

**FACTORS INFLUENCING THE ADOPTION OF OUTSOURCING BY
MANUFACTURING COMPANIES LISTED ON THE NSE IN KENYA****Denis Kamau Muthoni**

Cooperative University College of Kenya, Kenya

Geoffrey Ondari Nyakagwa

Taita Taveta University College, Kenya

CITATION: Muthoni, D. K. & Nyakagwa, G. O. (2014). Factors influencing the adoption of outsourcing by manufacturing companies listed on the NSE in Kenya. *International Journal of Social Sciences and Entrepreneurship*, 1 (11), 373-394.

ABSTRACT

Outsourcing refers to a situation where a business contracts its business processes to a third party. During this process, the business may transfer some of its resources (such as employees and assets) from one firm to another. Moreover, outsourcing is inclusive of both the domestic and the foreign markets; sometimes this may result to transfer of the business to another country. Outsourcing creates value within firms' supply chains beyond those achieved through cost economies. Intermediate markets that provide specialized capabilities emerge as different industry conditions intensify the partitioning of production. As a result of greater information standardization and simplified coordination, clear administrative demarcations emerge along a value chain (Jacobides & Winter, 2005). This study focuses on the factors that influence adoption of outsourcing by manufacturing companies that are listed on the Nairobi Securities Exchange and aims at establishing the effects of outsourcing to a company. The study relied on specific objectives which included; establishing the importance of the need to reduce costs on the adoption of outsourcing by manufacturing firms, the importance of resource inadequacy on the adoption of outsourcing and the importance of adoption of outsourcing by competitors on its adoption by the manufacturing firms. To carry out the study, semi-structured questionnaires were administered to the respondents by the researchers. Out of the estimated sample size of 50 respondents, 43 respondents completed the interview thereby providing sufficient primary data to establish reliable results for the study. From the findings the researchers recommend that; when making the decision to adopt outsourcing, the firm should consider factors only pertinent to it individually, but consideration may also be given to the impact of outsourcing on other similarly placed firms which may have adopted it. Outsourcing should not be adopted blindly just because it has been adopted by other firms.

Key Words: *Outsourcing, Insourcing, Organization, Cost-reduction*

Introduction

According to Overby (2007), outsourcing is often viewed as involving the contracting out of a business function - commonly one previously performed in-house - to an external provider. In this sense, two organizations may enter into a contractual agreement involving an exchange of services and payments.

The outsourcing phenomenon has been increasingly receiving attention both from academic and practitioners communities. Outsourcing of functions in regard to operations, which are not related to a firm's core competencies, has gained a lot of popularity since its introduction in the recent past i.e. from the 80's. Within a short time this trend progressed through investment intensive functions (Jäger et al., 2007) and in the 1990s, operations outsourcing started to gain ground, and typically argumentation in using it is justified with the costs, flexibility and quality (Lau and Zhang, 2006).

Outsourcing service providers were few if any in the 1970's and early 1980's, but currently they employ millions of people world-wide. Constant profitability requirements of companies have also increased pressure to increase the amount of outsourcing in economic downturn; Edgell et al. (2008) indicate that economic downturn will give ground for cost based outsourcing reasoning.

According to research on European outsourcing (Gemini, 2007) it was revealed that technology, manufacturing, transportation, warehousing, freight forwarding, among customs clearance and brokerage are typical functions to be outsourced. A report from Chinese market indicates that transportation; distribution and warehousing were the most frequently outsourced functions (Tian et al, 2008). However, an old mindset is limiting outsourcing decision in other supply chain functions, e.g. procurement, (Fernández & Kekäle, 2007).

The increasing pressure from markets, characterized by intense competition and instability led organizations and people to rethink their strategies in dealing with the other parts. In this context, the organizations will be guided to their core areas (core business), freeing themselves from areas/activities which do not master, the dependence on external/outside supply sources increases (Lopes da Costa, 2009). According to Sharpe (1997) outsourcing is the most recent tool to emerge in response to demands on improving firm level competitiveness- and is potentially the most powerful. Organizations, recognizing that they cannot be world class in every aspect of their operations are moving towards business strategies based on core competencies- a set of skill and knowledge that helps them to maintain their competitive advantage. Activities which do not fall under the banner of core competencies are candidates for outsourcing in pursuit of maintaining their firm level competitiveness.

Given the recent unprecedented rise in the number of firms outsourcing part of their operation and also the exponential increase in the variety of activities being outsourced the presumed

conclusion would be that outsourcing does indeed contribute to the competitiveness of a firm. This is because outsourcing allows a firm to cost effectively tap into specialized skills. Outsourcing is primarily driven not only by the need to reduce costs but also overall by the need to improve a firm's competitiveness (Sharpe, 1997).

Outsourcing is a strategy that concentrates an organization's resources on its core competencies allowing the organization to achieve a definable preeminence and provide a unique value for customers. The goals of outsourcing are strategic: improved efficiencies, lower costs, improved flexibility, higher quality, and a greater ability to achieve a competitive advantage. The ultimate strategic goal is to develop core competencies that develop into barriers of entry that make it difficult for competition to copy. By focusing on core competencies, and utilizing qualified vendors to provide process that are not one of the organization's core competencies, the organization's risk can be shared with its suppliers, and minimized. Core competencies are the collective institutional learning and capabilities of the company that allow it to supply products and services that uniquely add absolute preeminence in those competencies (Hilmer & Quinn, 1994). According to Greaver (1999) "Core competencies are the innovative combinations of knowledge, special skills, proprietary technologies, information, and unique operating methods that provide the product or the service that the customer value and want to buy".

