World Wide Journal of Multidisciplinary Research and Development

WWJMRD 2015; 1(3): 26-39
www.wwjmrd.com
e-ISSN: 2454-6615

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Evaluating the impact of outsourcing on organisational profitability

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Abstract
According to Susarla et al. (2003) organizations turn to outsourcing for a number of reasons, the most prominent of which is cost cutting. Hindle (2005) supports this assertion when he stated that companies make the decision to outsource for a variety of reasons but cost reduction tends to be one of the primary drivers. Also, The Outsourcing Institute Membership (1998) sees financial justification as one of the top ten outsourcing success factors. Consequently, outsourcing is thought to be successful when such financial-economic expectations as the achievement of a cash infusion, cost reduction, production and transaction cost economies, lower prizes for consumers' financial slack or even tax advantages are covered (Outsourcing Institute Membership, 1998). Other benefits of outsourcing to companies as according to Hindle (2005) include maximizing resources, making service improvements and freeing up in-house staff to focus on more strategic staffing issues such as workforce productivity, leadership development and succession planning. Another common reason for resorting to outsourcing is a firm's desire to focus its resources on those activities that are considered its strengths, often referred to as core competencies (Susarla et al., 2003).
One of the complex and important business decisions facing firms today is whether to purchase from outside – Outsourcing. The Chartered Institute of Purchasing and Supply (CIPS) define outsourcing as "the process of identifying the most suitable expert third party service provider to undertake the management, administration and provision of the service in question". In other words, outsourcing is the act of one company contracting another to provide services that might otherwise be performed by in-house employees. Facilities management is a type of outsourced service in that it is the contracting out of all activities connected with the organisation and control of a facility such as catering or security.
The Chartered Institute of Purchasing and Supply (CIPS) suggests that the first stage in any outsourcing strategy should be to determine whether the service in question should continue to be run in-house or whether it should be outsourced to an external service provider. If the in-house service can be improved, perhaps by advice from external consultants or ideas from a benchmarking exercise, coupled with increased training and targets for greater efficiency, the in-house option may remain attractive. The benefits of determining the "outsource "decision at the outset i.e. not having the in-house team compete with external service.

Keywords: Material Sourcing, Outsourcing, Organizational Profitability

Introduction
Both the popular press and academic literature have recently covered the growth of outsourcing or contracting out, of business activities and its economic implications. While Heshmati (2003) in his recent survey points out that there is no general definition or measurement of outsourcing, he broadly describes it as "different kinds of corporate action related to all subcontracting relationships between firms and the hiring of workers in non-traditional jobs". Outsourcing may provide a viable strategy if firms aim to save on labour costs (Abraham and Taylor, 1996), exploit production differentials both within the services sector and between services and manufacturing or take advantage of globalization (Feenstra and Hanson, 1999). A fundamental question to ask is whether outsourcing is value enhancing and, in particular, whether the firm that undertakes outsourcing shows higher profitability as a result. Essentially this question renders down to the transactions cost question regularly posed to university undergraduates: should a firm manufacture its own inputs by some form of vertical merger or should it seek to obtain possibly more competitively priced inputs on the open market? While the viability of vertical mergers as a determinant of profitability is comparatively well researched, less work has been undertaken on the viability of pursuing a less integrated strategy.

A UK survey focusing on the benefits accruing to firms from off shoring services, found that 68 percent of firms outsource at least some services, the main motivation being cost reduction (Brooks, 2004). However, in a recent survey, 56 percent of IT specialists claimed that outsourced IT work was at least inferior to that produced in-house. More worryingly, 11 percent reported that the outsourced work actually induced a setback to the firm's production (Tafti M.H, 2005). Accordingly, in the popular press one appears to have arrived at a point where experts begin to question the validity of outsourcing as a long-term strategy or even short term as a cost reduction exercise. Information on the knowledge available shows that, there are only a very limited number of more rigorous statistical or econometric studies looking at this issue. The evidence that has been produced in such papers, however, suggests that the value-enhancing link between outsourcing and profitability is not clearly established. Specifically, Kimura (2002) does not find any evidence that subcontracting leads to higher profits in Japanese manufacturing firms. Differentiating between outsourcing of services and non-services inputs, Görzig and Stephan (2002) found that outsourcing of materials is positively correlated with profits, while there is a negative relationship between profitability and outsourced services for a sample of German manufacturing firms.

Literature Review

The traditional concept of firm, in which the different value chain activities are carried out internally, is being replaced by the idea of a network organisation or even a virtual organisation, in which fewer and fewer operations are performed within the firm (Burn and Ash, 2000; Georgantzas, 2001; Tetteh and Burn, 2001). An organization will always outsource some activities such as the supply of water and electricity (Beaumont and Sohal, 2004). According to Ching et al., 1996 only those functions which generate added value and represent the firm's competitive advantage must be performed internally, the rest of their functions are outsourced. Some of the activities in which firms most often opt for outsourcing at present are those related to information management.

Outsourcing is defined as "procuring of services or products from an outside supplier or manufacturer in order to cut costs" (Brooks, 2004, p. 4). According to Gonzalez et al. (2005) outsourcing means that the physical and/or human resources related to an organisation's functions or departments are going to be provided and/or managed by an external specialised supplier. Beaumont and Sohal (2004) also define outsourcing as having work that was formerly done inside the organization performed by an external organization. The vendor, hereafter the outsourcer and outsource are, respectively, referred to as vendor and client may be an independent entity or a wholly owned subsidiary. In contrast, insourcing means applying outsourcing's discipline to internal suppliers, often having them compete with external suppliers (Beaumont and Sohal, 2004).The outsourced situation can be temporary or permanent, and can affect the client firm's whole structure or only a part of it (Gonzalez et al., 2005).

Hindle (2005) asserts that outsourcing might seem to be a simple cost reduction option, but there are challenges to getting it right. Knowing what benefits to expect in the first instance and setting measurable performance indicators for both the client and the outsourcer are important starting points (Hindle, 2005). Also, incorporating critical success factors such as finding a supplier with the right cultural fit, defining the contract precisely, obtaining senior management buy-in, clarifying roles and educating employees, and installing a layered governance structure will help increase the odds of having a successful Human Resource (HR) outsourcing relationship (Hindle, 2005). Outsourcing is been embraced all over the world by firms that wants to cut cost and maximize profit.

Outsourcing has experienced a considerable growth in recent years (Caldwell, 1996; Currie, 2000), so much that some authors suggest we find ourselves in the "Outsourcing Era" (King, 2001, p. 15). The reasons why companies outsourced for services is varied. According to Fulford and Love (2004) development costs of training talent for specific functions in an organization is often cited in the literature as a major factor influencing outsourcing. The high price tag of training certain professionals has led many organizations to seek help outside their organization. The shortage of certain professionals in certain countries such as Information Technology (IT) professionals is another main reason in global outsourcing (Robb, 2000). The high quality of professionals of vendors as compared to those of the customer organization is another reason why companies outsourced (Levina and Ross, 2003). King (1999) asserts that tax incentives offered by some countries can influence certain companies in some countries to outsource in these countries. For example many US companies are taking advantage of attractive tax incentives offered by other countries such as Ireland (King, 1999).

