

Outsourcing: benefits and risks-a case study on unilever

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INTRODUCTION

1. THE EVOLUTION OF OUTSOURCING

Businesses have evolved consistently over the years driven by different factors. First it was to build market share and market dominance, especially in the 1960s with the invention of new technologies and the evolution of the service industry. Then in the 1980s, it was on competition for market dominance and survival. Organisations needed to build competitive advantage by producing the goods and services their customers required, and maintaining customer relationships through these feats. Businesses evolved from being mainly product based, to being customer focused, and through that being able to ascertain what customers want, and redefine their operating models to fit in with these changes (Willcocks et al, 2009).

The constant evolution of businesses meant that they had to constantly change and adapt their resources and capabilities to fit with the changing customer taste, and this meant focusing their core efforts on what mattered most, that factor that resulted in sustainable competitive advantage for the company. The decision for organisations to focus on their major operations, put into consideration other back office functions such as Human Resources, Finance, Technology and Procurement, and steps that the organisation could take to make these more efficient, save costs, whilst also adopting best practices.

The revolution of the technological industry in the 1980s showed that the PC industry did not need just one provider for all-in-one computer technology (Hardware, software, peripherals), by showing that different parts could be

sold separately, especially with the establishment and growth of Apple, Oracle, and Microsoft. That same revolution has been showcased within organisations to show that the firm does not necessarily need to take ownership of all functions required within the organisation (InfoWorld, 2006). According to Varadarajan (2009), there are functions that are core to an organisation, while some others are basically support functions. Both entail capital, manpower, and other resources to run, however, core functions are also profit centres, while support functions usually serve mainly as cost centres. Therefore, organisations are increasingly concentrating on their core services, while delegating the function of their support functions to external service providers that specialise in providing these services, services otherwise known as outsourcing.

1. 1 OUTSOURCING

Outsourcing is defined as the transfer of an organisation's operations, processes or functions to an external service provider, which is obligated based on specific and/or flexible contractual terms to conduct these tasks on behalf of the organisation (Quinn et al, 1995). The global outsourcing has witnessed enormous growth over the past decade, from \$232 billion in 2000, to \$442bn in 2010, and predicted to grow to \$518 billion by 2013 (Accenture, 2009). Outsourcing usually involves the transfer of responsibilities, but could also include the transfer of staff and business processes to providers inshore or offshore. According to Accenture (2009), outsourcing has dramatically changed the manner in which most companies “ create and distribute value”.

Outsourcing has gradually evolved from being hardware and applications based, to higher-level business processes and services. Now instead of companies just outsourcing their IT maintenance and installation to external parties, they now outsource their support functions such as Human Resources, Finance, Procurement and Technology, all so they could reduce costs, avoid wasted resources, utilise best practices and concentrate on their core services, albeit theoretically. It is increasingly becoming a major strategic option for most small, medium and large companies, hence the reason why it has been chosen as an important topic for this study. The following are examples of companies that have adopted outsourcing as a strategic option for their organisational growth.

Ericsson has recently announced that it has finally signed an outsourcing contract with HP. It is a five-year contract that will allow HP to manage the infrastructure services, desktop support, helpdesk and output services for Ericsson. This contract is actually an extension of a contract that was signed in 2003. The IT services of Ericsson will be updated so that they will cater to the future needs of the employees of the company. It will also allow for flexible support for the global business. Outsourcing IT allows Ericsson to reduce IT spending, total costs of ownership and will help to make the IT structure more efficient (HP 2003).

Furthermore, Kodak has outsourced IT to IBM in order to reduce internal IT costs. The help-desk support for windows Server and Windows XP has been outsourced to IBM. This will help Kodak cut costs drastically and will also provide flexible pricing that will allow Kodak the ability to adjust the IT

operating budget. The contract between the two companies will allow IBM to build and maintain an energy-efficient green data centre in addition to the converged IP network infrastructure for Kodak. This will help Kodak save more than \$1.2 million in reduced energy costs and operational efficiency over the next five years (IBM 2005).

JP Morgan entered into a multi-sourcing, 7 year deal with 4 vendors. 45 percentage of JP Morgan's IT employees were transferred while 600 vendor's staff were also supplied to work together so as to achieve the targeted goals. The data-centres, mid-range computer distributed data services were outsourced to different vendors while It strategy, application development and vendor management were kept in-house. This outsourcing strategy led to an annual savings of \$ 700 million for JP Morgan (Willcocks et al, 2009).

1.2 UNILEVER, THE ORGANISATION UNDER STUDY

Unilever is a global company, and a group of companies responsible for producing and marketing some of the world's largest brands such as Persil, Knorr, and Lynx. Its major strategy is to add vitality to life by producing goods that help people live better, feel better and get the most out of life. With revenues exceeding \$40 billion in 2009, Unilever employs over 200,000 individuals globally and has operations in more than 100 countries worldwide.

1.3 OUTSOURCING IN UNILEVER

Unilever has embarked on several outsourcing agreements over the past decade with a number of notable vendors such as IBM, HP, BT and Accenture. They have outsourced a number of their non-core business

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operations to these third party providers, and the nature of these agreements are outlined as follows:

Unilever signed a seven-year application outsourcing agreement with Accenture in 2005, which covers the development of applications, their implementation and support for Unilever across the whole of Europe. The contract cost ? 500m and entails Accenture deploying a unified European IT platform and the provision of IT services to Unilever's operations in 20 European countries (Personnel today, 2006; Accenture, 2010).

IBM in December 2005 also signed a seven-year finance transactional services outsourcing deal with Unilever across Europe. This transition affected 750 staff across 20 European countries and entailed the handling of Unilever's Purchase to Pay, General Accounting and Bill to Cash functions (Silicon. com, 2005). In 2008, the agreement was extended to procurement outsourcing in which IBM assisted in integrating and standardising the procurement practices across all regions within Latin America (ComputerWeekly. com, 2008).

