remain in contact with other companies in order to meet their internal resource needs, and this initiates the establishment of a relationship.^{17, 18}

Relations based on inter-organizational sources may eventually result in one party being more dependent on the other. All organizations are dependent on their environment (or other organizations) to various degrees.¹⁹ Interdependencies that have emerged due to the needs of organizations for resources, and the sources that cause these dependencies are not only monetary. They are elements which include staff, information, physical resources, customers, and new markets. Possible interdependencies resulting from inter-organizational relations might lead to an organization acquiring more power over time than the other.²⁰

According to theorists of resource dependence, the possible asymmetric dependence and power associations that may be generated in inter-organizational relations may result in exogenous pressure of one organization over the other. Buchanan manifests how asymmetric dependence relations pose a threat to a focal organization and how it transforms into a control instrument for

the dominant party by examining the resource transactions in commercial relations.²¹ Nowadays it is possible to find similar structures when examining the relationship of hotel operations with travel agents.

When we look at the concept of outsourcing from the perspective of resource dependence, two relational situations are at the forefront. The risk is that an outsourcing business becomes dependent on the subcontractor. In this case, outsourcing will come to a point that threatens the existence of the business. The second factor is the fact that the orientation of enterprises towards jobs outside their core competency may create a risk of resource dependence on a market that is not dominated by them. In this case, enterprises will go outsourcing to deal with a stronger company in the related product market and try to eliminate the risk of dependency.

4. Reasons Why Enterprises Do Outsourcing

There are a number of qualitative and quantitative studies that determine the reasons that drive business outsourcing. These reasons has been summarised generally as being able to benefit from the expertise of specialists, follow technological developments, reach lower costs, reach more accurate information faster, avoid dealing with legal complaints, focus on the main activity area of the business, access better information management opportunities, and provide better service to employees.²²

According to the view that is common in academic circles, the main reason leading to outsourcing practices is based on the desire to reduce costs. Undoubtedly, reducing costs for enterprises is an important factor, but it is not correct to limit the enterprises' willingness to take advantage of external sources to a single reason. Cost is always an important factor for enterprises, but there is more than one reason for enterprises to benefit from external sources. For example, the trend of outsourcing in the business world is deeply affecting human resources departments that have become one of the indispensable functions of firms and the fields of activity of this division. Research shows that the most common area of outsourcing in human resources functions is the fulfilment of occupational needs and related functions. This way, enterprises will not encounter any problems in legal audits when they carry out functions other than their core competencies and reduce their costs while executing this function.²³

When the reasons for the management's decision to turn to outsourcing are evaluated in a wider context the existence of the following economic and managerial causes are striking.

- **Developing Core Competencies:** An enterprise that wants to improve its core competencies and gain competitive advantage can transfer the activities outside the core business to the subcontractor, which provides competitive advantage by taking advantage of the cost advantages of subcontractors.²⁴
- **Reducing Costs:** Reducing costs has a major impact on enterprises in the emergence of outsourcing practices. The fact that supplier companies are experts in their work is considered a more important factor for enterprises. Thus, the company acquires significant advantage in terms of costs by having a supplier company carry out the activity which it wishes to realise instead of undertaking a burden by making an investment. Moreover, in enterprises, carrying out activities that can be actualized by outsourcing with own funds leads to capital and operating costs. Since outsourcing expenditures are considered current

expenditures, they can contribute to the decrease of fixed capital expenditures and the resulting increase in profitability.²⁵

- **Increasing Flexibility:** Due to competition, enterprises have to concentrate on their core competencies and become more flexible. **Flexibility** is an important factor in achieving competitive advantage. Adapting to political, technological, economic, cultural, etc. changes is vital for the continuity of a business.²⁶ Outsourcing gives enterprises flexibility. This enables enterprises to have a flexible structure that enable making decisions, responding to changes in market conditions, and responding to the needs of customers and employees more quickly.
- **Downsizing Needs:** Enterprises are benefiting from external sources, saving resources, becoming smaller and more concentrated, and able to focus on the job they know best.²⁷
- **Gaining Speed:** Enterprises that have the ability to procure the goods and services they need in a short period of time due to outsourcing can save time and take the lead in time. The difference between the time it takes to supply a product or service from a supplier and the time it takes to produce the product and services using the entity's own resources constitutes savings.²⁸
- **Keeping up With Technological Innovations:** The way a company performs its core business due to ever-evolving technology is becoming outdated. In this case, the earlier core competencies become secondary and the enterprise faces adaptation or dissolution. Under these circumstances, enterprises must either develop new skills or outsource their assets in order to survive. Enterprises benefit from outsourcing functions such as new product development, design, manufacturing, distribution, marketing, and promotion, and they access new technologies in these fields. Thus, companies can avoid the cost of pursuing technology by utilising the research and development departments of subcontractors.²⁹
- **Resource Transfer:** A company benefiting from outsourcing can concentrate its limited resources on its core competencies, as well as providing significant resource transfer by eliminating the means of previously used production. Every investment has a certain risk factor. Risk assessment plays an important role in outsourcing management.³⁰
- **Reducing Investment Expenditures:** Enterprises are able to spend their resources on their business by outsourcing and are saved from unnecessary spending. This leads to a reduction in investment expenditures and an increase in profitability. Risky investments are transferred from the enterprise to an external source. In this way, the risk is reduced and the way to rapid growth is opened without being burdened by additional costs. Thus, enterprises can transfer their capital investments to their core competencies in the long term.³¹
- **Transformation of Fixed Costs Into Variables:** One of the most attractive and short-term benefits of outsourcing is reaching a supplier with a very low-cost structure. The opportunity to benefit from outsourcing is manifested if the inputs needed by the operator can be obtained at a much lower cost outside.³²
- **Increasing Quality:** Enterprises can get better quality product or services when outsourcing.³³
- **Decrease Competition Pressure:** Enterprises are concerned by outsourcing which involves practically all sectors and competitive pressures. One of the other reasons through which enterprises justify the use of outsourcing is eliminating or reducing competition.³⁴

