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## **CHARACTER AND APPLICATION OF OUTSOURCING BASED ON THE LODZ ENTERPRISES**

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### **1. Introduction**

In traditional, post-industrial revolution model an „organization” is assumed to own and manage directly most, if not all, of its required resources, and success in business is synonymous with acquiring the factors of production. Over the years, however, as organizations have become more complex, their resources likewise have become further specialized. This opened the door to outsourcing, especially non-core activities [2, p. 91].

Outsourcing is defined as a modern method of management and is connected with defining specific areas of activities being realized in a company and then transferring them to other, external firms, which specialize in these activities. The main purpose of the article is to analyse and estimate character and application of outsourcing based on research made in enterprises of Lodz.

Nowadays organizations of all kind use outsourcing every day to improve the products and services they provide customers, and more than 90 percent of companies say that this trend is an important part of their overall business strategy [4, p. 3].

### **2. Notion, features and application of outsourcing**

Outsourcing occurs when an organization contracts with another company to provide services or products of a major function or activity. Work that is traditionally done internally is shifted to an external provider, and the employees of the original organization are sometimes transferred to the service provider [1, p. 270]. For that reason a typical outsourcing transaction consists of two parts.

First, there is the transfer to a third party of the responsibility for the function or operation and management of part of an organization. This sometimes include the transfer to the supplier of some or all of the assets which comprise that function. Second, there is the provision of components or services to the organization by external supplier, usually for a period of several years [8, p. 3].

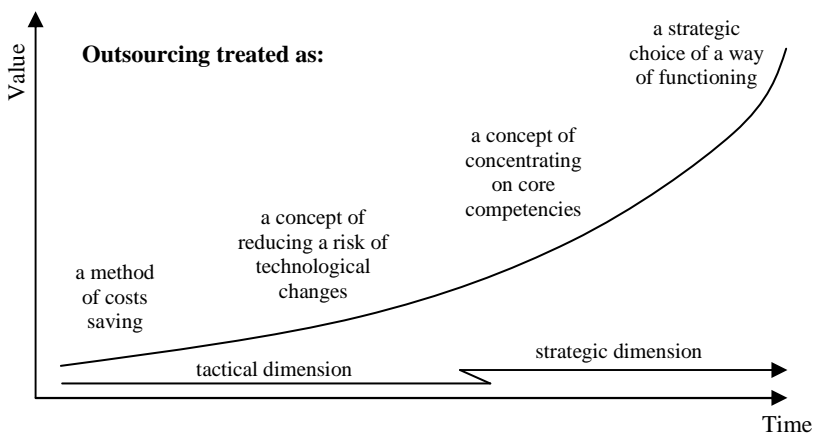
Using of outsourcing is connected with theory of transaction cost analysis. According to this, managers seek to balance transaction and production costs in their decision to internalize or externalize a function. This theory argues that the higher the transaction cost, the more likely that the transaction mode goes to making rather than buying. Therefore, when a firm makes an outsourcing

decision, it signals that the cost of this new external transaction mode should be lower than its former inhouse transaction's [7, p. 888].

Outsourcing has a long tradition in relation to the IT industry. Because of the high costs of IT infrastructure and the rapid change in technology, many companies have been looking for external providers for the IT function since the early 1980s [5, p. 675]. More recently whole business processes have been targeted for outsourcing and now this method is used in such fields as: manufacturing, call centres, transport and logistics, payroll processing, accountancy, cleaning, security, and many others, usually non-core related functions. The functions most susceptible to outsourcing are those [8, p. 10]:

- which are essential to the organization but with which the organization has limited experience,
- where the company has traditionally had some difficulty, financial or other, managing that function,
- at which the organization does not regard itself as an expert.

Presently a strategic meaning of this conception which supports development and increase efficiency of enterprises, is stressed. The evolution of meaning of outsourcing presents figure 1.



**Fig. 1.** Evolution of outsourcing  
Source: Own prepared based on: [9, p. 43]

Modern strategic outsourcing can be defined as the organizing arrangement that emerges when firms rely on intermediate markets to provide specialized capabilities that supplement existing capabilities deployed along a firm's value chain [6, p. 465]. In so doing the company becomes more entrepreneurial and is able to react faster to changes of business environment.

