CHAPTER – 2

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There is hardly a more salient question faced by industrial leaders than the question as to “which aspects of our value chain should we perform in house and what could be outsourced?” Some have addressed this question as the classic make-or-buy decision or the decision as to the extent of vertical integration. More recently, these demarcations of firm boundaries have been studied from the perspective of outsourcing. While considering outsourcing, firms are evaluating whether or not to reverse a prior decision to “make”. In other words, outsourcing involves the re-shaping of existing firm boundaries. Outsourcing can further be conceptualized as a process which begins with the development of a sound business case for outsourcing followed by the implementation of the external sourcing model, and ultimately the management of the relationship with the provider.

2.1. Rationale of the Study

Outsourcing has clearly emerged as a prevalent and transformational business practice in modern times. Given this popularity, the experiences being reported by many organizations are somewhat surprising. According to a Deloitte Consulting study (Landis et al., 2005)\(^1\), 64% of respondents indicated that they had brought outsourced services back in-house and 44% did not realize cost savings. Moreover, Dunn and Bradstreet found that 20–25% of all outsourcing relationships fail within 2 years and half of them fail within 5 years of inception (Doig et al., 2001)\(^2\). A more recent and expansive Deloitte survey of 300 business executives also found the need for improved outsourcing practices. Only 34% were satisfied with the provider’s innovation and 61% indicated that they had to “escalate” problems to senior management within the first year (Robinson et al., 2008)\(^3\). Further, 75% of

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the service providers interviewed felt that their clients were ill prepared for the outsourcing initiative often lacking a well-developed strategy and clear understanding of how it would work. These anecdotal findings which suggest that there is a troubling gap between expectations and reality serve as the motivation for this research.

2.2. Literature Review to Identify Research Gap

Literature review is covered in depth in a separate chapter. However for identifying research gap the following literature was being reviewed.

(E. Mahmoodzadeh & Sh. Jalalinia & F. Nekui Y., 2009)\textsuperscript{14} in recent times, with increasing competitive pressures and progressing globalization, firms have to reduce their costs and build new opportunities via optimized usage of internal and external resources.

(Gero W. & Stefan S., 2007)\textsuperscript{15} The term outsourcing originates from the Anglo-Saxon language realm and is a contraction of the words Outside Resource. Outsourcing describes the use of external resources to execute operational tasks.

(Bin Jiang & Amer Qureshi, 2005)\textsuperscript{16} Outsourcing is one of the most recent management strategies to emerge in response to demands for more efficient ways to address organizational competitiveness. In an age where management carefully weighs the costs and benefits of every discretionary investment dollar, finding evidence of the results of outsourcing has become critical.

(Bhimrao Ghodeswar & Janardan Vaidyanathan, 2008)\textsuperscript{17} Outsourcing is the act of transferring some of an organization's recurring internal activities and decision rights to outside providers, as set forth in a contract. Outsourcing today involves either IT or BPO.


\textsuperscript{15} Gero W., Stefan S., 2007. "Information needs in the outsourcing lifecycle". Industrial Management & Data Systems Vol. 108 No. 1, pp. 107-121


The advantages in outsourcing can be operational, strategic, or both. Operational advantages usually provide for short-term trouble avoidance, while strategic advantages offer long-term contributions in maximizing opportunities. In addition, outsourcing is defined as utilizing external suppliers to satisfy any of a company’s capital requirements included material, labor, or plant and equipment.

BPO is the delegation of a business process to an external service provider who owns, administers and manages it, according to a defined set of metrics.

Traditionally, empirical studies concerning firm boundary decisions focus on the ability of the various “theories of the firm” (e.g. transaction cost & resource based) to predict or explain existing firm boundaries found in practice. However, with few exceptions, this literature stops short of testing the performance implications of these decisions. Moreover, the sourcing decision itself is the focus of this literature, and not the actual management of the outsourcing effort. Performing an extensive strategic evaluation of an outsourcing opportunity not only facilitates the outsourcing decision, but also develops a clear understanding of the risk and coordination implications of outsourcing. This knowledge can be utilized to inform the development of an effective contract and strengthen the development of a mutually beneficial relationship with the provider. To our knowledge, these effects have not been empirically explored in the literature. This study also contributes a contractual completeness construct. The closest concept found in the extant literature is contractual complexity. The complexity of a contract has been operationalized by the level of customization and the length of the contract. The length and customization of a contract is not the same as the current...
conceptualization of contractual completeness. (Tosi et al., 1997)\textsuperscript{22} Other studies have looked at the effect of contract enforcement as a means of mitigating principal-agent conflict. A study by Aron et al.\textsuperscript{23} considers at how recent technological advances allow firms to more effectively monitor the activity of off-shore business process outsourcing providers resulting in more effective enforcement of contractual process quality objectives. Contract enforcement is certainly an important aspect of activity management. However, enforcement only comes into play after the development of a contract with well-specified service objectives. Thus, the focus in the current study is to examine the feasibility of an operational business process outsourcing model in an organization of the automotive industry.

