EFFECTS OF OUTSOURCING ON AN ORGANIZATION'S PERFORMANCE: A CASE STUDY OF KENYA REVENUE AUTHORITY NAIROBI CUSTOMS STATION

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ABSTRACT

Outsourcing has been adopted widely in the world as a strategy to gain competitive advantage. Companies are increasingly seeking outside firms to perform activities previously conducted in – house in order to achieve time, process and cost advantages. The main objective of this study was to determine the effects of outsourcing on an organization's performance: a case study of Kenya Revenue Authority Nairobi Customs Station. The specific objectives were to establish the influence of cost of operation, time saving in outsourcing, quality of service operation, business agility operation in outsourcing on an organization's performance. The study adopted a descriptive research design. The study targeted 15 procurement officers, 17 financial officers, 386 custom department staff and 50 support staff working in Kenya Revenue Authority, Nairobi Customs station. The study used census sampling to collect data from all 15 procurement officer, 17 financial officers and 50 support staff. The study randomly sampled 10% of the 386 custom department staff to involve 38 staffs. Stratified sampling was used to obtain a sample of 120 respondents from four sections of the Kenya Revenue Authority customs station. Reliability analysis was done through piloting the instrument at the KRA headquarters. Cronbach alpha coefficient was used to test reliability. Validity was ensured through discussion with the experts including supervisors and colleagues. Primary data was collected and analyzed using quantitative and qualitative techniques and then presented using narratives, tables and graphs. Secondary data was also obtained from journals and the Kenya Revenue Authority data base. Data collected was analyzed using SPSS (Statistical Package for Social Sciences). Descriptive statistics and inferential statistics such as Pearson's correlation were used. This assisted in determining the level of influence the independent variables have on the dependent variable. The findings indicated that outsourcing positively increases on the performance of organizations, it reduces costs of operation, time saving, quality of service and finally the affects positively business agility operation. Therefore, the rate of organizational performance as a result of outsourcing is high in both short and long- term and many business executives are committed to attach their success to the outsourcing process. At the end of the study, the study provides variable insight to firms on how effective the outsourcing can be, as performance management tool. Policy makers

and the government may be able to understand the challenges faced in outsourcing services and therefore may be able to formulate policies that may improve service delivery. The study may also form a basis for further research by scholars interested to explore how outsourcing affect performance at Kenya Revenue Authority.

Key Words: *Cost of Operation, Time Saving, Quality of Service of Operation, Business Agility operation*

Introduction

Outsourcing has been adopted widely in the world as a strategy to gain competitive advantage. Companies are increasingly seeking outside firms to perform activities previously conducted in –house in order to achieve time, process and cost advantages. Such outsourcing makes sense for firms that lack the necessary economies of scale, skills or technology to perform certain functions quickly and efficiently. Additionally, many firms seek third-party providers in order to focus on their own core business. It is not because they are incapable of performing the activities. As much as outsourcing has been reported as a successful story, the way in which it has been implemented seems to be of key importance (Rothman, 2003).

Procurement is the acquisition of goods and/or services at the best possible total cost of ownership, in the right quality and quantity, at the right time, in the right place and from the right source for the direct benefit or use of corporations, individuals, or even governments. Abdul-Halim and Che-Ha (2009) carried out a research related to outsourcing decision with 232 HR managers. According to findings, there is a significant relationship between organizations with proactive strategies and the decision to outsource both transformational and transactional HR functions. Outsourcing of both functions has a significant relationship with HR performance – traditional with a positive impact and transactional with a negative impact.

The procurement process helps companies negotiate prices and get the best quality resources for production processes. Smaller businesses do not usually have a department dedicated to procurement since they have much smaller business operations. Usually, small business owners or entrepreneurs are responsible for working with vendors and suppliers to obtain the necessary goods for business operations. Larger companies are able to purchase resources and inputs in large volume quantities; high volume purchases usually require a procurement management process (Baily and Crocker, 2008).

In today's world of ever increasing competition, organizations are forced to look for new ways to generate value. The world has embraced the phenomenon of outsourcing and companies have adopted its principles to help them expand into other markets (Bacon and Bender, 1999). Strategic management of outsourcing is perhaps the most powerful tool in management, and outsourcing of innovation is its frontier (Quinn, 2000).