Statement of the problem

Firms faced with declining revenues are constantly looking for ways to cut operational costs. After exhausting the traditional modes of cost cutting, such as staff rationalization, overheads reduction, and outsourcing has become the most favored avenue for cost cutting with the idea being to outsource non core business functions leaving the company to concentrate on its core objectives (Gicheni, 2009). Competitiveness is a primary aim of business enterprises all over the world. In its pursuit of competitiveness firms all over the world have adopted outsourcing of the non core activities. In relation to outsourcing as a competitive operations strategy, there are many research works that have been undertaken mainly focusing on Japan and other parts of Asia, (e.g., Chung et al., 2007) and USA (e.g., Rubesch and Banomyong, 2005), and most typically these research works are concentrated on large corporations in highly developed countries (e.g., Liu and Brookfield, 2006).

Many past researches have explored factors that influence outsourcing success, particularly in the context of North America, Europe and Australia. Amongst others, Lee and Kim (1999) put forth that the partnership quality is a key predictor of outsourcing success. Sun et al. (2002) investigated the factors influencing outsourcing partnerships and how it is associated with outsourcing satisfaction. The change in relationships between the clients and the service providers is the most imperative (Levina & Ross, 2003). Many researchers reported that closer relationships resulting from more frequent and relevant knowledge exchange were prevalent among high performance partners. Partnerships can create a competitive advantage through

strategic sharing of organizations' key information (Probst et al., 2000). Knowledge sharing through outsourcing partnership also contributed to outsourcing benefits (Sengupta & Zviran, 1997). Based on literature rooted from works of Nonaka and Takeuchi (1995), knowledge sharing (explicit and tacit) had been considered as one of the predictor in several IT outsourcing research (Lee & Kim, 2005).

The results of outsourcing on firm performance and the factors influencing the success of outsourcing have been well documented but the factors influencing the adoption of outsourcing by firms have largely been ignored, especially in relation to smaller firms operating in economically developing countries, such as Kenya. In Kenya there is lack of information on the factors that influence the adoption of outsourcing by manufacturing enterprises. Therefore this study sought to examine the factors which influence the adoption of outsourcing manufacturing enterprises operating within a developing economy such as Kenya.

General Objective

The overall objective of this study was to investigate the factors that influence the adoption of outsourcing by manufacturing enterprises in Kenya.

Specific Objectives

1. To establish the importance of the need to reduce costs on the adoption of outsourcing by manufacturing firms.
2. To establish the importance of resource inadequacy on the adoption of outsourcing by manufacturing firms.
3. To establish the importance of adoption of outsourcing by competitors on its adoption by manufacturing firms.

Literature Review

Outsourcing theories/ factors influencing the adoption of outsourcing

The outsourcing process is a complex structure consisting of numerous activities and sub activities, carrying many managerial dilemmas. It is no wonder that many theories have been utilized to help the academics to understand the nature of those activities, and to help practitioners successfully manage the process. It is a common knowledge that each phenomenon can be described by several frameworks that are embedded in various theoretical approaches. From its occurrence, outsourcing has been approached by different theories. This creates confusion among the researchers of the outsourcing phenomenon.

Various authors identified significant number of theories that could explain the outsourcing phenomenon. A content analysis of the selected research papers provides the distribution of the most utilized theories across the phases of the outsourcing process or in more precise terms the reasons for the adoption of outsourcing as discussed below:

Transaction cost economics theory

Cost reduction has been the primary rationale for outsourcing (DiRomualdo & Gurbaxani, 1998). Transaction Cost Economics (TCE) provides a theoretical foundation for addressing outsourcing from a cost perspective (Coase, 1937). Transactions are the exchanges of goods or services between firms. TCE maintains that the allocation of economic activity among firms depends on balancing each firm's internal costs against the cost of transacting for goods and services in the market (Alchian and Demsetz, 1972). This is the familiar make vs. buy argument which proposes that firms buy services from other firms (via "the market") if it is less costly than producing those services in-house (via "hierarchy"). When the market fails, products and services must be produced internally - a reason why firms exist-

TCE addresses two types of costs: production and coordination (Alchian and Demsetz, 1972). Production costs represent the costs of actually producing the goods or services, and would be expected to differ among firms. Coordination costs are the costs of controlling and monitoring workers if the goods are produced internally or vendors if purchased in the market. These costs arise from the need to define, negotiate and enforce contracts, and to monitor and coordinate activities across organizational boundaries. Buying in the market typically offers lower production costs through specialization and economies of scale. However, markets have high transaction costs because vendors tend to behave opportunistically and therefore require monitoring of their activities. Hierarchies, on the other hand, may have higher production costs because of their inability to achieve as great economies of scale. Hierarchies should have lower coordination costs, however, because employees can be managed more effectively and efficiently than vendors.

Transaction costs are also affected by asset specificity, uncertainty and frequency of transactions (Williamson, 1985). Asset specificity in the context of outsourcing refers to the degree to which a vendor's hardware and/or software architectures and skill set of employees are specific to a particular client. Such idiosyncratic investments would serve to increase the vendor's costs of any transactional relationship with a particular client because the resources cannot be used with another client, the costs cannot be amortized over other clients, and the client can threaten to terminate the relationship rendering the vendor's resources valueless. Vendors would be expected to demand higher fees. Conditions of high uncertainty in a relationship may be a result of an unpredictable market, technological, economic trends, or contractual complexity. The more uncertainty, the more difficult it is to completely specify a contract and therefore the greater cost to the client to monitor vendor behaviors. Many behaviors are difficult to monitor and pose a higher risk. The more frequently the parties transact, the less costly the transaction because of

relationship building and trust which can substitute for monitoring, as well as the ability to amortize some cost over a greater number of transactions. Thus TCE would suggest that relatively common and stable activities would be the most cost advantageous candidates for outsourcing.