In 2006, Unilever signed an additional seven year HR BPO outsourcing deal with Accenture that covered areas such as payroll administration, reward administration, performance management, workforce reporting and core HR administration across 100 countries in more than 20 languages, delivered through centres in Bangalore, Manila, Dalian, Bucharest, Prague and Curitiba (Unilever, 2006).

In 2006, Unilever also extended a BT outsourcing contract for an additional three years, for an extra fee of ? 270 million. This outsourcing contract covered areas such as voice, mobile, Internet, DSL, VPN, audio and

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videoconferencing solutions within Unilever Europe (Silicon. com, 2006).

Later in 2006, Unilever outsourced its global firewall management systems to BT over a 6. 5 years period for ? 10. 5 million (ComputerWeekly. com, 2006).

HP and Unilever in 2008 announced that they had signed a seven-year outsourcing contract in which HP was to manage the infrastructure of Unilever operations across the Americas, Asia, Africa, Turkey and Middle East. This arrangement included the standardizing, virtualizing and optimizing of existing enterprise infrastructure, and was predicted to enable the company work more effectively (Networkworld. com, 2008).

1. 4 PROBLEM STATEMENT

These contracts were part of the “ One Unilever” transformation initiative and were designed to deliver annual savings of \$927 million yearly. Unilever hopes to streamline the operations of its multi-domestic franchises across Europe, whilst also implementing shared services globally, and outsourcing agreements were deemed as the most efficient and effective way of having these done, especially across procurement, finance and infrastructure management functions. However, according to InfoWorld (2006), several issues may arise with outsourcing, especially when its conducted on a multinational scale, and these may comprise:

Security vulnerability – Outsourcing firewall to external parties

Employee resentment – Cutting staff and transferring a large portion to third party clients.

Change management difficulties – Inability of retained staff to quickly

recognise and blend in with newly established partners and processes. Inability to calculate cost savings and efficiency progress, and effectively manage contractual relationships with several third parties.

All these could make it difficult for Unilever as an organisation to appropriately recognise if / where it has saved costs and achieved efficiencies, and could even result in higher cost of operations and managing, than could have otherwise occurred when it was managing these operations itself, especially if the relationships between outsourcer and outsource goes wrong, or a security vulnerability occurs (InfoWorld, 2006).

1.5 RESEARCH OBJECTIVE AND QUESTION

Based on the overview of outsourcing as discussed earlier, and the problem statement highlighting possible ways in which these arrangements could go wrong, this research would aim to:

Investigate the current progress and success of outsourcing in Unilever especially in the UK, and to a smaller extent across Europe.

Ascertain how the maintenance of supplier relationships have been instrumental in achieving better results from outsourcing projects.

Understand how outsourcing has helped contribute to overall competitive advantage in Unilever, in the UK, and also across the UK.

Based on these objectives, the following research question has been coined:

To what extent has outsourcing with single or multiple partners contributed or disrupted the drive for sustainable competitive advantage within global multinational firms, what are the potential benefits attributable to

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outsourcing within companies, and how could possible disadvantages be identified and subjugated?

1. 6 Dissertation Structure

This study is structured in the following way:

The Literature Review chapter that follows would highlight relevant texts and reviews that have been obtained from academic theorists regarding outsourcing. The literature review would cover the theoretical definitions of outsourcing, business functions that are usually covered under outsourcing agreements, the different forms of outsourcing, the manners and processes through which organisations outsource, the benefits attributable to outsourcing and threats that could arise as a result of outsourcing. An outlook on the outsourcing industry would also be included.

The Methodology chapter would highlight the main methods through which data would be collected and analysed for the sake of answering the aforementioned research question, and accomplishing the research objectives. Additional information on the research approach and strategy would also be included.

The Results chapter that follows would include a concise response to all questions asked during the interview process, and these would be arranged according to the manner in which the results are structured. The results would be structured based on the topics covered in the literature review.

The Discussions chapter would seek to compare and contrast findings from secondary data analysis and also from the interviews, and compare them against findings from literature review, using a deductive methodology.

2 LITERATURE REVIEW

2. 1 Outsourcing

2. 1. 1 Theoretical definition of outsourcing

In our contemporary fast moving business world, many organisations are struggling to differentiate and crave the right competitive strategy in the market. Businesses are encountering enormous pressures in the market to improve and maximise their operational efficiency. In order to gain a sustainable competitive advantage in the market; organisations (both private and public) have turned to outsourcing as a major element in their business strategy.

Click & Duening (2005) defines outsourcing as “ the movement of business processes from inside the company to an external provider”.

Businesses outsource their management practices to add specialised expertise where needed to help management run or improve the organisation and business module. The ultimate reasons that facilitate the emergence of this strategy are competition, cost reduction and the emergence of information technologies.

Outsourcing has hugely enabled many organisations to focus on strategic aspect of their business and allows third parties to deals with their non-core activities (McIvor, 2005). Firms normally embarked on outsourcing activities when their secondary-level activities started to consume more of their existing scarce resources, consuming time and hindrance investment from their core activities. Companies that intends to concentrate on their core

business activities, will find outsourcing as a way of minimise the load and risk of their secondary-level activities (McIvor, 2005).

For majority of firms, outsourcing is a result of innovation (Quinn, 2000, Corbitt & Al-Qirim, 2006). Outsourcing derived from the daily changes that occurred in the environment, the emergence of new technologies, rapid changes in the market demands and shorter product life cycles are some of the crucial elements that have changed in the recent years.

Nowadays, outsourcing has been widely discussed issue in terms of business strategy, and has become a regular topic in the academics literature. Most successful organisation in the world use it, and its essence seems to be ever interesting. The major highlight about this topic is the offshore possibilities; where significant markets like India and China competing with the West. In the case more and more businesses are looking to East for cheap labour, efficiencies and market opportunities. Theoretically, outsourcing can tremendously leads to short-term profits.