There has been a significant rise in outsourcing activities across various sectors in the country. Many industries are sticking to their core businesses and outsource the rest. For example, East African Breweries has stuck to its core business of brewing while it outsources non-core services such as transportation and distribution of beer. It also contracts the farmers to produce the raw materials. Another sector that has adopted the strategy of outsourcing is the telecommunication sector. The mobile providers have concentrated their efforts in upgrading the platforms while leaving the non-core duties such as distribution of airtime vouchers and handsets to their agents. The sugarcane millers have not been left behind as they have contracted outside sugarcane farmers (out growers) to supply their need of sugarcane. Kenya Airways has recently followed suit and outsourced its cabin crew services.

The use of intensive case studies in manufacturing (automotive supply), service (hospitals) and public sector (primary and secondary schools) industries showed that low skilled workers in the organization received relatively high compensation thus companies opted for agencies temporaries and contract company workers for long term basis. This helped them to save cost and triggered the need to start outsourcing in the Kenyan market. In the early nineties, the Kenya government made smoother policies that actually enhanced and encouraged foreign firms to develop their branches in Kenya. These companies became the pioneering drivers of information technology, education, retail, and outsourcing.

Outsourcing

With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by outside suppliers (Yang, Yang, Seongcheol, and Changi, 2007; McIvor, 2008). The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). Traditionally, outsourcing is an abbreviation for “outside resource using”. Outside means to create value from without, not within, the company (Yang, et. al. 2007).

Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service (Lee, Ruby and Daekwan, 2010) and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Raiborn, Cecily, Janet, Butler and Massoud 2009; Elmuti, 2004). Outsourcing can also involve the transfer of both people and physical assets to the supplier (McIvor, 2005).

Outsourcing and Organizational Performance

Because of resource limitations, few firms have the ability to apply world-class resources to all areas of competition. Thus, in order to gain competitive advantage they must select areas in which they will concentrate their resources (Hamel and Prahalad, 1994). By outsourcing to specialist organizations services not generated by core competences, companies can see an improvement in their organizational performance (Kotabe, Michael, Mol, Janet and Murray, 2008). (Gilley, Matthew, Greer and Rasheed, 2004) state that there are three reasons for this. Firstly, the acquisition of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value (Gilley, et. al. 2004). Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Secondly, increasing the outsourcing of nonstrategic services can improve both the quality and the service.

Statement of the Problem

Outsourcing has become a recognized business strategy for enhancing the productivity and profitability of large companies (Grossman and Helpman, 2002). Business Process Outsourcing (BPO) is the most common form of outsourcing. It comprises transfer of operational ownership of some of the business processes to an external provider who manages the outsourced business processes according to the performance metrics prescribed by the parent company.

Vision 2030 is Kenya's new blue print that aims at transforming the country into a middle income country by the year 2030. One of the identified sectors that will catalyst the achievement of Vision 2030 is Business Process Offshoring (BPO). Thousands of jobs are expected to be created in this sector whose strength is expected to come from a well-trained manpower, Information Communication Technology (ICT) infrastructure and supportive Government policy. The arrival of EASSY, TEAMS and SEACOM undersea cables are seen as the first step in starting off this sector.

Kenya Revenue Authority has not met her target in revenue collection in the year 2013. The performance fell short of the initial treasury projection of 24.6% growth (KRA, 2013). Assessment of the first quarter of the financial year 2013/14 performance of revenue collection indicates underperformance amounting to over Kshs.15.3 billion. There has been a rising expenditure pressure which has amounted to over ksh.346 billion by end of November 2013 (National Treasury circular, 2013). The public sector wage bill has been rising at an annual average of 13 percent over the last three years. In the financial year 2012/2013 alone, the wage bill increased by 30 percent, largely due to hefty salaries awarded to teachers, health workers and the police (Institute of Economic Affairs report, 2013).

