

# Outsourcing

**Specification requirement—** Out-sourcing: nature, benefits and problems.

Outsourcing occurs when outside suppliers are involved in activities that could be undertaken internally by a firm. For example the outside suppliers or sub contractors may deal with phone enquiries, computer processing or production of components or even produce finished products.

Outsourcing has become a big management fad in the last 20 years, but unlike many fashions in business it seems here to stay.

Outsourcing moves jobs outside the firm, and may even replace them with employment overseas (sometimes called offshoring). Outsourcing may need lead to a net fall in employment (especially when offshoring occurs) but when jobs are moved outside the firm, we will see a loss of jobs internally, but new jobs can be created externally. For example many firms contracted out delivery services, and housekeeping services in the 80s and 90s, so shedding jobs in manufacturing, but new large companies grew to service the outsourced needs of the manufacturing firms. Overall the outsourcing increased efficiency and lowered costs.

## Offshoring.

Offshoring manufacturing jobs has been going on for decades, but it was with the full entry of China into the world trading economy, that the opportunities for relocating manufacturing jobs boomed. Over the last 10 years more and more firms have taken advantage of production in this low cost, but effi-

cient market, a picture partly repeated with an increase in investment manufacturing in the in the newest member states of the EU, such as Poland and the Check Republic. Over the last 10 or 15 years there has also been a massive growth in offshoring service jobs. Call centres for the USA, Australian and UK markets are found in India and the Philippines. Low cost communication systems allow jobs involving customer service to located potentially anywhere on the planet.

## Advantages and Disadvantages of Outsourcing.

There are of course both advantages and disadvantages to outsourcing.

### Advantages

- Significantly reduced staffing costs
- Well trained staff provided by the outsourcing company will reduce HRM costs such as recruitment and training.
- Existing workload and stress levels reduced, this is very important if a firm is operating near or at full capacity.
- Less investment risk. Instead of investing in new production facilities, let the outside supplier take the risk of investing
- Capital needs reduced. Because there is less investment, there is less need to raise finance
- Lower costs increase profits giving more capital for research and development, so speeding the development of new products.

### Disadvantages

- Potential of poor customer service (call centre related), with communication made difficult because of cultural difference,
- Existing employees may feel demotivated

if they believe their jobs are at risk, especially if previous redundancies resulted from outsourcing. This demotivation can increase staff turnover and reduce productivity.

- Quality of production / product cannot be guaranteed. Quality control systems are now in the hands of producers who may be 1000's of miles away. Quality may be maintained, but it is difficult to keep up with improvements in quality from competitor companies.
- More difficult to implement JIT systems, which reduce the need for working capital.
- Break down in communication in the production chain. It is often difficult for functional departments to talk to each other when they are in the same building. Speedy and effective communication becomes much more difficult when the person you need to talk to is on another continent, works for a different company, and speaks a different language.
- Loss of security of data. There have been cases where customer data has been made available to external organisations from subcontracting firms. In the worst cases the information has been passed to competitors or even criminal gangs.
- Lost tax revenues to the home government when off-shoring is used.

Outsourcing extended to its absolute limit will lead to the virtual company, where a firm does nothing except plan, and coordinate the actions of all the firms that are involved in production and supply of the good or service.

If this level of outsourcing occurs, focus can be placed on the Value Added aspects of the product such as brand, research and development, technological innovation etc.

### Notes