Outsourcing and Profitability

Essentially outsourcing addresses the issue as to whether a firm should make or buy intermediate inputs; an issue that has a long tradition in economics, dating back to the seminal work by Coase (1937) on the boundaries of a firm. Since then, a large body of literature has been concerned with analysing the determinants of this "make-or-buy decision", focusing on the role of incomplete contracts, specific assets and transactions costs (e.g., Williamson, 1975, Grossman and Hart, 1986, Bolton and Whinston, 1993). In a nutshell, firms would prefer to "buy" as opposed to "make" as long as the cost of outsourcing is lower than in-house production. Hence, outsourcing can be used to economize on production cost, in particular labour cost (Abraham and Taylor, 1996) by substituting in-house production with the buying-in of components. The cost of outsourcing is not only determined by the price of the bought-in components, but also by transaction costs due to transport and incomplete contracting costs, and the possible implications of asset specificity for supplier and/or customer.

In a recent paper, Grossman and Helpman (2002) provided a comprehensive theoretical analysis of firms' outsourcing decisions. In their model, firms decide whether to be vertically integrated or to outsource production of components to specialised producers. This involves a search process, whereby final good producers search for subcontractors and vice versa. There is incomplete information – subcontractors cannot easily signal their quality – and therefore a potential for a hold-up problem arises. *Inter alia*, Grossman and Helpman (2002) show that the viability of outsourcing is determined by the distribution of bargaining power between the two parties involved, the degree of competition in the market, and the number of potential partners in the market.

Taking this as a theoretical background, one may expect that the benefits from outsourcing are not always the same, but in particular depend on the characteristics of the firm and industry in question. Large firms may be in a better position to achieve high bargaining power vis-à-vis suppliers and may hence be better able to benefit from outsourcing. Also, large firms may face lower search costs as they may be better established in the market and have better knowledge of competitors and suppliers than small establishments.

In terms of industry characteristics, if there are more potential subcontractors in the industry, if the bargaining power is tilted towards the final good producers, or if the level of competition is high among subcontractors, final good producers are more likely to find outsourcing a viable strategy.

In another studies by Görzig and Stephan (2002) who use German data for a sample of large companies to examine the benefits of outsourcing. They find that firms that engage in materials outsourcing experience benefits, in terms of increased returns per employee, while services outsourcing induces a negative effect on measured returns. This, they infer, is due to the non-transparent way in which outsourced services are priced vis-à-vis more tangible inputs. They conclude that while the markets for intermediate products appear to function, outsourced services may be subject to certain inefficiencies. In related work, Kimura (2002) discovers that poorly performing firms (low surplus to sales and low value added to sales) are more likely to use subcontractors, in an analysis of the Japanese machinery manufacturing industry. He concludes that profits are highest for those firms that do not get involved in any type of subcontracting, whether as a supplier or as an outsourcer. These results, accordingly, are in line with the findings for Germany by Görzig and Stephan (2002).

Benefits of Outsourcing

According to Susarla et al. (2003) organizations turn to outsourcing for a number of reasons, the most prominent of which is cost cutting. Hindle (2005) supports this assertion when he stated that companies make the decision to outsource for a variety of reasons but cost reduction tends to be one of the primary drivers. Also, The Outsourcing Institute Membership (1998) sees financial justification as one of the top ten outsourcing success factors. Consequently, outsourcing is thought to be successful when such financial-economic expectations as the achievement of a cash infusion, cost reduction, production and transaction cost economies, lower prizes for consumers' financial slack or even tax advantages are covered (Outsourcing Institute Membership, 1998). Other benefits of outsourcing to companies as according to Hindle (2005) include maximizing resources, making service improvements and freeing up in-house staff to focus on more strategic staffing issues such as workforce productivity, leadership development and succession planning. Another common reason for resorting to outsourcing is a firm's desire to focus its resources on those activities that are considered its strengths, often referred to as core competencies (Susarla et al., 2003). Also, Beaumont and Sohal (2004) opine that managers should apply their experience and knowledge to core competencies and outsource activities in which they are less competent and can benefit from vendors' expertise. Vendors can supply expertise and state-of-the-art technology (Benko, 1993) and increase the flexibility and quality of services (Antonucci et al., 1998).Organizations further support their outsourcing decisions by reasoning that vendors possess economies of scale that are unavailable to an individual firm (Barthelemy, 2001). Economies of scale can lower costs because a vendor can supply, run and update for instance software needed for a common application such as classically payroll and share registries (Behara *et al.*, 1995) and distribute costs over many clients. By purchasing services at a fixed cost per transaction, a client can avoid financial uncertainty (Beaumont and Sohal, 2004). Outsourcing data processing may lessen the probability of disruptions to services and/or the likelihood of being exposed to legal action (Strassmann, 1997, p. 194); it buys insurance as well as services from the vendor. One of the key reasons organizations outsource their activities is to tap into the extensive knowledge and technical experience that a vendor may offer (Tafti, 2005).

Moreover, variable and fractional demand of goods and services by the consumer market is another reason for outsourcing by some companies especially small firms as limited internal resources make coping with sudden changes in demand difficult (Beaumont and Sohal, 2004). Responses to increased demand for small firms usually lag demand as new capacity is acquired or new staff are recruited and trained hence the need for outsourcing. In addition, "Cultural differences can often cause friction between staff and management" and outsourcing may allow the "elimination of an internal irritant" (McFarlan and Nolan, 1995, p. 14).

Factors and Risk to Consider Before Outsourcing

Beaumont and Sohal (2004) assert that outsourcing is a hierarchical sequence of decisions with the decision as to whether or not to outsource a business process or function being the most fundamental. This is the most important of a sequence of actions and decisions listed in maintaining the relationship. Generally outsourcing projects are susceptible to various types of risks including financial, legal, and managerial control issues (Baccarini *et al.*, 2004; Shi-Ming *et al.*, 2004). As stated by Kliem (2004) the benefits of outsourcing cannot be achieved if the associated risks are not properly identified and managed. Without careful considerations of various risks associated with outsourcing, any gain can be more than offset by significant losses not only in financial terms but also in the areas of individual privacy and data security among others (Kliem, 2004). As stated by Tafti (2005) one of the most important components of any outsourcing deal is the contract. The contract describes the services that a vendor is to provide, discusses financial and legal issues, and becomes the blueprint for the life of the agreement. Because the contract obligates the firm and the vendor to each other, extensive efforts must be taken to ensure that every detail of the outsourcing arrangement is spelled out in the contract (Tafti, 2005). A single provider is often preferred to multiple vendors for a number of reasons. First, it is easier to negotiate a better agreement if a number of solutions are being bought from one vendor. It is also simpler to manage one vendor, so less time investment is required by internal Human Resources (HR) staff. Having integrated solutions across the company is also a huge benefit of having a single vendor, who is also better able to cater for a client's global needs.

The success or failure of the outsourcing agreement can depend on the choice of vendor (Barthélemy, 2001). For this reason, prior to contract signature, a detailed evaluation and selection of potential vendors must be carried out. As stated by Hindle (2005) it is better for companies to look for a single HR outsourcer that has mature solutions and can leverage deep industry expertise, as well as having a proven track record. The selection of one vendor can help firms develop true partnerships with vendors that will result in their business objectives being met. Having a good cultural fit is critical to the success of this partnership as it means any issues and problems that arise can be dealt with quickly because employees and HR executives understand what each is trying to achieve (Hindle, 2005). Barthélemy (2001) states that it is advisable for clients to analyse the stability, quality and reputation of the provider chosen, after all, technology or business conditions may change during the contract's validity period, which means it is necessary to count on the vendor's stability and quality along with his reputation to make sure the provider will be a suitable one. It is important for HR personnel to see if client and vendor have the right mixture of competences and know-how for the client's information needs to be met. It should equally be checked that the respective organizational culture and working behaviors of both parties fit at all levels (Diromualdo and Gurbaxani, 1998).