5. Classification of Outsourcing

Outsourcing is classified through different variables depending on the types of outsourcing used by enterprises, type of used source, place of supply, and applied sector.

For Your Interest

Nowadays, many fields of activity such as design, marketing, human resources, finance, advertising, food, transportation, public relations, and R&D are being transferred to outsourcing. For example, Chrysler has given 100% of half of its vehicles to subcontractors. Again, Chrysler and Ford have produced less than half of their vehicles. Likewise, Boeing has begun to rely more on subcontracting partners in the manufacture of aircraft. In the production of the Boeing 767, Boeing's third largest commercial aircraft, the work has been outsourced to a consortium of Japanese manufacturers such as Fuji, Kawasaki, and Mitsubishi.³⁵

5.1. Classification According to Scope

Outsourcing can be categorised in two groups within the context of activities and the supplier involved. These have been classified and it is possible to distinguish three different phases in benefiting from outsourcing within the context of applied activities. These are:^{36, 37}

- **Individual Outsourcing Activities:** It is the transfer of positions of strategic importance related to human resources to external sources. Such a practice may be related to countering qualified personnel needs or personnel supply for issues that require accumulation of technical knowledge or operational activities.
- **Functional Outsourcing Activities:** Enterprises usually opt for outsourcing when any one of the operative functions carried out by the enterprise malfunctions. For example, an enterprise having a problem with its distribution channel will outsource the operation to an enterprise that is capable in this aspect.
- **Outsourcing Activities as a Process:** Similar and interrelated activities to produce goods or services that provide consumer satisfaction in organizations constitute the so-called production process, passing through numerous stages on a given production band. Using outsourcing as a process is to prefer the outsourcing route in case of a possible failure in activities related to the relevant structure.

It is possible to classify outsourcing in four dimensions within the context of associations established with the supplier. These are outsourcing in the form of secondary services, outsourcing as an auxiliary network, outsourcing in the form of strategic cooperation with supplier enterprises, and outsourcing in the form of cooperation with competitors.

Outsourcing in the form of secondary services refers to the fact that secondary services such as personnel dining hall, housekeeping, cafeterias, etc. are outsourced to an external supplier while the enterprise carries out the other activities within its own framework. Thus, enterprises do not employ personnel for secondary jobs and can gain a flexible structure by focusing on their own business.³⁸

Outsourcing as an auxiliary network is an application that enterprises use to have a more flexible structure and to fight with their competitors in an increasingly competitive environment. Thus, by moving from a complex structure to a simpler structure, the bureaucratic processes are reduced and a community of networks which are lined with contracts is established.³⁹

Outsourcing of supplier enterprises in the form of strategic cooperation foresees that the business and the supplier have a close relationship and work together to reduce costs and increase quality. Japan has successfully implemented the Keiretsu system in this regard. The Keiretsu is a business model in Japan in which the main business operator trains the staff of the supplier and provides them with technical support. In the model, the main business (sempai) means the parent and the supplier business (kohai) means the child.⁴⁰

Outsourcing in the form of cooperation with competitors consists of the establishment of alliances with competitors in a strategically formed collaborative partnership in order to reduce costs, maintain continuity, and increase customer satisfaction and quality in a competitive environment.⁴¹

5.2. Classification of Outsourcing According to Type

Outsourcing to be used can be classified as traditional outsourcing, provision of consulting services, utilization of independent experts, and personnel leasing.