Resource-Based Theory

Resource-Based View argues that a firm has the ability to achieve and sustain competitive advantage if it possess resources that are valuable, rare, imperfectly imitable and non-substitutable (Barney 1991). Not all resources are strategically relevant within an organization. The goal of an organization is to ensure it has access to and control of valuable resources by developing and securing all the relevant resources either internally or externally. If a firm possesses critical resources that have strategic value, it is better to retain the activity in-house. On the contrary, if the strategic value of target activities is low and no internal resources are available to perform such activities, it is beneficial for the company to outsource the resources (Roy & Aubert 2001). For the sustainable competitive advantages firms are forced to rely on a multitude of outside suppliers for parts, software, knowhow and sales and in doing so gain access to valuable resources and external capabilities (Langlois, 1990).

The core premise of the resource-based view is 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. 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 outsourcing process for defining the decision making framework and in the vendor selection phase for selecting an appropriate vendor. The theory has been also used to explain some of the key issues of the Managing relationship and Reconsideration phases.

Cheon et al. (1995) proposed a resource-based approach of outsourcing, which suggests that outsourcing is primarily pursued in order to fill the gaps in an organization's capacities. The capacities are determined by the organization's resource attributes (viz. value, rareness, imitability, and substitutability) and resource allocation. Among the organizational resources, asset specificity is considered a determinant intra-organizational feature that is negatively associated with the adoption and performance of outsourcing (De Looft, 1995). Functional complexity, which is the degree to which an organization's products or activities are diversified, is also negatively related to the frequency, benefit, and performance of outsourcing (Cheon et al., 1995).

Filling the gaps in resources is a second major rationale for outsourcing (Lacity & Willcocks, 1998). This may be because of an increase in workload beyond an organization's current

capacity, or a disparity between the existing and required resources (DiRomualdo and Gurbaxani, 1998). The Resource Based View of the firm (RBV) provides a theoretical foundation for addressing outsourcing from a resource gap perspective. Resource-based theory views a firm as a collection of productive resources and organizations compete based on having or controlling unique, valuable and hard-to-imitate resources. The organization will retain in-house the operations for which it has a higher capability, with the result of efficient production. The operations for which a firm does not have a higher capability or technical expertise would be outsourced. Usually, organizations outsource what they do not know how to do and develop in house on what they do better than the suppliers do (Argyres, 1996).

Resource-Based View argues that a firm has the ability to achieve and sustain competitive advantage if it possess resources that are valuable, rare, imperfectly imitable and non-substitutable (Barney, 1991). Not all resources are strategically relevant within an organization. The goal of an organization is to ensure it has access to and control of valuable resources by developing and securing all the relevant resources either internally or externally (Das and Teng 2000). If a firm possesses critical resources that have strategic value, it is better to retain the activity in-house. On the contrary, if the strategic value of target activities is low and no internal resources are available to perform such activities, it is beneficial for the company to outsource them (Roy and Aubert 2001). For the sustainable competitive advantages firms are forced to rely on a multitude of outside suppliers for parts, software, knowhow and sales and in doing so gain access to valuable resources and external capabilities (Langlois 1990).

Rather than competing from a specific product/market position, a set of resources could be used to create various products for various markets. Advantage comes from being the only organization with the resources needed to create and deliver those products. Sustainability of the advantage depends on resource immobility, that is, the difficulty for others to copy, acquire, or develop those resources (Rumelt, 1984). If competitors face no significant cost disadvantage or obstacle in developing those resources, then the resources can provide only a temporary ability to compete until they are copied by another firm.

Outsourcing is about acquiring resources from the market. Those resources cannot, by themselves, be strategic according to RBV, as they are not unique and can be acquired by competing firms. However, RBV is concerned not only with the deployment of existing resources, but with their leverage as well (Grant, 1991) To fully exploit a firm's existing unique resources the external acquisition of complementary resources may be necessary.

Those resources would be acquired externally because they may be more costly for the firm to create on its own (as per TCE). A firm may still realize a unique benefit from a purchased resource when combined with one that is unique, especially if that acquired resource complements or supplements its existing resources more effectively than it does for competitors (Dierickx & Cool, 1989). For example, while two competing firms may use the same outsourcing vendor to provide a CRM capability, it may be that one of the firms has a more

unique and valuable production capability, sales force, distribution channel, or other related resource which, in net, provides a greater overall advantage. Thus filling resource gaps through an outsourcing strategy not only maintains the firm's stock of resources, but can also augment resources and capabilities to remain competitive (Cheon, et al., 1995).

Institutional Theory

From an institutional theory perspective, organizations are influenced by pressure from external sources (Zucker, 1987). If they behave accordingly, they are rewarded through increased legitimacy, resources, and survival capabilities. Institutional theory provides a rich, complex view of organizations (Zucker, 1987). Institutional theorists believe that organizational decision-making is influenced by normative pressures that arise from both external sources (i.e. government, industry alliance) and internal sources. These normative pressures and assumptions determine what constitutes appropriate or acceptable behavior for the organization (Oliver, 1997). There has been some recent research that looks at how institutional norms and assumptions influence offshore outsourcing (Kshetri, 2007). In this research, existing laws and rules play a key role in the offshore outsourcing decision. The organizations adhere to these rules so that they do not suffer penalties for non-compliance. There are also researchers who propose that organizations will adapt to the norms and assumptions of the local institutional environment or locate only in areas where organizations have similar institutional beliefs Without insight into the operating environment, business models proven to work in some institutional settings may fail in others e.g. Wal-Mart's failure in Germany (Christopherson, 2007).

Loh and Venkatraman (1992) examined the adoption of outsourcing before and after Eastman Kodak's decision to outsource and found that adoption of IT outsourcing was motivated more by imitative behavior, than by external influence amongst user organizations. Outsourcing is often an imitative response to the hype and publicity surrounding the subject - the so-called "bandwagon effect." (Hu et al., 1997).

