The Outsourcing Process

Outsourcing has become an increasingly important issue for many organisations. This book provides a framework for an up-to-date understanding of the outsourcing process and the key issues associated with it. It integrates a number of contemporary topics including benchmarking, buyer–supplier relationships, organisational behaviour, competitor analysis, and technology influences. The analysis draws upon both empirical research and real case studies. The author starts by providing guidelines as to when outsourcing is appropriate and what its implications will be, before moving on to explain how outsourcing is implemented. The benefits of both successful outsourcing and the risks and consequences of outsourcing failure are outlined. The book is ideal for use by postgraduate students studying the area of outsourcing. It would also benefit industry managers who are considering outsourcing or who already have outsourcing programmes in place.

Ronan McIvor is a Reader at the University of Ulster.
The Outsourcing Process

Strategies for Evaluation and Management

Ronan McIvor
University of Ulster
# Contents

*List of figures*  
List of tables  
List of illustrations  
Acknowledgements  

1 Introduction  

2 The trend towards outsourcing  
2.1 Introduction  
2.2 An overview of the outsourcing concept  
2.3 Changes in the business environment driving outsourcing  
2.4 Evolving organisation structures  
2.5 The potential benefits of outsourcing  
2.6 The risks associated with outsourcing  
2.7 Inter-organisational relationship configurations  

3 Theoretical influences on outsourcing  
3.1 Introduction  
3.2 Transaction cost economics  
3.3 The resource-based view of the firm  
3.4 The industry view  
3.5 The relational view  
3.6 Integrating the theoretical influences into outsourcing evaluation and management  

4 The outsourcing process: a framework for evaluation and management  
4.1 Introduction  
4.2 Practical problems with the outsourcing process  
4.3 Background to the development of the outsourcing framework
4.4 A description of the stages in outsourcing evaluation and management 70
4.5 Implications for theory 83

5 Determining the current boundary of the organisation 90
5.1 Introduction 90
5.2 Value chain analysis 95
5.3 The value chain 98
5.4 The value shop 100
5.5 The value network 103
5.6 Business process perspective 108
5.7 Depth of analysis 110

6 Activity importance analysis 115
6.1 Introduction 115
6.2 Background to the importance level analysis 116
6.3 Understanding the competitive environment 122
6.4 Understanding the value concept 127
6.5 The critical success factors (CSFs) methodology 135

7 Capability analysis 146
7.1 Introduction 146
7.2 Analysing the type of advantage 148
7.3 Analysing the source of advantage 179

8 An analysis of the strategic sourcing options 183
8.1 Introduction 183
8.2 An analysis of the disparity in performance 184
8.3 Technology influences 190
8.4 External considerations 192
8.5 Supply market risk 196
8.6 Behavioural considerations 200
8.7 The implications of the strategic sourcing options 206

9 Developing the relationship strategy 218
9.1 Introduction 218
9.2 Establish objectives for outsourcing 221
9.3 Supply relationship strategy 223
9.4 Supplier development 236

10 Establish, manage and evaluate the relationship 245
10.1 Introduction 245
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.2 Supplier selection</td>
<td>246</td>
</tr>
<tr>
<td>10.3 Contracting issues</td>
<td>250</td>
</tr>
<tr>
<td>10.4 Managing the relationship</td>
<td>259</td>
</tr>
<tr>
<td>10.5 Relationship performance evaluation</td>
<td>264</td>
</tr>
<tr>
<td>11 Case study – outsourcing experiences at Telco</td>
<td>276</td>
</tr>
<tr>
<td>11.1 Introduction</td>
<td>276</td>
</tr>
<tr>
<td>11.2 An overview of Telco</td>
<td>276</td>
</tr>
<tr>
<td>11.3 Developments in the telecommunications industry</td>
<td>279</td>
</tr>
<tr>
<td>11.4 The impacts on Telco</td>
<td>281</td>
</tr>
<tr>
<td>11.5 Strategy formulation at telco</td>
<td>282</td>
</tr>
<tr>
<td>11.6 Outsourcing evaluation and management cases at Telco</td>
<td>284</td>
</tr>
<tr>
<td>11.7 Relating the cases to the outsourcing framework</td>
<td>291</td>
</tr>
<tr>
<td>11.8 Discussion</td>
<td>296</td>
</tr>
<tr>
<td>11.9 Going modular at Telco</td>
<td>304</td>
</tr>
<tr>
<td>11.10 Concluding comments</td>
<td>308</td>
</tr>
<tr>
<td>12 Conclusions</td>
<td>311</td>
</tr>
<tr>
<td>12.1 Introduction</td>
<td>311</td>
</tr>
<tr>
<td>12.2 Practical lessons</td>
<td>311</td>
</tr>
<tr>
<td>12.3 Future developments</td>
<td>316</td>
</tr>
</tbody>
</table>

