

Outsourcing vs. Insourcing: The Most Winning Strategy

Introduction

This paper seeks to explain advantages of outsourcing (buying) as compared to insourcing (making) by examples of manufacturing and service industry. The given paper also discusses the problems or disadvantages of outsourcing. In the given paper, e-commerce and hospital industries are used as examples to dramatize the possible advantages and disadvantages of outsourcing over insourcing. This paper will also discuss possible ways of overcoming the problems of outsourcing.

Analysis and Discussion

The Opportunity Cost of Making a Decision

Economic theory asserts that every decision a company or an organization must attain or at least contribute to the attainment of its own economic objective, is the increased profit. The requirement to meet profit is supported by the concept of opportunity cost, whereby, it is assumed that no organization would go into business to lose money. In simple terms, the stockholders or owners of business could opt just to place their money in the bank and earn interest income without risking their resources in business. In exchange for business risks, therefore, the capital or resource owners need to be earning above their cost of capital or opportunity cost in order to stay in business organizations where they invest (Samuelson & Nordhaus, 1992).

Translated from the organizational level, the company must, therefore, earn profits by means of getting more revenues or less cost of doing business. The decision to outsource rather than to insource is, therefore, a decision expected to attain cost reduction that will ultimately increase profit. Considerable cost reduction would keep the owners' investment in companies or justify further investments.

What the Advantages of Outsourcing Are

Outsourcing as a way of saving costs.

It is argued that it would cost less to 'buy' outside the organization than to 'manufacture' or do the service inside the organization by having more people as employees. In order to attain this advantage there must be a way to compare the cost of outsourcing from insourcing, which would, therefore, require a way of measuring the actual cost of two alternatives and involve the ability to identify what variable costs or relevant costs are as a result of resorting to outsourcing (Atkinson *et al.*, 2005). The one who will produce the higher return on investment would be a more advantageous choice between the two options.

Under the hospital industry, it is argued that hospital administrators can "save money, improve service and reduce hassle" (Williams, 2004). Thus, in 2003, 16% of hospitals' total budgets accounted for outsourcing activities their activities and the said figure was expected to be 30% in five years. Outsourced functions in the hospital industry include cafeterias, housekeeping, security, and other non-core services. Even patient care functions that may include radiology, laboratory services, and nursing radiology were noted as part of what was being outsourced by hospitals (Williams, 2004). Given the expanding use of outsourcing in the industry, there is evidence to sustain the economic reason for doing so. The advantage of such outsourcing activities had even felt eve in clinical engineering, or medical equipment management. It was also discovered that clinical engineering departments are not immune to being targets for outsourcing based on increase from the not-for-profit share-service programs of 1970s into for-profit equipment-maintenance programs in 1980. Outsourcing could, indeed, be considered to have exerted its considerable influence of many business functions (Williams, 2004).

Experts from both insourcing and outsourcing have their separate opinions as to whether outsourcing in the medical equipment management resulted in reduced cost or improved service. Those who favour outsourcing argue that outsourcing is to be handled properly (Williams, 2004). Examples of equipment manufacturers which provide outsourcing, include the Philips, the GEs, and the Siemens. The management of these equipment manufacturers are no longer part of the hospitals but they do offer equipment management programs as independent service organizations or third parties, according to what Williams (2004) says.

Under the e-commerce industry, the examples of outsourced services include those from the marketing aspects of an e-commerce site which may take the form of online organic marketing, Search Engine Optimization (SEO), data storage and/or data processing services, CRM, ad servings and similar third party services (ArticlesBase.com, 2009).

Outsourcing and organizational effectiveness.

Divisional, or organizational effectiveness is attained (ArticlesBase.com, 2009) if after outsourcing, the organization could now concentrate better on its core business that would allow the company to have competitive advantages in the issues it could do better than competitors (Porter, 1998). Divisional and organizational efficiency will also come out as a result of less cost for a division or division in delivering the same product or service to customers. The net effect of this advantage is still to minimize cost as in the first advantage. In addition this will increase value to a customer because of greater effectiveness.

Outsourcing and human resource capital reconfiguration.