Institutional theory provides a theoretical foundation for explaining the imitative behavior regarding outsourcing (Hu, et al., 1997). Institutional theory posits that organizations within the same organizational field grow increasingly similar. There are three mechanisms of isomorphic changes. Coercive isomorphism is a result of formal or informal pressures. Mimetic isomorphism is a result of organizations imitating other organizations within their field that they perceive to be legitimate or successful. Normative isomorphism is a result of normative pressures in the environment (DiMaggio and Powell, 1983). Thus, companies may make outsourcing decision based on other organizations that have already outsourced. In addition, organizations may adopt outsourcing due to other external factors such as the influence of vendors, consulting firms, trade periodicals and the general business climate. And again, the impact of outsourcing on knowledge and learning is not taken into account.

There are a number of benefits that an organization can gain by taking an institutional perspective. For example, an organization can benefit by being a follower and waiting to see if other organizations are successful in a given location (Westphal et al., 1997) thereby lowering its risk of entering that market. A firm can also adapt to pressures in order to gain power and control over the resources they need to be successful

Outsourcing

According to Jacobides and Winter (2005) outsourcing is defined as the arrangement that emerges when firms rely on intermediate markets to provide specialised capabilities that supplement existing capabilities deployed along a firm's value chain. Thus, we can classify the definitions into three types: (a) the outsourcing entails a stable, long-term collaboration agreement in which the supplier becomes a strategic partner and where there are exchange relations with independent firms (b) the type of activity or service that can be outsourced, i.e. activities and services that are non-strategic for the firm and (c) outsourcing is an action that transfers planning, responsibility, knowledge and administration of activities through contracts. This definition has three important characteristics. Firstly, it states that outsourcing has to be a strategic decision that forms part of the firm's strategy and the pursuit and maintenance of competitive advantage. Secondly, it considers the firm must be able to identify which activities or business processes are candidates for outsourcing and developed by suppliers whose capabilities and skills are superior to those of firm. That means outsourcing decisions are relate to the firm's resources and capabilities. Thirdly, it includes the concept of business processes, whereby resources can only be a source of competitive advantage if they exploited through it (Ray et al., 2004). Therefore, outsourcing is a strategic decision that entails the external contracting of determined non-strategic activities or business processes necessary for the manufacture of goods and services by means of agreements with higher capability firms to undertake those activities, with the aim of improving competitive advantage.

Outsourcing creates value within firms' supply chains beyond those achieved through cost economies. Intermediate markets that provide specialized capabilities emerge as different industry conditions intensify the partitioning of production. As a result of greater information standardization and simplified coordination, clear administrative demarcations emerge along a value chain.

In the past purchasing by organizations had been based on obtaining a best price taking into account other factors such as quality and delivery. However, in many cases a significant number of factors such as delivery, reliability, technical capability and the financial stability of the supplier were not taken into consideration (Canez et al., 2000.) Few companies took a strategic view of their make or buy decisions with many companies deciding to buy rather than make based on a short-term reasons of cost reduction and capacity utilization (Humphreys and McIvor, 2000). In all of the outsourcing alternatives, economics of scale is emphasized accompanied with

flexibility. Most often benefits are driven by simplification and centralization of own processes, and eventually by ‘merging’ them together with other customers of outsourcing service providers.

The numerous benefits of outsourcing are well established. According to Lacity and Hirschheim (1993) firms pursue outsourcing strategies to reduce costs and mitigate risks associated with their business processes. Increased competition forces companies to deal with the cost cutting that is necessary to stay in business. The popular business press is replete with examples of manufacturing firms that have been successful in harvesting the benefits of outsourcing by reducing costs, improving speed and responsiveness, reducing cycle times, improving innovativeness and quality, increasing flexibility and agility, and improving overall competitiveness (Chamberland, 2003). Adoption of strategic outsourcing as an operations strategy enriches a firm’s competitiveness and success. Core business-related outsourcing, offshore outsourcing and shorter-term outsourcing have positive effects on outsourcing firms’ competitiveness. Kang et al. (2008) confirmed a casual relationship between strategic outsourcing practices and the competitiveness of firms in the Chinese market. They further indicate that Case companies not only reduced cost but also enhanced their core business outcomes by utilizing high level of outsourcing at these items. Because of low outsourcing risks at these categories, companies could exploit buying power and access the external capabilities for competitive advantage. According to them multi-national corporations (MNCs) are successful through strategic outsourcing practices in generating consistently high level of profits in the Chinese market.

The growth in the importance of outsourcing can be attributed to the ability of outsourcing programs to create or protect competitive advantages for a firm. The strategic benefits and competitive advantages generated by a well-executed outsourcing plan can provide numerous competitive benefits, including improved quality, lower costs, increased flexibility, and superior product designs (Ettlie & Sethuraman, 2002).

While outsourcing is associated with various benefits, it can also be a serious risky factor (Bahli and Rivard 2003). Examples of outsourcing risks are interface within activities, loss of competitive base, opportunistic behavior, rising transaction and coordination costs, limited learning and innovation and higher procurement costs in relation to the fluctuating currency exchange rates. If firms only focus on achieving short-term benefits of outsourcing without considering these risk factors, they may fail to access original goals of outsourcing. Kotabe and Mol (2008) argued that the outsourcing-performance relationship takes on an inverted-U shape which suggests an optimal degree of outsourcing. The extremely high degree of outsourcing may result in external relational inefficiency, technological dependence and high transaction costs. Firms need to carefully consider balancing the benefits and risks to maximize the outsourcing effects on their long-term competitive advantages (Hitt et al., 2006). In this sense, firm’s approach to outsourcing is becoming increasingly strategic.

Policy on outsourcing Kenya

In Kenya the legal framework governing outsourcing by the private sector is minimal, unlike that of the public sector which is governed by the Public Procurement and Disposal Act of 2005 (PPDA). Outsourcing however, especially Business Process outsourcing is considered to be one of the major components of Kenya's development blue print (Vision 2030) aimed at converting the country into a middle-income country providing a high quality life to all its citizens by the year 2030. The Business Process Outsourcing and Offshoring (BPO) sector in Kenya is a small and new part of the economy, accounting for less than 0.01 per cent of GDP. The global outsourcing sector grows by a Compound Average Growth Rate of 12 per cent per annum (Vision 2030, 2006).

