

Determinants of Outsourcing as a Competitive Strategy in Supply Chain Management of Manufacturing Companies in Kenya (A Case Study of East African Breweries Limited)

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ABSTRACT

Outsourcing has become a very vital business strategy in the current world. Due to the effects of globalization and increased cost of production in Kenya, many companies are finding it important to innovate on ways which can reduce cost of operation and growth their profit margins. This study sought to investigate the factors affecting outsourcing as a competitive strategy in manufacturing organizations in Kenya. The study adopted a descriptive design. The target population comprised of management and supervisory staffs currently employed at East African Breweries Limited. Stratified sampling technique was used to select the sample. The target population was stratified through top/senior management level, middle level and low management level. From each stratum the study used simple random sampling to select 45 respondents. Primary and secondary data was used in the study. Primary data was gathered directly from respondents through questionnaires while secondary data involved the collection and analysis of published material and information from other sources such as annual reports, published data. The researcher personally administered the questionnaires to each respondent. Before actual data collection, the researchers carried out a pilot study to pretest and validate the questionnaire. The researchers selected a pilot group of 10 individuals from the target population at East African Breweries Limited (EABL) to test the reliability of the research instrument. Lastly, the completely filled questionnaires containing data from the respondents were first edited then coded to facilitate statistical analysis. Quantitative data collected was analyzed by the use of descriptive statistics. These included frequency distribution tables and

measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies among others. The analyzed data was presented in tables and charts.

Outsourcing strategy is adopted by companies so as to be more cost effective in its operations, the needed for the company to improve the quality of the services, and to acquire the expertise required. Through outsourcing the company is able to improve on service delivery and efficiency, improve responsiveness to needs of clients and improve company focus. The study recommends that management of EABL in Kenya should adopt outsourcing as a strategic initiative to enhance competitiveness, performance and responsiveness of the various processes. The study also recommends that further study should be carried out to investigate how outsourcing affects other organizations in different lines of business since this study focused on the manufacturing line.

Key Words: Outsourcing, manufacturing, cost, competitive advantage, quality.

1.0 Introduction

It is evident that the outsourcing of activities traditionally performed internally by firms to third party partners has become increasingly important in recent years. While in the past outsourcing was primarily relegated to the procurement of non-core components and services, today the outsourcing trend has expanded to include virtually every activity of a firm, including core and non-core components, business processes, information technology processes, manufacturing and distribution activities, and customer support activities (Chamberland, 2003; Gottfredson, Puryear, and Phillips, 2005; Holcomb and Hitt, 2007; Insinga and Werle, 2000; Kakabadse and Kakabadse, 2000b; Niezen and Weller, 2006; Venkatraman, 2004). Today's hyper-competitive environment, characterized by constant change, market unpredictability, and the pressure to reduce costs and cycle times, coupled with the globalization trend, has provided further impetus to the growth of outsourcing (D'Aveni, Canger, and Doyle, 1995).

It is also evident that manufacturing firms are now outsourcing functions and processes across the supply chain, including research and design, product development, product component manufacturing, product final assembly and distribution and logistics functions (Adler, 2003; Chamberland, 2003; Gottfredson et al., 2005; Heikkila and Cordon, 2002; Kirk, 2001; Niezen and Weller, 2006; Nohria, 2005; Orr, 2001; Palvia, 2003; Quinn, 1999; Ross, Dalsace, and Anderson, 2005; Willcocks, Hindle, Feeny, and Lacity, 2004). The growth of outsourcing has led outsourcing strategies to become an increasingly important component of firm success (Gottfredson et al., 2005; Kakabadse and Kakabadse, 2000a; Kakabadse and Kakabadse, 2000b; Talluri and Narasimhan, 2004).

East African Breweries Limited (EABL) is the leading branded alcohol manufacturing companies in East Africa. During the 2006/2007 financial year, it was decided that the company will outsource most non-core activities to allow the staff to concentrate on the core business of producing world-class, innovative beers and spirits.

2.0 Problem Statement

Supply Chain Management (SCM) and outsourcing have both been given increasing attention since their applications were recognized by many as significant profit and performance enhancers. Every business is a part of a big Supply Chain (SC) and supply network (Handfield and Nichols, 1999). Nevertheless, the management of a company could choose to either; (a) implement only SCM, or (b) implement only outsourcing or (c) implement both outsourcing and SCM. The decision to apply either outsourcing or SCM or even both rests on the management's readiness to face the consequences each application brings.

As outsourcing may increase organization's operating flexibility and allows the transfer of operational risks to another party, SCM though utilizes more resources in a way gives the organization direct involvement with each stage of every processes and functions, and thus allowing clearer view and direct control for improvements. A company may choose not to embark in the management of SC; the reasons may range from inadequacy of assets or expertise, to the nature of businesses they are in. It may however at that time outsource a number of the company's functions, such as those perceived as non-core activities like cleaning, maintenance of buildings and so forth. These are the cases where outsourcing function stands individually to the respected companies, though they may be involved in a SC managed by another organization (Jennings, 2002).

