

Sourcing Strategy: Where do the benefits lay?

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Abstract: Literature on insourcing was reviewed. It found that there are benefits to insourcing across a wide range of management functions. It was also seen that the number of benefits found, exceeded those benefits expected, and that these occurred in areas not generally measured in efficiency equations such as time and cost. Unexpected benefits were found primarily in the areas of increased capability, quality and capacity building, indicating that insourcing may be an effective tool for management. Whereas the primary instigator appeared to be a greater sense of control and need for more responsive time lines.

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In the past decade there has been a shift from outsourcing to insourcing and multi-sourcing within different industries. This paper explores reasons for the shift and attempts to identify the benefits that it has provided to those industries that have moved away from the outsourcing philosophy of the 1980 and 1990's, and reverted to insourcing as a means of providing services

This paper will be of interest to those who work in both public or private sectors and are involved in either contracting in or contracting out services. It provides insight into which industries are moving to insourcing and why it has been seen as a benefit to them. It highlights that sound business analysis is a must when sourcing products and services, and that simply following the latest trend, whether insourcing or outsourcing, is a disservice to business and industry in general. This paper looks at the literature available and attempts to explain the benefits behind the decision to insource, who is doing it and why. A new definition of insourcing is provided which better fits a range of implementations.

Method

In 1996, Hodge published work that was based on locating empirical evidence on contracting out. Large scale contracting out, particularly in the public sector, was still a reasonably new. His three level review of contracting out literature was an important step in understanding the benefits gained by outsourcing. Since that time, outsourcing has been used not only for cost effectiveness but also to control the effectiveness of outcomes. The methodology proposed here closely follows that used in the first two (of three) stages detailed in Hodge's (1996, p13) work, but applies the rigorousness of the study to insourcing and comes up with some surprising findings.

Literature in brief

The paper reviewed literature on both outsourcing and insourcing, with the focus on benefits that accrued from each. Central to this work is discussion on definitions of both insourcing and outsourcing, as definitions impact on the way in which articles, both peer reviewed or otherwise, are classified.

For outsourcing, there are a plethora of definitions to choose from, some more closely aligned with particular industries than others. Consensus appears to have been reached however with Lankford & Parsa (1999, p311) who defined outsourcing as

the procurement of products or services from sources that are external to the organisation.

Chase et al (2004, p372) who defines outsourcing as an

act of moving some of the firm's internal activities and decision responsibilities to outside providers

which echoes the focus on the organisation's externality of sourcing. This focus on externality forms a key element of this paper, which contrasts the outward focus to that found in organisations that source products and services from within.

If outsourcing is defined as sourcing products and services from outside the organisation, then insourcing must necessarily be defined as sourcing these items from within an existing organisation. However the literature is not consistent on this point. A preliminary literature review shows that insourcing means different things to different people and can range from in-house contracting between departments from the same company, service level agreements (Dobb 1998, p106), and creating new in house departments (Canez et al 2000).

Perhaps the most comprehensive definition is given by Beaumont & Sohal (2004 p689-690) who define insourcing as:

applying outsourcing's discipline to internal suppliers, often having them compete with external suppliers.

The literature on insourcing found that there was no consistent definition of insourcing and that it varied in use across countries and time. To combat this, the following definition of insourcing is provided:

The act of moving some of the firm's externally sourced activities and decision responsibilities to internal providers.

This is based on a reversal of Chase et al's (2004 p372) definition of outsourcing, and can be applied to insourcing, re-insourcing and service level agreements.

Economists state that cost savings and efficiencies associated in outsourcing have been a major factor in controlling costs and maintaining profitability (Cohen & Young 2006, p1). As such, it is set to continue, both at a national and international level. Turner (1996, p19) concurs with this view citing an almost doubling of outsourced networks within trans-European carriers within a four year period.

In the international market, Schniederjans and Zuckweiler (2004, p978) state that outsourcing risks fall into three categories including economic or currency stability, political stability, and cultural differences including language barriers. Intellectual property protection is becoming a concern to some (Clegg et al 2005; Dahl 2006), while time zones, time to market and dedicated lines are concerns for Rao (2004). These risks are not just seen as belonging to the manufacturing sector. In service industries such as call centres, cultural differences can be marked, with growing customer dissatisfaction with internationally outsourced service functions having an adverse effect on business. Yet cheap labour is alluring. Low wage eastern block countries represent competitive threat to industrialised European countries states

Drejer & Sorensen (2002, p389). For Goodyear, cheap Mexican labour seemed the answer to labour demands in the USA (Schneiderjans and Zuckweiler 2004, p979). In both service industries and manufacturing, there are numerous examples of outsourcing to Asia and India to lower costs.

