ANTECEDENTS OF OUTSOURCING DECISION AMONG SERVICE INDUSTRY IN SABAH

LIEW LI LING

A dissertation submitted in partial fulfilment for the degree of Masters of Business Administration (MBA)

SCHOOL OF BUSINESS AND ECONOMICS
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(Penulis: LIEW LI LING)  

(TANDATANGAN PERPUSTAKAWAN)  

Alamat:  
28, Lot 125, Lorong Lengkuas 2  
Taman Seputeh, 88300 Luyang  
Kota Kinabalu, Sabah  
MALAYSIA  

Tarikh: 2008  

(Penylia: Dr. Kalsom Abd. Wahab)  

(Tarikh: __________)  

CATATAN: ° Tesis bermaksud sebagai tesis Ijazah Doktor Falsafah dan Sarjana secara penyelidikan atau disertassi bagi pengajian secara kerja kursus dan penyelidikan, atau laporan Projek Sarjana Muda (LPSM).
DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, excerpts, equations, summaries and references, which have been duly acknowledged.

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Liew Li Ling
PE2007-8132
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SUPERVISOR

______________________________
(Name of Supervisor)          (signature)
ABSTRACT

Outsourcing was defined as a method of new management thinking that allowed external parties to perform some of the organization's business functions which were used to perform internally before. When making the outsourcing decision, organizations had to consider the factors of demographic like age, size, and location of organizations, strategic factors like cost efficiency, risk management and core competencies enhancement and environmental factor like economic condition because they were main drivers in influencing the outsourcing decision. From the seven hypotheses that tested, four of the hypotheses were significant, where the independent variables were age of organizations, size of organizations, location of organizations, and cost efficiency. It meant that all these four independent variables had an impact/relationship on outsourcing decision, while the other independent variables like risk management, core competencies enhancement and economic condition had no impact toward outsourcing decision.
ABSTRAK

Penentu-penentu Keputusan Persumberan Luar di Kalangan Industri

Perkhidmatan di Sabah

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CHAPTER 1

INTRODUCTION

1.1 Introduction

It is an important question to ask about why organizations would like to outsource some of their business functions and even all. What makes the organizations implement the method of outsourcing? How does outsourcing implementation bring advantages to organizations? Does the outsourcing decision give a negative effect to organizations? To answer these queries, here are the factors. In the past decade, most of the organizations were implementing the basic principles of management theory and it was called as traditional management which includes planning, organizing, leading, staffing, and controlling (Dessler, 2003). In this traditional management, organizations planned for the tasks, scheduled the tasks with related staffs, led the staffs in doing the tasks, provided appropriate training for the staffs, and controlled all the tasks as well as other activities in the reason of achieving the organization's mission and objectives.

But however, the traditional management did not seem to be linear with the changes of employees' attitude, products, control of resources, technologies, and market's preferences. So for many organizations, they were struggling to survive in the turbulence environment which was caused by the changes of external factors. In order to continue the business in this turbulence environment, organizations had to have a new paradigm to gain competitive advantages over the competitors as well as to lower the costs, produced higher quality products and provided better service by regarding to the adaptability, flexibility, speed, aggressiveness and innovativeness (Morris, Kuratko, 2002).
Besides that, the conditions and relationships among variables within organizations had changed and so that, different models and theories were required with a number of new concepts and tools such as Business Process outsourcing (BPO), Shared Service and Outsourcing (SSO), self directed work team and so on. These concepts and tools were called as "new management thinking" while they had been used widely over the last few years (Morris, Kuratko, 2002). Among these concepts and tools, outsourcing was the most popular and frequently used by the organizations. Then, the idea of outsource the non-core business functions had gained a large popularity especially from the private organizations and it had been defined as one of the best solution to transform organization’s costs and revenue structures (Christiansen, Maltz, 2002).

1.2 Problem Statement

In the recent years, there were a number of organizations especially service-based organizations had shifted from the traditional management to the method of outsourcing in order to improve their non-core internal functions. These new concepts and tools of innovative management did not replace the basic principles of traditional management but they merged and brought benefits to organizations. But however, there were some negative effects if organizations were not fully adaptable to the outsourcing implementation and so that, organizations needed to be clear with the determinants that affected the outsourcing decision to avoid inappropriate implementation.

In response of this issue, some determinants should be concerned. The relationship between demographic factors such as age, size and location of the organizations with outsourcing decision was the first consideration. When the developments of organizations were not stable, an outsourcing implementation increased the burden of the organizations because of the increasing operating cost. Second, the main drivers of outsourcing decision like cost efficiency, risk management, and core competencies enhancement had to be concerned as well in order to make sure that outsourcing was a correct method to move forward. Third, the environmental factor which normally referred to the economic condition had not be forgotten because
organizations were not able to stand and performed excellently in a turbulence environment. All these must be taken under consideration before the organizations made a decision to outsource.

After recognized the determinants and considerations, the outsourcing decision in organizations had to be emphasized. Outsourcing was a new method of innovative management where it can be defined as management approach that allowed external parties to perform certain of tasks or services which organizations performed internally but never reach the level of core competencies (Kakabadse et al., 2000). With this idea, many organizations realized that some of their internal functions such as cleaning, transportation and facilities management were not core competencies enough and they had decided to outsource those functions where this application helped organizations to gain competitive advantages if they performed it in a proper way.