Bill Lattimer of Arthur Andersen Consulting, a company that supports companies to benefit from outsourcing around the world explains traditional outsourcing as the transfer of personnel and assets to a company and provision of services to the company in return for fees. The use of information technology in data operations from external sources is an example of this. Lattimer identified consulting services as office services covering centralised outsourcing activities and emphasized that consulting services do not involve the transfer of personnel or assets.⁴²

The activity of utilising independent experts is generated by the need of employers to use independent experts in the fields they need. Scholars who have worked for many years as lecturers in universities, scholars who have academic accumulation and management practice, and managers who have gained important experience by specialising and working for long years in the fields of the professional business life are examples in this area.⁴³

Personnel leasing refers to employment in a “temporary status” for longer periods. Today’s employees want to have more flexible working conditions. Working with a rental company helps people have the flexibility they need by being active in business life and determine the working times during periods of willingness to take part in various projects at various times. In personnel leasing associations, the personnel leasing company undertakes the responsibilities of the employees. This prevents the employer from having headaches because of employees and gives him extra time to work which is what makes her/him earn money. Thus, in personnel leasing, the employer will no longer pay salaries to the staff but will only make a payment to the leasing company.⁴⁴

For Your Interest

After the automotive and information technology sectors, the tourism sector is one of the sectors where outsourcing is encountered the most nowadays. Travel agencies are supported by

subcontractors in the domestic transportation of tourists coming from different countries. The products and services of companies that serve in the health sector are used in medical tourism applications.⁴⁵ Outsourcing has become an important aspect of modern hotel management practices. Outsourcing practices are increasingly taking place in high income-generating units such as the front office, food and beverage, human resources, entertainment-animation.⁴⁶ Outsourcing practices are utilized in the tourism sector especially in the supply of human resources.

5.3. Classification According to Place of Supply

Outsourcing practices are separated into three classifications according to place and region where a supply classification is made, namely, offshore, onshore and nearshore outsourcing.

In offshore outsourcing the service provider is located in a country that is geographically remote from the client's country. This is also known as global acquisition. Organizations have discovered that certain costs can be substantially reduced by manufacturing in third world countries. Competition pressure has forced companies to outsource, especially with regard to offshore outsourcing. Remote offshore outsourcing is a cost reduction method with short-term potential. Canada, India, Ireland, and Israel are known as attractive offshore outsourcing countries in this regard.⁴⁷

For Your Interest

During 1992-2002, 3.3 million jobs from the US went to overseas countries. That means 220,000 people per year were unemployed during this period. When we look at the number of overall employees, this figure does not seem very high. However, an executed survey indicated that 17-20% of workers in the USA had been affected by this change. Western Europe and Japan in addition to the United States are at the forefront of countries that resort to the offshoring method. In countries such as India, Malaysia, and China where labor is more affordable, the demand for labor in the market is steadily increasing.

In onshore outsourcing the supplier company is in the same country as the outsourcing company. The outsourcing takes place in the country where the activity is taking place and therefore the social, cultural, and economic differences between the service provider and the serviced entity are eliminated.⁴⁸

In nearshore outsourcing the supplier company is rather close geographically to the outsourcing company.⁴⁹ For example, Teleperformance multi-language call center, which provides outsourcing services with over 138,000 employees in 46 countries, is organizing nearshore activities in Istanbul for Germany.

5.4. Sector-Based Classification

Outsourcing is categorised in two different forms, public sector and private sector, when it is classified according to the sector in which it is implemented.

Outsourcing in the public domain can be defined as the transfer of some or a part of the services to external specialized entities and enterprises for a number of reasons by countries, territories, local authorities, and public service providers that are obliged to provide public services. These

reasons include legal reasons, cost savings, management opportunities, lack of specialization, and limited resources.⁵⁰

Outsourcing in the private sector is a concept that only explains the applications regarding the utilization of external sources by the private sector. In other words, it covers the outsourcing relationships that the private sector makes outside the public sector.⁵¹

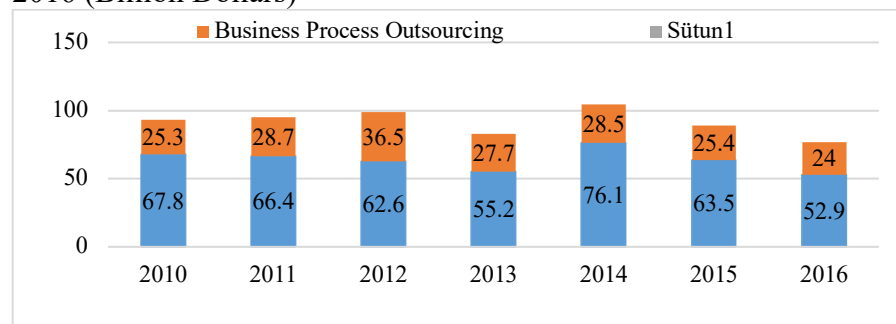
According to a survey of 3,700 participants in 8 European countries (Norway, Sweden, Finland, Denmark, Spain, Germany, UK, and Netherlands) in 2013, the distribution of outsourcing by industry is as follows: the government and public sector (41%); the service sector (20%); production and industry (18%); trade and distribution (7%); other (14%).