While both government and business have embraced outsourcing, critics state that efficiency gains are smaller than those claimed when additional costs such as managing the tendering, appointment and monitoring of contracts are taken into account (Paddon 1991). Paddon and Thanki (1995), and Walker and Walker (2000) go on to state that costs savings often occur at the expense of quality reductions as corners are cut and work conditions deteriorate. This is particularly the case where contracts are outsourced to a third party.

Beaumont and Sohal (2004 p697) rated 14 possible reasons for retaining internal sourcing arrangements and found that among the highest listed were concerns around levels of control, cost and confidentiality issues. It would seem that these are valid reasons for retaining control internally. Furthermore, when contracting from internal sources there is a lower risk of litigation, but depending on the organisational culture contracts' key performance indicators may be either easier or harder to enforce.

Benson and Littler (2002 in Clegg et al, 2005) found that outsourcing did not have a significant impact on performance compared to other sources of restructuring.

Early literature suggested that cost efficiencies of up to 30% were possible with outsourcing, with Clegg et al (2005, p48) continuing to indicate that for facilities management savings of 17-18% are still achievable. Hodge (1996) indicates that a more conservative estimate across all industries is that of around 10%. According to Cohen and Young (2006 p2) outsourcing no longer provides a competitive advantage when everyone is doing it. They go on to state that 50% of outsourcing (service) contracts signed between 2000 and 2004 will fail to meet expectations.

Clegg et al (2005, p44) believe that second generation contracts often lead to much closer partnership arrangements, as relationships develop between the outsourcing organisation and the provider. While Cohen and Young (2006 p2) recommend a combined approach which obtains business services from multiple sources inside and outside corporate walls to obtain the best business outcomes.

In short, there are risks associated with managing outsourced contracts. Insourcing does not negate all of these risks, but it does spread the risk differently. Each organisation will have its own risk management strategy that contributes to the organisation's strategic outlook.

Key Findings

The review of literature on insourcing found that there are benefits to insourcing across a wide range of management functions. It was also seen that the number of benefits found exceeded the benefits expected, and that these occurred in areas not generally measured in efficiency equations such as time and cost. Unexpected benefits were found primarily in the areas of increased capability, quality and capacity building, indicating that insourcing may be an effective tool for management.

Hodge's (1996) study had a greater number of peer reviewed articles to work with. His three levels of review produced a sufficiently large sample in each category to allow for full exploration of the data. However, this study of insourcing literature, did not find a sufficient number of articles falling within Hodge's third level to allow for full exploration of articles falling within level 3.

The following chart shows reported articles on insourcing based on industry type. Manufacturing, IT and service industries represented 85% of the industries willing to consider insourcing or re-insourcing as a valid method of management.

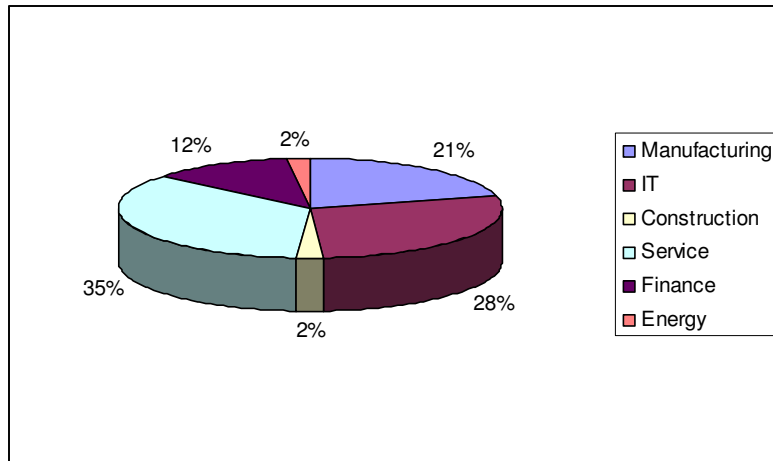


Figure 3: Insourcing by Industry Type

Articles on insourcing were found over a 12 year period with the majority being found in the 11th year. 46% of articles on insourcing referenced the data collected in the USA. This may indicate a trend forming in one country that may then move to other countries. The United Kingdom also had a significant number of articles on insourcing, though these related mainly to help desk re-insourcing.