The Outsourcing Process

According to Hindle (2005) there is a set of processes that a company needs to go through before outsourcing any services. These processes are as follows as:

- Before selecting an outsourcing partner, a company needs to go through a rigorous process to establish what functions and processes should be outsourced. Any savings must be made in line with the company's HR and business objectives. The implications for staffing, technology costs and productivity impact across all employees must also be taken into consideration. A list of criteria should be identified for quantifying outsourcing decisions.
- Once a business knows what it wants from an outsourcing partnership it needs to find the best supplier. Key to finding the right partner is establishing which vendor or partner has the right cultural fit with the company's own business. This is because the HR outsourcing team will be an extension of the HR department of the firm. It is therefore critical that both client and provider understand each other's values, visions, processes and capabilities, and that they match sufficiently to make the relationship more workable.
- Next in the outsourcing process is the agreeing of the contract which is critical to all future work and outcomes. The outsourcing contracts should precisely define what is to be done and how. This should not be left to chance because the more specific and detailed the contract the fewer problems that will occur due to ambiguities. The contract should include the right performance indicators. If a company wants to show good return on investment it needs to benchmark all HR activities and set improvement goals. Clearly defined financial reporting and service performance measurements that are agreed upon and written into the contract provide the basis for evaluating the provider's performance and demonstrating return on investment.

Kern and Willcocks (2000) state that the provider's understanding of clients' objectives is very important to the success of the outsourcing programme. The same as it is important to make sure that the client knows what is sought through outsourcing; it must also be guaranteed that the provider knows client's objectives for outsourcing. Client-provider relationship management should basically focus on the provider's managing to achieve clients' aims (Kern and Willcocks, 2000). Suppliers that have a good understanding and an interest in the outsourcing firm's business will be better positioned to help define mutually beneficial goals (Behara et al., 1995) that turn out to be essential for the middle/long term continuity of an outsourcing relationship.

Methodology

Research Design

The study adopts both qualitative and quantitative approaches to research. The qualitative approach makes use of words and descriptions in investigating the research problem. The quantitative approach on the other hand expresses the data obtained in numerical form and analyzes them systematically to arrive at a conclusion (Anaman, 2003). The study will specifically undertake the following activities in order to achieve stated research objectives:

i. Identify persons in the target institution under study who will provide data for the study.
ii. Design questionnaires and interview schedules to collect adequate data relevant to answering research questions and study objectives
iii. Administer questionnaires (and conduct interviews where necessary) with target respondents in the informal sector
iv. Collate and sort all data gathered
v. Analyze data using appropriate tools such Statistical Package for Social Sciences (SPSS)
vi. Present, discuss and conclude on findings

Population and Sample Design

The target population consists of both multinational and local organizations currently operating in the country. However, for the purpose of using organisations which had outsourced vendors in the past, the study focuses on organizations located in Nation's capital Accra and where organisations were randomly selected to form the sample size.

Research Instrument

The main instrument for this study is questionnaires (see Appendix 1). According to Hannan (2007), the use of structured questionnaires brings standardization and uniformity in the presentation and answering of the questions to different respondents thereby reducing bias. The questionnaire which consists of both closed and open-ended questions was used to elicit information on the various outsourcing issues confronting these organisations. The effectiveness of the various outsourcing activities were assessed using the questionnaire and many other

Sources of Data

Both primary and secondary data sources were used. Trochim (2006) defines primary data as raw data collected on source which has not been subjected to processing or any other manipulation. Schoenbach (2004) also defines primary data as data collected for the first time and used specifically for the particular problem or issue under study. The main source of primary data in this study is the responses obtained from the structured questionnaires administered to the selected vendor organisations which were outsourcing on regular basis. This data are cross-sectional in nature since they were collected from the respondents at a single point in time.

The secondary sources on the other hand were mainly from published and unpublished articles, journals, textbooks, magazines, newspapers and internet publications on the subject matter. Sekaran (2003) defined secondary data as previous data collected and recorded by another researcher or organization, usually for different purposes other than the current problem or subject matter under investigation. According to Sekaran, secondary data is very important in research in that it helps to improve the researcher's understanding of the research problem, the various lines of inquiry to be followed and the alternative courses of action which might be pursued. Secondary data also helps in reviewing and relating the past researches conducted by other researchers to the subject matter under investigation. According to Scot (2008), blending primary and secondary data in research helps to improve the quality of the study.

Data Collection Method

The questionnaires were self-administered directly to managers and other high profile members of staff whose duty or mandate it was to outsource vendors from other institutions. This was to ensure that the people who answered are people who could provide solid information on outsourcing and the processes involved in outsourcing vendors and any other related issues.

This was appropriate because the respondents are literate and as such can read and understand the questions by themselves. Self-administered questionnaires also give respondents the privacy and enough time to respond to the questions. It also reduces interviewer biases that usually occur when questionnaires are administered with the assistance of the researcher. One disadvantage usually associated with self-administered questionnaires is high non-response due to the fact that most of the respondents end up misplacing their questionnaires. To avert this, the questionnaires were administered during the break hours of the respondents and responses collected immediately.

Prior to the main field data collection, a pre-test survey was carried out using three companies. The purpose of the pretesting was to identify and correct some of the problems that were likely to occur in the main survey. The pre-test survey uncovered respondents' understanding and general reaction to the questionnaires and helped in making the final correction on the questionnaire before sending them to the field. It also helped to assess whether the method of data collection adopted was appropriate for the study. The pilot survey also helped to examine the data analysis techniques used in the main research.

Data Analysis

The data collected were first edited and coded. Data coding entails the transformation of the edited raw data into numerical codes so as to facilitate the computerized data analysis. The coded data were then entered into the computer for analysis. The analysis was done using computer software called Statistical Package for Social Sciences (SPSS) version 16 and Microsoft Excel 2007. The study makes use of both descriptive and inferential statistical tools in the analysis. The descriptive tools used include frequency tables, bar charts and pie charts. The inferential statistics on the other hand involves the test of hypothesis.

Hypothesis Testing Procedure

H0: There is a linear relationship between outsourcing and profitability

H1: There is no linear relationship between outsourcing and profitability

Qualitative responses given to the questions on the need to outsource vendors and the extent to which this affect the profitability of the organization. These responses were scored by assigning quantitative values and encoding them into the SPSS software. The independent sample t-test was used to test for the hypothesis at 5% level of significance. The independent t-test is appropriate because both the outsourcing and profitability were measured from independent populations. The computed test statistic (t-value) value was compared with the critical value read from the critical points table to determine whether the respective null hypothesis stated should be rejected or not to be rejected.

Data Collection and Analysis

This chapter deals with the analysis and the discussion of the findings from the responses obtained from the questionnaires sent to the designated representative of the sample company Millicom Ghana Limited. Prior to the analysis of the data collected, the questionnaires were checked for consistency of responses. The objectives of the study were basis upon which this analysis was made.