For Your Interest

A review of the sector on an individual basis, the automotive sector is the sector that has the highest rate of outsourcing. In recent years, the outsourcing rate for the automotive industry has increased significantly (subcontractors counter 75% of the cost of a single vehicle). The most important reasons for this increase are the low cost, low risk, and profitability in labor capital. The automotive industry uses outsourcing in many areas, primarily electrics, as do many other enterprises in sectors such as textile, insurance, mechanics, chemistry, and tourism.⁵²

A review of the distribution of global income according to service type incurred by private sector outsourcing between 2010-2016 reveals that information technology has benefited the most from outsourcing, which is outstanding. While total revenues from outsourcing in information technology were \$67.8 billion in 2010, this figure was \$52.9 billion in 2016. Total revenue provided by outsourcing during business processes was \$25.3 billion in 2010, while it remained at \$24 billion in 2016 (Exhibit 2).

Exhibit 2. Breakdown of Outsourcing Industry Income according to Service Type Between 2000-2016 (Billion Dollars)



Source: <https://www.statista.com/statistics/189800/global-outsourcing-industry-revenue-byservice-type> (07.08.2017).

6. Outsourcing Utilisation Process

The outsourcing process consists of nine steps. This process begins with the need of the operator to benefit from outsourcing and ends when the operator undersigns a contract with a subcontractor selected by the operator among alternative contractors. Successful continuation of the process after

that depends on an effective communication network between the enterprise and the subcontractor.⁵³

6.1. Need for Outsourcing

Outsourcing practices start with the need for enterprises to benefit from external sources. Enterprises need outsourcing for various reasons such as the need to reduce costs, develop basic skills, downsize to the right size, increase flexibility, accelerate process innovation gains, and resolve problems caused by uncontrolled functions. In addition, various reasons such as resource transfer, reducing investment spending, increasing quality, and making the most effective use of financial resources can also increase the need for outsourcing by enterprises.⁵⁴

6.2. Evaluation of the Operator

When an enterprise feels the need to benefit from outsourcing, it needs to make a self-assessment and determine which activities should be outsourced. The ability of an entity to gain by benefiting from outsourcing depends on the initiative that the top management will demonstrate in this regard. The senior management must determine which activities should be outsourced before the entity decides to benefit from outsourcing. Two criteria are taken into consideration in this regard:⁵⁵

- a) The strategic significance of the function for the enterprise,
- b) The capability of the enterprise personnel realising the function.

6.3. Decision to Outsource

Outsourcing practices are an important process that will affect the entire enterprise for a long time. In this respect, the top management needs to think about this issue and make a decision. Senior management must consider at length:⁵⁶

- a) Whether the enterprise needs to benefit from outsourcing,
- b) Which activities should be outsourced by the enterprise,
- c) Whether or not the organizational culture supports outsourcing applications.

The management's decision to outsource is affected by the number and capabilities of suppliers on the market, developments in technology, and the competition in the market. The decision to outsource is a crucial factor for the success of the enterprise. This decision directly affects the quality and costs of the entity's products and services.

6.4. Determination of Outsourcing Strategy

It is important that the initiative to outsource by the top management is able to generate profits from outsourcing. The top management must determine which activities should be transferred to outsourcing before deciding to take advantage of them.

The following issues should be taken into consideration when determining the outsourcing strategy:⁵⁷

- a) Resources owned by the operator

- b) The overall status of the economy
- c) Outsourcing expert's level of expertise
- d) Short and long-term financial advantages
- e) Ability to manage functions
- f) Determination of activities related to core competencies
- g) Supplier's quality and cost reliability
- h) Status of gains and losses in productivity and costs
- i) Whether the latest expertise and technology will be acquired or not
- j) How outsourcing will affect the gains and losses in performance quality
- k) What the dependency level on suppliers will be.

6.5. Preparation of the Request for Proposal

Once an enterprise has prepared a supplier list, a request for proposal to be sent to all suppliers is prepared. The proposal form is prepared to notify the suppliers about the enterprise's outsourcing application and inform them about the current transaction scale, expected performance level, application deadline as well as industry- and enterprise-related matters. The proposal form is useful for conducting an analysis of the enterprise and for identifying the specific needs of the enterprise.⁵⁸

The proposal form to be prepared by the enterprise must include the following information:⁵⁹

- a) **Introduction:** It explains features such as the history of the enterprise, type of company, number of employees, location, etc.
- b) **Needs and Expectations:** The type of activity to be outsourced along with the needs and expectations of the enterprise are specified in detail.
- c) **Supplier's Characteristics:** Detailed information is requested about the supplier.
- d) *Records and administration:* Detailed information in systems and reporting methods is requested about the past references of the representatives of the supplier as well as service information.
- e) **Communication and Training:** Information is requested about the communication capabilities of the supplier and personnel training meetings.
- f) **Technology:** Information is requested about the level of technology used by the supplier.
- g) **Mutual Consultation and Implementation:** If the agreement is signed, information will be requested on how the negotiations will take place and who will be responsible for communication and project execution.
- h) **Reporting:** Information will be requested about periodical reporting.
- i) **Financial Details:** Detailed information about fees and a sample of the supplier's service contract will be requested.