The Kenyan government is under pressure to fund the jubilee manifesto that includes the free laptop for class one pupil's project. This project will need to a tune of Ksh 50 Billion to cater for the targeted 1.3 million pupils in public schools. The LAPPSET project will need at initial stage Ksh. 3.7 Billion to facilitate the construction of three berths. The government will need Ksh 22 billion to commence the construction of a two-track standard gauge railway line from Mombasa to Kisumu to improve turn-round time and reduce significantly the cost of freight from Mombasa to Kisumu, by as much as 79 percent from about Ksh.140,000 to Ksh.30,000 (Kenya 2013/2014 Budget Statement).

The country is spending in implementing the new constitution that advocates for devolution. The Kenyan Constitution advocates a minimum of 15% of the Total revenue collected by the National Government to be shared among the counties. This amount was raised by the National Assembly to 32% of the Total Revenue. All these funds are supposed to be generated from KRA tax collection. It is against this background that the study seeks to establish the effects of outsourcing on the performance of Kenya Revenue Authority Nairobi customs station. This study sought to establish the effects of outsourcing on an organization's performance at the Kenya Revenue Authority Nairobi Customs Station.

General Objective of the Study

The general objective of this study was to establish the effects of outsourcing on an organization's performance: a case study of Kenya Revenue Authority Nairobi Customs Station.

Specific Objectives of the Study

1. To establish the influence of cost of operation on an organization's performance.
2. To determine the effect of time saving on an organization's performance.
3. To establish how quality of service of operation affects an organization's performance.
4. To examine the influence of business agility operation on an organization's performance.

Literature Review

Resource-based view theory

The resource-based View illustrates that resources and capabilities can vary significantly across firms and that these differences can be stable (Barney and Hesterly, 1996). If resources and capabilities of a firm are mixed and deployed in a proper way they can create competitive advantage for the firm, this can be related to cost of operation, time saving, quality of service operation and business agility.

The resource-based view in outsourcing builds from a proposition that an organization that lacks valuable, rare, inimitable and organized resources and capabilities, shall seek for an external provider in order to overcome that weakness. Therefore the most prominent use of the theory is in the Preparation phase of the out sourcing process for defining the decision making framework and in the vendor selection phase for selecting an appropriate vendor. The theory has also been used to explain some of the key issues of the managing relationship and reconsideration phase (Crook, Ketchen, Combs and Todd, 2008). This theory demonstrates that resources and capabilities should form the platform of strategy development.

Transaction Cost Theory

Transaction Cost economics (TCE) has been the most utilised theory of outsourcing. TCE is perceived to provide the best decision making tools to help organizations to decide to outsource and to prepare themselves for forthcoming outsourcing arrangements. The governance features of the theory influenced that it has been applied in studying the managing relationship phase, whilst the concept of switching costs made the theory applicable in the reconsideration phase. This is the business agility operation in this study. Another useful issue for outsourcing provided by TCE is explanation of contractual complexity. Though TCE has not been utilized explicitly for studying the Vendor selection phase, its sub-theory, the theory of incomplete contracting, has been applied in studying the structure and contents of outsourcing contracts, and related preparation and contract management activities.

Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. By outsourcing tasks to specialist organizations, firms may better focus on their most value-creating activities, thereby maximizing the potential effectiveness of those activities. In addition, as outsourcing increases, costs may decline, and investment in facilities, equipment, and manpower can be reduced. The rationale for outsourcing looks simple and compelling. Outsourcing research can be divided into three areas: decision-, process- and result-oriented. Jiang and Qureshi (2006) demonstrate that, during the last decade, most academic studies have focused on understanding outsourcing decision determinants and outsourcing process control.

Core Competencies in Management Theory

A core competency is a concept in management theory originally advocated by Prahalad and Gary (1990). In their view a core competency is a specific factor that a business sees as central to the way the company or its employees work. How core competencies are defined is unclear, but the essence is that core competencies should be kept in-house, but that other things that the organization does, which are not deemed core, or critical to its mission or function, should be considered for outsourcing Galunic, and Rodan (1998). This can be related to quality of service as a factor in outsourcing. Klainguti (2000) indicated that the perspective of core and non-core competencies starts to look less useful when the mission and main functions of the client organization are changing, along with the skills required of its staff. The core competency perspective is useful in prompting serious consideration about the functions which are truly cost-effectively done in-house, and those which could be outsourced, without any loss to future requirements in expertise. The core competency perspective is less useful when some of the functions are core, but some, or most of the tasks involved could be outsourced as it would be cheaper to do that. For purchasing arrangements, libraries often need to consider the effects on staff functions, of sharing or delegating the work of previewing serials prior to purchase with other members of a purchasing consortium.

