

## Outsourcing. The Concept

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**Abstract.** *In the last two decades, an economic phenomenon took place, phenomenon characterized by the transfer of manufacturing activity from the developed countries to those in developing process. This practice can be considered as the response found by the large companies to the problem of production costs that were in a continuous rising, concomitant with the rising of living standards and remuneration.*

*This paper aims to analyze the concept of outsourcing in terms of its evolution, but also in terms of incentives, ups and downs associated with the concept. On the other hand, this paper seeks to capture the fundamentals of this concept veracity and whether it could be implemented in the public service.*

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**JEL Codes:** G31, G33, L25, L26.

**REL Code:** 17G.

## 1. General considerations

The concept of outsourcing came from the American terminology “outside resourcing”, meaning to get resources from the outside. The term was later used in the economic terminology to indicate the use of external sources to develop the business, which typically were using their internal resources.

According to an article published in *The Economist*, Tim Hindi stated that outsourcing is an old phenomenon that has made its presence felt since the time of the Second World War, knowing a remarkable trend especially after 1990. According to some estimates, in 1946 only 20% of the value added of US goods and services from external sources, 50 years later, the proportion has tripled, reaching 60%.

The same is repeated by Rob Aalders, in “*The IT Outsourcing Guide*”, which supports the fact that outsourcing is not a new phenomenon, that even now 50 years companies have outsourced advertising, legal services, maintenance and production (Aalders, 2001, p. 38).

A. Duhamel and B. Quélin say that outsourcing is often accompanied by a transfer of material and human resources to the chosen provider. It has the task of substituting domestic services in a medium or long term relationships (on average five-six years) with the customer enterprise (Quelin, Duhamel, 2003, pp. 647-661).

Although outsourcing is seen by many as a future trend, which brings many benefits to the partners, yet there are voices that question the effects of this phenomenon. Henry Kissinger is one of them, making some sarcastic comments on outsourcing during a lecture at Las Vegas, wondering if America will still remain a great power or at least a dominant one in the context of the growing importance of outsourcing. He is joined by Gary Hamel who is aware of the changes taking place in the world, and the speed of these changes. He says in the book “*Leading the Revolution*” that the world is aware that we have entered a new era dominated by major changes, but the question is whether we like these changes.

In recent years, the specialty literature was focused increasingly on outsourcing strategy when addressing the topic selected design variant. The plan for the development of a system is found and the option of outsourcing and as well as how this solution can be used during any project to implement the system. If in the choice of outsourcing routine activities, accounting, human resources, marketing things are relatively clear and can call on previous experiences in the systems development quite a few problems appear, due to demanding requirements of clients, lack of experience leading to difficulties in

selecting the strategy that best meet business objectives (Outsourcing Institute, 2002).

Studying the views of the authors, we could identify the following options for outsourcing, given the multiple criteria of classification (Wilcocks, Fitzgerald, 1993, pp. 201-217):

- The proportion of outsourcing: total, selective, partial.
- Outsourcing can be applied in: human resources, project development management, and service management.
- The outsourcing contract can be: general, transitional or of an economic process.
- The type of outsourcing relationships can be described as: one provider - one customer, one supplier more customers, some vendors - a client or several vendors - more customers.
- The period of outsourcing can be on long term or short term.
- Location of the supplier is local, international (offshore) and regional (near shore) - closer to the customer.

The phenomenon of outsourcing generally refers to procurement of materials and services inputs by a firm from a source outside. In this context, outsourcing can be both internal and international.

Internal outsourcing is the purchase by a company of services or material inputs from a source located in another firm within the same country.

International outsourcing is defined as the purchase by a company of services or material inputs from a source located in another country. This term includes both intra-firm international outsourcing (by which foreign supplier of inputs is still held by the firm), and distance international outsourcing (by which foreign supplier of inputs is independent of the company that uses inputs). International outsourcing is part of imports of goods and services of the country. Another term often used for international outsourcing is "off shoring".

International outsourcing is mostly used by firms in advanced economies, which directs part of the work by companies located in developing countries in particular to reduce costs.

The novelty at this time in the field of outsourcing is that it has gained momentum in the services. For a long time the service sector was considered impenetrable to international competition. With improved communications technology, such as the internet, services can cross political borders via the airwaves, getting at the same time, access to cheap labor, but well prepared.

Although outsourcing may be expected to bring long term benefits, there may be adjustment costs in the form of job losses, a process visible especially at the microeconomic level, since even in the advanced process outsourcing service is started.

## **2. Incentives of outsourcing**

There can be seen some factors that influence changes in the world and, at the same time, make outsourcing attractive to business people around the world.

Globalization and competitiveness forces companies to find better ways to develop and use the technologies of information to obtain competitive advantages and increased performance. Development of information systems has become increasingly expensive, requiring human resources skills and competencies growing, highly trained and professional. To cope with fierce competition, companies must be efficient, to provide products to market on time and within a budget as small. Moreover, the requirements and preferences are in a continuous change. In response to these challenges, companies are trying to transfer the responsibility of having specialists, facilities and equipment to a third party, localized mostly in developing countries where there is great potential for human and multiple opportunities, which favors the development projects in a short time and at minimal cost.

Professor Michael Porter says in one of his books, "Competitive Strategy", that the effect of globalization can generate cost savings (or cost of energy production), and reducing distribution channels. "Part of this reduction may be caused by aggressive companies multinationals to spread their techniques throughout the world. Thus, Porter argues that, 'regardless of case, globalization leads to reducing impediments to global competition'" (Porter, 1980, p. 86).