6.6. Consideration and Evaluation of Alternative Subcontractors

In the process of evaluating alternative subcontractors, there are two options that must be followed in order for the enterprise to be successful: the outsourcing manager and the outsourcing committee. After the enterprise has appointed one of these two options, the evaluation of the proposals from the subcontractors is carried out. The proposals that are best suited to the enterprise are selected and re-evaluated.^{59, 60}

Enterprises can allocate the duties and responsibilities to a single administrator during outsourcing applications. This manager needs to have some qualities and features in order to be able to perform the activities effectively and efficiently. The outsourcing manager will be responsible for planning, implementing, and harmonising activities in line with the outsourcing strategy as projected by the top management. Establishing a committee for benefiting from outsourcing will determine which subcontractor can respond fully to the needs of the enterprise. Expert advisors will have an active role in the selection of the most appropriate supplier from among alternative subcontractors, technical experts will have a role in the process of supervising the tools and equipment that must be supplied in order to achieve technological goals, and legal counsellors will have an operative role in the process of discussing legal issues between the enterprise and the selected subcontractor.⁶¹

6.7. Choosing Between Alternative Subcontractors

At this stage, the enterprise has approached the end of the process and will determine the contractor who can provide the most appropriate service. The subcontracting company to be selected should be in line with the objectives and goals of the enterprise. It should not be contrary to the structure of the enterprise.

The most important criterion to be taken into account at this stage is the quality level of service to be provided by the supplier. After all, the enterprise resorts to outsourcing for an activity because it is believed that the supplier can do it better than the enterprise itself. Otherwise, outsourcing will not be rational. Another important criterion to consider when choosing between alternative suppliers is the prices. Likewise, the cost factor is at the core of the enterprise's reasons for outsourcing. A high price will have a negative impact on the operating costs. The quality and price as well as flexibility to adapt to changes that may arise in the market, and on global terms, adaptability to the enterprise culture, having a healthy financial structure, modern technology, and innovation culture of the subcontractor should also be taken into consideration.⁶²

6.8. Negotiation and Signing of Contracts With the Subcontractor Company

A contract is a document that establishes a relationship between the service recipient and the service provider and is signed by the parties. Contracts should ensure trust and cooperation between parties in complex outsourcing issues. A single contract may not always be sufficient to ensure this harmonisation. In this case, it will be necessary to apply several contracts such as framework contracts, service contracts, and transfer contracts.⁶³

The contracts must be carefully examined and signed as they are documents that set out mutual obligations during the course of work. The success and duration of the contracts are related to the quality of the preparations and the prepared processes prior to the contract. The contract content should be consistent with the facts of the service provider and the service recipient. The duration, scope, targeted service levels, critical success factors, and penalty-reward criteria must be specified in the contract.⁶⁴

After the selection of the supplier company, the contract is made and signed. Care should be taken with the following issues during the signing of the contract:⁶⁵

- a) It is necessary to make the contract clear, precise, and comprehensive so as to eliminate all doubts and hesitations.
- b) The parties have to understand and accept the terms of the contract.
- c) The contract should contain all the relevant definitions.
- d) Financial conditions such as payment, delay, and guarantees must be detailed in the contract.
- e) The duration of the supply relationship must be specified in the contract.
- f) The contract must be flexible.

6.9. Establishment of an Effective Communication Network With the Subcontracting Company

At the end of the process, an effective communication network shall be established between the enterprises. The basic function of this phase is to reduce uncertainty. The more open, honest and reliable communication between enterprises is, the greater the harmony will emerge between the parties.

Outsourcing is important for the continuity of contracts between related entities. It is possible to make various changes over time to the contract made between the parties. Change of technology and economic conditions as well as the introduction of new and strong opponents into the market are main reasons for changes in a contract. This kind of change in contracts depends on the association level and strategic alignment between the parties. If a healthy communication and relationship cannot be established between the parties, cooperation is not possible.⁶⁶

7. Benefits and Risks of Outsourcing

The decision to take advantage of outsourcing can have positive results in various ways and it also has the potential of leaving enterprises face to face with various risks. Therefore, managers must make detailed evaluations of the structural and economic aspects before making a decision to benefit from outsourcing.