Research Methodology

Kothari (2004) defines research design as the structure that guides the execution of a research method, and the subsequent analysis of acquired data. It provides a framework for the generation of evidence that is suited both to a certain set of criteria and to the research question in which the investigator is interested. This research was conducted on a descriptive research design by use of structured questionnaires to be administered on the defined sample. The study involved a one-time interaction with groups of people of Kenya Revenue Authority Nairobi customs station. Inferences about relations among variables are made, without direct intervention from concomitant variation of independent and dependent variables (Paton, 2002). In this study, variables were investigated without any manipulation or alteration. A descriptive research design allow one to present data collected from multiple methods that is surveys and document review to provide the complete story (Yin, 2009). This study explored the effect of outsourcing as a strategy to improve firm performance.

Population

According to Cox (2010) a target population for a survey is the entire set of units for which the survey data are to be used to make inferences. According to Ngechu (2004) a population is a well-defined set of people, services, elements and events, group of things or households that are being investigated. Target population constitutes the entire or totality of the items under study (Kothari, 2004). The population consisted of the procurement and finance officers, customs department and support service staff of Kenya Revenue Authority at the Nairobi Customs station. The reason for selecting Nairobi Custom station was because of its proximity to the researcher.

Sampling Frame

This study sample frame involved different departments at Kenya Revenue Authority Nairobi Custom station. These included the procurement and finance officers, customs department and support service staff (KRA, 2013). Thus the target population defines those units for which the findings of the survey are meant to generalize. In this study, the sampling frame consisted of all the 468 staff working at the Kenya Revenue Authority Nairobi custom station as a source list from which the sample is drawn (Kothari, 2004).

Sample Size and Sampling Technique

Sample of responding staff was drawn from the 15 procurement and 17 finance officers working in Kenya Revenue Authority Nairobi Customs station where census sampling technique was used (Mugenda and Mugenda, 2003). The study employed stratified sampling to sample the four groups; procurement officers, finance officers, support service and custom department staff. The study sampled all the 15 procurement officers, 17 finance officers and 50 support service employees and randomly sample 10% of the 386 custom department staff to involve 38 employees this was because Neuman (2003) indicated that 10% - 20% is an adequate sample in a descriptive study. The study applied census sampling to sample all the procurement, support service and financial officers because they are involved directly in outsourcing of services in the firm and hence formed important respondents for this study. The study therefore sampled 120 respondents.

According to Mugenda and Mugenda (2003) stratified sampling involves selecting subjects 'in such a way that the existing subgroups in the population are more or less reproduced in the sample'. In this study, the subgroups were procurement officers, support service, custom department staff and financial officers in the Kenya Revenue Authority Nairobi customs station. Neuman (2003) argues that the main factor considered in determining the sample size is the need to keep it manageable enough. Also this enabled the researcher to derive from it detailed data at an affordable cost in terms of time, finances and human resource (Mugenda and Mugenda (2003). The study adopted stratified sampling technique to select suitable sample sizes.

Results and Discussion

The study sought to determine whether cost of operation, time saving, quality of service operation and business agility operation influences organization's performance. The objective was assessed by use of statements which were on the questionnaire where the respondents indicated their degree of agreement with the statements. The study sought to investigate whether outsourcing leads to low supply costs. It was found that majority 85 (89%) of the officers agreed that indeed outsourcing leads to low supply costs. A few 7 (7%) disagreed to the statement. Majority of the respondents 86 (90%) agreed while a few 9 (9%) disagreed that urge to achieve savings leads to outsourcing, from the respondents 68 (72%) agreed that there is saving of indirect costs through outsourcing. A few 23 (24%) disagreed that there is saving of indirect costs through outsourcing this shows that there might be saving of indirect costs through outsourcing. Majority of the respondents 65 (69%) of the officers agreed that outsourcing leads to better cost control in an organization, Majority 42 (44%) of the respondents agreed that outsourcing shifts fixed costs to variable costs while a few 38 (40%) disagreed to the statement. This finding indicates that indeed outsourcing shifts costs to variable costs.