The search for competitive advantage and world class standards has brought all traditional business practices under a microscope, and fundamental changes have been introduced already into many companies. Consumers have become more demanding in terms of the standards of product quality and delivery of service which they now expect, while still looking for cost and price reductions. This has driven many firms to outsource non-core services so as to pay more emphasis on their core business and ensure customer's demands are met (McIvor, 2002).

A number of studies have been conducted on SCM and outsourcing in Kenyan companies; however from the researchers observations, none of the studies have emphasized on looking on whether, outsourcing ensures competitive advantage on the firms operations and especially those in the manufacturing sector. It against this background therefore that the researcher sought to conduct a study on the determinants of outsourcing as a competitive strategy in supply chain management in manufacturing companies in Kenya, and with a specific focus at EABL Ltd.

3.0 Literature Review

3.1 Theoretical Background

Over the years, various outsourcing decision models have been developed by different researchers. The Transaction Cost Theory (TCT) point out that outsourcing decisions are influenced by the degree of asset specificity, frequency and uncertainty (Holcomb and Hitt, 2007, Caniëls and Roeleveld, 2009). The outsourcing decision from a resource based view is driven by the focus on core competences. It recognizes that, in addition to costs, resources and competences should be considered in outsourcing decisions to achieve sustained competitive advantage (Bolumole et al., 2007). The resource-based view proposes that organizations should define their core competences and core activities and keep those activities in-house. All non-

core activities could be outsourced. Identifying the core activities of the business, however, is not straightforward.

Caniëls and Roeleveld (2009) introduced an alternative view on outsourcing: the power and dependence perspective. Their empirical findings show that power and dependence play an important role in make-or-buy decisions and that it should be considered complementary to cost and core competence considerations. According to Caniëls and Roeleveld (2009), power and dependence may be key factors that influence the outsourcing decision process and that this is especially true for the outsourcing activities close to the core of the organization.

3.2 Outsourcing and Cost efficiency

In the past outsourcing focused on tactical and non-essential activities such as payroll, security (Chung, Jackson and Laseter, 2006) and catering, however the focus is shifting and many businesses are now pursuing outsourcing in strategic operations of businesses such as manufacturing and logistics (Chung, Jackson and Laseter, 2006) that are key to the business performance.

Major drivers of outsourcing in business have been cost efficiency and production reorganization (Franceschini, Galetto, Pignatelli and Varetto, 2003). The globalization effect has shifted the way businesses have been conducted in the past. Today businesses have advanced the art of outsourcing to the extent that even the core business operations which were never thought possible such as design, engineering, research and development, production are now being contracted out (Dehoff and Sehgal, 2007). The benefits derived from reduced costs of operations as a result of outsourcing can be reinvested back into the business.

An important source of cost reduction is the outsourcing firm's access to economies of scale and unique expertise, since most contracted firms receive a huge number of clients and can invest in new technologies and innovative practises (Jiang, Frazier and Prater, 2006). Desire to save indirect costs can be a major source of motivation to outsource. Having fewer employees requires less support system and infrastructure which gives rise to nimble and more efficient organizations (Kremic, Tukel and Rom, 2006).

3.3 Outsourcing and Quality of Products

Outsourcing faces three broad types of risks; Operational risks, strategic risks and composite risks (Knowledge @wharton, 2005). Operational risks arise when there are slippages on time, cost and quality, this occurs when the service providers fail to understand the client's requirements (Boer et al (2006), Knowledge @wharton, 2005). Strategic risks arise when the service provider is involved in deliberate and opportunistic behaviour that undermines the client's business in the long run, through practices such as cutting corners by understaffing, or theft of intellectual property (Knowledge @wharton, 2005). Composite risks occurs when an organization outsources a certain function for so long that it can no longer implement the process for itself, Yvonne T (2003) , Knowledge @wharton,(2005). This puts the organization at the risk of losing competence which is very important when developing new products/ services

to meet new customer requirements. Hence it is important for companies to retain minimal residual capacities so that they always have in-house access to outsourced skills (Knowledge @wharton, 2005). To address operational and strategic risks, organization must recognize that when they outsource a task, they don't outsource the responsibility and accountability of that task (Knowledge @wharton, 2005, Boer et al (2006)). Many risks can also be avoided by transferring best practices to the service providers (Knowledge @wharton, 2005, Dehoff and Sehgal (2007)).

Couto and Divakaran (2003) argue that service providers are being pushed by the buyers need to create business value that continue to build offerings that deliver economic, strategic, operational and human resource benefits.

3.4 Outsourcing and competitive advantage

Outsourcing has become thoroughly interwoven into the business fabric and is being used to drive competitive advantage. Outsourcing is moving beyond the initial cost focus to become an enabler of innovation and business growth (Cuoto & Galioto, 2007). Technology is driving a revolution in the way business has been operating. More and more businesses are embracing IT as the back bone to their infrastructure.

