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THE REASONS FOR OUTSOURCING AND ITS SCOPE IN RESTRUCTURING AN ENTERPRISE

Summary

Restructurization is an essential process, which allows the company to change and adopt to constantly developing business environment and to maintain its competitive advantage. In the first part of the article the factors and needs for restructuring are presented. Further the author describes the specificity of outsourcing as a tool in restructuring process. In the third part of this article advantages and drawbacks of outsourcing are shown. The author of this work tried to identify the sources for successful implementation of outsourcing in restructuring process.

1. Introduction

Growing competition in the global market is forcing contemporary enterprises to search for and to renew its competitive edge constantly. An effective way of achieving and maintaining competitive edge is effective management and getting rid of these elements of company resources which may hinder its development and absorb its potential. This means that contemporary enterprises have been forced to look for and to create ventures aiming at adapting to increasingly changeable environment but also to perform serious systemic reconstruction and modernization of their organizational structure, which all point to permanent restructuring.

Restructuring in the 21st century stems from the need and necessity to adapt to the turbulent environment. Changing market conditions of economic activity account for the fact that isolating some functions from the organizational structure of the enterprise and entrusting their performance in the hands of other economic entities [Trocki 2001, p. 13], in other words – outsourcing, often plays a decisive role in a chain creating value and shaping competitive edge.

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The aim of the article is to present the reasons for using outsourcing in the process of restructuring enterprises and to describe its types, advantages and drawbacks, which will allow us to determine the scope in which it can be used.

2. The essence and subject of company restructuring

In western literature the common area in definitions of restructuring is the emphasis on the strategic nature of the process of changes taking place in an enterprise aiming at improving the way it functions (its effectiveness) [Hurry, 1993, pp. 69 – 84]. Another definition points at abrupt change in company assets, capital structure or organizational structure [Kowalczyk – Jakubowska, Malewicz 1992, p. 8]. Polish reflections of these definitions can be found in works of A. Nalepka, who treats restructuring as “a deliberate re-orientation of the company mission and aims (mostly on the strategic level) in accordance with past or future environment changes and adaptation of the organization, efficiency, human resources and technologies to it” [Nalepka 1999, p. 20]. A. Stabryła, taking into consideration the scope of restructuring, distinguishes the following types of restructuring [Stabryła 2000, p.251]:

- subject restructuring, concerning legal and economic transformations,
- object restructuring – concerning changes in technical and technological area as well as changes of the product assortment,
- repair restructuring, conducted in companies threatened with bankruptcy, aiming at improving unfavorable economic conditions and restoring company solvency,
- development restructuring, based on strategic decisions taken by the enterprise, concerns innovative and developmental activities, covers the period of 2-5 years.

Other classifications point at the following types of restructuring: marketing, product, company resources, technical and technological [Suszyński, p. 138]). It is worth emphasizing that all divisions are arbitrary, as restructuring plans in enterprises are a complex scope of tasks usually covering several elements from various areas. Moreover, the line between the areas is becoming blurred due to technological progress.

Economic practice and specialist literature indicate many reasons why companies restructure, attributed to joint appearance of tensions and weaknesses in the management and controlling system of an enterprise or in constant changes of the environment [Weston 1992, p. 1083]. Table 1 presents the factors causing the restructuring need, taking into account their division into those inside the company and the ones coming from its surroundings.

Table 1. Factors causing the restructuring need in contemporary enterprises

Internal factors of an enterprise	Factors coming from the environment
• depriving owners of direct control over enterprise activities,	• growing international competition,
• planning and controlling system faults which will not guarantee search for best solutions,	• changes in technology and intensified competition between different branches of the industry,
• excessive diversification of activity and problems in organizing business units,	• changes of manufacturing methods, replacing economies of scale with economies of scope of activities,
• incoherent internal systems of generating and spending cash, not fully compliant with the discipline requirements of capital markets	• changes of philosophy of human resources management from managerial to participative,
	• changes of currency exchange rates and changing consumer goods prices,
	• acceleration of unfavorable changes in basic industry branches, banks and other financial institutions,
	• government deficit causing uncertainty and fear of increase inflation and high interest rate

Source: own elaboration on the basis of: [Borowiecki 2003, pp. 77 – 79].

The above factors affecting the restructuring need confirm an obvious conclusion that contemporary enterprises, in order to survive and maintain their market position, must both predict and appropriately assess their situation in light of changes taking place in their environment. These changes constitute present indicators of expansion intentions formulated by enterprises in order to secure their efficient operations and long-term development. [Borowiecki 2003, p. 80].

For our further considerations we adopted a multi-dimensional approach to restructuring, treating it as a process of changes inside the company, whose aim is to adjust the company to its environment. In such an approach, real restructuring takes place when appropriate changes happen simultaneously in three areas of:

- strategy, covering the company's vision and policy, long-term planning, annual objectives and its budget,
- structure, covering static organization, process organization, information systems, operational rules,
- organizational culture, entailing attitudes, behaviors, norms, certain values, communicating style, forms of meetings.