Outsourcing may be an interesting concept as well for large companies as small and medium enterprises. The literature often cites generating cost efficiencies and controlling the costs as the key goals for outsourcing. But through outsourcing companies can generate also various non-financial benefits. Firms can respond to environmental uncertainty in ways that do not increase

costs associated with internal bureaucracy. They can also focus on building their core competencies, can speed innovation and accrue higher returns at lower costs [3, p. 577]. Using of outsourcing also assures access to new technologies, experience of supplier and flexibility for the future.

On the other hand using of this method is connected with potential risks for host company, such as becoming locked into a supplier at the time when the company requires maximum flexibility. Supplier can also failing to provide the contracted services to the required level of quality, incurring high charges for additional services or even become insolvent [8, p. 9]. This prove companies interested in using of this method should take into consideration many internal and external factors before sign an outsourcing agreement.

### **3. Analysis of the outsourcing application in Lodz enterprises**

To qualify the characteristic features of outsourcing application, the questionnaire research was made in 50 enterprises of Lodz in 2007. The researched companies were differentiated according to a size of an employment, and a range of running business.<sup>1</sup> The top managers and owners of small and medium enterprises were the respondents of that research.

All studied enterprises outsourced at least one function from their activity. The most enterprises (15 units, that is 30% of whole test) outsourced 2 functions, 14 enterprises (28%) outsourced 3 functions and only one enterprise outsourced 5 functions. IT services were outsourced more often than others functions (figure 1), and first of all in them: the working stations management, the network and internet infrastructure management and applications management. Almost all studied companies (42 units, that is 84%) declare using these services. Financial services are indicated on the second position by respondents. This kind of outsourcing was in 27 enterprises (that is 54%). There were also outsourced the logistic function, including transport, distribution, storing (23 companies, that is 46%) and auxiliary functions, such as cleaning, protection, etc. (21 units, that is 42%). Human Resources function was outsourced in the smallest degree by studied enterprises. This type of activity was pointed only by 7 companies, that is 14 % whole of them.

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<sup>1</sup> 36% of the analysed enterprises were small (total number of the employees was not more than 50 persons), 52% medium enterprises (total number of the employees from 51 to 249 people), 12% big enterprises (the employment more than 249 people). The enterprises running business in different areas: 2 companies at the local market, 10 companies at the regional market, 20 at the national market, 12 at European market and 6 enterprises were global.

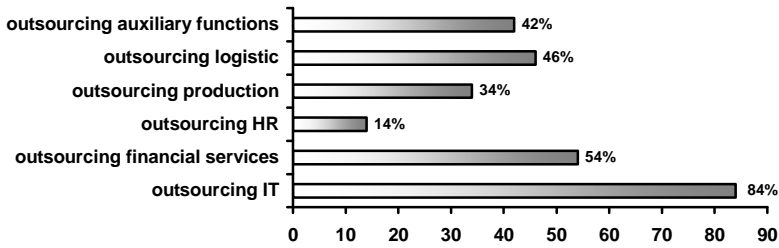


Fig. 2. Types of outsourcing in studied enterprises.  
Source: Own research.

An increase of the effectiveness and efficiency of the business activity is the general goal of outsourcing, but one can also distinguish varied partial purposes of it. Respondents were asked for the indication of four the most important goals, which decided about the particular activity to outsource. Figure 3 presents the results.

