

Outsourcing Business Activities: A Decision Tree for Systematic Evaluation

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Abstract

In today's rapidly evolving market, it is difficult for startup companies to survive if they do not have a high-growth profile. Scholars believe that either the startups expand rapidly to capture major market segment or they slowly die out. Large companies usually outsource non-core activities to invest additional resources in the core activities, whereas, expanding startups have limited flexibility and have to outsource business activities in order to survive the high-growth expectation of the market. With limited resources at the entry level, startups certainly have no other choice except outsourcing business activities. There are various advantages and disadvantages of outsourcing depending on the business the company is operating in. Various companies fall into the trap of outsourcing activities that are important to keep inhouse. The present study offers a decision tree comprising the most critical parameters that enables the user to differentiate activities to be kept in-house from those to be outsourced. These parameters include measuring the business activity on the basis of standardisability or specifiability, receiving input for innovation, establishing proper barriers to entry in place, and keeping correct contract agreements setup with the suppliers.

Keywords

Outsourcing, Decision tree, High-growth startups

1. Introduction

Business owners have been practicing outsourcing for a long time. Managers outsource business activities not only to capitalize on labour costs (Tate et al., 2009) but also on offering products and services that are not within their capability. Activities that are not core activities are outsourced to gain maximum competitive advantage (Sharpe, 1997). Companies hire suppliers that manage non-core activities; therefore, the overall efficiency of the organization increases that provides the possibility to invest more of the available resources in the core activities. Thus, it is important for organizations to consider the option of outsourcing (Tayles and Drury, 2001).

Outsourcing is dissimilar compared to other major business trends such as servitization (e.g., Tauqeer and Bang, 2018), personalization (e.g., Kavadias et al., 2016), and sharing economy (e.g., Zervas et al., 2017) etc. because outsourcing primarily focusses on organisation capability whereas other business trends are customer oriented.

Our literature review reveals various advantages of outsourcing business activities. Outsourcing enables companies to become agile to market disruptions and provides the capability to quickly adapt to market changes (Dess et al, 1995; Moore and Barnett, 2004). It enhances the core capabilities of the organization and the overall competence level (Blumberg, 1998; Quinn, 1999). Cost efficiency through offshoring (Oshri et al., 2015) and avoiding vertical organizational bureaucracy is achieved (Lei and Hitt, 1995; Robinson, 2001). On the other hand, the demerits include the dependency on suppliers, and losing control such that the suppliers become the bottleneck and start controlling the business (Cullen et al., 2006). In several cases, suppliers become competent enough and started marketing the products and services independently. Hence, companies need to trade-off between these merits and demerits, to decide what to outsource.

Established companies generally have the manoeuvrability to strategically inhouse or outsource business activities. However, many startup companies have to primarily rely on outsourcing in order to become a high-growth company.

Kutcher et al. (2014) emphasised that in the modern time high-growth is necessary for startup companies to remain in the market; else, they would eventually lose their marketplace. For startup companies, achieving the required independent high-growth is nearly impossible and outsourcing is a viable option that can contribute in achieving the set target. Several scholars discuss demerits of outsourcing and recommend businesses to avoid it (e.g., McIvor, 2000). However, startup companies do not necessarily have a choice. The authors of the present study believe that outsourcing is nearly essential for startup companies to achieve high-growth but the startups need to systematically determine what activities to outsource in order to avoid pitfalls that can prove detrimental for the company at a later stage.

McIvor (2000), through his systematic model, highlighted not to consider outsourcing as a short-term cost reduction method, rather embed it in the strategy of the company. The four stages of the model include defining core activities, evaluating value chain, total cost analysis, and relationship analysis. Rouse and Corbitt (2004) determined outsourcing as a nearly irreversible process. It is difficult for organisations to insource processes that are already outsourced. Ruiz-Torres and Mahmoodi (2008) have proposed a model for manufacturing supply chain. They conclude that the outsourcing decision is sensitive to the supplier reliability, cost of lost production, and the replacement ability of the manufacturing network.