7.1. Benefits of Outsourcing

Key factors that keep enterprises up in the new world economy are speed, quality, competitive advantage and low cost. Outsourcing is a strategic application that contributes to the positive outcome of all these variables in terms of enterprises.

Outsourcing improves the yield of internal resources and facilitates access to external resources as it allows companies to concentrate on their core competencies by transferring provisional services to outsourcing providers.⁶⁷

By outsourcing, production costs and investment costs for factories and equipment can be reduced. Outsourcing companies gain the right to access the latest technology without making any investment to this end.⁶⁸ The impact of outsourcing on costs is not limited only to the operational aspects of the business. At the same time, it can be financially beneficial to operate by reducing the costs of investments during the establishment phase. This allows the enterprise to gain competitive advantage by using less capital through outsourcing.⁶⁹

Enterprises want to make the most of their limited resources by reducing operating costs, compete with other enterprises, and increase their profitability. Outsourcing offers an alternative opportunity for efficiency in enterprises. With outsourcing, the building space used by the enterprises, the savings in the order, labor costs in the production processes, and efficient use of resources bring about an increase in productivity in the enterprises.⁷⁰

The benefits gained by the main company in its own sector by exploiting the outsourcing practice can lead to significant increases in the value of the company in the medium and long term. The focus of the management's attention can be more on strategic issues of the business and less on daily operational problems and conflicts which will increase business value.⁷¹

The positive consequences of outsourcing enterprises can be summarised as follows:⁷²

- a) Improves the financial indicators of the companies,
- b) The expertise of the supplier company is utilized,
- c) Enables administrators to decrease audit areas to more efficient dimensions,
- d) Improves the quality of the goods and services offered to customers and produce more flexible solutions,
- e) Provides effective use of time and resources,
- f) Helps increase productivity,
- g) Provides the ability to improve the quality of services and to benefit from advanced technology,
- h) Ensures the management of functions that are difficult to manage or uncontrollable,
- i) Ensures enhanced differentiation, namely, the quality of activity performed by specialist is greater than if activity were performed by the company,
- j) Focuses on the core business,
- k) Distractions are removed,
- l) Company can allocate attention/resources on activities important for value creation/competitive advantage.

Nowadays, increasingly complex and uncertain conditions, increasing globalization of the market, and increasing competition necessitate enterprises to be more flexible and dynamic. Therefore, many enterprises are in need of reorganisation. Reorganisation was discovered at the end of the 1980s and early 1990s and changed the structure of many American and international enterprises. Reorganisation, a common strategy among the US enterprises during this period, subsequently spread to countries such as Japan and Germany. Reorganisation refers to the amendment of various business areas and/or the financial structure of an organisation.⁷³ Reorganisation is generally defined as organizational changes carried out within an organization in order to facilitate the implementation of an organization's downsizing or expansion policies.

Outsourcing is considered one of the management tools used in reorganisation. Enterprises have the opportunity to make changes during this process by delegating activities outside of their core competencies to external sources.⁷⁴ In addition, the equipment and investments of the suppliers that are successful in their areas of activity reduce the time required for the enterprise's reorganisation cycle.⁷⁵

If a business wants to be reorganised, it must be able to dispose of its internal resources, downsize, and increase its flexibility. This may be possible by outsourcing processes that require highly complex, costly, and advanced expertise such as maintenance.⁷⁶ Reorganisation by downsizing often aims to focus on the organization's core business and enhance its flexibility. Outsourcing at this stage is viewed as a means of ensuring efficiency and flexibility in management. Before going into reorganisation with the intention of growth, it is useful to explain what is meant by horizontal and vertical growing. While the concept of **horizontal growing** is used to operate and grow in similar or different areas of the business, the concept of **vertical growing** is used to describe the qualitative and quantitative development of the business in the same sector. Outsourcing in growth-oriented reorganisation efforts is a tool to reduce the pressure on management on a number of functions in parallel to the expansion of the enterprise and to increase competition among departments within the enterprise.⁷⁷

7.2. Possible Risks of Outsourcing

In terms of enterprises, the decision to benefit from outsourcing can provide all these positive results as well as providing a basis for the formation of some potential risks. In general, outsourcing can leave enterprises to be confronted with risks such as loss of intra-organizational flexibility, loss of control over suppliers, selection of an unskilled supplier company, loss of business capabilities, loss of control over personnel, hidden costs, and loss of information security.