Section A: Socio-Demographic Characteristics

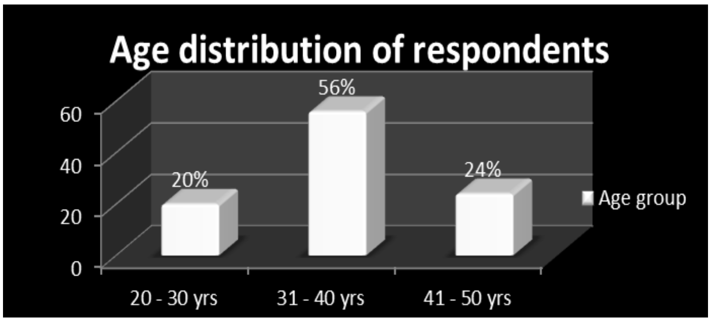

Fig 1: Data of total outsourced questionnaire Respondent – of their Age Distribution

Source: Author's Field Data

The age distribution of the respondents showed a very matured sampled. The least age group was the 20 – 30 years age group which represented 20% of the entire population size, followed by age group of 41 – 50 years which also 24%. The age group with the highest representation was 31 – 40 years which represent more than half (56%) of the entire population. The average respondent age was 37 years and the youngest respondent was 23 years. This is so because of the study target respondents who were directly involved in the outsourcing processes in the organisation or had enough information about the outsourcing process in the company.

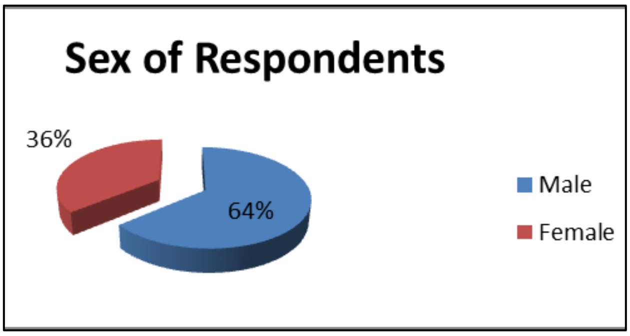

Fig 2: Data of Questionnaire Respondent Sex

Source: Field Data from questionaire

The pie chart above revealed that there were more males than female. The females formed 36% of the entire respondents while the males form 64%. Although the sex representation was not even, the selection was not international to be gender biased but to select individuals within a certain category to answer to specific questions and these were the people who qualified.

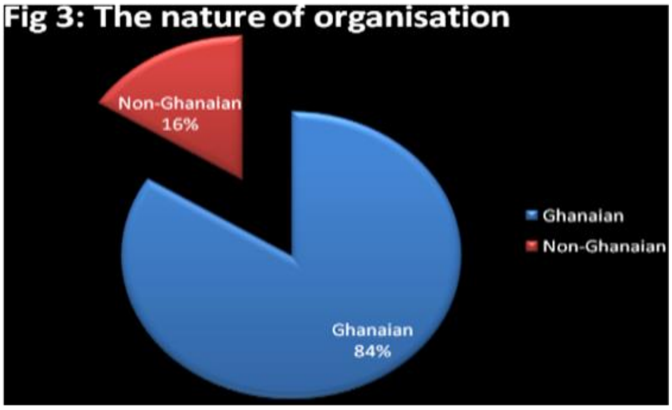

Fig 3: Data of the nature of Organisation

Source: Field Data

The results in the figure 3 shows that most of the respondent (84%) sampled were Ghanaians with only 16% been foreigners.

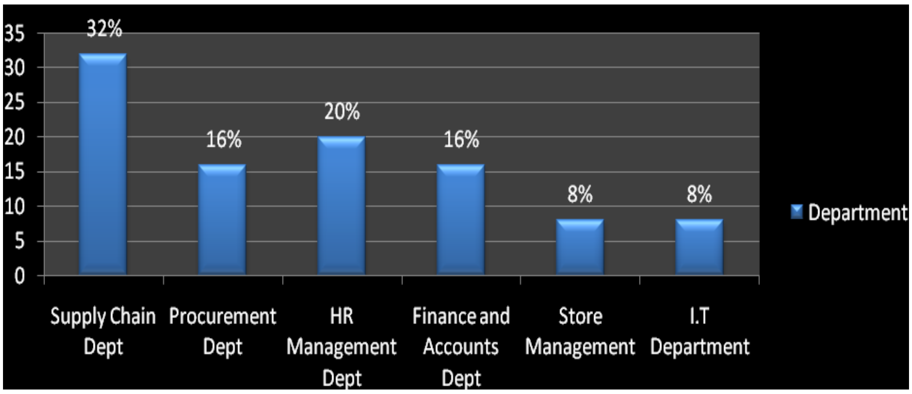

Fig 4: Operational Department of Respondents

Source: Field Data from Millicom Ghana Department

Most of the respondents (32%) were from the Supply Chain Department, followed by the Human Resource Department (20%). Both the Procurement and Finance and Control Departments had 16% representation whiles I.T and Stores Department had the least of representation of 8% each.

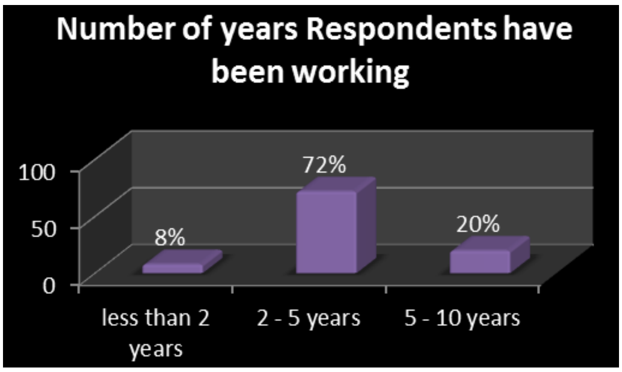

Fig 5: Respondent duration of working with Millicom Ghana Limited

Source: Field Data

When in it comes to working experience with respect to the respondents current position or department, the fig 5, indicates that majority of the respondents (72%) had been in their current department for at least 2 – 5 years. Only 8% of the respondents had been in their current position for less than 2 years whiles 20% have been in their current department for 5 to 10 years. This indicates that the respondents were people who were very experienced considering their years of working.

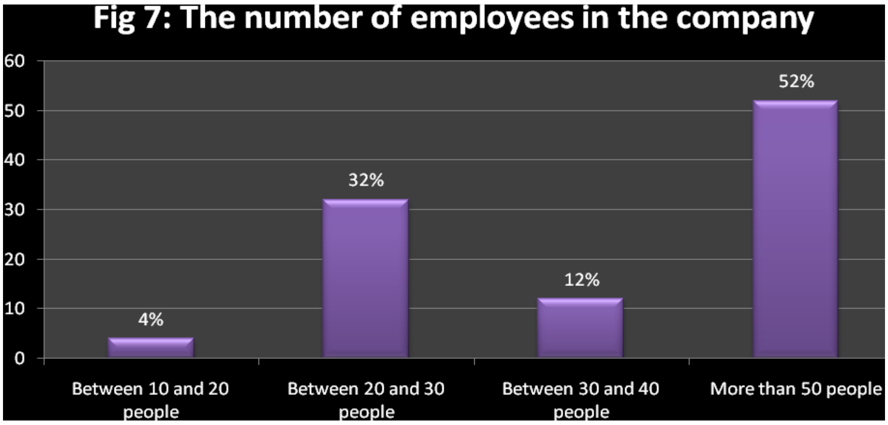

Fig 7: The number of employees in the company

Source: Millicom Ghana Limited primary data

More than half of the respondents (52%) had more than 50 employees, an indication of high numerical strength. About one-third of the respondents (32%) also had an employee number of 20 to 30 peoples. Whiles 12% of the companies had employee number of 30 to 40 people, about 4% of these companies employees about 20 people.