Won (2015) studied the influence of entrepreneurship related to insourcing and outsourcing in decision-making. Doval (2016) has reviewed key strategic aspects of outsourcing and concluded that geography, competition, IT development, organisational structure, fiscal regulations, and cost of human resource are the six factors that facilitate in carrying out decision for outsourcing.

The objective of the present study is to propose a tool for startups to evaluate business activities that can be outsourced.

2. Decision tree for outsourcing evaluation

The most critical factors that need to be taken into consideration while deciding to outsource business activities by startup companies are shown as a decision tree in Figure 1. This tree has been established conceptually by considering academic literature and the cases of various companies. It starts with the selection of a business activity that is to be evaluated. Common business activities in a company, as described by Porter's value chain (Porter, 2008) are marketing, production, logistics, research and development etc. The present study argues that the most important factors that need to be kept into consideration while outsourcing business activities are measuring standardisability or specifiability of the activity, receiving input for innovation, having barriers to entry in place, and correct contract agreements setup with the suppliers. The decision tree is explained as follows.

2.1 Standardisable or specifiable

Standardisable activities are the ones that can be explained through a set of instructions and can be communicated to the potential vendors. For example, the accounting of a company is a fairly standard activity and the activity follows defined rules that should give the same results independent of who actually does it. Various companies have outsourced standardised production processes to the vendors. The objective behind standardisability is that the standardised activities can be well communicated to various vendors, and the performance of the vendors can be monitored and compared. Standardisability is directly linked to vendors' capability enhancement. Outsourcing of known standardised activities such as accounting, IT support or the production of commoditised products does not enhance capabilities of the vendor significantly, and such activities can be outsourced with less concerns. Contrarily, manufacturing of highly sophisticated equipment should not be outsourced as their production processes have not been standardised and can probably significantly enhance vendors' capabilities. This could result in vendors themselves become competitors or introducing new competitors. Therefore, standardised or standardisable activities can be outsourced with less concerns compared to nonstandard activities as strategically they may lead to introduction of new competitors. Another challenge is that non-standardisable activities cannot be well communicated to different vendors and the performance is difficult to monitor which may be leveraged by the vendors. Non-standard activities include for example research and development. It is difficult to assess the performance of a vendor carrying out research and development. Some aspects within research and development can be standardised and thus outsourced for example data collection or conducting experiments.

Activities can alternately be outsourced based on the agreed specifications. For example, marketing can be outsourced with the specification of number of customer acquisitions at an agreed price. Similarly, production can be outsourced against delivery of number of products with the agreed specifications. Specifiable outsourcing is comparable to procurement. However, procurement is generally attributed to procuring commoditised items available off the shelf whereas specifiable outsourcing is the process of reaching out to vendors and get them to deliver specified output.

For activities that are neither standardisable nor specifiable, like the mentioned research and development, there can sometimes be other options for leveraging. Establishing partnerships is a potential way to outsource such activities but it generally emanates with distribution of equity in the company. It also lacks the flexibility outsourcing gives. Normally standardisability or specifiability ensures quality of the output from the suppliers and the suppliers that cannot deliver as per agreed standard or specification can be changed out.