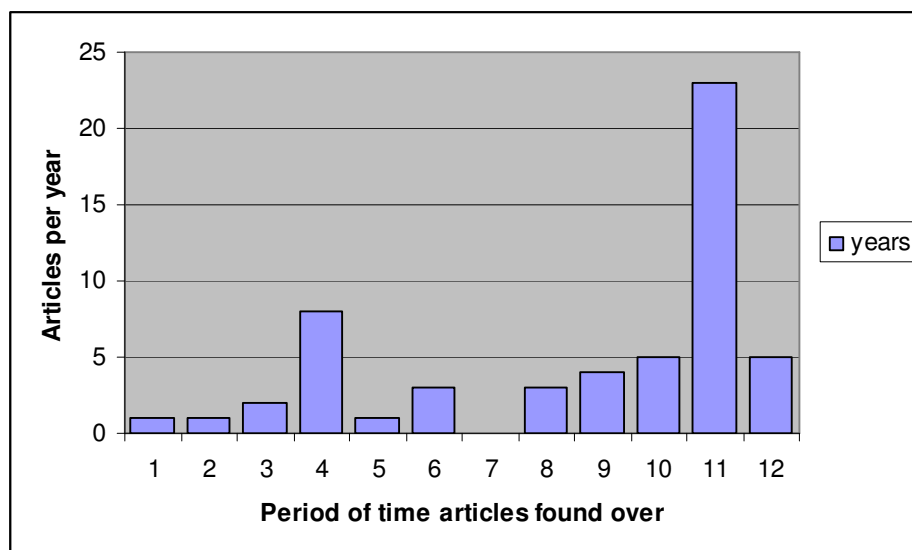


Figure 1: Distribution Years of Publication

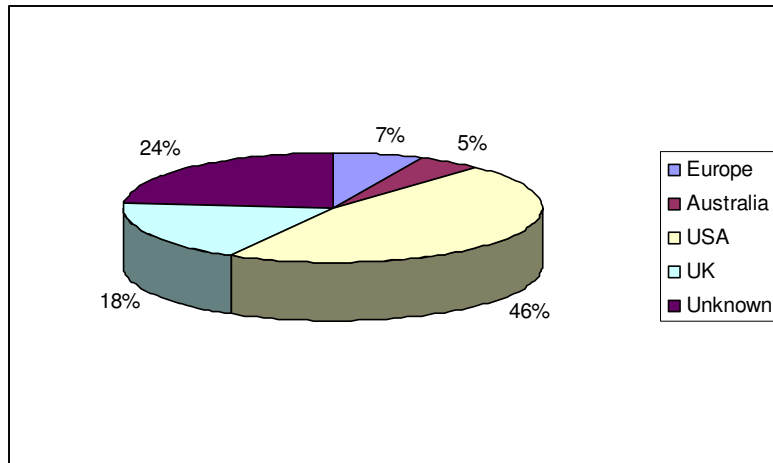


Figure 2: Insourcing by Country

The review of literature on insourcing found 57 articles (not all peer reviewed) that reported empirical data and fell into the first level, which provided a general overview of the data gathered. The intent was to identify the basic variables and note the number and incidence of attributes that are reported in order to ascertain who is writing about it, and whether the reports are biased due to funding mechanisms, what sectors or countries are involved and who the authors in this field are. The second level reported and assessed studies undertaken with a reasonable level of empirical data. It looked at the analytical basis of the report, evidence presented and supported conclusions. Just 14 studies fell into this category, all were peer reviewed. Studies reporting in a complete and open manner were used in the third level, where empirical integrity was strongest. The aim was to highlight linkages that may exist, and differences that may become evident within the data in relation to benefits. The literature on insourcing found there were only 4 studies reporting sufficient empirical data to fall into the equivalent of Hodges' third level, with three co-authored by Lacity, and reporting on the IT industry.