While businesses outsource, they targeted few core activities and try to gain substantially from outsourcing their non-core activities. Such strategy would ultimately improve performance through scope economies and reduces costs through scale of economies (Harland et al., 2005). When strategic alliances are formed, the core business skills and competence are hardly maintained and can be easily lost. This may not be a potential threat to some firms because outsourcing can enormously allow them to learn quickly new skills and competences from third party. However, it is essential for outsourcing firm to maintain its most crucial part within the organisation and retain

developments and manufacturing of essential parts. The manufacturing is the most crucial element in terms of how customers perceived the firm product (Brandes, Lilliecreutz & Brege, 1997).

Many researchers believed that business non-core activities should be outsourced and the core activities remain in house (Kakabadse and Kakabadse 2000a). Core activities are corporate skills that impact numbers of activities within the organisation, but it is not that simple to define a core competence.

As per Willcocks, et al 2002, the firms which have decided to outsource will need to spend considerable time on carefully choosing those processes which need to be outsourced and those which should be retained within the firm. Much time need to be spent on evaluating and distinguishing between the core processes which should be controlled in-house and commodity processes which can be outsourced. The authors argue that the processes which lead to value creation should never be outsourced. It is therefore required that the top level executives spend considerable time in ranking the various organizational processes according to “ their potential for value creation and their potential of value capture”.

This ranking can help in creating a value hierarchy which provides further clarity on which processes can be safely outsourced. Willcocks et al. 2002 suggest that the business processes should be carefully evaluated or compared with the concept of value creation as described above along with their “ contribution to competitive positioning”. This leads to the following

grid which can be used in choosing those processes which can be outsourced.

Fig1. Decision making Matrix on Outsourcing

2. 1. 2Core Competencies

Activities that firm continuously engaged on such as; functions that are performed in-house, that create huge competitive advantages, critical to business success, and activities that drives growth and innovation (Kakabadse and Kakabadse 2000a). Quinn and Hilmer (1994) added that core competencies are not only products or functions, but are also skills or knowledge sets. Competencies are sets of skills stretching across all functional borders. Managers should pinpoint on aspect where the firm dominates, instead of stretching their over the entire value chain.

Competencies are limited in number, therefore, managers must be able to understand the strategic fit that directly relate to understanding of serving and meeting with the customers' requirements (Quinn & Hilmer, 1994).

2. 1. 3Non-core competencies

For organisation to outsource its non-core activities or non-essential activities is a vital way of thinking. Reason had been that, such strategy enables the organisation to redirect its people towards performing activities in accordance with the firm core competences. (Brooks, 2006). Many researchers believed that, a firm strategy to outsource it non-core activities can free its human resources from undertaking low level jobs, and build a platform wherein the people can work on more highly knowledge intensive project that may be beneficial to the organisation and its people (Lacity et al.

1995). This concept was also supported by McKinsey Global Institute (2003) about the benefits of outsourcing on a national level. The report claimed that outsourcing low-level jobs mainly to developing countries would release the burden in the human resource, and also allowing the developed countries to create a higher value adding activities.

The combined effort to focus on organisations core activities and releasing human resources enables an optimisation of the organisational capital investments (Quelin & Duhamel, 2003), which ultimately maximises the returns on internal resources (Bailey et al. 2002).

2. 2 Different forms of outsourcing

2. 2. 1 Technological outsourcing

Technology has been one of the most crucial components in terms of outsourcing. Getting access to technology or competence outside the organisation may be a motive to engage in outsourcing as a solution of shortcoming. The situation when this approach may be favourable is when suppliers prove to be more advanced (Harland et al. 2005) or have protected their own technology through patents, which render access impossible. Then the only cost-effective way for the organisation to access this technology may be to engage in an outsourcing agreement with the supplier. To get access to the specific technology needed outsourcing also give firm the opportunity to reduced potential risk of investing in research and development associated with large and often irreversible investments (Quelin & Duhamel, 2003). The technology example may also be applied to the search for relevant competence when companies may perceive a gap

within their own organisation compared to knowledge and competence found outside the organisation (Quelin & Duhamel, 2003). Couple of years back, IBM Business consulting services signed a seven-year outsourcing contact with Unilever which covered significant parts of Unilever's financial transactional services, including its Purchase to Pay, General Accounting, and Bill to Cash functions. Furthermore, when accessing to a new technology the host organisation may find themselves in a situation where they end up rediscovering their old technology. This may occur in the adaptation process between the host organisations technology systems and the systems used by the third party supplier (Weigelt, 2009).

2. 2. 2 Business process outsourcing (BPO)

Business process outsourcing is relatively new business phenomenon. BPO is an outsourcing phenomenon where much responsibility has been given to third parties to undertake and perform the entire business functions on behalf of the client organisation (Dibbern et al., 2004). Incredibly, there are vast number of industries that are embarking on business processes outsourcing such as; the financial sectors (Banks, insurance companies) the government services, financial services, logistics, transportation, healthcare etc.

BPO initially started with non-core activities and is now moving towards core activities. Mainly targeted areas were; call centres, help desks/customer support, hotlines claims management, document processing etc., and its gradually booming core areas like software development, Finance and Accounting, Human Resource etc. The trend at which these activities are moving is beyond the speculations outlined on the above literatures. Due to <https://assignbuster.com/outsourcing-benefits-and-risks-a-case-study-on-unilever/>

the trend and pace of competition, outsourcing of typical back-office functions are now and shifting into middle-office functions (Millar, 2004).

Recent research showed that, India, China or the Philippines are not the only nations that have benefited with BPO, but also Eastern and Central Europe's markets are also chasing near shore outsourcing from Europe.

Many outsourcing organisations are beginning to think that BPO is drastically moving from efficiency to effectiveness. Another research done by Terra (2005) concluded that 73 per cent of BPO customer's survey shows that BPO is enhancing their outsourcing processes.

For the host organisation to deliver outstanding and quality service, it must have the requisites service methodology, people/expertise, technology, infrastructure, metrics capabilities etc. All these requisite plays major roles in helping the outsourcing party by reducing " investment" risks, increase transparency, improve the overall process quality and above all lowering costs.