The study investigated the effect of time saving on an organizations performance by studying if outsourcing leads to less time taken in performing services, if consolidating outsourcing functions affects time saving and if outsourcing focused on one area of expertise saves time. The study sought to know if outsourcing leads to less time taken in performing services. It was found that majority of the respondents 69 (73%) agreed that outsourcing leads to less time taken in performing services. The researcher studied if consolidating outsourcing functions affects time saving. It was found out that majority of the respondents 47 (49%) agreed that consolidating outsourcing functions affects time saving while a few 35 (38%) disagreed. The study sought to investigate outsourcing focuses on one area of expertise thus saving time. It was found out that majority 46 (49%) of the respondents agreed that outsourcing focuses on one area of expertise thus saving time.

The study investigated the effect of quality of service of operation on an organizations performance by studying if outsourcing leads to convenience in development where majority 53 (56%) of the respondents agreed that outsourcing leads to convenience in development. The study then sought to investigate if there is scaling up of projects by outsourcing. It was found that majority 78 (82%) of the respondents agreed that there is scaling up of projects by outsourcing while a few 12 (13%) disagreed to the statement. The researcher then sought to know if outsourcing provides protection against technical risks. It was found out that majority 70 (74%) of the managers agreed that outsourcing provides protection against technical risks while a few 20 (21%) disagreed to the statement. The study then sought to find out if there is better management of business and organizational knowledge through outsourcing. It was found out that majority 79 (83%) of the respondents agreed that there is better management of business and organizational knowledge through outsourcing.

The researcher investigated the influence of business agility operation on an organization's performance by studying if outsourcing leads to acceleration of a firms evolution in providing services, if it leads to acceleration of a firms evolution in providing services and if there efficiency and cost containment through outsourcing. The researcher sought out to know if Outsourcing leads to acceleration of a firm's evolution in providing services It was found out that majority (65%) of the respondents agreed that outsourcing leads to acceleration of a firms evolution in providing services while a few 45 (23%) disagreed to the statement. The researcher then sought out to find out if there is efficiency and cost containment through outsourcing, the respondents agreed that there is efficiency and cost containment through outsourcing. It was found that majority 80 (84%) of the respondents agreed to the allegation. A few 9 (10%) disagreed. The study then sought out to find if outsourcing leads to protection against technical risks, the researcher probed if outsourcing leads to protection against technical risks. It was found that majority 77 (81%) of the officers agreed that outsourcing leads to protection against technical risks. A few disagreed. Therefore it can be deduced that outsourcing protects a firm against technical risks. The study also sought out to find out if there is better management of business and organizational knowledge, It was found that majority 77 (82%) of the respondents agreed that there is better management of business and organizational knowledge. A few 11 (11%) disagreed. Outsourcing therefore leads to better management of business and organizational knowledge.

Regression Analysis

The results in Table 1 of the model summary provide the correlation coefficient (R) and coefficient of determination (R2) value. The regression had a correlation coefficient (R2) of about 0.6084 and an adjusted R2 of 0.56. This means that cost of operation, time saving business agility operation and quality of service explain 56 percent of the variations in organizational performance.

F test is used to test the significance of R2, which is the same as testing the significance of the model as a whole with a probability of 0.00 at 5% significance level indicated that the joint contribution of the independent variables was significant in predicting the dependent variable.

Table 1: Regression Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics F Change	df1	df2	Durbin-Watson
0.78	.6084	.56	.64593	34.974	4	90	2.090

a. Predictors: (Constant), cost of operation, time saving business agility operation and quality of service.

The Table 2 shows the ANOVA test which indicated that the regression model predicted the outcome variable significantly well. The F critical at 5% significance level was 2.472. Since F calculated is greater that F critical this shows that the overall model was significant.