From the literature, it appears that 23% of companies were willing to re-insource in an attempt to rectify failed outsourcing contracts. The results also indicate that the number of benefits exceeds the number of expected benefits. Benefits were found across a number of areas ranging from knowledge learning to

economic. Interestingly, it was to gain benefits across such a broad spectrum of management that outsourcing, according to Kakabadse and Kakabadse (2002, p15) was implemented in the 1980s.

The most reported benefits were cost savings (70%), increased service levels (33%), improved quality (28%), and increased control of processes including time to market (26%). There was an unexpected reporting of increased expertise and knowledge (18%) as a benefit. This is contrary to much of the existing literature which cites access to increased expertise and knowledge as a reason for outsourcing. One reason for outsourcing's failure to produce on this is that staff may move to the outsourced firm, therefore no knowledge or expertise is gained.

Multiple benefits were reported in 79% of cases. Twenty six percent of studies reported cost and quality as benefits, while 19% reported both cost and service increase as benefits. Seven percent reported all three as benefits. This compares with no studies reporting these three as expected benefits.

A number of unexpected benefits were also found. These included cultural benefits (2%), and benefits in controlling intellectual property (4%).

Benefit	Reported Benefits		Expected Benefit	Benefits greater than expected
	Number	%	%	%
Cost savings	40	70	53	18
Increased service levels	19	33	9	25
Quality improved	16	28	21	7
Control increased	15	26	16	11
Increased expertise & knowledge	10	18	2	16
Capability increased	5	9	4	5
Flexibility	4	7	5	2
New markets (strategy)	2	4	16	(12)
New revenue sources	2	4	4	0
Intellectual property control	2	4	0	4
Quality decreased as a benefit	2	4	0	4
Cultural benefits	1	2	0	2

Figure 4: Summary of expected and actual benefits Insourcing

It was seen that there were valid reasons for companies to insource, and that these relate to a weighing of long and short term benefits, with long term insourcing strategies being more cost effective, while in the short term outsourcing seen as beneficial on a cost basis. From this viewpoint there is no disjointedness between insourcing and outsourcing both being cost effective measures, since they rely on differences in organisational goals and economic climate.

It was further noted that there was a positive gap between the expected benefits and actual benefits. Organisations that insourced expected to lower costs and improve quality. These expectations were realised, and additional benefits were also evidenced. Additional benefits included increased service levels, increased expertise and knowledge, capability and control. The only expected benefit that did not materialise was that insourcing did not attract as many new markets as expected.

A summary table was produced that sorted actual and expected benefits into four central categories of cost, service, quality, capacity and capability. These groupings were seen as key areas of management focus. The groupings show that while cost savings and increased service levels were expected and reported, quality and increased capacity and capability reported benefits from insourcing far greater than expected.

Benefit	Reported Benefits		Expected Benefit	Benefits greater than expected
	Number	%	%	%
Cost savings	4	100	100	0
Increased service levels	1	25	25	0
Quality improved	1	25	0	25
Capacity & capability increase	2	50	0	50

Figure 5: Summary of expected and actual benefits

When data was viewed from a managerial perspective, management principles were identified as cost reduction, quality improvements, capacity building and strategic direction including flexibility and control. All reported significant benefits over the 10% quoted in literature as being required to

significantly influence sourcing decisions. Overall, it was demonstrated that a range of crucial business decisions can be positively influenced by an insourcing strategy, amongst these the building of capacity and capability building which will have an effect on staffing levels well into the future.

Benefit	Reported Benefits		Expecting Benefit	Benefits Greater than expected
	Number	%	%	%
Cost	40	70	53	18
Quality	37	65	30	35
Strategic Direction	25	44	40	4
Capacity Building	16	28	5	23

Figure 6: Summary of Benefits by Management Groupings

The literature demonstrated that an organisation's knowledge base can be eroded during outsourcing for a number of reasons. The literature on insourcing clearly identified that knowledge, expertise and capacity building were key benefits for those companies that insourced. References to resource based theory's re-emergence were found highlighting relationships between resources, capabilities and competitive advantage. For management then, attracting and keeping skilled up employees is paramount. This is important, particularly for the IT industry as their product is intellectual know how.

The study noted the possibility that the public sector was disadvantaged in terms of IT insourcing in that their salary structure did not allow them to compete adequately in the market place for the required skills. Public Sector IT insourcing was therefore not seen as likely to occur, despite any benefits that may accrue.