Outsourcing could also increase people's contribution to the organization, which could be in effect an act to reconfigure the human resource capital, according to

ArticlesBase.com (2009). The advantage of outsourcing is, therefore, closely related to improving divisional or organizational effectiveness and efficiency, since human resource would be converted to their greatest value in delivering goods and services to customers.

Problems and Disadvantages of Outsourcing

Outsourcing vs. insourcing: costs.

Outsourcing also has its faults, since its nature involves the use of resources. Economically speaking, there is always an opportunity cost for making a choice. In this particular case, the opportunity cost would be net advantage of having undertaken insourcing or producing own goods or services when the latter would be better than outsourcing. Although it was asserted that outsourcing requires spending and time savings due to reduced cost of maintenance, from the net benefit of third party's expertise in design, optimization and functionality, it is possible for outsourcing to cause greater cost than the expected advantage. The misbalance of the cost and the revenue could occur in case there was an error in the preparation of cost information for comparative purposes, or there was a mistake in calculating the differential costs of the two alternatives.

Outsourcing could not be as simple as the decision to purchase that may easily guarantee a better result than insourcing. Third party providers of outsourced services may produce not what they have offered, which could cause more problems than anticipated. Thus, outsourcing contract may also involve some maintenance cost that could not have been factored in when the decision to outsource was made. Instead of actually reducing the number of personnel, the outsourcing contract could possibly cause a discomfort or headache to management by not delivering as promised or represented (Williams, 2004). Of course, the parties can assert their rights in court,

which may come as surprise and, thus, entail an additional cost to the company which has decided to outsource.

Outsourcing: dependency on third parties.

The business organization is presumed to be an independent and sustainable organization where its own people may be relied upon the control of the organization. The organizational desire for better profit on the basis of less cost and thus resorting to outsourcing may create the greater risk of loss of control due to overreliance to third parties (ArticlesBase.com, 2009). Since third parties are independent organizations, they may come out exerting too much power that could result in the fact that the company decides to outsource some of its functions as a candidate from the third party providing the outsource product or service, thus, demonstrating vertical integration (Brigham & Houston, 2002).

It may appear that in the selection of a third party is, indeed, viable enough to provide the outsource product or service but actual performance could be deficient. Although the company's management may be viewing it as a simple economic decision on the most profitable sources, the given idea could affect the strategic direction of the organization which has decided to outsource (ArticlesBase.com, 2009). It may be more costly to insource the same service or product, yet it may have created already a competitive advantage to the company without its knowledge and yet it still decided to outsource the same for cost considerations. Active insourcing, thus, could create a problem in the strategic position of the company in relation to competitors, as Porter (1988) and Pearce & Robinson (2004) reassure. It could be as simple as removing the competitive advantage. Thus, the company will not only lose the competitive advantage when it would outsource, but will also come to its eventual downfall because of the incorrect decision.

Under the Porter's five-force model, one of the forces is the bargaining power of the supplier (Porter, 1980). If this supplier's power is strong, the same could be an industry threat to the organization designing its strategy. Thus, outsourcing could result in encouraging an industry threat instead of protecting the organization from it. The consequences of outsourcing would cause a greater cost in the long run although it may appear attractive in the short run (ArticlesBase.com, 2009).

To rely and depend much on a third party to provide the outsource product or service could remove the company's negotiating power that instead of strengthening, the end result could be loss of the business. This could be aggravated if valuable human resource capital would be more motivated to leave the company because people believe that an outsourced service could be of better use (ArticlesBase.com, 2009). Thus, the employees who will feel alienated could apply to the third party organizations, which could create a vacuum in terms of knowledge and expertise. Since the latter are the possible sources of significant competitive advantage for the organization, the decision to outsource could be an act of giving up some or all control over some material functions of the organization which has decided to outsource (ArticlesBase.com, 2009)

Overcoming the Disadvantages of Outsourcing

The company should know the cost of the alternatives. Before proceeding with taking appropriate measures, there must be good preparation to prevent possible problems in implementation of any outsourcing agreement. There is a need to prepare for the bidding of the outsourcing contract correctly. After a company has decided to outsource, hospital management should consider several factors to be defined before contract goes out to bid, which would include conducting an inventory of functions and checking what equipment is being maintained (Williams, 2004). The check should also

include conducting an in-depth analysis of the functions that these perform.