2. 2. 3 Applications Outsourcing

This practice is concerned with maintaining client applications, which may include Enterprise Resource Planning (ERP) systems, legacy systems, portals and middleware (Deloitte, 2010). The service provider is responsible for maintaining and developing the applications, delivering technical and end-user support, and providing technological infrastructure support as covered in the outsourcing legal agreement (InfoWorld, 2006).

2. 2. 4 Infrastructure Outsourcing

This practice is concerned with managing all relevant IT related infrastructure that enable the technological processes of the organisation function effectively. Infrastructure such as data centres, servers, desktop management systems, and hosting services are outsourced to competent third parties, with the aim of reducing the cost associated with managing these infrastructure internally, as it could be found cumbersome for a non-technical organisation.

2. 3 How organisations outsource?

As described earlier, the general rule for all outsourcing is to outsource the more commodity-like activities to one or more external suppliers in hope that they can provide the service equally or even better for less money (Lacity et al., 1995). There many critique against this approach since it tends to oversimplify the complexity around the outsourcing decision, which easily can lead to disappointment (Lacity et al., 1995).

To outline in a simple format on how organisation outsourcing is a daunting task. Let assumed when Unilever decided to outsource its IT to third parties. The question all managers need to answer when outsourcing the IT function of the organisation is which aspect of the activity should performed internally, and what other aspect should be managed by an external vendor (Willcocks & Lacity, 1998) In recent scenario where Unilever found out that its in-house calls centres were incapable to respond to its increasing business needs, they outsourced this activity to external parties. Over a period of time, Unilever team shortlisted and scrutinised 11 call centres companies and choose a particular vendor on the basis on its below industry attrition <https://assignbuster.com/outsourcing-benefits-and-risks-a-case-study-on-unilever/>

rate and the way it managed its staff. On a daily basis, staff members from Unilever supervise their operation and report back to the firm. The crucial aspects of this partnership demonstrate that Unilever succeeded in maintaining the right level of control with its operations without getting involved in the technical aspect of the operations. A strategic measure employed by Unilever to ensure outsourcing a viable long-term solution was the way the firm utilises and combined its own in-house product knowledge to specialist resources gained from its vendor.

But since every organisation is different and faces different challenges, it is impossible to give a simple answer. IT is today a highly important and integrated part of most businesses and can therefore be said to affect and shape most processes within an organisation. More research on this aspect concluded that the following activities are unwise to outsource; activities that require enormous knowledge of business needs, IT strategy, IT architecture and activities that are perceived as a problem (Lacity and Hirschheim, 1994).

The degree of outsourcing is a quantitative measure of categorising different outsourcing options. Different types of outsourcing models can be developed on the basis of the total IT resources (Lacity et al, 1997).

Total outsourcing – simplifies that mostly 80 per cent of the IT budget is outsourced, on the other hand;

Total in sourcing – simplifies that 80 per cent of IT budget is kept in-house after outsourcing alternatives has been evaluated.

Selective outsourcing – a mix of outsourced and in-sourced functions, neither

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reaching 80 per cent of IT total budgets.

De facto in sourcing – the internal IT department is used without any evaluation of external alternatives.

Generally, large scaled outsourcing deals (total outsourcing) is often a part of a bigger and more lasting change involving the way in which the organisation need to be structured, focused and managed (Willcocks & Lacity, 1998). Applying total outsourcing while using one or a few vendors can put the client at risk since it tends to increase costs and decrease flexibility over time. An alternative to total outsourcing is to use selective outsourcing. This approach assigns specific functions or services to the vendors that are best suited for the job. However, many believed that selective outsourcing is a successful form of outsourcing since it incorporates the fact that the information technology p includes a wide spectrums of activities that are different in terms of the levels of technical of maturity, integration with existing processes and the business contribution (Lacity et al. (1997).

Arguably, there is no one internal IT department or suppliers that has the experience and economies of scale to perform all the required IT activities effectively. By using selective outsourcing, the organisation should be able to increase its flexibility and control and also minimise risks by spreading it onto different vendors and time horizons. This approach also takes into consideration that IT activities, depending on their characteristics, require different amount of management attention, security and consideration to be successful IT outsourcing objects (Lacity & Willcocks, 2000). The authors

also stresses that selective sourcing works most effectively within the context of business strategic concerns and an overall IT-sourcing strategy that retains both flexibility and control.

Other benefits of using selective outsourcing are for example motivated in-house personnel competing with external suppliers, reduced risk since it is spread over a number of vendors and a learning process that can be incorporated more swiftly. Possible downsides with selective outsourcing are increased costs while managing multiple contracts and vendors, problems with the integration and cooperation among the different vendors and finally a risk of losing sight of the overall strategic issues while focusing on maximising the operational possibilities (Lacity & Willcocks, 2001).

2. 4 Benefits OF outsourcing

2. 4. 1 Cost Saving

The reduction of operational costs is still one of the main goals of outsourcing. Significant savings in capital and operational costs have been reported from organisations that outsource parts of their in-house operations (Harland et al., 2005).

To reduce costs, the organisation needs to start by locating and subsequently divide the organisation into core and non-core activities. After the organisation core and non-core activities have been identified, the non-core activities/competences may be outsourced to a third party contractor/vendor. The idea is thus to remove a part of the organisation that the organisation don't have adequate resources, time or strategic interest to accommodate in-house.

The reason why the third party contractor can produce the same product at a lower cost is generally through achieving a production of greater scale (Kakabadse & Kakabadse 2005). The larger volume is maintained by taking on many small volumes from a variety of different clients. The larger scale also enable the supplier to further specialise in its field which leads to higher plant efficiency and hence, lower costs per item or service produced (Weigelt 2009).

Furthermore, one of the catalytic factors that have hugely driven and enabled the implementation of cost effective outsourcing possible is the increased globalisation over the last 50 years. The focus has moved towards outsourcing low level jobs to developing countries where the wages and labour costs are significantly lower than in the developed countries (Farrell, 2006). The low level jobs are hypothetically characterised by a low need on experience level and prior knowledge. The transfer of these jobs have also been facilitated when they have been regarded as unattractive in the developed countries but considered attractive in low wage countries (McKinsey Global Institute, 2003).