3. Definition and use of outsourcing in the restructuring process

The term 'outsourcing' was first used in the second half of the 20th century. However, the specialist literature and economic practice point at numerous examples of forms of cooperation similar to outsourcing in their assumptions concerning the relationship between cooperators, such as subcontracting^[1]. The etymology of the word shows that it is composed of three words: "outside-resource-using" [Laskowska, 1995, p. 17]. Outsourcing is defined as "the use of complex services being combination of various unit services sold and settled per single unit, offered by external contractors (service providers)" [Penc, 1997, p. 302]. Outsourcing analyses usually emphasize changes in the main company prior to the use of selected form of cooperation. P. Bendor-Samuel and M. F. Greaver Junior stress a characteristic feature of a relationship between the principal and the agent, consisting in the takeover of not only principal's resources but also decision competencies concerning their use by the agent in line with the provisions of a contract signed by both parties. M. Trocki, on the other hand, draws our attention to the fact that the functions passed to other economic entities are not key competencies of the main company [Trocki 1999, p. 16]. The concept of key competencies of an enterprise calls for explanation here. The most accurate definition was provided by C. Prahalad and G. Hamel: „key competencies are groups of resources, processes and skills determining the competitive advantage of an enterprise, providing access to important markets or market segments, making significant contribution to the benefits discerned by customers, allowing the company to lower costs, making it difficult for competitors to imitate the company or enabling the company to create strategic architecture” [Hamel., Prahalad 1999, p. 213]. Key competencies then refer only to specific, most essential functions of the company activities. In the outsourcing process the realization of other functions is passed to outside companies, which due to their specialization are able to replace the internal function effectively and efficiently. M. Trocki indicates a range of questions which allow us to propose the optimal range of outsourcing use. These are: [Trocki 1999, p. 181],

- Which functions are realized efficiently and effectively within the existing structure?
- Which company functions may be realized more effectively and efficiently outside the company structure?
- Which company functions realized outside the company structure could be realized more effectively within its structure?

1 See more on this subject in: Lewis H. T., *Subcontracting: The Current Problem*, [in:] „Harvard Business Review”, vol. 19, No 4.

Outsourcing is a method of company restructuring consisting in shrinking or downsizing the company, which provides better flexibility in understanding the speed, effectiveness and efficiency of adapting to environment changes.

The superior aim of the restructuring should be to provide or restore the ability to compete effectively. In a turbulent environment ability to compete is mostly associated with companies characterized by such features as: flexibility and cooperativeness. Flexibility can be seen in enterprises which can quickly and precisely make investments and resign from them without incurring huge costs. Cooperativeness refers to cooperation with a wide range of interest-holders [Romanowska, Trocki 2002, p. 74]

In the current turbulent environment, enterprises, in order to be flexible, are looking for some kind of optimum of functions performed by them in the restructuring process. These functions are defined as a particular set of repetitive actions. There are a few main elements which locate these functions within or outside the company structure. The first of them is their significance, that is whether they are key competencies, the next one is their controllability [Trocki 1999, p.76].

In recent years the science of management has witnessed new trends and concepts of such restructuring ventures as: reengineering, lean management, flat organizations, network organizations or the outsourcing process [Garstka 2006, pp.23-28].

4. The reasons for outsourcing and its scope

The most important reason for using outsourcing in the restructuring process is the possibility of cutting costs understood as a difference in price at which an outsourcer may provide manufactures goods or services and the price at which the company would produce it. This difference is attributed to the specialization effect, economies of scale and scope [Kakabadse, Kakabadse 2000, p.7]. We should also point out that the presentation of cost benefits of outsourcing is the presentation of direct costs. There are also indirect costs, such as infrastructure and information systems.

There is no doubt that for the company undergoing the restructuring process improvement of its cost efficiency is the essential issue. Therefore we could conclude that it will be the most important reason for using outsourcing in the restructuring process. The next reason is the ability to achieve better control over costs and better information flow inside an organization, which is a vital factor in the change process.

Another, often emphasized in specialist literature, benefit of outsourcing is that it is a decision decreasing operational risk by transmitting part of it on the outsourcer. This argument gains importance if we assume the

changeability of the environment, when the operational risk is continuously increasing and there is more room for assessment-related mistakes. The main challenge then is to shorten the time the company needs to adjust to new conditions. This does not only consist in flexible approach to the production volume of a particular good or service, but also in making its kind and scope more flexible. This is of vital importance in organizations whose time of adjusting to constantly changing environment determines their competitive edge, such as in the IT branch.

Outsourcing also affects objectivity of economic results, introduction of economic acting and thinking as well entrepreneurship, fulfilling its motivation aims.

When deciding whether to use outsourcing as a restructuring tool, the company should consider the optimal scope, taking into account all costs, including process implementation costs.

The basis criterion is the choice between capital outsourcing and contract outsourcing.. The first option consists in creating a new economic entity (daughter company), in which a parent company will secure optimal ownership structure for itself [Trocki 2001, p. 134]. The new economic entity will perform the tasks within the isolated function on the basis of appropriate contract. Contract outsourcing, on the other hand, consists in resignation from independent realization of a particular function and passing its performance to an independent economic entity on the basis of a long-term contract. The prerequisite of outsourcing in this form is the existence of stabilized market offer of such services provided by independent economic entities. It is also essential that their offer is competitive in terms of quality and price in comparison to an analogical period of activity realized independently by an enterprise [Trocki 2001, p. 90].

