

Outsourcing

Business



2f. Definition of Five Key Terms Outsourcing The term denotes the act of one business entity entrusting another with the responsibility of carrying out a certain exercise on its behalf.

Risk This term refers to the possibility of losing or compromising an opportunity in business. Competency Competence relates to all knowledge, skills, and possessions of an organization. Theory Theory is a set of interrelated ideas that are helpful in understanding phenomena. Technology

Technology is a reflection of the state of development in terms of capacities and abilities relative to time. 2a. Literature Review and Arguments on

Outsourcing In the prevailing dynamic business environment, a high percentage of companies, irrespective of size, have begun to acknowledge the significance of attaining and sustaining a competitive edge that is possibly based on the development of information technology.

However, Hanson (2011) observed that to stay ahead in business, a great deal of investment in terms of effort is mandatory as the development and maintenance of such capability is costly as well as time consuming. Despite the promise of reaping benefits after investing heavily in developing various business infrastructures, there is a possibility that the expected results might not be attained (Olive 2011). It is possible because the adoption of new technology may lead to unprecedented losses. In order to reduce the chances of incurring huge losses, the preference for the outsourcing approach has gained dominance among SMEs in Singapore (Hanson 2011). In 1990's, outsourcing gained prominence after its successful application by EastmanKodak.

The company externalized its information system to Businessland, DEC and IBM (Krugman Obstfeld & Melitz 2012). Outsourcing is relatively an old concept since it took place in 1960's. The only change is, perhaps, the name. It is notable that during 1960's, firms turned to third party firms such as computer service bureaus to contract for automated services (Blinder 2011). The computer service bureaus often offered various programs which were customized or prepared for general purposes.

Hence, individual firms were required to accommodate their operations to standardized options. The bureaus dictated the pace of the technology that the firms employed. Most of the firms were small and medium enterprises. For instance, the Frito-Lay and Blue Cross received outsourcing services from the Perot Electronic Data Systems (Mankiw & Swagel 2010). Outsourcing has more clear-cut risks than the ones pointed above.

Despite the several compelling benefits associated with outsourcing, it has several risks. The considered risks have a potential of preventing a business from achieving its goals. According to Willcocks, Fitzgerald & Feeny (2010), the following are some of the risks: Decline of in-organization expertise
Decline of control
Decline of intellectual capital
Double sourcing
Added responsibility of managing vendor relationships
Additional risks attributable to offshore outsourcing
Outsourcing for wrong reasons
Dangers to data security
Increased costs
Hidden costs in contracts
Demoralizing to employees
Exposure to contractual disputes
Irreversibility of contractual decisions
Some of the risks are put into perspective. The first to be considered is the loss of control. Loss of control presents a primary concern to organizations that rely on outsourcing.

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Those organizations that opt for total outsourcing stand a risk of losing control over their internal and external operations as they surrender their control over processes to outsourcers. Hence, they lose control over such aspects as quality and timelines. However, Willcocks, Fitzgerald & Feeny (2010) did not find an association between outsourcing and the loss of control over core activities. Under this aspect, the focus is made on the process versus project work. The process work reflects the core activities, while the project work captures a non-core issue.

However, at the current time in the new organizational environment, the core function of business entities is the production of new products in addition to maintaining relationships with consumers. Information technology remains central in the development of products. Hence, the organizations that outsource intellectual capital and people to develop products risk losing control of their business ventures. Keen observers also note that outsourcing presents a risk in regard to the flexibility of organizations. With outsourcing, it is possible to award long-term contracts to various outsourcing vendors (Willcocks, Fitzgerald & Feeny 2010).

Long-term contracts could reduce flexibility, create unnecessary dependence and constrain alternatives. Similarly, it is possible to experience scenario where a vendor claims that certain aspects are not covered in contracts. A worse scenario emerges when it becomes apparent that an organization is dependent on a vendor. In such a case, the organization in question could become susceptible to the whims of the vendor. Another risk highlighted above rests on the relinquishing of in-house expertise.

The practice of outsourcing services predisposes an organization's employees to loss of expertise. It poses a serious risk regarding the loss of competences as well as critical skills. It is notable that the organizations that erect to outsource services stand a big chance of losing their position in regard to information technology capability. It reduces their ability to exploit IT-related opportunities (Barney & Hesterly 2011). The potential loss of organizational learning as well as a decline in the innovative capacity is a major shortcoming associated with outsourcing (Barney & Hesterly 2011).

In practice, organizations learn as they execute various projects or processes. Hence, outsourcing certain tasks denies the opportunity to learn by literally passing it to another organization. Learning is best attained when the hands-on approach is used. Hence, by denying such an opportunity even the innovative capability of an organization is compromised. 2b.

Academic and Theories in Regard to Value Creation Several theories are relevant in regard to the process of outsourcing process.