Thus, implementing outsourcing can be seen as a management technique that creates radical changes by step-by-step improvements. These are aimed to lower overall costs within the organisation (Bailey et al. 2002) as well as creating a price competitive advantage over competitors. Though, when engaging in outsourcing activities to reduce costs in one part of the organisation other parts will often require increased investment and higher management attention. Areas concerned are primarily related to the

management of increased interactions with the buyer and supplier network. This as well as an increased level of outsourcing demands needs to acquire and to maintain a higher level of logistic excellence within the organisation. Further on, savings gained by outsourcing is weighed against costs due to the need to monitor the performance of the supplier. This to ensure that for example; quality, service and timing of delivery remain on a high level (Quelin & Duhamel, 2003). These are negative aspects that may lower the motive of outsourcing an activity with the sole goal of achieving cost reduction within the organisation. However, hiring expertise from host country has not been proving to be an effective cost saving strategy.

For example, to hire skilful personnel from another country especially outside the host country region can be burdensome and frustrating tasks as there are many protocols involved like visa processing time, immigration rules and settlement.

The concepts about cheap local labour are gone, a Chinese operating firm in the UK may find it extremely difficult and expensive to hire expatriates from China, in that case outsourcing can sometimes be the right strategy. On the contrary, empirical research shows that in India, \$10,000 or less can hire a highly qualified software engineer for an entire year (annual basis). This figure may not be enough to hire UK software engineers in the US or UK, therefore in a country where work permits and other restrictions are not essential, then companies may find this strategy as a cost-effective one.

2. 4. 2 Flexibility

Besides the aim of cost reduction, the strategic goal of sustaining a higher level of flexibility within organisation has forward as one of the strategic motives in implementing outsourcing activities. Acquiring higher levels of flexibility becomes essential for the firm, in an approach to handle the uncertainty parameter connected with increased volatility in the global market (Buckley, 2009). This was further emphasised by another researchers who revealed that companies' intention to outsource application services was positively related to environmental uncertainty (Verwaal et al. 2009). By engaging in outsourcing activities the organisation acquire flexibility in the sense that it is easier to change purchasing requirements for a contracted service then to change in-house activities. This, due to in-house, the needs of different stakeholders perspective's such as employees and trade unions needs to be taken into account (Hendry, 1995). Outsourcing in this sense also presents a mean to downsize the organisation to render it more flexible (Bailey et al. 2002). This enables large static and vertical organisations to move towards smaller and more horizontally structured organisation where the focus has moved towards increased flexibility and control over the organisations network. This enables the possibility to change, when needed, the direction of the organisation to pursue new opportunities and openings in a fast and shifting market (Lacity et al. 1995).

When relevance is concerned, Bengtsson and Dabhilkar (2009) found in their survey that the motive to gain flexibility was judged nearly equally important as the number one motive, to reduce costs. This is as well as Quelin and Duhamel (2003), whom showed that the motive to establish flexible may be

considered as the third most crucial aspect after the aim to lower operational costs and focus on core activities.

In outsourcing, for a firm to be able to change conditions to a third party organisation, the ethical aspect of the arrangement particularly between the supplier and the host is highly essential. A good contract between the two parts should contain a certain degree of flexibility and to maximise flexibility the host organisation should aim towards establishing short-term contracts (Kakabadse & Kakabadse, 2005) that enables renegotiations of conditions with suppliers in accordance with changes in the market.

This may specially be vital for organisations that find themselves in a fast moving field like information technology. Here, a long-term contract may turn out to be costly when price changes and technology improvements occur rapidly. Thus the organisation may risk to be stuck with old technology over the contract length whereas the rest of the market may benefit from better technology at a lower price. To avoid this problem, shorter contract length is a good method where flexibility is gained through maximising competition between different suppliers at each renegotiation process (Lacity et al. 1995).

Further, flexibility and competitiveness may be gained by dividing the organisations activities and outsource them to different suppliers. This lowers the dependence of one specific supplier just as it lowers potential switching costs if it proves to be necessary to change supplier (Lacity et al. 1995).

2. 4. 3 Knowledge and Expertise

Skills, knowledge and expertise are the core competences of a firm, and are likely to develop to a cost for the organisation should outsourcing decreases. In a situation where the business core competences decline in the market, the organisation may be forced to look elsewhere for an alternative outsourcing as a means of compensating the cost for staying competitive in the short-term. This may have a tremendous effect on the firm competitiveness (Arbaugh, 2003). Many organisations have suffered enormous consequences when attempting outsourcing, often they might have little knowledge about the market. Therefore, strategic capabilities and market knowledge must be embedded and integrated within the firm.

In that regard, the phenomenon of outsourcing business activities is regarded by some, as a learning dilemma (Bengtsson, & Dabhilkar (2009). There are many resisting forces within a firm trying to outsource, particularly “ offshore outsourcing”, employees may restrain the process, when realised that the motive of outsourcing is not to gain new opportunities but to lose to exist ones (Corbett, 2004). Many outsourcing companies these days are trying to select the right supplier, reason had been that most suppliers’ actions might have a tremendous impact on the outsourcer. This often happened when businesses become dependable on their external suppliers, core business strategies, trading patterns and other crucial information’s are revealed, and it can be more crucial if the same supplier is working for other competitors.

Most activities that are outsourced are not likely to provide the firm with the same knowledge and expertise as it would have performed in-house.
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However, if the supplier has a more sophisticated resource base, then the outsourcer may ultimately benefit from their recent technologies (Harland, et al. 2005). Market knowledge can be a key to organisation when shaping the future of the firm and its employees.