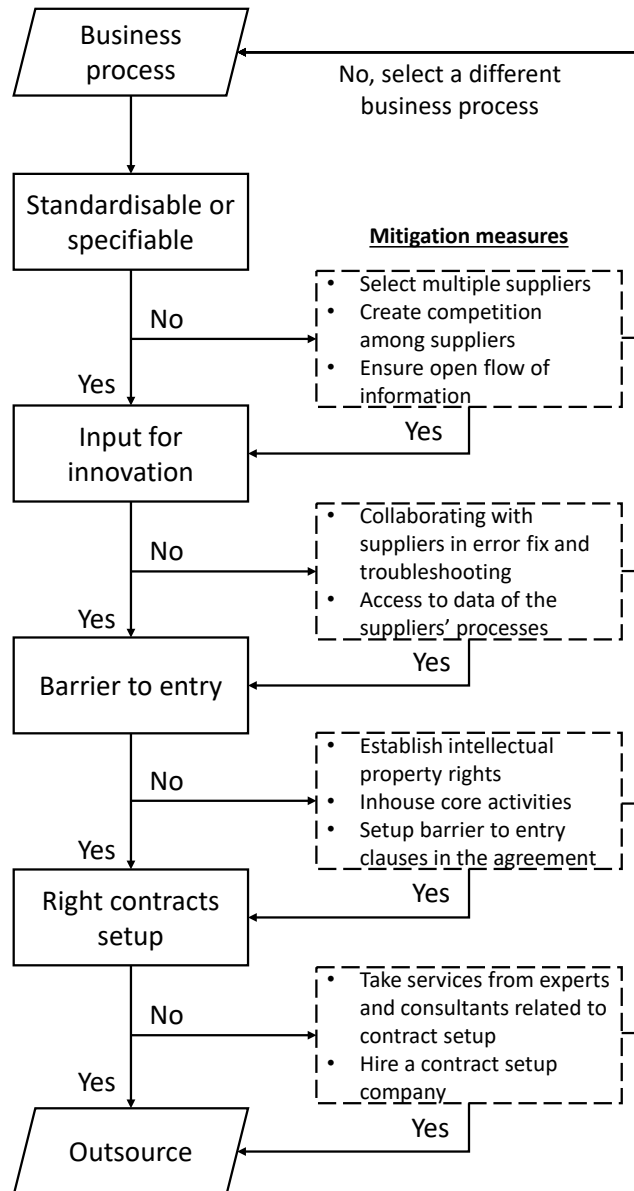


Figure 1. Decision tree to evaluate business processes that can be outsourced

2.2 Input for innovation

Studies significantly regard innovation as the forefront of sustainability of the companies. Outsourcing can be a key hindrance to innovation especially when major business processes are outsourced. Generally, organisations innovate by acquiring tacit knowledge of the business processes. Therefore, ensuing input for innovation is a key concern while outsourcing business activities.

Input for innovation becomes irrelevant if non-core activities are outsourced e.g., IT support. However, when major business processes like production are outsourced, input for innovation becomes a significant concern. Recently production intensive companies like automakers have adapted to acquire input for innovation despite outsourcing production by obtaining data from the vendors and deploying their engineers at various levels of the production facilities of the vendors (Becker and Zirpoli, 2017). Before deciding to outsource a business process, input for innovation shall be addressed. Else, the company may lose competitive advantage over time.

2.3 Barrier to entry

Another concern while outsourcing business processes is barrier to entry. Vendors can gradually become better and can originate as potential competitors. Various examples in electronics industry exists where the suppliers started offering the same products and services as their clients. This challenge can be lowered through intellectual property rights such as patents, trademark and brand. However, strictly speaking, patents provide some protection to the potential entrants but it is often possible to go around them. A portfolio of patents around the business may serve the purpose. Protection in terms of brand also requires massive marketing costs and significant duration to be well established. Barrier to entry is business dependent and varies across businesses and business activities. Therefore, the major concern is that the barrier to entry shall be carefully considered before outsourcing a business activity.

2.4 Right contract setup (other risks)

Contracts setup is among the critical concerns while outsourcing. Through the establishment of a suitable contract, barriers to entry and input for innovation can be ensured. It is vital to set up a contract with the vendors that provides protection against various other risks. Such risks include for instance, sharing data or information to third parties and/or exploitation of intellectual property rights. For startup companies, hiring consultants that have expertise in contract setup can be a useful way to mitigate various unknown risks associated with outsourcing of the activities.

3. Conclusion

Outsourcing has various advantages and disadvantages. However, for startup companies aiming to become a high growth company, outsourcing is nearly vital. The present study highlights four major parameters to be considered while determining to outsource business processes. They are parameters like measuring standardisability or specifiability of the activity, receiving input for innovation, having barriers to entry in place, and keeping correct contract agreements setup with the suppliers. The present study has emphasised that startup companies cannot overlook these foremost parameters while outsourcing business activities. These parameters are arranged in a decision tree with easy 'yes' and 'no' options so that they can be applied by the leaders of startup companies to decide which activities to outsource and which to keep inhouse.

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