Section B:

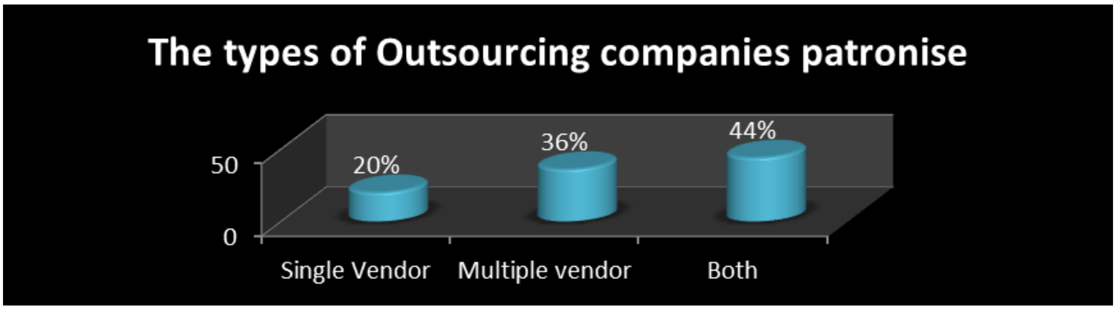

Fig 8: Determining the functions and process to Outsourcing Companies

As known already, all the company selected for this studies was a company who outsourcing
vendors for various kinds of services. So further questions were asked about the kind of vendor being outsourced and the most of the respondents (44%) said they were using both single and multiple vendoring so that they could benefit from both services depending on kind of services they require. Multiple single outsourcing (36%) was the second most preferred type of outsourcing. Single vendor outsourcing was the least patronised type of vendor outsourcing. What was clear in this submission was the fact that, the organisations did not have a specific vendoring type that they usually practice but rather were prepared to explore any type that will bring them the desired results.

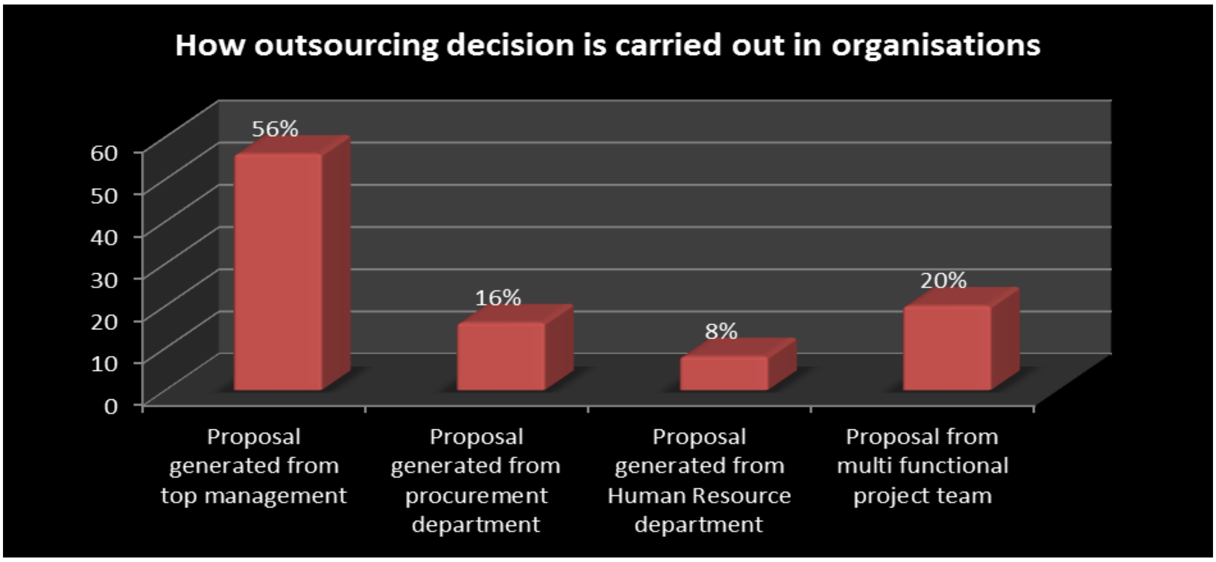

Fig 9: How Outsourcing decisions is carried out in organisation.

Source : Millicom Ghana limited field data of questionaire.

In the process of determining whether or not outsourcing was an option at any point, more than half of the respondent (50%) said that such a decision would always be generated from top management whiles 20% of the respondents also said with their company usually such a decision will be proposed by the functional team undertaking the specific project that requires outsourcing. However, some respondents (16%) stated that in their company, proposal to outsource a vendor will usually eminate from the Procurement Department whiles 8% said that the Human Resources Department in their organisation has always been the main proponents of outsourcing vendors whenever there is a major projects going on and they thick they team involved might need more hands.

Section C: How to Identify and Select Suitable Supplier

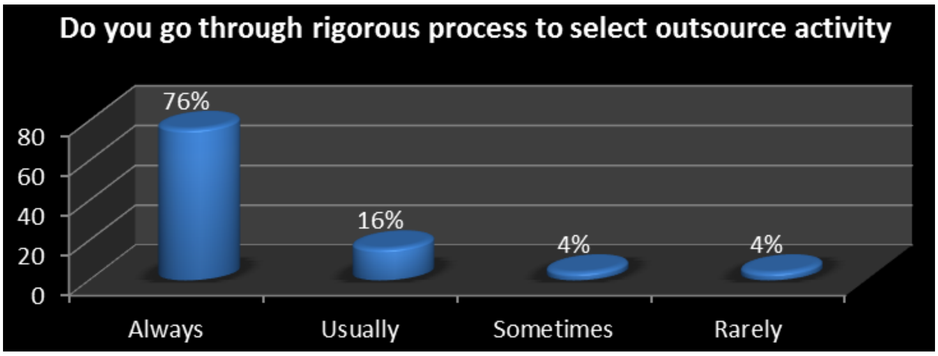

Fig 10: Do you go through rigorous process to select outsource Activity

Source: Field Data

When the participants were asked as to how often they select their outsource activity, about three-quarters of the respondents (76%) said they always go through rigorous process to select vendors for outsourcing activities. Only 4% said they rarely go through the process of selecting outsource activity. Again all the respondents said they have a list of criteria they use in arriving at outsourced decisions.

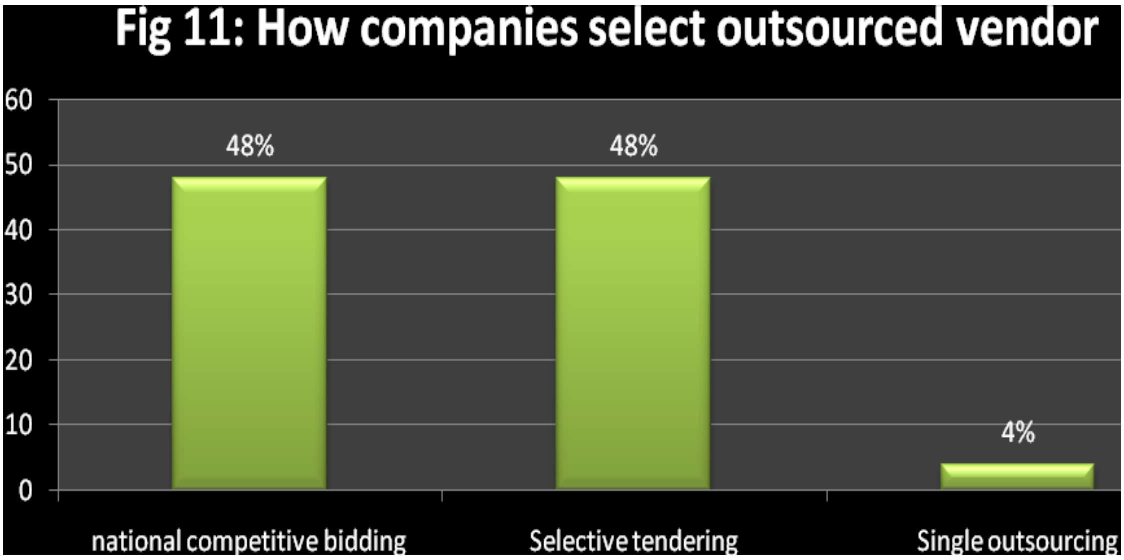

Fig 11: How Companies Select the Outsourced Vendor

Source: field Data

The use of National Competitive bidding and Selective tendering were the two most preferred methods of selecting vendors to provide outsourcing services to Millicom Ghana, although 4% of the respondents said the company would usually have a single outsourcing company. The use of National Competitive bidding to select an outsourcing vendor is the most common especially with government institutions as the constitution makes it compulsory for the award of contracts or outsourcing of services to be done through this process. The other multinational companies have also resulted in multiple or selective tendering were outsourcing vendors are made to bid and usually a committee is set up to select the vendor with the highest or competitive bid.