2. 4. 4 Quality and Efficiency

The opposite of outsourcing with a cost reduction motive is to outsource with a quality driven motive. Maintaining efficiency and outsourcing to gain a higher quality is a strategic choice that is difficult to combine with gaining a lower cost (Varadarajan, 2009). Yet, outsourcing with the goal of improving product or service quality has, as shown by Kakabadse & Kakabadse (2005) been an important motive when implementing outsourcing. Hence, an organisation may choose to pay more to gain a higher quality to standardise its product or services efficiencies. Though, the quality aspect of outsourcing is often brought forward when the organisation reviews its internal activities and benchmarks them against external competitors (Quinn & Hilmer, 1995). This action may evoke the question to why outsourcing organisation should create a service or product internally when an external supplier may provide the same product or service within the same frequency and quality but at a lower price. Hence, outsourcing may prove useful to gain a higher quality than would not be possible to achieve internally for the same costs.

2. 4. 5 Innovation

Innovation is mostly the primary reason why businesses outsource their activities, so that they can acquire competence and establish a platform within the firm that may enable innovation in the future (Verwaal et al. 2009). This may enhanced the organisation to develop and improve their

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products or services, business processes or reduces the time products stay in the market.

Hence the organisation motives are different from getting access to new technologies and competences that aim to reach a short term goal to fill up current or temporary knowledge and technology gaps within the organisation. Consequently, innovation motives are a part of the possibilities connected to strategic outsourcing (Harland et al. 2005) where the goal is to ensure the organisations future position and survival in the global market.

What makes strategic outsourcing with the motive to create future innovation possible is the increased level of expertise on the supplier level.

Outsourcing of activities has shifted from low level jobs to include outsourcing of high level and more problem resolving tasks. Thereby providing the sourcing organisation with new and innovative solutions (Varadarajan, 2009), (Bengtsson and Dabhilkar, 2009).

2. 4. 6 Competitive advantage:

Innovation is a motive to gain a competitive advantage and to aspire a world leading position within their field. i. e. becoming the number one choice for potential customers. The argument to focus on the organisations core business was put forward by Prahalad and Hamel (1990) and presents a vital step in this direction. Though, when focusing on the core business, non-core activities regarded as non-essential for the organisation may be selected to be outsourced (Prahalad & Hamel 1990).

Applying this, the organisation may gain an advantage compared to competitors when they, through their outsourcing network may come in

contact with different/smarter solutions. These different solutions may be presented as the possibility to produce offered item or service at a lower price, which increases the price pressure on competitors acting on the same market. The price pressure may be created when production is outsourced to a supplier that may use scale driven cost efficiencies (Varadarajan, 2009), domestic or abroad. When outsourced abroad, suppliers and producers situated in developing countries possess an even greater cost competitive advantage compared to sourcing competitors situated in developed countries (Farrell, 2006). To challenge this problem, the companies situated in developing countries need to create and offer solutions with different attributes (Varadarajan, 2009) such as offering flexibility, services etc. that may benefit the customer in different ways hence putting aside the temptation of choosing a lower price alternative. Outsourcing in this perspective gives the organisation the possibility to increase responsiveness to the customer's needs (Bailey et al. 2002).

Furthermore, a competitive advantage may also be created when outsourcing an activity from the organisation will contribute to a higher efficiency in the organisations remaining activities. This was brought forward by Verwaal et al. (2009) who showed that production efficiency advantage was positively related to organisations intent/motive to outsource application services through a third party supplier (Verwaal et al. 2009). The last motive brought up here is connected to the competitive advantage related to the latest management trends. Which is followed by a way of “if everyone else does it, we have to do it too”-thinking. Hence, at times, organisations make

outsourcing decisions because it's considered an acquirement to stay competitive and increase innovation (Brooks, 2006).

2. 4. 7 Business benefit contracting

Business benefit contracting is a contractual agreement or the last stage of outsourcing arrangement that outlined the vendor contribution to the client, in terms of the associated benefit to the business (Millar 2004), and the payment that the customers are willing to make based upon the vendor's ability to deliver the services. The associated risks with business benefit contracting based on how the third party providers and the vendor can match the costs with benefits and then apportion the risks.

2. 5 OUTSOURCING RISKS

Many organisations failed to evaluate the risk factors associated in outsourcing. For instance, when outsourcing activities such as IT services or capabilities, the outsourcer will assign a substantial part of its operations to the third party's and setting unrealistic expectations for the outsourcing outcomes. To avoid the likelihood of loss as a consequence of uncertainty in the market, recent studies done by Ross and Westerman (2004) divided these risks in four major categories: strategic risks, relationships risks, vendor/technical risks and transition risks.

2. 5. 1 Relationship risks

When businesses formed an outsourcing relationship, both the parties should take into consideration the changing circumstances of their relationships during and at the end of the business contracts. The emergence of new technologies has changed the market drastically, and it has opened

tremendous opportunities and challenges for businesses. Therefore, since these unprecedented changes and their impact are unpredictable, clients should be very technical when signing a new deal with third party's that later might not be needed or meet future needs. Risks should be not be underestimated at all cost, especially when signing new and long-term contracts (Ross & Westerman, 2004; Lacity et al., 1995).

2. 5. 2 Transition risks

All IT outsourcing arrangements includes a transition phase where the organisation, the processes and the staff need to adjust to the new situation. This phase often involves great technical challenges; e. g. linking outsourced applications together with internal applications or transferring technical staff to the vendor. Other challenges are related to dealing with organisational changes, which are likely to appear as the vendor makes changes to the old IT processes. (Ross & Westerman, 2004) It is important not to underestimated the time and money needed during the transition phase. If not calculated correctly these additional costs can easily turn the positive margin of the outsourcing deal into negative. According to the Ross and Westerman (2004) it can particularly become an issue when handling new technologies since the vendor are probably selling undeveloped competencies. Dealing with new technologies can hence be particularly hard for the parties involved.

2. 5. 3 Strategic risks

As concluded earlier, organisations in general want to outsource what they consider to be non-strategic activities (Ross & Westerman, 2004). But using this approach solely when deciding upon which part of the IT-function to
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outsource can lead to problems. The risk lies in simplifying the complexity of IT and the uncertainties surrounding it. Since IT often is a highly integrated part of the business it can be hard to identify so called non-strategic activities. The rapid technical advances in this area together with the complexity and unpredictability of the global market make it possible for the commodity of today turn into a strategic advantage tomorrow (Lacity et al., 1995).