Outsourcing is complex as it entails a number of activities that pose serious managerial dilemmas. It explains why numerous theories are applied to understand the outsourcing exercise. It is understandable that various phenomena are approached differently. Thus, it is not surprising that outsourcing has been examined using different theoretical approaches. Such authors as Gotttschalk & Solli-S? ther (2010) and McIvor (2011) have supported this position.

The first considered theory is the transaction cost economics theory. It is one of the most employed theories in regard to outsourcing. The theory is seen

as providing the best decision-making platforms useful to organizations in arriving at outsourcing decisions. Specifically, the theory offers a useful guide in terms of preparedness. The theory helps in explaining the contractual complexity that outsourcing entails. Business organizations appreciate the significance of decision-making (Barney & Hesterly 2011).

A decision to outsource is based on the understanding of economic costs that are involved in a transaction. Hence, the decision to outsource is beneficial in terms of reducing cost to both the recipient and the offering organization. The Relational View theory is also crucial in explaining the concept of outsourcing. The theory focuses on how organizations gain and go ahead to sustain a competitive edge (McIvor 2011). The primary concept of the theory is the relational rents (McIvor 2011).

Under the concept, firms choose future inter-organizational partners as well as preferred relationship types. Organizations which encourage outsourcing have an opportunity to build strong relationships as well as foundations of prosperity. In business, the role of associations is critical, an aspect that enhances the chances of attaining and sustaining a competitive advantage. The concept “core competencies” was developed with the help of resource-based theory. According to Pati & Desai (2010), core competencies reflect the collectivity of an organization with specific reference to the coordination of diversity in the production skills as well as managing multiple technologies.

The concept is highly applicable to the outsourcing process. In practice, an organization that is able to manage its relationships well is better placed in

its pursuit for success as organizations work in an environment where working with others is necessary. In order to progress in an environment of interdependence, the role of coordination assumes further significance. From the relational point of view, outsourcing is critical since it helps organizations to learn from others. Also, outsourcing is helpful since competence is vital in the process (Feeney et al 2011; Levina and Ross 2012). From the above realization, further probing of the resource-based theory is necessary.

The basic attribute of the theory is that both capabilities and resources differ significantly among organizations. Barney and Hesterly (2011) opined that such variations could be stable. Due to the differences, mixing resources and capabilities and deploying them properly could be essential for obtaining a competitive edge. Thus, the resource-based theory rests on the view that firms which do not have adequate, valuable, inimitable, and rare capabilities and resources have to seek external providers to overcome such weaknesses. Also, it is notable that organizations have a number of goals that they seek to achieve.

Given the limited nature of resources, working with other partners is critical towards attaining such goals since such a move allows for maximization of resources. Evolutionary economics is another theoretical perspective that is applicable to outsourcing. The theory borrows heavily from Darwinism. Also, it incorporates assumptions modeled to fit economic species. Andersen (2010) highlighted the assumptions as follows. The first assumption rests on the idea that agents, organizations or individuals, never have perfect information although they have to optimize locally as opposed to globally.

The agents' decision-making is bound by norms, rules, and institutions. The third assumption is that agents have the capacity and ability to imitate and learn. However, they can also innovate. The innovation and imitation process is characterized by high levels of path dependency and cumulateness. Nevertheless, the process is fraught with interruptions and occasional discontinuities. It is necessary to point out that the process of change as captured by the said assumptions is open-ended, non-deterministic, and irreversible.

It explains the high degree of applicability of the theory to outsourcing. The final theory considered is the agency theory. Jensen and Meckling (2011) indicated that originally, the theory focused on the association between stakeholders and managers. However, the relevancy of the theory has expanded on its applicability based on its emerging focus on the association between inter-firm subjects. Specifically, the theory concentrates on the vendor and the outsourcer. In this regard, issues which relates to the agency problem, adverse selection, moral hazards etc.

should be resolved using a bonding approach (Barney and Hesterly 2011). Thus, the question of handling organizational issues emerges. By solving issues of common interest, an organization enhances its capacity in terms of conflict resolution, an aspect that is integral to business progress. 2c. Theoretical Contribution relevant to Reducing Outsourcing Risk As pointed in the theoretical literature, various theories are critical in explaining the outsourcing process.

The first theory considered was the transaction cost economics theory. The theory provides the best decision-making platforms to make outsourcing decisions. Small and medium enterprises appreciate the implication of decision-making. A decision to outsource is made based on the understanding of the economic costs that are involved in a transaction. Therefore, the decision to outsource is beneficial in terms of reducing costs to organizations.

Since the SMEs in Singapore need to maximize their value, outsourcing is critical in regard to cost reduction. The Relational View theory was also assumed to be crucial in explaining the concept of outsourcing. The theory gravitates around how organizations gain and maintain a competitive edge. In business, gaining and retaining a competitive edge is significant for reducing risks associated with a contracting and highly competitive market. Under the “relational rents” concept, firms choose future inter-firm partners as well as preferred relationship types (Davies 2011).