According to vision 2030 (2006) Kenya is targeting to become one of the top three BPO destinations in Africa. The goal is to create 7,500 BPO jobs with an additional contribution to GDP of KES: 10 Billion. Kenya will make efforts to gain a large share of this growing global BPO market. Africa as a whole has managed to capture a mere 1–2 per cent of the BPO market so far. In the next few years, the major competitors in this market, namely India, China and the Philippines, will be unable to meet the expanding global demand for labor required to produce BPO services and products. An estimated two million workers will be needed to meet this demand by 2008. A shortage of 200,000–500,000 workers is likely to be experienced by that time, presenting business opportunities for countries like Kenya, which are new players in this field. Local onshore outsourcing by multinational company subsidiaries (captive firms) in Kenya is non-existent. This form of outsourcing will be nurtured and encouraged as a source of income and employment and as a means of technology transfer

Measurement of outsourcing adoption

Rogers (1995) defines adoption as the process by which an innovation is communicated to and put into action/implemented by the members of a given system. Zmud and Apple (1992) developed a system of measuring the adoption of outsourcing by business enterprises based on usage. They define adoption of outsourcing as the extent to which outsourcing has been infused into an organization's operational and managerial work systems. According to them routinization does not sufficiently describe outsourcing adoption. Saga and Zmud (1994) develop three different facets of measuring outsourcing adoption: More integrative use (using outsourcing to create new workflow linkages among organizational activities), more extensive use (outsourcing more activities within an organization over time) and emergent use (using outsourcing to perform tasks previously not considered possible within an organization).

Measurement of importance

According to Zacharias (2009) there is no commonly used definition to measure importance. However it may be loosely defined as level of significance. In practical studies there are often criteria which are highly correlated thus making it impossible to come up with a measure of importance for all criteria. Factor analysis might overcome the problem of multi-colinearity but often the resulting factors do not give concrete hints for optimization. Some definitions of importance are not easy to handle – e.g. an averaging over ordering can result in extensive computational work when the number of criteria is high. Some ways to derive importance are sensitive to the variables included in the model, so if the first criteria is more important than the second this relationship could flip if we omit other variables from the model. Most commonly used methods to derive importance are restricted to linear relationships and Statistical predictive models. Bar graphs and charts show the relative importance of research variables, they condense large amounts of information into easy-to-understand formats that clearly and effectively communicate important points (Beyene et. al, 2009).

Research Methodology

Research design

A survey research design was adopted for this study. Kothari (1985) defines survey research as “the process of collecting representative sample data from a larger population and using the sample to infer attributes of the population”. The main purpose of a survey is to estimate, with significant precision, the percentage of population that has a specific attribute by collecting data from a small portion of the total population (Ranjit, 2005). Data is ever-changing and survey research portrays a brief moment in time to enhance our understanding of the present (Kothari, 1985). Primarily data collected from such a study is more reliable and up to date (Kothari,1985). According to Yin (1994) a survey research design allows an investigation to retain the holistic and meaningful characteristics of real life events. Survey research is the most widely used research method in outsourcing research (Myers, 1997), and is well suited to understanding the interactions between outsourcing and the factors influencing its adoption. Survey research is an appropriate research strategy where a contemporary phenomenon is to be studied in its natural context (Benbasat et al., 1987) and the focus is on understanding the dynamics present in a variety of settings.

Population

The population for this study was all the manufacturing and allied firms listed under this sector on the Nairobi Stock Exchange (NSE) which have an activity or a collection of activities which have been outsourced. This sector was chosen since manufacturing firms have a wide variety of

activities. Due to the wide range of these activities most manufacturing entities are forced to outsource and concentrate on their core competencies

Sampling frame

The sampling frame for the study comprised of procurement officers, Managing Directors, Supply chain directors, Procurement Managers, Operations Managers, operation officers, administrative officers, administrative managers, supply chain officers, supply chain managers/directors, Logistics managers, Logistics officers or their equivalents in the selected manufacturing companies.

Sample and sampling technique

The sample consisted of 50 respondents selected from 5 different manufacturing and allied firms. 5 manufacturing and allied firms were selected for the study from the full list of 9 companies listed under this segment on the NSE. Companies with branches were considered to be one entity together with their branches. The judgmental sampling technique was used for the study in selecting the companies where the questionnaires were administered while random sampling technique was used in selecting the respondents.

Data collection Method

Primary data was collected by means of a semi-structured questionnaire. The questionnaire had close ended questions and will consist of four sections. The close ended questions were meant to elicit quantitative answers for analysis the respondent were exposed mainly to questions related to outsourcing and the factors influencing its adoption by the firm. The researcher made appointments with the respondents with detailed schedule of place, date, and time when questionnaires were personally administered by the researcher. The respondent were allowed to make consultations and references to organization documentation while answering the questions so as ensure accuracy of answers provided.

Data analysis

The completed questionnaires were checked for completeness and consistency. Any incomplete questionnaire was discarded. Descriptive data analysis was used. According to O'Neill (2006) descriptive data analysis allows for a broader study, involving a greater number of subjects, and enhancing the generalization of the results and can allow for greater objectivity and accuracy of results. The data was broken down into different aspects of strategic responses and arranged into logical groups for analysis. This offered a systematic description of the objective of the study.