Index 321
# Figures

2.1 Backward and forward integration  
2.2 Smart Ville’s integrated suppliers  
4.1 The stages in outsourcing evaluation and management  
5.1 Stages in the personal computer industry chain  
5.2 The chemical industry value chain  
5.3 The relationship between capabilities, activities and resources  
5.4 The value chain for a manufacturing-type organisation  
5.5 The value shop  
5.6 The value shop of a software house  
5.7 The value network of a retail bank  
5.8 Business processes  
5.9 The levels of evaluating relevant organisational activities  
6.1 Samples of perceived use values for high technology company  
6.2 Sample products on customer matrix  
6.3 Sample critical success factors and activities matrix for a retail bank  
7.1 Make-or-buy break even analysis  
7.2 The difficulty of obtaining information and its impact upon outsourcing evaluation  
7.3 Customer service activities  
8.1 The strategic sourcing options  
8.2 The relationship between the number of buyers and suppliers and risk  
8.3 Suggested ideal conditions for the choice of strategic sourcing options  
9.1 Relationship strategies  
9.2 Toyota’s network-level knowledge sharing processes  
10.1 Interaction patterns in adversarial and collaborative relationships  
10.2 Major categories for the components of total cost of ownership in a manufacturing context  
11.1 The Telco value chain  
11.2 Structure of relationship between Telco and the LSP  
11.3 Organisation of supply base for in-house sub-rack assembly  
11.4 Organisation of supply base for outsourced sub-rack assembly
11.5 The strategic sourcing options matrix 297
11.6 The relationship strategy matrix 298
11.7 An overview of the major parts of Telco’s supply base 305
11.8 Modular production and supplier integration in Telco and its key suppliers 306
# Tables

3.1 The generic drivers .......................................................... page 52
3.2 Causes of variations in profits across business units ............ 54
4.1 The relationship between activities, advantage and resources .... 75
5.1 An overview of terminology associated with the resource-based view ......................................................... 97
5.2 Value network elements of eBay ........................................ 107
5.3 Characteristics of value configurations ............................... 113
6.1 Performance measures associated with critical success factors .... 139
7.1 Cost of buying and marginal cost of making .......................................................... 150
7.2 The effect of the limiting factor on internal production .......... 151
7.3 Sales demand and total hours required .............................. 151
7.4 Allocation of labour hours based upon rankings of advantage .... 152
7.5 Sample activities and cost drivers ...................................... 153
7.6 Unit cost using the volume driver ....................................... 156
7.7 ABC costs ...................................................................... 157
7.8 Activity data for each product per annum ......................... 157
7.9 ABC cost per product ...................................................... 157
7.10 Sample productivity measures ......................................... 163
7.11 Benefits and limitations of benchmark partners ................ 165
7.12 Four types of benchmarking for rail operator .................... 167
7.13 Focus-performance-measure illustration for an R&D company ......................................................... 170
7.14 Sample metrics for performance areas ............................. 171
7.15 Examples of potential drivers of advantage in organisational activities ......................................................... 180
10.1 Supplier partnership selection criteria ............................... 248
10.2 Supplier performance evaluation criteria ........................... 266
10.3 Factors indicating the strength of the relationship ............... 269
11.1 The de-layering of the organisation .................................. 277
11.2 Telco’s critical processes ................................................ 283
Illustrations

2.1 Offshoring  page 12
2.2 The SMART arrangement  30
2.3 Outsourcing and the consequences of failure  35
4.1 The hidden costs of outsourcing  65
4.2 A comparison of outsourcing in the public and private sectors  86
5.1 Value chain positioning in the chemical industry  93
5.2 Network economics at eBay  106
6.1 An analysis of outsourcing and its effects on organisational performance  120
6.2 Developing critical success factors  136
6.3 Critical success factors and critical activities in the financial services sector  141
7.1 Activity-based costing at Wavin  159
7.2 Benchmarking classifications based upon partner type  165
7.3 The role of benchmarking in information systems outsourcing evaluation  177
8.1 Developing national competitiveness: the rise of India as an outsourcing destination  193
8.2 Virtual integration at Dell  199
8.3 Modular production in the automotive industry  212
9.1 Insights on global outsourcing from the toy industry  219
9.2 The development of knowledge sharing at the buyer–supplier interface  231
9.3 Supplier development at Honda  241
10.1 Effective contracting  251
10.2 Formal contracting and relational contracting as complements  257
10.3 Japanese supply chain superiority  261
10.4 Offshore supply management  272
Acknowledgements

I would like to thank the many people who have helped in the writing of this book. The rationale and structure of the book was greatly influenced by empirical research and numerous discussions with academics and practitioners. In particular, a number of colleagues including Paul Humphreys, Eddie McAleer, Tony Wall and Marie McHugh provided valuable feedback on the structure and early versions of certain chapters of the book. Many of the strategies and concepts in this book are based on a number of literature streams including business strategy, economics, organisational behaviour, and inter-organisational relationships. I would like to thank those academics and researchers whose work I have cited throughout the book. Students at the University of Ulster provided valuable feedback on various ideas and concepts in the book and also contributed to the development of a number of the case illustrations. I am also indebted to the companies that allowed me to carry out in-depth case studies to validate many of ideas and concepts introduced. In particular, I would like to thank the people in the organisations that assisted in the development of the case study presented in Chapter 11. The four anonymous reviewers of an earlier draft of the book provided valuable guidance and suggestions for improvement. Eric Willner and Emily Yossarian at Cambridge provided helpful advice and useful comments at various stages in the writing process. Finally, I would like to thank my family and in particular, Deirdre who contributed support and encouragement throughout the preparation of this book.