7.2.1. Loss of Intra-Organization Flexibility

The main long-term problem that enterprises can face with outsourcing is over-reliance on the supplier of the outsourcing application. Indeed, a close relationship in the sense of partnership can ultimately make the business that makes use of outsourcing dependent on the supplier company. As a result, contrary to the initial expectation, the outsourcing company can lose its flexibility and control over the relationship. Thus, this application, which is expected to provide a competitive advantage, can make the business disadvantageous.⁷⁸

7.2.2. Loss of Control Over the Supplier Company

The efficiency level of enterprises benefiting from outsourcing will depend on those external services. Therefore, the control over the services procured by the enterprise will be reduced. For this reason, an enterprise benefiting from outsourcing must carefully monitor the activities of the supplier company and communicate continuously.⁷⁹

7.2.3. Selection of an Unskilled Supplier Company

The choice of supplier is critical to the success of outsourcing technology. Choosing a supplier based only on cost calculations can cause enterprises to face certain problems in the future. Cost calculations made without considering transaction costs can lead enterprises to the selection of unskilled suppliers.⁸⁰

7.2.4. Loss of Business Capabilities by the Business

Some enterprises benefit from outsourcing as a specific activity while others outsource the whole function. The fact that certain operations, especially business-specific operations are carried out

by supplier enterprises means that the suppliers are increasingly able to carry out the activities of the original enterprise through experience and learning. In a way, benefiting from outsourcing techniques weakens the important competencies which the enterprise needs to sustain itself in the future.⁸¹ Outsourcing technology is hollowing out enterprises and creating competition for itself and when the core competencies of a business are learned by suppliers, the business risks losing its competitive advantage.⁸² Therefore, it is necessary for the management to develop relations with the supplier company carefully to achieve success when benefiting from outsourcing.

7.2.5. Loss of Control Over Personnel

Outsourcing applications may cause stress, concern for the future, and distress in personnel which may lead to low productivity. A system should be developed to respond to the needs of the staff while developing the outsourcing strategy. Furthermore, inability of the managers in exercising authority on the personnel of the subcontractor and the inability to communicate effectively with these personnel may result in loss of control within the enterprise.⁸³

7.2.6. Hidden Costs

Although reducing costs seems like an advantage of outsourcing, the desired benefits may not be achieved if outsourcing is not planned properly and the wrong supplier is chosen. In an increasingly competitive environment, managers cannot predict what benefits and losses the future may bring to the enterprise and this uncertainty may be manifested as costs which must be borne.⁸⁴

7.2.7. Loss of Information Security

If the determined subcontracting company is not selected well and is unreliable, there is a risk that shared information reaches competitors.⁸⁴ If confidential information falls into the hands of a subcontractor, competitors can mimic the goals and objectives of that enterprise. In such a case, the image of the enterprise will be damaged, and competitiveness will decrease, increasing risks.⁸⁵

For Your Interest

The seven items that could lead to poor outcomes if they are not observed in outsourcing as follows:⁸⁶

- a) Outsourcing of activities that should not be outsourced,
- b) Wrong choice of external supplier,
- c) Inadequate contract,
- d) Personnel-related problems are overlooked,
- e) Loss of control and inspection over the outsourced activity,
- f) Overlooking hidden costs in outsourcing,
- g) Failure to make a plan for the cancellation of outsourcing.

In order for a company to manage the risks associated with outsourcing and make optimal use of its potential, it is necessary to formulate a strategic vision and plan that highlight company goals first. However, it is important to work with the right service providers (supplier) in order to provide continuity in relationship management, prepare an appropriate contract, benefit from external

experts, and determine the service level and performance criteria. If dismissing personnel is an issue due to outsourcing, due diligence and regular feedback is important.⁸⁷

Summary

In the late twentieth century, when modern management techniques began to have critical importance in making strategic decisions, enterprises found themselves in a complex social and economic environment that differed from what they had been accustomed to. This new and different setup changed the market, management-organization, production, and resource perception that these enterprises had. This shift in paradigm brought many new applications and concepts to the agenda of enterprises and decision-makers. Over time, new concepts and approaches were put on the agenda of enterprises. One of these management-organization concepts that have emerged in recent years is the use of outsourcing applications.

In the New World Economy, the most important factors that can provide efficiency for organizations are speed, flexibility, and adapting to environmental conditions. These three factors transform organizations into high-mobility units, and they gain a highly functional structure on the market. Outsourcing is a managerial strategy that helps organizations gain professional human resources potential and build relationships with the environment on the basis of mutual productivity.

Outsourcing activities are increasingly beginning to cover many business functions. Enterprises outsource activities that have complex and critical functions that contribute to growth. Although it has been mostly used in sectors such as automotive and information technology, outsourcing areas are increasingly diversifying today and it is applied in areas such as support services, maintenance and repair, logistics, communication, and human resources.

In addition to the automotive industry, information technology industry, and tourism industry areas, outsourcing practices are frequently encountered in areas such as textile, household appliances, banking, informatics, human resources, food, retail, cleaning, and personnel transportation services.