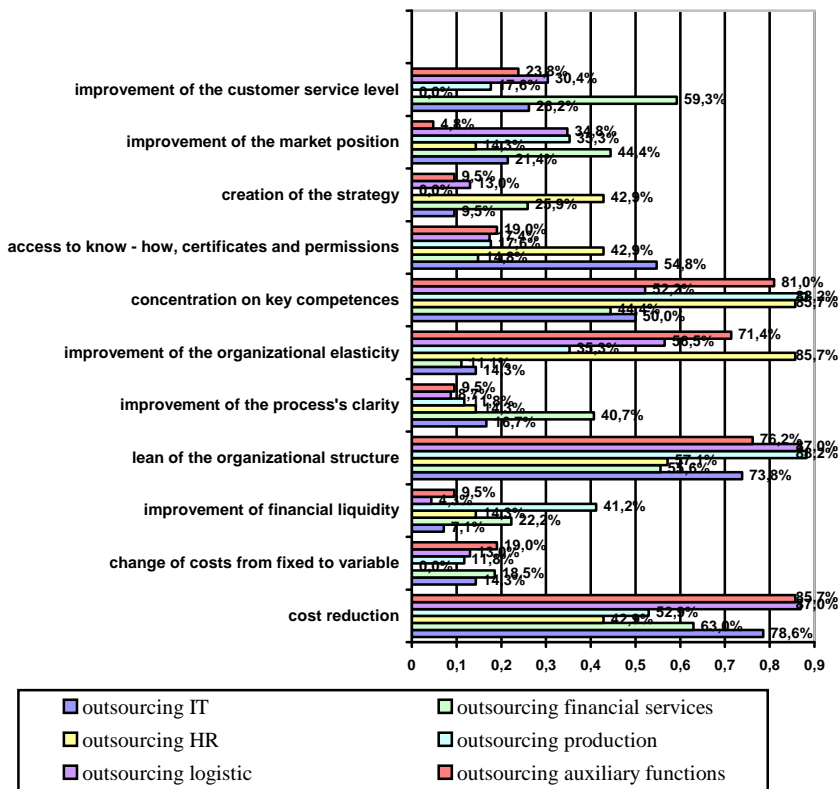


Fig. 3. The aims and areas of outsourcing in studied enterprises.  
Source: Own research.

Goals indicated by respondents differ in dependence on the type of outsourced enterprise's function. However one can notice, that the concentration on the key competences was mentioned the most often (especially in relation to outsourcing of the production, HR and auxiliary functions). Respondents have often pointed the cost reduction (particularly by companies outsourcing the logistic, auxiliary function and IT services), lean organization and improvement of its elasticity. In companies, which outsourced the financial services, the major goals of outsourcing, except these mentioned above, there were the improvement of the customers service level (59,3 %), the improvement of the market position (44,4 %) and the improvement of the processes' clarity (40,7 %). One can notice that the strategic goals predominated in all studied enterprises. First of all the concentration on the key activity of the enterprise was the most important, because it has often decided about enterprise's competitive position and its developmental perspectives. The partner selection is also an essential factor in outsourcing process. Free partners' selection lets get the access to know-how, which is impossible to achieve by own. The reduction of the operative problems as the result of outsourcing application lets managers a possibility to concentrate on the key enterprise's problems. Outsourcing should also cause better market goals realization, e.g. the improvement of the enterprise's market position, extension of the business activity, diversification or the market concentration. Following, it should lead to the better realization of economic goals, such as an increase of income, cost reduction, improvement of the economic results and the economic risk's limitation. Another goal of the outsourcing application is to lean organizational structure and the improvement of the management. Motivational goals can also be reached by applying the outsourcing tools. The objectivation of economic results, the dissemination of economic thinking and working, the development of the entrepreneurship are reached owing to outsourcing concept. The variety of outsourcing goals, introduced above, shows, that they cannot be reduced exclusively to economic goals, and especially to the cost reduction. The cost reduction is important, but not only purpose of outsourcing undertaking. Next to the cost reduction, the leaning of the organizational structure, the improving of the performance elasticity and the concentration on the key competences are very significant goals of outsourcing in the respondents' opinion.

Estimating the character of the outsourcing application in studied enterprises one can notice that in 22 units it was the strategic dimension. That means it was the element of the strategic plan of the enterprise, it was determined by long term goals and an external company was the partner rather than the supplier. According to 12 studied enterprises the character of outsourcing was tactical and it was the result of the current enterprise's needs. In that case the external company plays the supplier part more than the partner, and their co-operation was middle or short term. Both, the strategic and the tactical character of outsourcing were in 16 enterprises.

The outsourcing is often related to liquidation departments (persons) responsible for the realization of the outsourced functions. Table 1 presents respondents' opinions about that.

**Table 1.** The liquidation of departments (persons) responsible for the realization of the outsourced functions in studied enterprises.

The liquidation of departments (persons)	IT outsourcing	financial services outsourcing	HR outsourcing	production outsourcing	logistic outsourcing	auxiliary functions outsourcing
<b>Yes</b>	7/42	4/27	1/7	2/17	3/23	13/21
<b>No</b>	17/42	13/27	3/7	6/17	6/23	2/21
<b>Partly</b>	18/42	10/27	3/7	9/17	14/23	6/21

Source: Own research

The respondents' answers divided enterprises into three groups. This division follows to the type of outsourcing, which was applied. In the first group there are all studied companies except the enterprises, which applied outsourcing of auxiliary functions. The majority of these organizations (39, 4 %) got rid the organizational units (persons) responsible for the realization of the outsourced functions partly or they did not get rid them at all (32,8 %). The only small part enterprises of this group (12, 4 %) decided to do away with the departments from the enterprise. In the second group, there are companies, which applied outsourcing of production and logistic. Similarly, in this group the majority of studied enterprises (57, 5 %) indicated the partial emission of the organizational units and 12, 5% companies decided to close them down. In the third group there are companies, which applied the outsourcing of the auxiliary functions. These enterprises in 61, 9 % entirely got rid the organizational units responsible for the realizing of outsourced auxiliary function. Only 1/3 these enterprises got rid those units partly, and 2 firms left them without changes.