Management should know that services must continuously be outsourced and which functions should be stopped by evaluating the effects of the outsourcing programs according to defined objectives. Management should also have a complete inventory of equipment that would be managed by the outsourcing company; otherwise, the management could face the risk of unnecessary overruns (Williams, 2004).

Hospitals are aware of the equipment they need; however, the price for the given equipment is constantly rising. In addition, the lack of equipment during the bidding process could result in a losing situation for the contracting company as the absence of equipment could create problems (Williams, 2004). It must be defined clearly what equipment is needed at the hospital. Relying on inventories provided by the contracting company should be avoided for this would have the effect of letting the contract to have a say of what needs to be done under the contract (Williams, 2004).

It is suggested that the inventory of all equipment should be complete between the hospital and the contractor (Williams, 2004). One factor that is suggested to be clear in the contract is the role of clinician to make the equipment available to the contractor. The hospital could retain control on the cost on this aspect (Williams, 2004). Another fact is the performance measures by which the contractor will be judged, as Williams (2004) marks. Contractors must have their boundaries on when the services should be terminated, so that the ownership of the data after termination should be thoroughly spelled out. Failure to do the clear definition may cause frustration and cost overruns that would outweigh the expected benefits (Williams, 2004).

Since outsourcing of the medical equipment management function could mean reduced costs, improved service, and fewer headaches for a hospital or the reverse could happen in the outsourcing program is not successful. Thus, there are certain

guides that must be done to ensure the success of the outsource program. It is important for the hospital to know the performance metrics of their in-house programs. Knowing these metrics require that the decisions to outsource should use realistic evaluations of costs (Williams, 2004). This would entail, therefore, an ability to prepare comparative cost comparison of options. Service levels must also be realistic. Service levels represent the ability to know the level of demand where services would be needed by customer and would properly determine the proper evaluation of costs (Williams, 2004). There must also be a realistic level of management commitment that is necessary for success of the outsourcing program (Williams, 2004).

Hospitals should not outsource for the wrong reasons. To ensure this, hospital management should take a look carefully to its existing department and determine really if there is a need to outsource. Some management may resort to outsource to solve a personality problem or a personal issue in the organization but before management realizes the same, the program may have failed and it would be harder to solve a problem that is created in the process (Williams, 2004). The problem may just be needed to reassign some people to their proper places to become productive. An attempt to use outsourcing for the purpose of making the investment to make an in-house program effective or reducing the amount of department requires would not solve the problem, as experts say (Williams, 2004).

It is even advised by some experts that a hospital does not need to outsource any function that could not be presently done in-house for the simple reason that hospital cannot expect someone outside the system to solve a problem that could not be solved in-house (Williams, 2004). The rationale appears logical and reasonable since what should be outsourced is exactly that would promote the greater objective of the organization.

To prevent a sudden unprepared shifting to outsourcing, there is a need to analyze one's situation before one should talk to contractors. A company needs to know its priorities and know what issues should solve that a contract for outsourcing cannot (Williams, 2004).

Conclusion

To conclude, the economic net benefit is a pervading reason why companies should go into outsourcing. However, it is obvious now that various economic factors must be considered before outsourcing should be adopted by manufacturing or service industries. In accordance with the laws of practicing free trade based on political and economic ideas (Slavin, 1996), companies may be restrained by legislation as to the limit of what they can or cannot outsource. Economic reasons are, however, very influential in making the decision to outsource because of opportunity cost of resources. Thus, it would be harder to prohibit what can be outsourced using the internet. A decision to outsource may not resort to insourcing. It is clear that no legislation could force private companies to adopt outsourcing if they will be losing money in running their organizations. Otherwise, the unprofitable business would eventually fail to sustain these organizations and lead to their fast collapse (Massie, 1987; Plunkett, 1985).

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