Research Findings

Importance of the need to reduce costs

According to a breakdown of the responses obtained from the study most of the respondents indicated that the need to reduce costs influences the adoption of outsourcing by manufacturing and allied entities. The specific costs indicated in the order of the most important to the least important were: monitoring and supervision costs, overheads, labor costs and quality costs. The need to reduce the three was of equal importance in making the decision to outsource while raw material costs were of lower importance. These types of costs are important since they determine the overall costs incurred by an enterprise. All 43 respondents representing 100% of the respondents indicated that the need to reduce monitoring & supervision costs, overheads, labour costs, and quality cost were important in making the decision to outsource any of their operations.

However in relation to the need to reduce raw material costs 15 respondents representing 35%, of the respondents indicated that they were an important factor in adopting outsourcing while 28 who represented 65% of the respondents believed that these cost were not applicable in making outsourcing decisions.

In an informal interview with some of the respondents on this issue it was found out that those who had indicated the need to reduce raw material costs as being important believed that an outsourcing agents well established network with supplier and access to information would result in overall lower costs to the entities while those who had indicated that the need to reduce raw material costs was not applicable were of the opinion that their firms would not outsource any activity that required manufacturing since that was their core competency while others believed that outsourcing would not result in raw materials cost savings since the raw material cost would be passed on to the entity plus markup therefore making it more expensive for the entity thereby defeating the purpose of outsourcing.

Importance of resource inadequacies

From the study 39 of the respondent representing 91% of the total respondents indicated that the shortage of human resources within an enterprise is an important factor influencing the decision to outsource within a manufacturing entity while 4 of the respondents representing 9% of total respondents indicated that the inadequacy of human resources was not important in influencing the decision to outsource. Upon further investigation it was found that this response arose from the belief that their respective organization could hire more if need be and as long the benefits of additional hiring outweighed the costs. None of the respondents indicated they had adequate human resources.

100% of the respondent indicated that the inadequacy or unavailability of machinery and equipment which may be required for some operations within the organization was a key factor

in making the decision to outsource. It was found that where the required machinery or item of equipment required to perform a task was unavailable or the capacity available was inadequate the natural option was to outsource the activity that required that specific machine or equipment.

On information it was found that 30 respondents representing 70% of the respondents believed inadequacy information was an important factor in influencing the decision to outsource, the rationale behind this mode of thinking being that the outsourcing agent would have access to more sufficient and up to date information than the organization could obtain, this was more so in activities related to marketing, promotions and public relations. A further 6 respondents representing 14% of the respondents, believed information inadequacy was not an important factor influencing the adoption of outsourcing by an entity. The rationale behind this thinking was that operating in the same information technology environment as the entity; an outsourcing agent would also have the same information as the entity no more and no less. Additional 16% respondents representing 7 of the respondents responded that information inadequacy was not applicable in making the decision to outsource since necessary information could always be obtained by a manufacturing concern cheaply from the many sources available in an information age such as the present one. None of the respondents were neutral to in relation to information.

On space as a resource and its inadequacy's influence on the decision to adopt outsourcing, 100% percent of the respondents indicated it was an important factor in influencing the decision to outsource. Warehousing was cited as one of the service that these manufacturing entities have to outsource due to the fact that currently available space was not adequate to meet the storage requirements of the entity for their finished products and their raw materials. The need to outsource warehouse was more so made obvious while serving markets outside the region of the factories and whilst serving international markets where investing in own warehouses would involve excessive capital outlay.

From the findings financial inadequacies are an important factor in influencing the decision to outsource by manufacturing entities. 100% of the respondents indicated that shortages in available finance was an important factor in making them and organization to opt for outsourcing various operations since such an arrangement would ensure that they obtained the required goods and services more cheaply than when the investment was made to facilitate their availability internally.

The importance of adoption of outsourcing by other firms

From the study the following data was obtained in relation to the adoption of outsourcing by direct competitors: 20 of the respondents indicated that the adoption of outsourcing by direct competitors was an important factor in influencing their decision to outsource. They indicated that if a direct competitor adopted outsourcing they would also give it consideration to determine whether there were any gains to be made from such outsourcing. These respondents represented 47% of the total respondents. 14% of the respondents, i.e. 6, stated that they would be neutral in

making their outsourcing decisions regardless of whether their direct competitors have outsourced or not. This stemmed from the argument that all organizations are different and each stood to benefit or lose from outsourcing individually based prevailing internal and external factors. A further 7 respondents representing 16% of the total respondent indicated that the adoption of outsourcing by direct competitors was not important to them in making their outsourcing decisions. 10 respondents, representing 23% of the respondents, indicated that the adoption of outsourcing by direct competitors was not applicable in influencing their decision to adopt outsourcing since their direct competitors were fringe firms in the industry whose actions are unlikely to have any major consequence on the market share status quo.

On the adoption of outsourcing by indirect competitors 4 respondents indicated they were neutral. This represented a sum total 9% of the respondents. The argument being that being in businesses outsourcing was likely to have different outcomes for both. 39 of the respondents representing 91% of total respondents indicated that the adoption of outsourcing by indirect competitors was not important in influencing the decision to outsource by a manufacturing entity. None of the respondents considered indirect competitors outsourcing adoption either important or not applicable.

The adoption of outsourcing by industry leaders was considered important in influencing the adoption of outsourcing by manufacturing entity by 30 of the respondents representing 86% of the respondents. This arose from the rationale that a practice adopted by an industry is also likely to be beneficial to any other enterprise within that industry. 3 (7%) of the respondents indicated that they were neutral on the adoption of outsourcing by an industry leader and its effect on their own decision on to adopt outsourcing, i.e. it would not make them either adopt or not adopt outsourcing. 5% of the respondents indicated that the adoption of outsourcing by an industry leader was not important to their own decision to adopt outsourcing for their organizations while 8 respondents representing 19% of the respondents indicated that it was not applicable. This response arose from the fact that the respondents considered their enterprise to be the industry leader.