Generally, the application of organizations toward outsourcing were depending on the factors of stableness level in organizations, reduction in operating cost, risk sharing with external parties, core competencies focusing in all the departments, and also strive to increase the organization's efficiency and effectiveness. Thus, organizations were wondered how these factors affected the outsourcing decision and why were these factors affecting the outsourcing implementation in their organizations.
1.3 Objectives of Study

Basically, the traditional management was the main guideline for organizations to run their business because managers can easily control all the functions, tasks and activities. But nowadays, more and more organizations outsourced some of the business functions while they believed that they had to do it. When organizations outsourced their non-core business functions, there were certain advantages that organizations gained like productivity improvement with external parties, cost reduction, risk sharing between the organizations and the external parties. At the same time, organizations managed to save cost (including hidden cost because some of them were not discovered unless the business functions were outsourced) and time because when external parties took over the non-core business functions, organizations had a higher cash liquidity for other activities and as well as their time consuming (Embleton et al., 1998).

But however, all these benefits were gained only after organizations identified the determinants like years of established, size and location of organizations, organization’s policies of cost efficiency and risk management, the level of core competencies and the economic condition. If not, managers lost certain authority in control because they did not have capability or experience to manage the outsourced activities as a negative effect. Then, organizations confidentially documents or strategies were exposed to the public if the external service providers misused that particular information. Besides that, organizations de-skilling was another issue where organizations were over-reliance to the external parties and this phenomenon affected the performance of the employees (Franceschini et al., Pignatelli, Varetto, 2003).

In response to these effects, the factors that influenced the organizations to outsourcing decision were recognized. So, the main objective of this study was to investigate the relationship between the demographic factors which include age, size and location of organizations, strategic factors which include cost efficiency, risk management, and core competencies enhancement, and economic condition as an environmental factor (independent variables) with the outsourcing decision among
service industry in Sabah (dependent variables). Then, the primary intentions of this study were to:

- Measure the influence of age, size, and location of the organizations in making outsourcing decision.
- Evaluate the effects of cost efficiency, risk management, core competencies enhancement on outsourcing decision.
- Identify the conformity of outsourcing decision on the economic condition.

1.4 Scope of Study

By narrowing the field, this study focused in the relationship between the demographic factors (age, size, and location of organizations), strategic factors (cost efficiency, risk management, core competencies enhancement), and environmental factor (economic condition) with outsourcing decision in service industry. So, the population in this study was among the service-based organizations with a number of different departments in Sabah. A hundred and fifty copies of questionnaires were distributed to the organizations (100 in urban areas and 50 in rural areas) to conduct this study where those selected organizations include courier service industries, hotel industries, transportation industries, information technology service and other service-based organizations. In the intention of knowing the relationship between the independent variables and dependent variable, the questionnaires focused on how the years of establish, size and location of organizations influenced the degree of outsourcing decision, how the factors of cost efficiency, risk management, and core competencies enhancement affected the decision in implementing outsourcing strategy, and how the economic condition gave an impact on outsourcing application.

1.5 Significance of Study

In order to know how significant the variables in this study were, the seven independent variables (from three categories of factors) played an important role because they were the determinants of outsourcing decision that either brought positive or negative effects to service-based organizations. In a belief of outsourcing always brought benefits to
organizations, this study provided a number of appropriate information to organizations and future researchers with:

- Guide organizations in making outsourcing decision by referring to age, size, and location of organizations, cost efficiency, risk management, core competencies enhancement, and economic condition.
- Allocate appropriate external service providers in doing certain tasks of work.
- Improve organization's internal work force and the quality of performance.
- Provide a useful guideline or reference to the future researchers in this particular topic.

1.6 Key variables

By locating outsourcing was a method from new management thinking to overcome the changes of external factors, there were a number of variables that had to be defined. In this study, the variables were stated as below:

Independent variable:
- Age of organizations
- Size of organizations
- Location of organizations
- Cost efficiency
- Risk management
- Core competencies enhancement
- Economic condition

Dependent variable:
- Outsourcing decision among service industry in Sabah

Age of organizations had the same meaning of year of establishment for organizations. In the term of age or year, it affected the overall performance of organizations. This was because the longer the organizations were established, the more
knowledge and experiences they had gained and thus, these helped them in an effective problems solving.

Size of organizations pointed the view to how huge were the structure of organizations. In a simple way, it mean to the number of employees in the organizations. Number of employees reflected the human capital powers that were used to run the whole business functions for organizations. In a higher level of human capital powers, there were more experienced employees and skillful workers who worked for these organizations in order to reach the higher level of performance.

Location of organizations was an influencing issue for the success of organizations where organizations with strategic geographical locations had higher possibility to get more customers especially for those service-based organizations. They gained an ease to their suppliers for raw materials or other services as well as in term of reducing their operating cost.