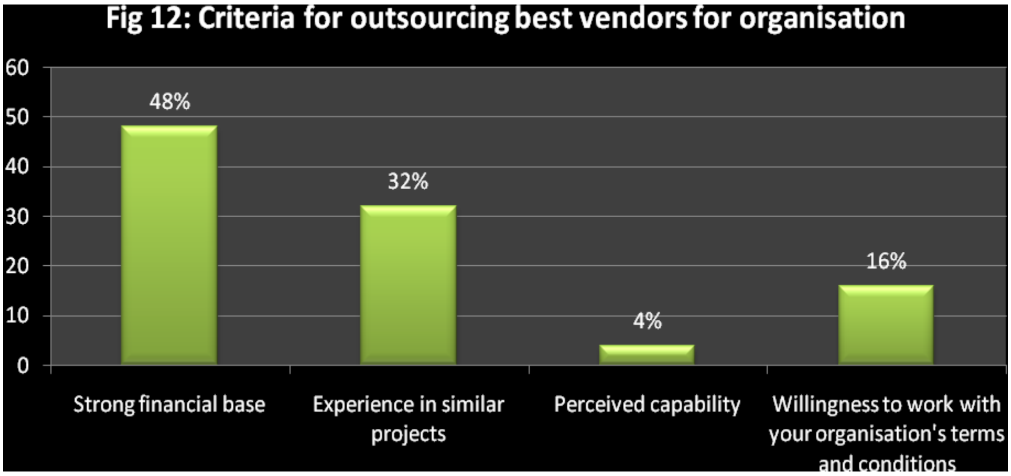

Fig 12: Criteria for Outsourcing best vendors for Organisation

Source: field Data from Millicom Ghana Limited

There are several criteria used in selecting a vendor for outsourcing. The fig 12 reveals that amongst the many things the companies consider in selecting a vendor for outsourcing services, the first must satisfied criterion is a company with a strong financial base. About 48% of the companies interviewed indicated that before they select any vendor, the vendor above all things must have a strong financial base because the company outsourcing the vendor would always want the vendor to start the project or services with its own resources in the initial stages before the company commits any resources to it. Furthermore 32% of the respondents also said they would prefer someone with much experience in projects before they contract such a vendor to provide any kind of services. Other respondents (16%) said they were outsourcing vendors willing to work their organisation's terms and conditions before they outsourced them. Only 4% said they consider the perceived capability of the individual before they contract the vendors.

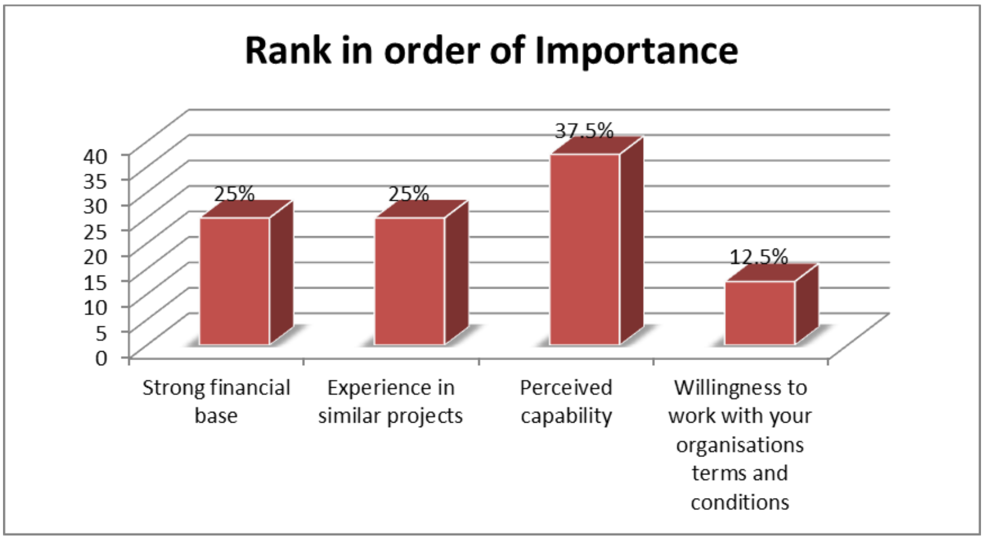

Fig 13: Rank in order of Importance

Source: field Data from Millicom Ghana Limited

When the respondents were asked to rate in order of importance what vendor quality they placed value on, more than one-third (37.5%) of the respondents said they consider the capability as the most important before other things are considered. But 25% of the respondents maintained that, they consider a vendor with strong financial base and experience in similar projects before they are awarded any contract. A vendors' willingness to work with companies terms and conditions still did not receive much premium as only 12.5% said they would consider this first before any other qualities.

Section D: Developing Appropriate Contract and Creating an Efficient Governance Structure.

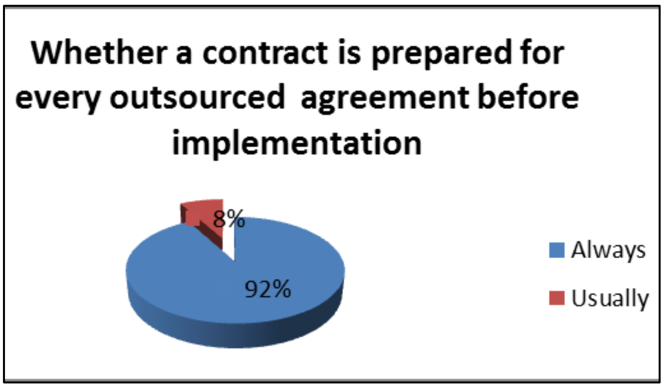

Fig 14: Whether a contract is prepared for every outsourced agreement before Implementation.

Source: Millicom Ghana Limited

Almost all the rsepondent (92%) said they prepare a contract agreement, was always prepared for outsourcing vendors before the vendors start providing their services. Although 8% of the respondents said they were not preparing contracts for every vendor they outsourced.

However, all of the respondents said, once the contract was settled, a fixed period of term was set for very vendor they outsourced in their company.