On the effect of adoption of outsourcing by multinational corporations on the adoption of outsourcing by a manufacturing firm: 4 of the respondents indicated that it was an important factor influencing their decision to outsource. This represented 9% of the respondents. 10, (23%) of the respondent indicated they were neutral i.e. the adoption of outsourcing by a multinational would make them indifferent on their decision to outsource in their own organization. 29 of the respondents representing a percentage of 67% considered the adoption of outsourcing as unimportant to their own decision to outsource. This arose from the fact that a multinational given its global coverage might benefit more from out outsourcing as opposed to a manufacturing entity in a third world developing country such as Kenya.

Summary of Findings

A survey of selected organizations was carried out and the following findings were made: 92% of the respondents indicated that resource inadequacies would be an important factor in influencing the adoption of outsourcing by a manufacturing entity. 87% of the respondents supported the view that the need to reduce costs would be an important factor in influencing the adoption of outsourcing by a manufacturing concern while 31% of the respondents specified that the adoption of outsourcing by other firms would be an important influencing factor in their decision to adopt outsourcing in their own firms. In relation to the adoption of outsourcing by other firms 13% indicated they would be neutral, 45% indicated it was not important while 11% specified that it was not applicable

Conclusions

Based on the results of this study, which aimed at determining the importance of the variables in the adoption of outsourcing and not on the importance of the magnitude of the variables, it can be concluded that need to reduce costs and resource inadequacies within a manufacturing entity are of high importance in influencing the adoption of outsourcing. However the adoption of outsourcing by other firms is of least importance among the three factors in influencing the adoption of outsourcing by an organization when compared to the other two factors, i.e. the need for cost reduction and resource inadequacies, on the contrary evidence established that the adoption of outsourcing by other firms does not automatically lead to its adoption by a manufacturing entity and therefore there is some level of independence when it comes to the adoption of outsourcing by manufacturing entities. The above conclusions drawn from the study were informed by the cross tabulation of all three variables.

Recommendations

From the research findings the need to reduce costs is a major factor influencing the adoption of outsourcing; therefore it is recommended that in making outsourcing decisions a firm must consider whether the costs are excessively high and in need of reduction. If costs are within an acceptable range and no significant savings are likely outsourcing should not be undertaken. In this light it must also be considered whether outsourcing will actually lead to a reduction of the costs or simply a transfer of the original point of cost incurrence but the final incidence of the costs will eventually fall on the firm as a result of it being transferred by the outsourcing agents.

From the findings of the study Resource inadequacies are another major factor influencing the adoption of outsourcing, therefore whenever a firm is weighing its options with regard to make or buy decisions consideration must be given as to the resource availability within the organization. Where the required resources are wholly available then the required goods or

services must be provided from within. However where resource inadequacies exist outsourcing would be a more appropriate option.

In relation to the adoption of outsourcing by other firms, it was found that it was not a factor of great significance in comparison to the other two in influencing the adoption of outsourcing by a manufacturing entity. Therefore it is recommended that in making the decision to adopt outsourcing the firm should consider factors only pertinent to it individually, but consideration may also be given to the impact of outsourcing on other similarly placed firms which may have adopted it. Outsourcing should not be adopted blindly just because it has been adopted by other firms.

References

- Alchian, A.A., and Demsetz, (1972) H. Production, information costs and economic Organization, *American Economic Review* (62), pp. 777-795
- Argyres, N. (1996), Evidence on the role of firm capabilities in vertical integration decisions, *Strategic Management Journal*, 17, pp. 129 – 150
- Bahli, B. and Rivard, S. (2003) The information technology outsourcing risk: a transaction cost and agency theory-based perspective. *Journal of Information Technology*. 18 (3), pp. 211-221
- Barney, J.B. (1991) Firm resources and sustained competitive advantage, *Journal of Management* (17), 1991
- Barney J.B., Hesterly W., (1996). Organizational Economics: Understanding the Relationship Between Organizations and Economic Analysis, in Clegg S.R., Hardy C., Nord W.R. (Eds.) *Handbook of Organization Studies*, Sage Publications, London
- Benbasat, I. Goldstein, D. K. and Mead, M. (1987). The Case Research Strategy in Studies of Information Systems. *MIS Quarterly*, 11 (3), 369-386.
- Beyene, J. Atenafu, G Hamid, S. J., Teresa, T. and Sung, L.(2009) Determining relative importance of variables in developing and validating predictive models *BMC Research Methodology*, 9:64
- Canez, L., Platts, K. and Probert, D. (2000) Developing a framework for make-or-buy decisions, *International Journal of Operations & Production Management*, Vol. 20, No. 11, pp.1313–1330.
- Cap Gemini (2007) Third-Party Logistics, *Results and Findings from 12th Annual Study*, available at http://www.de.capgemini.com/m/de/tl/Third-Party_Logistics_2007.pdf, accessed on 6 February 2008.
- Chamberland, D., 2003. Is it core strategic? Outsourcing as a strategic management tool. *Ivey Business Journal Online* (Jul/Aug), 1-5.
- Cheon, M.J., Grover, V., and Teng, J.T.C. (1995) Theoretical perspectives on the outsourcing of information systems, *Journal of Information Technology* (10),
- Christopherson, S., 2007. Barriers to ‘US style’ lean retailing: the case of Wal-Mart’s failure in Germany. *Journal of Economic Geography* 7 (4), 451-469.
- Chung, W.W.C., Ko, C.C.Y., Cheung, E.W.M. and Wong, T.C.W. (2007) ‘IT-enhanced order and delivery process of a fast moving consumer goods (FMCG) company’, *Benchmarking: An International Journal*, Vol. 14, No. 1, pp.123–139.