Increasing outsourcing practices around the world, along with many positive aspects, can bring about certain risks and adverse consequences if not implemented with an effective strategy. The negative consequences of outsourcing are factors that can threaten the future assets of companies such as loss of in-house flexibility, loss of control over suppliers, selection of an unqualified supplier, loss of competence by an enterprise, loss of control over personnel, hidden costs, and loss of information security. Therefore, the outsourcing decision must be made carefully and carried out with a logical strategy.

Case Study

Resources From Humans: New Human Resources Term at Unilever

In recent years, especially large-scale enterprises have focused on their core business by transferring all human resources processes together with their legal responsibilities to companies that provide outsourcing services. These enterprises ensure efficiency by transferring the management and applications of human resources to a company with professional consultants.

One of the companies that initiated outsourcing in the human resources department was “Unilever Turkey” starting from 2009 when it conceived a new working period with the slogan “Resources Human”. For the first time in 2009, a foreign manager was appointed as the head of human resources at Unilever’s branch in Turkey, the headquarters of which is in the Netherlands. Lennard Boogaard started a new change movement in the human resources department in 2009 as soon as he started his duty. The change can be summarised as the human resources department providing more boutique services within the company

As a first step in this process, they looked for a company that would carry out “paperwork” such as payroll in human resources and outsourcing the recruitment of certain levels of staff, at which point an agreement was reached with Accenture, a global company. “Accenture, our new business partner in human resources, will undertake interviews and other paperwork.” explained Boogaard. For this structuring, the human resources staff underwent a training process and preparations were made for them to acquire consulting skills.

This change brought a different status to the human resources staff. There are now human resources partners from the company called HRBP within Unilever. Now, with this title, dozens of people give boutique consultancy service to department managers. Every business partner will be responsible for counselling the relevant department’s officer. The incumbent is responsible for guiding the manager about the profile of the staff that is necessary for the department to achieve its goals. The incumbent will teach methods and show what needs to be looked for during an interview and how to distinguish the personnel with that profile. In this way, young people who are not clogs in a machine and who can manifest their individual creativity with independent studies will be gained into the business world.

Internet Tour

- www.invensis.net/
- www.xotels.com/en/outsourcing
- www.iaop.org/
- www.accenture.com/tr-en
- www.remotestaff.com.au/
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Definitions

- **Individual outsourcing:** The transfer of positions of strategic importance related to human resources to external sources.
- **Outsourcing:** Procuring certain parts of the work from external companies or specialists who are experts in the field with a contract.
- **Outsourcing strategy:** Determining which activities should be outsourced to external sources by the top management before deciding to outsource.

- **Vertical growing:** It is used to describe the qualitative and quantitative development of enterprises in the same sector.
- **Flexibility:** The ability of enterprises to adapt to political, technological, economic, cultural, etc. changes.
- **Functional outsourcing:** The procurement of a function which has become problematic to execute in the enterprise from an external source.
- **Traditional outsourcing:** It describes the transfer of personnel and assets to a company, which in turn provides a fee-based service.
- **Trading cost approach:** According to the approach, enterprises operating in a specific market structure are formed as institutions that reduce transaction costs.
- **Keiretsu System:** In this model the association of main enterprises with supply enterprises in Japan involves the training of the supply enterprise staff by the main enterprise and providing technical support.
- **Resource Dependence Theory:** According to the theory possible dependencies which are generated based on the dependencies of inter-organizational relations may result in one organization having more power than the other organization over time.
- **Downsizing:** Conscious decisions and implemented strategies by the enterprise management to decrease the number of personnel, costs and work processes.
- **Personnel leasing:** The employment of long-term personnel with a ‘temporary status’.
- **Outsourcing as a process:** Outsourcing is preferred in case of a possible failure in activities related to the production process.
- **Subcontractor:** The individual, organization or company that has undertaken to execute a part of the work done by the primary organization or individual.
- **Supplier:** Wholesalers delivering a merchandise or service to companies as input, raw material.
- **Proposal form:** A form prepared by the enterprise for the activities to be outsourced providing the current transaction scale, the expected performance level, the deadline for application, information about matters related to the industry and enterprise to the suppliers.
- **Core competency:** The unique knowledge, skill and ability of an enterprise that distinguish it from other enterprises, play an essential role in the realization of an enterprise’s activities and which cannot be easily imitated by competitors.
- **Offshore outsourcing:** The service provider is in a country that is geographically remote from the client’s country. This is also known as global acquisitions.
- **Nearshore outsourcing:** The geographical location of the supplier company is rather close to the place where the outsourcing company is located.
- **Horizontal growing:** It is used to describe activity and growth of enterprises in similar or different areas.
- **Reorganisation:** A structural change within the organization to make it easier for an enterprise to implement its downsizing or expansion policies.
- **Local outsourcing (Onshore):** The supplier is in the same country as the supplied enterprise. The outsourcing takes place in the country of activity.

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