Many businesses today continue to outsource most of their non core activities. In 2003 Procter and Gamble outsourced its IT processes to Hewlett Packard, its HR processes to IBM, its facilities management to Jones Lang Lasalle, these engagements yielded improvements in services and efficiency (Couto and Divakaran, 2006). Couto and Divakaran (2006) argue that menu for BPO continue to expand with sophisticated end to end services now being available in human resource, IT, finance, and procurement with forward looking offering such as analytics, advanced customer care, and innovation without boundaries. Couto and Divakaran (2006) further argue that outsourcing is entering into a transitional period in which the most sophisticated suppliers and customers will shape the structure of business to business service environment all over the world. They further argue that every business be it large or small, will eventually be plugged into this network of interoperable interwoven processes and tapping into this network will be an absolute requirement for success otherwise it will cost a company its competitive edge.

A thorough value chain analysis can illuminate the business system to facilitate outsourcing decisions, Lysons and Farrington, (2006). To decide which activities to outsource, managers must understand the firm's strengths and weaknesses in each activity, both in terms of cost and ability to differentiate, Porter (1985). By having clear linkages of various parts of the value chain, the organization can reduce costs of supply chain administration, Porter (1985). When such linkages are properly coordinated, products are delivered on time, Lysons and Farrington (2006).

4.0 Methodology

The researcher applied a descriptive research design. The target population composed of management and supervisory staffs employed at East African Breweries Limited. At the time the entire population of management and supervisory staffs at EABL was 150. For purpose of

this study the target population was stratified through top/senior management level, middle level and low management level. From each stratum the study used simple random sampling to select 45 respondents in total.

The researchers administered the questionnaire to each member of the sample population. The questionnaire was carefully designed and tested with a few members of the population for further improvements. This was done in order to enhance validity and accuracy of data to be collected for the study. The researchers selected a pilot group of 10 individuals from the target population at EABL to test the reliability of the research instrument.

5.0 Findings

The study got a response rate of 77.5% and was therefore considered appropriate to derive the inferences regarding the objectives of the research. The study established that EABL had highly outsourced security services as revealed by 88.6% of the respondents, staff training and development (80%), medical services (74.3%), staff recruitment (71.4%), logistics services (65.7%) and warehouse administration and management (62.9%). However, the company had not highly outsourced internal services such as sales, marketing and customer care services (94.3%), accountancy / book keeping services/ payroll services (65.7%), IT Help desk / technical Support and maintenance (62.9%) and staff catering services (54.3%).

The study established that the company considered to a great extent aspect such as cost, competence, contract terms (credit terms), reputation (credibility), experience, and past performance. However, the respondents reported that they considered aspects such as professionalism, flexibility and compatibility of the provider to a moderate extent.

On the determinants of outsourcing, the study show that majority of the respondents agreed that the company outsourced since it was more cost effective, the company needed to improve the quality of the services, the company also did not have the expertise required. The respondents further agreed that the company outsourced so as to improve on service delivery and efficiency, improve responsiveness to needs of clients and improve company focus. However, the respondents disagreed that they outsourced since they had a strict time limit on a project and outsourcing was the only option.

Moreover, the study established that EABL outsourced so as to remain competitive, reduce costs, to gain access to much needed skills that the company do not have in-house, to meet the company's needs that cannot be fulfilled in future and to improve operations or service levels. However, the respondents were neutral on whether the company selected an outsourcer based on the likelihood of forming a trusted business partnership.

On the benefits of outsourcing, the study established that EABL achieved cost effectiveness benefits, increased quality of the business process due to experts undertaking the tasks and enjoyed quicker and more effective work. Outsourcing was also beneficial to the company as management did not have to oversee the day to day running of the business process which reduced work load on the management; it also reduced payroll costs and employee management costs as the company did not have to do not have employees for the tasks.

On the inhibitors of outsourcing, the study found out that majority of the respondents reported that loss of in-house expertise; security issues; internal management policies opposed to

outsourcing; vulnerability to dependence on external vendors; loss of key application skills/resources difficulty to manage the provider relationship also inhibited outsourcing in the company.

6.0 Recommendations

The study recommends that management of EABL in Kenya should adopt outsourcing as a strategic initiative to enhance competitiveness, performance and responsiveness of the various processes. The management should provide the required support through monitoring and control of the quality of service delivery to realize the designed benefits of cost reduction, improved efficiency and increased performance by effectively managing the contracted party.

It is also recommends that management outsources processes that exhibit high manpower costs and demonstrate inefficiency in the various levels of the value chain. These shall deliver cost leadership through effective contract management.

It also recommends that outsourcing should not only be subjected to the traditionally non core activities, but the whole of those activities that a third party can deliver at lower cost than can be done in-house, with adequate management control on quality of delivery.

Finally the researchers recommend that further study should be carried out to investigate how outsourcing affects other organizations in different lines of business since this study focused on the manufacturing line and in particular the case study of EABL.

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