Although outsourcing can talk about now since a few decades, however, this phenomenon was only introduced in the field of strategic management in the 1980s, and this is due to Professor Michael E. Porter and Professor Charles Handy, both bringing into question how a company should establish strategies and how important is the company to focus on the skills they have and to outsource the rest, generating cost savings. However, more diversified product lines and services and a greater flexibility and differentiation from other producers in the market.

Prahalad and Hamel believe that sometimes, short-term outsourcing can bring some benefits, providing a shortcut to a more competitive product', but consider that this does not allow creation of the necessary abilities to maintain competitive advantage gained.

## **3. Pluses and minuses of the concept**

When we talk about the pluses, we can immediately think of the employees of the provider who are offered permanent trainings in their field.

According to Mark Power, Kevin DeSouza and Carlo Bonifazi, outsourcing is a strategic tool used by organizations to achieve competitive advantage.

The unfavorable economic context determines the large companies to outsource business processes in the main line, thereby sacrificing a part of control over resources and information to reduce costs. The level of savings made by outsourcing companies can reach 10 to 15% on the total cost, mainly due to economies of scale.

Besides financial considerations, there are some advantages of outsourcing, such as increased focus on core processes, access to resources not available internally and standardizing processes. On the other hand, there are some concerns about outsourcing, and organizational strength, loss of control and doubts about the quality and performance.

Outsourcing initially a preferred option for small businesses and non-collateral sufficient to support activities of their specialization, in recent years has become a solution for medium and large firms.

A study made by the Economist Intelligence Unit (EIU) shows that the countries of Central and Eastern Europe, along with those of North Africa are becoming favorites for displaying the following destinations centered outsourcing, especially for companies based in Europe. According to EIU, India is becoming increasingly expensive, and European companies want countries that have a greater cultural affinity.

In Romania, the market began to grow in 2005, once the multinational IT outsourced services to local subsidiaries.

Companies hire sub-contractors when it needs additional staff and delegate them to undertake short-term activities. Outsourcing projects is made due to lack of resources and expertise of the company.

### **3.1. Advantages**

In Romania and in Eastern Europe, the process of outsourcing is a relatively new phenomenon, which is viewed with skepticism and considered by many to be one full of risks. In highly developed countries, things are better defined, and outsourcing, in some cases, is considered a natural and necessary process in improving the situation of the company.

The Outsourcing Institute, a strong voice in the field of outsourcing, have built a top 10 reasons that a company would have to resort to such services:

1. Cost reduction and operations control;
2. Improving company focus;
3. Gaining access to the various possibilities;
4. Free internal resources for other purposes;

5. Resources are not available within the company;
6. Accelerate the benefits reengineering;
7. Driving is expensive for some time;
8. Employment equity becomes available;
9. Sharing risks;
10. Capital injection.

There are also additional benefits such as specialized, complete, professional solutions ease of installation and configuration, integrated applications, powerful, flexible and secure, increase accuracy, productivity and efficiency, reduce or even eliminate storage needs.

Also, outsourcing brings benefits at the macroeconomic level, directing capital flows to developing economies in the process. These capital flows materializing by building units of production and in creating jobs, helping to raise living standards and sustainability of these economies primarily by reducing unemployment rate and by increasing the gross domestic product.

### **3.2. Disadvantages**

Of course there are also disadvantages, as in any association in which one of the basic conditions is a compromise.

One disadvantage is lack of knowledge of his client outsourcer environment, both internally and externally. Of course, with good collaboration, communication and patience, this impediment can be easily removed.

A second disadvantage would be an incorrect definition of the objective of outsourcing an activity, after a serious analysis of the outsourcing decision. Decision must be made taking into account both benefits and other considerations.

From these considerations we can remember poor alignment of objectives, response time and quality, with control by various methods pre supplier, and the difference in mentality between “the company employees” and “outsourcer colleagues' level of personal pride to compensation packages.

Outsourcing results are not immediate. Most organizations had a 20% decline in labor productivity in the first year of an outsourcing contract, mainly because of time spent on knowledge transfer to the outsourcing provider. After bringing their customer and supplier knowledge and goals, they can work together more effectively, thereby generating cost savings.

At the macroeconomic level, the disadvantages are more pronounced for advanced economies, because the outsourced activities are transferred to a different economy, and along with it and jobs, leading to a diminution of the living standards and an increasing at least on short-term of the unemployment rate.

## Conclusions

In the analysis made in this research paper, we concluded that with the market liberalization in developing countries, large companies from developed countries have found a way to reduce costs by redirecting part of their production to subsidiaries or partners of these areas. The strategy adopted by these big companies, brought reductions of their cost production of approximately 20%, thus encouraging them to emphasize the increasing globalization with outsourcing practices.

Therefore, these practices have contributed greatly to accelerating the process of globalization, interconnecting developing economies with the already developed countries (USA, UK, Germany, Japan, etc.).

Comparing the pros and cons of the concept of outsourcing, we see that the balance tilts in favor of micro-level benefits of implementing this concept, while at the macroeconomic level we can speak of a balance between the losses suffered by the advanced economies and the benefits of developing economies. In this case we can talk about a global redistribution of income, from developed economies to developing economies.

As to the second objective of this article, the possibility of implementing the concept of outsourcing in the public service, given the macroeconomic costs caused, we believe to deepen these issues is necessary, although the world has some successful examples of outsourcing of public services (health system in the United States and part of the education system in the same country).

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