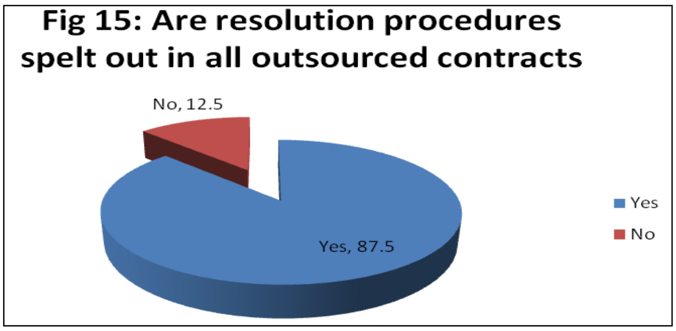

Fig 15: Are Resolution Procedures spelt out in all outsourced contracts

Source: field Data from Millicom Ghana Limited

In most of the contracts prepared for outsourced vendors, 87.5% of the respondents said, their contracts contained a resolution procedures which the vendors need to go through at the end of their contract, although 12.5% of the companies said their contract did not contain any resolutions.

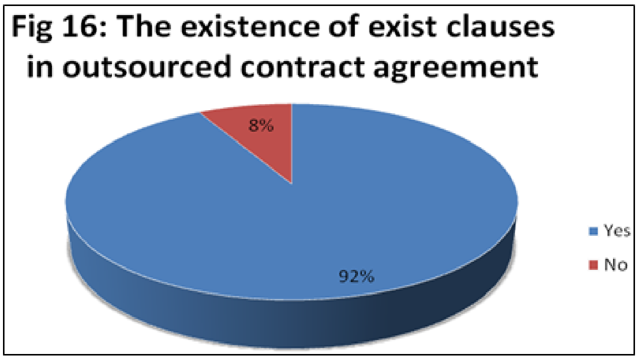

Fig 16: The existence of exits clauses in the Outsourced Contract Agreement.

Source: field Data from Millicom Ghana Limited

One other important thing that is considered is the existence of exist clauses in outsourced contract agreement for both parties. In this regard, majority of the respondents (92%) stated that their outsourced contracts always contained an exist clause binding on the outsourced vendor such that if at any point, they want to part ways, it can be done harmoniously based on the terms on of the exist clause.

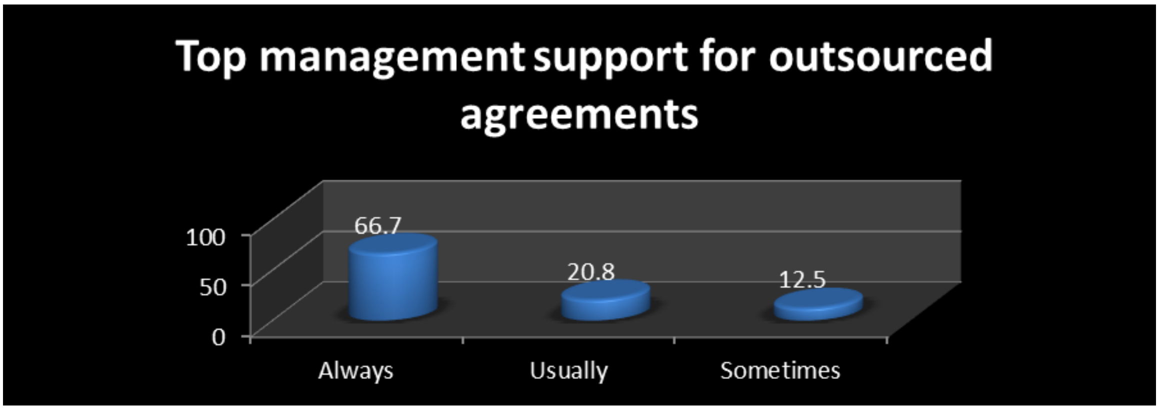

Fig 17: Top Management Support for Outsourced Agreements

Source: field Data from Millicom Ghana Limited

The result in the fig 17 above gives a clear indication that in two-thirds of the companies interviewed (66.7%), these companies had the full backing of the top management in the company when it comes to outsourcing vendors to provide specific services. Another 20.8% said, although the support of top management was not always guaranteed it was forthcoming usually whiles 12.5% of the respondent said the support of the top management sometimes help them to secure the services of vendors.

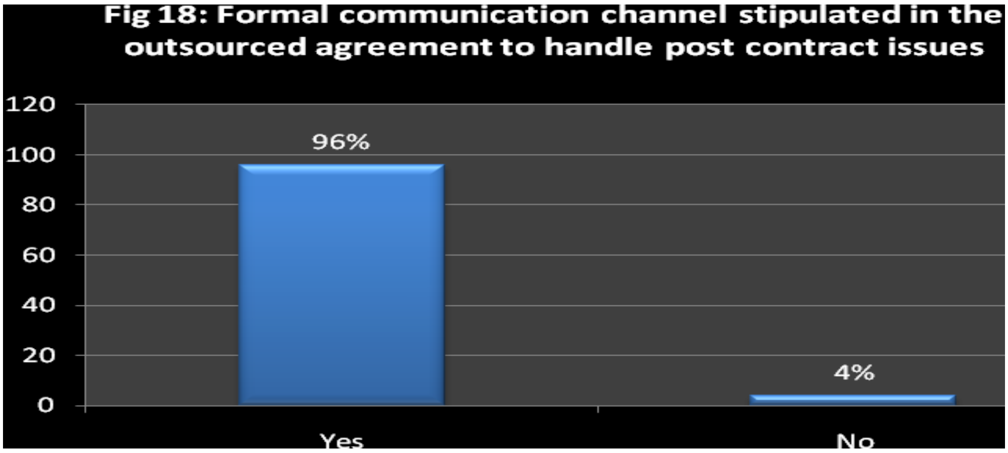

Figure 18: Formal Communication Stipulated in the Outsourced agreement to handle post contracts Issues.

Source: field Data from Millicom Ghana Limited

Most of the respondents (96%) confidently articulated that the outsourced agreement had a formal communication stipulated in it to handle post contract issues so that if there are any issues of clarification or readjustment in the final delivery, these vendors could be contacted to work on it although the period of outsourcing might have elapsed. However, there were other respondents (4%) who did not have any post service clauses in their agreements.

Section E: Outsourcing and its benefits of Improving in terms of Profitability, Service improvements, Strategic Core Business, Reduce or Control operating cost, Access to new technology and Access to experts knowledge

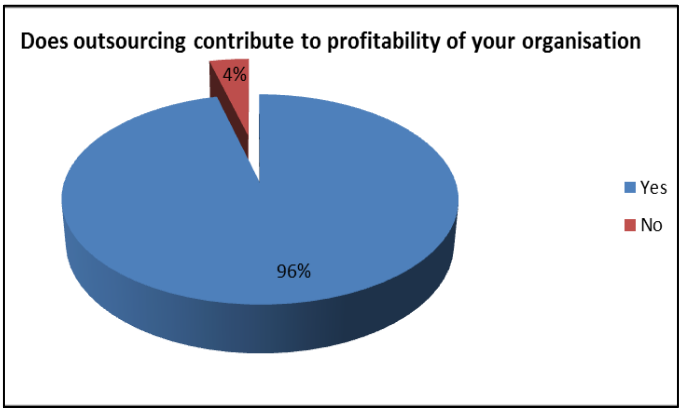

Fig 19: Does Outsourcing contribute to profitability of your Organisation

Source: field Data from Millicom Ghana Limited

Attached Millicom Ghana Limited financial statement in Appendix.