The success of the outsourcing undertaking depends on the enterprise and its partner. Before you make a choice of the partner you should qualify what actions he has to execute. You should also be sure, that the partner is interested in cooperation and he is able to do it. The choice of the partner starts with the goals' qualification of outsourcing and ends with the signature of the contract. You should ask yourself what causes that you want to cooperate with the chosen firm and not with the other. According to questioned persons the most important factors of the partner choosing are: price of the service (51%) and the partner experience (49%). A quality of supplied services is also important for 37% researched persons. This category is the most essential for enterprises applying production and logistic outsourcing. For some respondents (37%) recognized position on the market is also important. A size and a location of the partner are the least essential of all factors of the partner choosing. These factors were pointed accordingly 4% respondents (size) and 28% (location).

Considering the role of outsourcing in the project realization, 65, 69 % respondents claim, that the role is executive, 32, 11 % of them estimate the role

as advisory and only 7, 29 % respondents pointed the conceptional role of the outsourcing. The conceptional role realizes partners who offer IT and financial services.

You should also remember that the obstacles and difficulties can also appear in the outsourcing application. Generalizing, respondents indicated following obstacles:

- choice of the good (appropriate) partner - 85,4 %,
- full control's loss of the outsourced function - 65,7 %,
- adaptation of the standards of the information's flow - 54,7 %,
- human resources management engaged in the project - 45,9 %,
- structural changes management inside the enterprise - 41,6 %.

Despite of these difficulties of the outsourcing realization respondents are satisfied with it. The degree of their satisfaction presents table 2.

**Table 2.** The degree of the satisfaction of the outsourcing in the studied enterprises.<sup>2</sup>

Degree of satisfaction of outsourcing	IT outsourcing	financial services outsourcing	HR outsourcing	production outsourcing	logistic outsourcing	auxiliary functions outsourcing
<i>The average result</i>	<b>4,3</b>	<b>4,3</b>	<b>4,4</b>	<b>4,5</b>	<b>4,2</b>	<b>4,2</b>

*Source: Own researches*

The average assessment of the individual types of outsourcing is in the section from 4,2 to 4,5. Outsourcings of logistic and auxiliary functions were estimated the lowest by respondents, while the production outsourcing was estimated the highest. However quite high averages for all types of outsourcing testify to the large satisfaction of the studied enterprises.

#### 4. Conclusion

The application of the outsourcing concept lets the enterprise concentrate on the key activity and devote the whole attention to satisfy the customer needs. It allows the company to build the competitive advantage and reach profits. Outsourcing is a strategic business tool, which helps to manage the enterprise and makes possible the quicker growth of it. It is not easy to learn specialist knowledge about digital technologies, which are steel developing and even it is

<sup>2</sup> The respondents were asked for the opinion of the degree of their satisfaction of the outsourcing realization in the scale from 1 to 5 (1 means dissatisfaction and 5 the highest degree of satisfaction).

more difficult to be steel on up to date with them. It seems better to cooperate with a special external company than to invest in the employees constantly. The external company could guarantee a good level of the service and the employees can leave the organization after they had attended the specialist knowledge. The studied enterprises use outsourcing and they are going to use it in the future. The majority of them uses outsourcing above 5 years and mainly it is the outsourcing of strategic character. This type of outsourcing is applied by the large joint-stock companies and physical persons. The outsourcing of computer technologies is applied the most often. This is mainly caused by quick technological progress. However the studied companies are interested in HR outsourcing in the future. This type of outsourcing has rarely been applied so far. Presented findings show that the respondents' satisfaction from applying outsourcing is on the very good and good level. This satisfaction depends on the external firm (partner), which the enterprise decides to cooperate with. Bad choice of the partner, incorrect description of the outsourced functions and inappropriate preparation of the contract raise the risk of the failure of the outsourcing process. However, despite of many requirements, some obstacles and limitations, outsourcing gives lots of advantages. In relation to that, outsourcing meets with lager interest and it is applied more and more often in Polish enterprises.

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