Concurrently evaluating the effects of contractual completeness and relationship management on outsourcing performance is the third contribution of this study. There is an impressive body of supply chain literature which evaluates how inter-organizational relationship practices influence the performance of pre-established exchanges. (Carr and Pearson, 1999; Chen et al., 2004; Shin et al., 2000)\textsuperscript{24} Many have studied the positive effect of cooperative buyer–supplier relationships on exchange performance from the buying firm’s perspective. (Benton and Maloni, 2005; Prahinski and Benton, 2004)\textsuperscript{25} Others have considered these effects from the perspective of the supplier. The current study extends this literature to a realm of outsourcing which entails the establishment of new exchanges for business activities traditionally performed within the firm, often with no physical product involved. Moreover, the influence of relationship management on outsourcing performance is considered along with the influence of contractual completeness. To date, the influence of these two constructs on outsourcing performance has not been concurrently evaluated.

The management practice of outsourcing a company’s core and supporting activities in a variety of business functions has been a focus of


attention, not only recently, but also during the last few decades. Apart from the growing volume of literature describing various facets of outsourcing, the consultancy business welcomes outsourcing as a weapon to fight within a competitive market place as well as to focus on business strategies. The research at hand will present a concise analysis of outsourcing core and supporting activities, with an emphasis on the evaluation of parameters which have an impact on outsourcing performance in the automotive industry.

2.3. Definitions

**Outsourcing**: Often refers to the process of subcontracting to a third-party. While outsourcing may be viewed as a component to the growing division of labor encompassing all societies, the term did not enter the English-speaking lexicon until the 1980s. Since the 1980s, transnational corporations have increased subcontracting across national boundaries. Outsourcing is a growing phenomenon and it needs to be assessed from a broad standpoint as it constitutes a new historical phase in global production and the global division of tasks.

**Business Process Outsourcing**: Business Process outsourcing in simple terms is defined as the movement of business processes from inside the organisation to external service providers.

**Automotive Industry**: Designs, develops, manufactures, markets, and sells the world's motor vehicles.

**Strategy Evaluation**: Reflects the extent to which the outsourcing team performed a comprehensive evaluation of the strategic implications of outsourcing a business activity.

**Contractual Completeness**: Is the extent to which the outsourcing firm and the chosen provider develop a contract which effectively coordinates resources and addresses identified inter-organizational risks.

**Relationship Management**: Represents the degree to which an outsourcing firm has strived to establish and maintain a mutually beneficial relationship with the supplier or vendor. Outsourcing Performance: The outsourcing performance variable included in the structural models is a
composite of the informant's rating of performance for annual cost, quality, responsiveness or flexibility, and reliability relative to expectations.

2.4. Objectives of the Study

- To develop conceptual domains for business process outsourcing
- To establish relationship between domains such as strategy evaluation, contractual completeness, relationship management, outsourcing performance, and organizational performance alignment.
- To examine the impact of each domain over the other using structural equation model.
- To analyze the problem faced by the automotive industry in the absence of business process outsourcing model.
- To identify the managerial implications of business process outsourcing and make suggestions for applying the same in the automotive industry prevalent in Iran.

2.5. Scope of the Study

This research study has considered two major manufacturers of automobiles in Iran, namely IKCO and SAIPA. IKCO (Iran Khodro Industrial Group) was founded in 1963 in Tehran (the capital city of Iran). Now, it is the biggest company in the Iranian automotive industry which had 48% of the market share and 57% of the financial market in Iran in 2008. During this period, the company succeeded to achieve many national and international awards like:

- EFQM Crystalline Statue
- EFQM Thank letter
- Certificate of commitment to EFQM
- Thank Brede for being a good exporter
- Plus sage Thank Brede of Muslim countries
- Being ranked first in the 100 industrial companies in Iran
- Being selected as an appropriate designer and producer of vehicles by the Islamic Conferences Organization
SAIPA was established in 1966. From its inception till date, SAIPA has entered into joint ventures with CITROEN & RENAULT of France, NISSAN of Japan and KIA Motors of Korea. Given the quality and affordability of SAIPA products in its target markets, SAIPA has successfully implemented its export strategy and increased sales outside Iran, especially in the Middle East, CIS and the North African markets.