It was shown that insourcing is best used as a medium to long term business strategy, while outsourcing can reduce costs in the short term. In creating a medium to long term business strategy, insourcing or re-insourcing should therefore be considered as a way to meet key management needs across a number of areas.

The literature indicated that there has been a move from core competencies to core capabilities. This is evidenced by the need for business to rebuild areas such as IT inhouse, in order to support quality issues. It was further evidenced that while IT outsourcing is predicted to increase, this relates primarily to large scale telecommunications IT, and not the day to day business support, for example a help desk.

Failed contracts played a part in influencing business to re-insource, but was not the primary reason cited for re-insourcing, suggesting some objectivity in companies when planning their business strategies.

There was evidence that companies have learned how to process improve to save costs while maintaining internal sourcing. Cost savings, even small ones when coupled with quality improvements and skilled up knowledge workers, may become the future strategy of choice as companies compete for resources.

Five potential drawbacks were reported in the literature studied. Due to the way in which some research was reported, it was seen that there were difficulties in determining whether all benefits were reported. It was further noted that while some authors reported by company name, others reported by a unique identifier known only to them, making it difficult to identify when a company had been reported more than once, therefore skewing the results. Thirdly, a discrepancy within the findings is that it is not always clear from the literature what parts of a business was insourced. Fourthly, the majority of reports were case studies that reviewed only one business, so that the study population was limited. Lastly, because this study was undertaken over a short time span, it is difficult to see whether a long term trend to higher levels of insourcing is occurring. What can be stated is that much of the current insourcing literature focuses on the IT, service and manufacturing industries, and that there is an anomaly between the literature on insourcing and outsourcing in relation to IT. This paper found that insourcing of IT applied to IT as a non core capability, while projected increases in outsourcing related to IT as the central aspect of a business.

Areas for further Research

Areas for further research from the study fell into the following categories.

- A number of studies attempt to define strategic decision methodology for outsourcing, defining risks only and do not weight these against the benefits of insourcing, suggesting a need to adjust to a more balanced strategic view.
- There is a growing body of literature which indicates that where competencies are available inhouse, there will be cost savings made by insourcing, regardless of whether the competencies are central to the company's operation.
- A particular finding was that organisations were concerned about control, but the way in which they wanted to control events or processes was not clearly defined, and remained nebulous at times.
- The differences in how IT is dealt with in terms of insourcing need to be resolved through further research. These entail a systematic way of classifying what falls into the IT category. It also entails further investigation into the finding that insourcing of IT applied to IT as a non core capability, while projected increases in outsourcing related to IT as the central aspect of a business: the study size was too small to clarify this.

This research identified drawbacks in the literature and areas for further research. Despite this, it was found that while insourcing may not meet every business's needs. The 'right' sourcing arrangement may include insourcing when of all the benefits available are coupled with short and long term goals.

Conclusion

The paper investigated the state of literature in relation to sourcing and showed that a company's sourcing strategy will depend on past sourcing strategies, the global economy, risk mitigation and current goals. Hodge's (1996) methodology on outsourcing was applied to insourcing, in an attempt to ascertain who is

doing it, for what reasons, and what benefits were achieved. It contrasted the outward focus of outsourcing to that found in organisations that source products and services from within. However, before these issues were addressed, the need for clear definitions and consistent language to describe what is meant by insourcing was discussed.

The study addressed several areas that relate to sourcing. To begin with, it looked at outsourcing risks and benefits, touched on the move towards partnering models and took a deeper look at insourcing as a strategy. It found evidence that the right sourcing strategy needs to be determined at regular intervals to take into account changing long and short term strategies. Although strategic decision making methodology was reviewed, the creation of new formula did not form part of this paper.

The paper aimed to investigate the state of knowledge in the area of insourcing, one of several sourcing strategies, by assembling available research data, and assessing the result of the data to ascertain what benefits may be accrued for the organisation involved. The literature indicated that there had been a shift away from outsourcing and towards insourcing, particularly in relation to the specific areas of IT, service and manufacturing.

This paper has found that there are definite benefits to management for insourcing which include economic, capacity building, strategic direction and quality control areas. These benefits encompass the key areas that management deal with and as such, insourcing is worthy of consideration as a sourcing strategy.

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