2. 5. 4 Vendor – Client risks

When signing an outsourcing contract the client loses some of its control over the IT function and processes, becoming dependent on the external vendor for delivering the capability needed in the way and the quality agreed upon in the contract. Therefore, the client should always be aware of the risk that the supplier goes out of business or for other reasons not be able to deliver the agreed upon service level. (Ross & Westerman, 2004) Thus it is important to choose the vendor with care in order to minimise the risk of this occurring.

Another issue concerning the vendor selection is the occurrence of a so called bidding war over attractive outsourcing contracts between different vendors. This situation, which at first can seem positive, will in worst case result in vendors making unrealistic bid offers. Sometimes the vendor already knows or discovers by hand that they are unable to recover their business results and operational costs for the near future. This situation is called the “ Winner’s curse” and can lead to additional costs, poor service or considerable switching costs for the client. (Kern et al., 2002) It can

particularly become an issue when handling new technologies since the <https://assignbuster.com/outsourcing-benefits-and-risks-a-case-study-on-unilever/>

vendor are selling capabilities they may not be fully developed. When dealing with new technology it is hard for both parties to weigh the potential benefits against the technical and organisational difficulties that might arise (Ross & Westerman, 2004).

2. 6 Outlook in the outsourcing industry

In the some previous research, the effects of outsourcing have been evaluated in different level of performance. Theoretically, outsourcing can be a useful tool to help organisation gaining profit. It is an opportunity to companies learning from outside expertise and making benefit from it. However, in recent study, fewer firms achieved significant benefits than what they initially speculated. In some circumstances, the profitability in some firm decreased in their first year's of outsourcing. Within the outsourcing industry, cost reduction, innovation ability, benefits from supplier, improving operational capabilities and improving risk management have one way or the other affecting the firm's products and services. And now it is become more unpredictable for any to forecast what the future strategy hold for outsourcing firms. Incredibly, innovation and reduction of the operational costs are still the main reasons of outsourcing, but many other researchers belied that the trend will change as the importance of this argument will decrease in the next years (Kakabadse & Kakabadse, 2002).

3 METHODOLOGY

3. 1 Research Philosophy

Saunders, et al. (2009) state, “ a research philosophy depends on the way that a person thinks about the development of knowledge” (p. 83). When looking at knowledge development, it becomes clear that three main schools of thought exist: ontology, epistemology, and axiology. According to Saunders et al (2009) “ ontology is the study of the nature of existence or being.” Epistemology, or theory of knowledge, is defined as “ the branch of philosophy that studies knowledge and attempts to answer the basic question: what distinguishes true knowledge from false knowledge”. A more recent philosophical development in the study of knowledge has revealed axiology, which studies judgements about value and the role value plays within research (Saunders, et al., 2009). Within these three main research philosophies exist four dominant views regarding the research process: positivism, realism, interpretivism, and pragmatism.

3. 1. 1 Positivism

Positivism relates to natural sciences and can result in law-like generalizations (Remenyi et al., 1998). During the positivism process, the researcher serves as an objective observer and is independent of the research itself. Jankowicz (2005, p. 110) describes three aspects of positivism: “ events exist out there”, “ data pertaining to them can be found by anyone who follows the same procedure”, and “ truth exists independently of the people who seek it and can be found through logical deduction or through the collection of data which result in unarguable facts.” The process of positivism utilises existing theory to develop hypotheses. These hypotheses are then tested and either confirmed or denied. The

replication of such experiments is therefore paramount to the positivism process. Saunders et al. (2009) emphasize the importance of value-free research in the positivism approach. This is a result of the fundamental process of positivism in that the researcher is objective and independent of the research. However, it can be postulated that evidence of a value-free approach does in fact imply the existence of a value position.

3. 1. 2 Realism

The process of realism relates to social occurrences and the affects they have on individual awareness. According to Saunders et al. (2003, p. 84) “realism is based on the belief that a reality exists that is independent of human thought and beliefs.” Therefore, this philosophy suggests that reality exists outside of and independent of the mind. This view can be said to be the direct opposite of an idealist view, which suggests that the mind and its contents are the only variables that do exist.

3. 1. 3 Interpretivism

The research philosophy of interpretivism argues against positivism in that it suggests that the world we live in is too complex to apply law-like generalisations. Social constructionism, which is an ontological form of interpretivism, is said to “view reality as being socially constructed” and seeks to “understand the subjective reality of those being studied in order to be able to make sense of and understand their motives, actions, and intentions” (Saunders et al., 2003, p. 84). An important factor to interpretivism is that of empathy, in which the researcher seeks to enter the world of research and understand the motives and feelings of those being researched: the researcher seeks to become part of the research. As

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opposed to positivism, interpretivism begins with the collection of data and then compares that data to existing theory.

3. 1. 4 Pragmatism

The research philosophy of pragmatism argues, “ the most important determinant of the epistemology, ontology, and axiology you adopt is the research question – one may be more appropriate than the other for answering particular questions” (Saunders et al., 2009, p. 109). Pragmatism suggests that the researcher does not have to be limited to one research philosophy, and that it is in fact possible to employ multiple approaches when conducting research. Tashakkori and Teddlie (1998) suggest “ it is more appropriate for the researcher in a particular study to think of the philosophy adopted as a continuum rather than opposite positions.” Whereas other philosophical approaches are concerned with data collection and theoretical analysis, pragmatism is concerned with producing positive results. According to the pragmatism philosophy, this can be achieved through a mixed methods approach.

The research philosophy utilised in this research study is that of objective ontology and positivist epistemology. This research philosophy was chosen due to the fact that the researcher chose to ascertain the effectiveness of outsourcing within Unilever through objective means, rather than subjectively interpreting what was researched. Through the positivist approach the researcher was able to serve as an objective observer and independent from the research. Through this approach the researcher was also able to utilise existing theories in understanding the topic and conceptualising a research objective and question. The results from the <https://assignbuster.com/outsourcing-benefits-and-risks-a-case-study-on-unilever/>

study were then tested against the existing theory. Given the mixed method approach chosen by the researcher, it can also be stated that an element of pragmatism has been adopted within this research.