Cost efficiency was an objective that organizations wanted to achieve. In organizations, there was a total cost that had to be covered such as labor cost in manufacturing department, shipping and logistic cost in transporting department, quality cost in administration department, hidden cost, and miscellaneous cost because all these costs directly affected the total profits of organizations and so that, organizations had to ensure that they were always minimizing the cost and maximizing the profits (Jiang, Frazier et al., 2006).

Risk management was a process or system of organizations in managing all the risk capacity which includes business risk management, market risk management, operational risk management, fraud risk management, insurance risk management, compliance risk management and so on (Frost, 2003). So, to avoid or minimized the probability of facing risks, organizations planned and controlled all over the tasks or activities that were going on and analyzed the uncertain risks from external factors. If not, outsourcing had to be implemented to reduce the risks through risk sharing concept.
Core competencies enhancement was another factor that should be emphasized in organization because it affected the organization’s performance when the service was not good enough in quality. The good quality of human capital with core competencies business functions helped organizations in performing all the tasks with high standard of self-requirement and then, the services that provided were the best outcomes to satisfy their customers (Hindle, 2005).

Economic condition was an important environmental factor. A good economic condition led to a good market and a good market led to a higher profit for organizations, especially for those service-based organizations because most of the consumers looked for a better service when they were in a good situation of financial (economic) status and this phenomenon affected the organization’s growth and survival rate. So, this environmental factor had given a direct impact to all the organizations even just with a small fluctuation in economic condition.

As the dependent variable, outsourcing was a management approach that allowed external service providers to take operational responsibility for processes or services which previously provided internally by organizations (Swink, 1999; Smith et al., 1996; Lankford and Parsa, 1999; Elmuti and Kathawala, 2000). By outsourcing, organizations focused their efforts on core competencies business functions, reevaluate their medium/long targets and diversification opportunities of the business (Linder et al., 2002).

Generally, in making an outsourcing decision, organizations had to consider the factors like years of established, size and location of organizations, cost, risk, the level of core competencies, and economic condition because these were the factors that directly affected the organizations success. Because the outsourcing decision was a result from these factors, this study investigated the relationship between the age, size and location of organizations, cost efficiency, risk management, core competencies enhancement, and economic condition with outsourcing decision.
1.7 Organization of Study

In this study, it was divided into five chapters where:

Chapter one included introduction, problem statement, objectives of study, scope of study, significant of study, and key variables.

Chapter two included introduction to outsourcing decision, definition of key concepts, the relationship between independent variables and dependent variables, and summary.

Chapter three included introduction to research framework and methodologies, research framework, hypothesis, research design, unit of analysis, sampling design, instrument design, data collection method, data analysis, and summary.

Chapter four included the introduction to analysis of results, organization profile, descriptive analysis of variables, and hypotheses testing.

Chapter five included introduction, recapitulation, discussion and implication, limitation of study, suggestions or recommendation, and conclusion.
2.1 Introduction to Outsourcing Decision

Nowadays, outsourcing decision was important and its implementation was a common method for organizations as a tool to move forward and achieved a higher level of performance. So, many researches were done regarding this topic together with some influencing factors. To have a better understanding, a number of reviews about this study especially the variables and influencing factors were discussed in details in this chapter.

Basically, this study discussed about the age, size, and location of organizations, cost efficiency, risk management, and core competencies enhancement, and economic condition because they were the main drivers in making the decision of outsourcing. Then, as a dependent variable, outsourcing was defined clearly as well because it gave a great impact to those organizations which had implemented it. With a deeper explanation about these variables, the understanding of researchers about these factors and variables were clearer and then, the relationships between the independent variables and dependent variable were discussed as well where they contributed a better result for this study.
2.2 Definition of Key Concepts

In this study, there were seven independent variables that had been grouped into three categories: (1) demographic factors, (2) strategic factors, and (3) environmental factor and one dependent variable which was outsourcing decision. In the category of demographic factors, there were three elements which included age of organizations, size of organizations, and location of organizations. Then, in the categories of strategic factors, there were three elements too, which included cost efficiency, risk management, and core competencies enhancement. As the last independent variable, economic condition was the only element in the category of environmental factor. All these were the determinants of outsourcing decision for organizations and because of that, they were defined in details in this chapter.

2.2.1 Age of Organizations

The age of organizations or in another word, the life cycle of organizations was another yardstick to determine the outsourcing decision. Large sized aging organizations became less innovative at the later stages of their evolution/business and it had certain level of influence in making outsourcing decision (Chang, 1999). This statement was viewed to describe the mature businesses/old organizations with slow growth, more stable technologies, resources, self sufficiency were not tended to anticipate in any huge changes like outsourcing implementation. With a longer period time of establishment, the resource of self sufficiency became an added value/benefit for organizations to perform all the business functions and activities by themselves and so that, they didn't need external parties to interfere into their organizations (Chang, 1999).

On the other hand, there was a Jovanovic Model which said that the effects of age was less clear as growth rate apparently declined with age for the small-size but then increased or declined for larger plants (Graham Hall, 1995). In the Jovanovic Model that represented by Jovanovic (1982), economists were surprisingly little to say about age of organizations had a positive relationship with the survival rate of organizations where the longer the organizations were established, the more sufficient they were and
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