Favorable ownership share of a parent company in the first option provides it with a possibility of eliminating one of the most serious drawbacks of outsourcing, namely limited possibilities of controlling the performance of tasks. Such a solution is possible, however, only if the parent company is technically and organizationally capable of such isolation. Another reason for using capital outsourcing is fulfillment of necessary conditions in the process of restructuring. We can divide all the arguments into those coming from the parent company and from the isolated unit, as in Table 2.

Table 2. Criteria of choice between capital and contract outsourcing

From the point of view of the parent company	From the point of view of the isolated unit
Provision of favorable ownership structure in a daughter company which takes over the isolated activity allows the parent company to maintain control over isolated activity through financial resources at its disposal.	Capital outsourcing is effective when isolated enterprise has the legal, technical and organizational abilities, which is connected with sufficient human resources both at the management level (executives) and production level (specialists). An essential element is also the existence of external market, that is outside the boundaries of a parent company. This factor makes competitiveness of an isolated unit more objective and may lead to its independence through obtaining revenue from other sources. This market should be the source of new external revenue increasing the independence of the isolated unit.

Source: own elaboration on the basis of: [Trocki M 1999, p. 207].

Choosing the scope of outsourcing we should take into account both general and specific conditions in the broadly understood environment of the enterprise [Trocki 1999, p. 207], such as: acceptance of the owners of isolated functions by showing them planned profits or predicted improvement of effectiveness in the strategic, market or economic area. It is also essential to obtain the acceptance of the staff employed in the function which is being isolated. Moreover, in case of external outsourcing, there must be a market offer of potential partners. This offer should include competition in Porter's understanding of this word: it covers price, quality and also scope. It is also important to determine the potential power of agents so that we could influence their decisions. The conclusion which is becoming more common in outsourcing literature, basing mainly on IT sector, assumes change of perspective on the central point in a relation between the provider of outsourcing services and their customer. Research conducted by [Kern & Willcocks 2002] points at the role played by properly formulated outsourcing contracts describing the scope and quality of provided services (service level agreements). The formal role of the contract offers a potential possibility of mutual trust and involvement in its development. [Goo 2009]

Basic limitations of the outsourcing use result from legal aspects of this process. Companies should decide whether the use of outsourcing in the restructuring process is legally regulated and feasible. An example here could be outsourcing in banking services concerning correspondence, which according to regulations cannot be commissioned outside the parent company.

Another frequently made mistake is too optimistic approach to possibilities of cost cuts, which may lead to the situation in which the outsourced process turns out to be more expensive than the process realized by the parent company.

This may be due to frequent omission of internal costs which the restructuring company has to incur, such as the costs connected with the contract, its monitoring and execution.

Another group are social costs, such as changes to employee motivation or even lower productivity in the company after outsourcing some of its processes. What is more, Lafferty and Roan indicate that through fully implemented outsourcing the company is losing the possibility of constant quality and task realization control, which creates additional risk of not performing it correctly [Lafferty, Roan 2000, pp. 76-85]. Much controversy has also arisen around the fact that the use of outsourcing may cost the company the loss of learning ability. In literature this ability is also known as intellectual capital of an organization [Oshri, Kotlarsky, Willcoc, p. 63] and consists of three elements: structural capital, defined as the behavior which could be used as a tool of inducing new people, human capital, seen as individual abilities to provide customers with best solutions, and client capital understood as the knowledge shared in the organization based on relations between people who interact with each other. The organization, therefore, runs the risk of losing such intellectual capital by taking advantage of the outsourcing process. [Oshri, Kotlarsky, Willcoc, pp. 62-68]

The above arguments induce some companies not only to avoid making outsourcing decisions in times of restructuring but also to initiate the opposite action, namely to restore the formerly outsourced processes to the structures of parent companies (in-sourcing).

5. Conclusions

Analyzing the effects of restructuring by means of outsourcing we should remember that the measurable effects, such as improved financial indicators, better use of production factors, sales or isolation of part of the equity, improvement or deterioration of product quality, changes in production organization or changes in transport or technologies, are all complex changes, often correlated with each other. The effects of these changes should be analyzed in a company in a long, dynamic period of time, in which we should also assess the grounds for the introduction of outsourcing.

The aim of the article was to present outsourcing as a tool of company restructuring. We presented the possible scope of outsourcing use in restructuring the company and the reasons for its use. The article proves that outsourcing cannot be treated as the autonomous and exclusive factor of changes inside the company. It is a method of restructuring, that is a complex process referring to organizational structure, strategy and culture, therefore it requires adjustments in the whole organization of the company. We are entitled to pose

a thesis that there is a positive correlation between restructuring by means of outsourcing and the success of the restructuring process in the company, but this is not the sui genesis factor, but only a tool, an instrument which we can use appropriately to the current situation of the company and which must be analyzed in detail with reference to other environment changes. Such conclusion is compliant with the aim of the above article.

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