- In terms of outsourcing contributing to the overall organisation profit, almost all the respondents (96%) responded in the affirmative. The respondents asserted that whenever, they had outsourced vendors to provide services in certain projects, those projects ended up profitably. However, 4% of the respondents also said their organisation did not see a additional profits whenever they outsourced vendor services in their activities. **Outsourcing and Profitability: Pre and Post Outsourcing Financial Data.**

Summary, Conclusions and Recommendations

Summary of Findings

Socio-Demographic Characteristics of respondents

The demographic characteristics of the respondents showed that most of the matured people and the average age of the respondents was 37 years with majority of the respondents (64%) being male. Most of the respondents were selected from functional departments such as Supply Chain, Human Resource, Procurement, Sales and Marketing, Finance and Control etc. and most of the respondents (92%) having been working in their current position for more than two (2) years. Again the case study organisation has both Ghanaian and expatriate staff, and Millicom Ghana limited having been operating for more than Ten (10) years also have quite a sizable number of employees working in the company.

Assessing whether firms that undertake Outsourcing show higher profitability

In terms of outsourced vendors contribution to the overall organisation's profitability, almost all the respondents (96%) responded in the affirmative and overwhelmingly considered Outsourced Services as very profitable to their organisation. The respondents asserted that by the use of Outsourced Services, they are able to cut down on huge cost associated with such projects. Also it gives the companies an access to experts knowlegde from these outsourced vendors and stand the chance of using new or modern technology in carrying out some of these projects. This assertion is support by Hindle (2005) who also reported that "companies make the decision to outsource for a variety of reasons but cost reduction tends to be one of the primary drivers". This finding in research is back by Millicom Ghana Limited financial statement in Appendix. (2008-2010).

In the past the amount of resources and time needed to complete projects were huge and these companies would struggle in most of their activities. However, with the advent of outsourcing services, most projects are now done with speed and little resources. Outsourcing Services now gives these companies the liberty to hire few employees and yet able to acquire every expertise they would need for their projects once the companies can afford the services. This also confirms Tafti (2005) findings that companies outsource services in order to tap into the extensive knowledge and technical experience that a vendor may offer.

The cost of transaction of Outsourced Services

The management of the company will first and foremost consider the type of projects, numerical strength of available staff, the skill requirement of the project, the duration, cost of the project and when management are convinced that the enormousness of the project is beyond the capability of the available staff whether or not they would outsourced, the vendors or not and if they can afford an outsourced vendor then the decision is made and communicated to the project team. Notwithstanding these, the most important factor for consideration is the overall cost of the outsourcing vis-à-vis the money available for the project. The respondents claimed that the overhead cost of projects they outsourced in the past has always been lower and they the companies make more profit by outsourcing.

The results however is unlike in Australia where Beaumont and Sohal (2004) concluded that the cost factor was also identified as a major factor for not outsourcing by companies as the huge cost associated with outsourcing was hindering companies in the country from patronising outsourced services.

Determination of the need for Outsourcing and the process of selecting a Vendor

In determining the need to outsource a vendor to provide the companies any kind of services, the study revealed that such decisions were mostly proposed by the top management of the company with the support of the lead from the particular project. There are only few instances that the proposal to outsource a vendor would come from the project team. The decision has always been top-down. Hindel (2005) agrees if the decision of outsourcing is top-down, the project is likely to get the full support of the management and it eliminate any setbacks from the management.

This decision to outsource a vendor is always arrived at after a rigorous process of activities. A single vendor, multiple vendors or both are usually employed in selecting vendors depending on the kind of project involved. The two methods of selecting a vendor which were been employed by these companies were the use of National competitive bidding and Selective tendering. This enables to companies to scan through a variety of prospective vendors in order to select the best for the job. The results from this study show that the outsource vendor with the requisite experience in similar and the also strongest financial base is the one usually chosen to provide the kind of services required. This according Antonucci et al., (1998) and increase the flexibility and quality of services.

Whether or not there exist any relationship between outsourcing and profitability

Spearman's rho correlation of total scores

N	*Correlation Coefficient*	*Significance (2-tailed)*
100	**0.65**	**0.038**

The results above show a strong positive correlation (0.65) between outsourcing scores and total profitability scores. But this is significant since the significant value (p-value) of 0.038 is less than 0.05 level of significance. Therefore the hypothesis of perception that there is a relationship between outsourcing and profitability is established. This was even supported by figures 18 and 19 where respondents overwhelming concluded that outsourcing was very profitable as it contributes to the overall profitability of their organisation.

Conclusion

Assessing whether firms that undertakes Outsourcing show higher profitability

The impact of outsourcing on organizational profitability is very positive and companies seeking to outsourced vendor services stand a high chance of making profit. From this study, almost all the respondents (96%) responded in the affirmative and overwhelmingly considered Outsourced Services as very profitable to their organisation. The respondents asserted that by the use of Outsourced Services, they are able to cut down on huge cost associated with such projects and affords them the opportunity to access experts knowlegde as well as new or modern technology.

The cost of transaction of Outsourced Services

It was evident from this study that prior to any significant Outsourcing decision, management would have to conduct cost benefits analysis to ascertain the viability of the project before committing organisation's resources. In this regard, 89% of the respondents confirmed that they have internal mechanism to verify and quantify benefits of outsourcing prior to commencement. Therefore, unless there is overwhelming benefits to support Outsourcing projects, it must not be undertaken.

At what stage is Outsourcing necessarily in Organisation?

In the process of determining whether or not outsourcing was an option at any point, more than half of the respondent (50%) said that such a decision would always be generated from top management whiles 20% of the respondents also said usually such decisions are proposed by the functional team undertaking the specific project. It must be noted that most outsourcing decisions are of strategic nature and should be taken in line with companies objectives as well as to reduce operating cost, have access to new technonology, improve service levels to customers, improve profitability and above all focus on oganisation's core business.

Is there a relationship between Outsourcing and profitability?

The study revealed a strong relationship between Outsourcing and profitability. This was evident as (96%) of the respondents indicated that outsourcing contributes significantly to their organisations 'profitability. Hindle (2005) supports this assertion when he stated that companies make the decision to outsource for a variety of reasons but cost reduction tends to be one of the primary drivers. Also, The Outsourcing Institute Membership (1998) sees financial justification as one of the top ten outsourcing success factors. Consequently, outsourcing is thought to be successful when such financial-economic expectations as the achievement of a cash infusion, cost reduction, production and transaction cost economies, lower prizes for consumers' financial slack or even tax advantages are covered (Outsourcing Institute Membership, 1998). In summary, the study confirmed a strong relationship between outsourcing and profitability of an organization. Also within this research finding before outsourcing was done in Millicom Ghana limited thus the period of 2008 and after outsourcing was done 2009 to 2011 there is great impact on profitability as attached in appendix 2 of the financial statement.

Recommendation

- Finally, in recommendation, I propose that companies seeking to explore the use of outsourced vendors should undertake thorough background checks of potential vendors to ensure they have the requisite skills, expertise and resources needed to accomplish a given project. This study has confirmed that there is a relationship between outsourcing and organisations profitability, based on the findings of the research, the following recommendations were made:
  1) Clearly determine functions and processes to be outsourced
  2) Resources should be invested in time, money, training for staff within that function responsible for the outsource service.

For an organization to optimize outsourcing strategy, the following steps are highly recommended:

- Clearly determine functions and processes to be outsourced
- Conduct cost benefit analysis to assess viability of the project
- Seek top management support prior to implementation
- Use rigorous process to identify and select suitable vendors
- Develop appropriate contract to manage outsourced activity.
- Agree and sign service level agreements
- Set up resolution procedure to manage conflicts in the course of the project
- Ensure exit clauses are agreed and documented in the contract
- Develop internal mechanism to verify and quantify benefits

Recommendation of future research work into this study

- Importance of SLA to outsource service.
- Develop internal mechanism to verify and quantify benefits of Outsourcing service.
- Developing appropriate contract to manage outsourced activity.

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