3. 2 Research Approach

There are two different approaches that can be utilised when undertaking research: inductive and deductive. With an inductive approach “ theory is developed from the observation of empirical reality” (Collis and Hussey, 2003, p. 15). Conversely, a deductive approach starts with the relevant theory or hypothesis and focuses on developing a strategy for testing that theory or hypothesis (Saunders et al., 2009).

The research approach that was utilized during this study was that of deductive. This approach was chosen due to the fact that the research philosophy adopted was positivist epistemology, and also because the researcher aimed to compare existing theories with the findings supplied through interviews and secondary data. The deductive approach supported this research study more appropriately than would the inductive approach due to the fact that the researcher began with the theory and sought to test that theory based on data collection and analysis. A deductive approach represents the most common view between theory and research. Results obtained through this approach are developed using logical reasoning (Bryman and Bell, 2007).

According to Robson (2002), five sequences exist when undertaking a deductive approach to research:

Deduction of a testable research question regarding the connection between two or more variables,

Relation of the question to the current research study or question(s),

Thorough testing of the available data to answer research question,

Analysis of results generated through data analysis, and

Reevaluation of the theories with regard to results generated through testing.

3. 3 Research Strategy

A research strategy is a general plan or road map of how the researcher intends to answer the research question(s) (Saunders et al., 2003). When looking at the research strategy, six different methods can be utilized: experiment, survey, case study, action research, grounded theory, and ethnography. The specific research strategy type used during the research will be dependent upon the specific objective(s)/question(s) of the research.

The case study strategy was adopted in this study. Case study is defined as “ a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence” (Robson, 2002, cited in Saunders et al., 2003, p. 93). Morris and Wood (1991) suggest the case study strategy if the researcher “ wishes to gain a rich understanding of the context of the research and the processes being enacted.” The case study strategy was chosen for this research project due to the fact that the researcher utilized both secondary and primary data when evaluating the research objective(s)/question(s). Because the research aim of this project was to

ascertain the extent to which outsourcing has affected Unilever's competitive advantage, the research strategy needed to be one that allowed the research to be "descriptive", "illustrative", "experimental", and "explanatory" (Scapens, 1990). Therefore, the case study strategy was utilized.

Table 1: The different research approaches utilized in this study

Strategy	AIMS	SAMPLE	DATA COLLECTION	METHOD OF ANALYSIS
Semi-structured interviews	Ascertain manager's view regarding effectiveness of Unilever's outsourcing activities	2 UK relationship managers in separate departments responsible for managing outsourcing contracts (Pranab and Jamil).	Semi-structured interviews	Content analysis
Secondary data analysis	Compare relationship manager's views with existing theories	Relevant journals, company information, websites, etc. All relevant, accessible means	Content analysis	

3. 4 Data Collection Methods

There are five main ways that data can be collected for research projects: observation, sampling, secondary data, questionnaires, and interviews (Saunders et al., 2009). Contained within each of these five main methods are various sub methods that can also be utilized when collecting research data. Saunders et al. (2003, p. 93) suggest that the methods of "questionnaires, interviews, observation, and documentary analysis" are best suited for a case study strategy.

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3. 4. 1 Data Choice

The data chosen to be collected for this research project consisted of both primary and secondary data. The primary data for this project was collected through semi-structured, face-to-face interviews. Secondary data was also gathered utilizing organizational records and data, journals, web sites, industry statistics and reports. The approach of choosing to use both primary and secondary data was done in an effort to ensure triangulation throughout the research process. This approach also helped in the efforts to guarantee the aspects of reliability, validity, and generalizability.

3. 4. 2 Sampling Method

For the purposes of this research project, a non-probability sampling method was utilized. Due to restrictions imposed upon the researcher, it was not possible to interview all relationship managers or a random selection of managers within Unilever. Therefore, it was necessary to single out two specific managers to be interviewed. These individuals were chosen on the basis of previously existing access between the managers and the researcher. As mentioned above, the researcher also chose to use secondary data through gathering public and academic opinion regarding outsourcing activities within Unilever.

3. 4. 3 Data Collection

Primary data for this research project was collected through conducting semi-structured, face-to-face interviews. Interviews were conducted with two UK relationship managers within Unilever. The interview information was gathered using a voice recorder and then transcribed at a later point in time.

Secondary data for this research project was collected through extensive Internet research regarding information on Unilever and outsourcing. This information was gathered, analyzed, and collated accordingly. Two different managers were interviewed (Pranab and Jamil), and in order to be able to interview them effectively, the semi-structured questionnaire was divided into two major sections. The first one was on the background of outsourcing within Unilever, and its nature within the company. The second was on the potential benefits or threats in outsourcing. Pranab was interviewed on the nature and background of outsourcing, while Jamil was interviewed on benefits and potential threats, just so the researcher could use her time more effectively and obtain more information in the process.

3. 5 Data Analysis

Content analysis was used when analyzing the primary and secondary data gathered during this research project. This technique was used due to the fact that the information being analyzed was qualitative in nature and needed to be authenticated across a large cross-section of resources (Saunders et al., 2003).

Qualitative analysis was also utilized during this study. Qualitative analysis is described as “ the processes and procedures whereby we move from the qualitative data that have been collected into some form of explanation, understanding or interpretation of the people and situations being investigated” (Saunders et al, 2009). For these purposes the researcher chose to gather information from a smaller, but more focused group of individuals within Unilever. This data was then analyzed using a qualitative

method for deeper and richer information. The result of such analysis was categorized into three separate groups according to background on outsourcing within Unilever: outsourcing background and nature, potential benefits and likely threats. This categorization allowed for more content rich analysis and support for the overall research objective(s)/question(s) (Saunders et al., 2003).

3. 6 Access

The researcher has an existing relationship with a relationship manager employed at Unilever UK. This relationship has afforded the