Also, it is significant in attaining and sustaining a competitive advantage. The resource-based theory recognizes that capabilities and resources vary greatly among organizations. Due to the variations, mixing resources and capabilities and could be essential towards improving an organization’s competitive edge. It is notable that Singaporean organizations have a number of goals that they seek to achieve. Given the scarcity of resources, cooperating with other partners is critical in the pursuit of such goals since it allows for the maximization of resources.

Evolutionary economics is another theoretical perspective that is considered. The theory incorporates various assumptions considered critical in outsourcing. Evolving is necessary for organizations that seek dominance. Hence, in the Singaporean context, organizations that encourage change stand a better chance of progressing than those that do not. According to this review, the theories are helpful in understanding how outsourcing helps organizations in Singapore to reduce or mitigate business risks.

2d. Impact and Rationale of Using Outsourcing (Why outsourcing) Singapore is a tiny country found in the South-eastern part of Asia. In the 1960's, Singapore was a developing nation. However, the country has managed to transform itself from that state to a modern state at the current time. The country recognized that to attain growth and development, it had to extrapolate itself from the past. Its new economy has three main features: intangibles, speed, and connectivity.

When referring to connectivity, the focus is on how the economy is linked electronically. The link also reflects on countries, companies, products, and people. Speed centers on the capability to be ahead of competitors. Thus, differentiating oneself becomes the primary goal. Apart from enjoying a high level of literacy, Singaporeans have a high rate of comprehension on computer knowledge.

The World Competitiveness Report of 1994 put Singapore in position one across the globe in regard to computer literacy (Copeland 2011). In Singapore, the government has remained a strong advocate of outsourcing. It is manifested in the manner in which the state has adopted the approach

of handling its business. As Rowthorn & Coutts (2010) opines, the government agencies do not only outsource IT applications, but it also outsources the maintenance of the same systems. It has spread to such sectors as the manufacturing and banking and sectors. The primary motivation for the adoption has been to consolidate their business positions in their respective industries (Baldwin 2010).

Also, it is notable that the trend in Singapore is that outsourcing of specific information technology components. However, there is an emerging scenario where entire business processes and operations are being outsourced (Parry & Roehrich 2009). Technology continues to become more of a good/commodity as the technologies that are integrated into various organizations are becoming increasingly similar (Lawrence 2011). Thus, developing the customized platforms depending on specific needs of an organization have taken a back seat, as the drive to acquire ready solutions gain widespread acceptance. Although the approach is cheaper and faster, the organizations that adopt readymade solutions run a big risk (Hira & Hira 2010).

The risk is borne out of the notion that adopting a technology just because it was successful elsewhere does not guarantee similar success. Since a technology is proven, it would work anywhere for as long as the implementation is done well. However, this might not always be the case since circumstances differ within organizations (Koulopoulos 2010). Thus, some form of customization could be required. Thus, a risk in outsourcing could be the failure to replicate the anticipated success.

Despite the risks posed by outsourcing as mentioned above, small organizations such as SMEs do not have huge resources to run every project (Buchholz 2010). For instance, in case that there is a need to implement a new project, it might become necessary to hire new employees. Such an exercise would call for mobilization of gargantuan resources beyond the organization's capability. In such instance, outsourcing proves an easier option for launching and completing projects. Still, there is a possibility that the SMEs with their limited capability may be unable to recruit and retain highly skilled workers (Weidenbaum 2012). In this respect, outsourcing helps in reducing the risk of project execution since it guarantees the provision of expert services at an affordable rate.

Industry Example Besides the active role that the government of Singapore has played in other sectors of the economy, it focuses its energies on the SME sector. Often, the government has urged the sector to adopt e-commerce as a way of obtaining a competitive edge in business. The main approach has been to ask the SMEs to use readymade packages offered by various e-commerce service providers (Easterly 2012). Such move shows how outsourcing is used by SMEs to bolster their positions. Outsourcing is a faster and cheaper way that allows the SMEs to access a wider pool of service providers as well as consumers of their products. The main advantage is that businesses are able to enjoy the benefits of ready-made products and markets.

Thus, primarily they are in a position to escape the risk of developing software or a platform that could failure to the inability to suit into a business or any other reasons such as inadequacy of funds (Stiglitz & Charlton 2012).

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Equally, the risk of wasting time on developing a program that might never work is eliminated. Time is a critical success factor. Hence, the risk of losing time on developing software is reduced since businesses get an opportunity to outsource programs from tested and proved service/program service providers. 2e.

Summary The paper focuses on outsourcing in regard to small and medium enterprises in Singapore. Outsourcing entails businesses or entities procuring given services from others. The central theme is that small and medium enterprises do not have the kind of resources necessary to carry out each activity effectively. Moreover, it is also observed that the possession of adequate resources do not necessitate carrying out each exercise. Thus, the role of outsourcing becomes more significant.

Although outsourcing has its advantages, adopting the approach predisposes organizations to certain risks as discussed in the paper. In brief, this paper focuses on literature review and arguments on outsourcing, the impact and rationale of using outsourcing, theoretical contributions relevant to reducing outsourcing risks, and relevancy of the theories in regard to value creation.