**SAIPA History – A glance**

1998 - It developed into a full range Vehicle Manufacturing Company by Purchasing Iran Kaveh (SAIPA Diesel) and Zamyad Companies.

- 1999 purchased Pars Khodro company
- 2003 achieved production of 1800 units per day
- 2004 gained market share of approximately 40% for the passenger car segment in Iran
- 2006 55% of the local Iranian market share
- 2007 launched an assembly line in Syria

**2.6. Research Design**

The research design adopted is a descriptive study structured with clearly stated hypothesis. It makes a description of the phenomenon of outsourcing in automotive industry and further attempts to discover associations among different variables.

**a) Hypotheses**

The theoretical underpinnings for each of the hypothesized relationships, is provided in the following sections. The conceptual model in figure 2.1, illustrates the direct and indirect influence of strategic evaluation on outsourcing performance, along with the direct effects of contractual completeness and relationship management on the performance of outsourcing initiatives.
The Existing Model

![Diagram of the Existing Model]

Figure 2.1. The Existing Model

Hypotheses

Hypothesis 1. Strategic evaluation has a significant positive effect on outsourcing performance.

Hypothesis 2. Strategic evaluation has a significant positive effect on contractual completeness.

Hypothesis 3. Strategic evaluation has a significant positive effect on relationship management.

Hypothesis 4. Contractual completeness has a significant positive effect on overall outsourcing performance.

Hypothesis 5. Relationship management has a significant positive effect on overall outsourcing performance.
b) Methodology

The research at hand would employ a two-stage structural equation modeling (SEM)\textsuperscript{26}. In the first stage, the reliability and validity of the measurement model will be evaluated and established. In the second stage, the nomological validity of the structural model will be assessed and the hypothesized relationships will be statistically evaluated.

c) Measures and Questionnaire

The research instrument is a questionnaire which will be representing outsourcing management practices that will be well grounded in the literature streams reviewed. Where possible, items will be adapted from prior validated scales. The specific outsourcing initiative will be taken as the unit of analysis for this study, and the survey instrument will be designed to ascertain practices used during a specific outsourcing effort.

d) Data Collection
The research objectives was best achieved through data collection from primary sources such as obtaining responses from professionals holding senior level positions and representing a diverse set of outsourcing experiences in terms of the type of outsourcing activity (e.g. manufacturing vs. business process, domestic vs. international, and contract size), industry, and firm size. Contact information for well-qualified sample informants identified with the assistance of an officer of the International Association of Contract and Commercial Management. Industry experts who was reviewed the preliminary survey also provide insights as to the type of job titles that would reflect probable knowledge of outsourcing initiatives. Utilizing their guidance, the sample of 500 was selected based upon job titles and job descriptions available. Further, secondary data sources from the selected companies were used in research analysis.

e) Statistical tools and analysis
Statistical tools such as EFA (Explanatory Factor Analysis), T-Value, Cronbach's $\alpha$ and reliability will be measured using the SPSS software. Matrix correlation analyzing is made for finding correlation between various dimensions of the framework of outsourcing.
CFA (Confirmatory Factor Analysis) and the structural equation model would be employed for hypothesis testing using LISREL software.
2.7. Scenario of Automotive Industry in Iran

The change in global automotive industry has had an impact on the automotive industry in Iran. The scenario of automotive industry in Iran is as follows:

- **Between 1969 – 1979:** The manufacturing cycle of automotive industry did not go beyond assembly. This incompleted cycle led to low internal manufacturing. As a result, there was increase in import of new and second hand vehicle.

- **Between 1980 – 1990:** The automotive industry faced an economic siege of war. This was the time when the industry struggled to survive.

- **During 1990 – 1993:** The opportunity cost of losing the market share for several years was felt. At the same time war came to an end. Economic regulations were initiated. Market was opening but the industry could not cater to the market and there was an import of 164,000 cars during this period.

- **Between 1993 – 2004:** There was revival of the automotive industry, Policies were supportive, Designer companies were established, Engineering and manufacturing of vehicle parts started.

- **2005 – Plus:** The automotive industry moved from the stage of assembling to CKD (Complete Knock Down) to SKD (Semi Knock Down). Presently, there has been an increase of 70% in manufacturing of automotives in order to meet the demands of the national market.
References and Bibliography