Table 2: ANOVA

Model	Sum of squares	df	Mean Square	F	Sig
Regression	58.366	4	14.5915	34.974	0.00^{b}
Residual	37.548	90	0.4172		
Total	95.9346	94			

a. Dependent Variable: Organizational Performance
b. Predictors: (Constant), cost of operation, time saving business agility operation and quality of service.

Table 3 presents coefficients information on each predictor variable. This provided the information necessary to predict influence of outsourcing on organizational performance from the provided variables; cost of operation, time saving, business agility operation requirements and quality of service. Taking all factors (cost of operation, time saving, business agility operation requirements and quality of service of operation) constant at zero, organizational performance will be 0.512. The data findings also show that a unit increase in cost of operation will lead to a 1.237 increase in organizational performance, a unit increase in time saving will lead to 0.8593 increase in organizational performance, a unit increase in quality of service will lead to a 1.271 increase in organizational performance and a unit increase in business agility operation will lead to a 1.281 increase in organizational performance.

Table 3: Regression analysis

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	T	Sig.
(Constant)	.512	.160		3.2	.022
Cost of operation	1.237	.541	.52	2.286	0.01
Time saving	.8593	.368	.40	2.335	0.02
Business agility operation	1.281	.471	.411	2.720	0.01
Quality of service	1.271	.457	.123	2.781	0.05

Table 3 also presents the level of significance called the p value, This is the coefficient that is used to test the significance of the independent variables the level of significance for this study is 0.05 and therefore if the p value is less than 0.05 then it means that the variable is statistically significant and vice versa is the p value is greater than 0.05. From the table, the results showed the following findings. The t and p value of cost of operation and time saving were ($t=2.286, p<0.05; t=2.335, p<0.05$) and Business agility operation and Quality of service were ($t=2.720, p<0.05; t=2.781, p<0.05$). Therefore cost of operation, time saving, business agility operation and quality of service were all statistically significant and showed a positive influence in the organization performance.

Conclusions

It can be concluded from the findings that cost of operation influences organization performance. This is because it was indicated that outsourcing leads to low supply costs, the urge to achieve savings leads to outsourcing, there is saving of indirect costs through outsourcing, there is better cost control in an organization and outsourcing shifts fixed costs to variable costs.

The findings also showed that quality of service of operation positively affects organizational performance. The response indicated that outsourcing leads to convenience in development, scaling up of projects, provides protection against technical risks and that there is better management of business and organizational knowledge.

It can be concluded that time saving influences organizational performance since it leads to less time taken in performing services. Consolidating outsourcing functions affects time saving positively and outsourcing focuses on one area of expertise thus saving time.

It can also be concluded that business agility operation requirement influence positively organizational performance. This is because it leads to acceleration of a firm evolution in providing services there is efficiency and cost containment through outsourcing. Outsourcing leads to protection against technical risks and there is better management of business and organizational knowledge. Outsourcing therefore leads to better management of business and organizational knowledge. From the regression analysis, it can be concluded that business agility mostly influences organizational performance since it had the least p-value of 0.01 compared to 0.012 for cost of operation, 0.02 for time saving and 0.05 for quality of service.

Recommendations

Organizations should outsource their noncore business to outside providers that can bring a cut in cost of operation to a great extent. Organizations should establish a partnership with the service providers to establish tools to measure the performance where organizational requirements should be matched with the implementation process through identifying new skills, abilities and knowledge for each project, thus, encourage organizations to obtain front-edge outsourcing.

The quality of service should be enhanced through considering many choices for service outsourcing as well as their providers; this puts organization on attention to strategically assess their partners. Organizations should not only consider cost reduction and base on low prices and big players to fill their requirements, but should also emphasize the type of relationship and the trend of behavior between the outsourcing organization and the service providers.

To enhance time saving in the firm, the organizations should come up with clear acknowledgement on whether the provider will be able to respond reasonably to the expectations and frequent changes in business and technology requirements to ensure continuity in service provision.

For organizations to enhance business agility operation, they should measure outsourcing effectiveness as regards to performance, they should put in place a standard format of measuring performance such as performance evaluation, performance ratios and performance appraisal such that the success from outsourcing management point of view is the same as what clients deem to be success.

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