- Coase, R. (1937) Nature of the Firm, *Economica* (4), , pp. 386-405.
- Cost. 2012. In *Merriam-Webster.com*. Retrieved May 25, 2012, from <http://www.merriam-webster.com/dictionary/cost>
- De Looft, L.A. (1995). Information systems outsourcing decision making: a framework, organizational theories and case studies. *Journal of Information Technology*, 10, 4, 281-297
- Dierickx, I., and Cool, K. (1989) Asset stock accumulation and sustainability of competitive advantage, *Management Science* (35:12), , pp. 1504-1514.
- DiMaggio, P., and Powell, W. (1983) The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields, *American Sociological Review* (48:April), pp. 147-160.
- DiRomualdo, A., and Gurbaxani, V. (1998) Strategic intent for IT outsourcing, *Sloan Management Review* (39:4), pp. 67-80.
- Edgell, J., Meister, G.E. and Stamp, N. (2008) Global outsourcing trends in 2008, *Strategic Outsourcing: An International Journal*, Vol. 1, No. 2, pp.173–180.
- Ettlie, J.E., Sethuraman, K., (2002). Locus of supply and global manufacturing. *International Journal of Operations & Production Management* 22 (3), 349-370.
- Fernandez, I. and Kekale, T. (2007) Strategic procurement outsourcing: a paradox in current theory, *Int. J. Procurement Management*, Vol. 1, Nos. 1/2, pp.166–179.
- Gicheni, E.M. (2009). *Factors that influence the adoption of business process outsourcing; a case study of East African Breweries* (unpublished master's research project). Jomo Kenyatta University of Agriculture and Technology, Juja, Kenya.
- Grant, R.M. (1991) The resource based theory of competitive advantage: implications for strategy formulation, *California Management Review* (33), pp. 114-135
- Greaver M.F. (1999). *Strategic Outsourcing: A Structured Approach to Outsourcing Decisions and Initiatives*, AMACOM, New York
- Hu, Q., Saunders, C., and Gebelt, M. (1997) Research report: Diffusion of information systems outsourcing: A reevaluation of influence sources, *Information Systems Research* (8:3), pp.288-301.
- Humphreys, P.L. and McIvor, R. (2000) A decision support framework for strategic purchasing, *Journal of Materials Processing Technology*, Vol. 107, pp.353–362.
- Jacobides, M.G. and Winter, S.G. (2005) The co-evolution of capabilities and transaction costs: explaining the institutional structure of production, *Strategic Management Journal*, Vol. 26, pp.395–413.
- Jäger, K., Ujvari, S. and Hilmola, O-P. (2007) Operating as a third party logistics integrator without any distribution operations ownership, *International Journal of Services and Standards*, Vol. 3, No. 2, pp.154–168.
- Kotabe, M., M. J. Mol, et al. (2008). Outsourcing, performance, and the role of e-commerce: A dynamic perspective. *Industrial Marketing Management* 37(1): 37-45.
- Kothari, C.R. (1985), *Research Methodology-Methods and Techniques*, New Delhi, Wiley Eastern Limited
- Kshetri, N., (2007). Institutional factors affecting offshore business process and information technology outsourcing. *Journal of International Management* 13 (1), 38-56.
- Ranjit, K. (2005), *Research Methodology-A Step-by-Step Guide for Beginners*, (2nd.ed), Singapore, Pearson Education.

- Lacity, M.C., and Hirschheim, (1993). R. *Information Systems Outsourcing: Metaphors, Myths and Realities*, Wiley, New York,
- Langlois, R. (1990). External economies and economic progress: The case of microcomputer industry. *Business History Review*, vol. 66, (1), pp. 1-50.
- Lau, K.H. and Zhang, J. (2006) Drivers and obstacles of outsourcing practices in China, *International Journal of Physical Distribution & Logistics Management*, Vol. 36, No. 10, pp.776–792.
- Lee, J. N and Kim, Y. G. (2005). The Effect of Partnership Quality on IS Outsourcing Success: Conceptual Framework and Empirical Validation. *Journal of Management Information Systems*, 15(4), 29-61.
- Levina, N. and Ross, J.W. (2003). From The Vendor's Perspective: Exploring the Value Proposition in Information Technology Outsourcing. *MIS Quarterly*, 27(3), 221-364.
- Liu, R-J. and Brookfield, J. (2006) Japanese subcontracting in mainland China: a study of Toyota and Shanghai Koito, *Supply Chain Management: An International Journal*, Vol. 11, No. 2, pp.99–103
- Loh, L., and Venkatraman, N. (1992b) Diffusion of information technology outsourcing: Influence sources and the Kodak effect, *Information Systems Research* (3:4), , pp. 334-288.
- Lopes da costa, r. (2009). a coordenação dos recursos como factor de competitividade de no sector da banca. master thesis, management department, indieg – iscte, university of lisbon, lisbon.
- Muema, K. (2011) *Factors influencing outsourcing as a cost saving tool; a case study of British American Tobacco, logistics department* (unpublished master's research project). Jomo Kenyatta University of Agriculture and Technology, Juja, Kenya.
- Myers, M. (1997). Qualitative research in information systems. *MIS Quarterly*, vol. 2, (2), pp. 241-242
- Ngugi, G. (2011) *Factors influencing the adoption of outsourcing by private firms; a case of Bidco Oil refineries* (unpublished master's research project). Jomo Kenyatta University of Agriculture and Technology, Juja, Kenya.
- Nonaka, I., and Takeuchi, H. (1995) *The Knowledge-Creating Company: How Japanese Companies Create the Dynamics of Innovation*, New York: Oxford University Press, O'Neill, R. (2008), the advantages and disadvantages of qualitative and quantitative research methods. [Online] http://www.roboneill.co.uk/papers/research_methods.html
- Noor, I. S. (2011) *Effect of outsourcing on organizational performance; a case study of Safaricom limited* (unpublished master's research project). Jomo Kenyatta University of Agriculture and Technology, Juja, Kenya.
- Oliver, C., (1997). Sustainable competitive advantage: Combining institutional and resource-based views. *Strategic Management Journal* 18 (9), 697–713.
- Overby, S (2007) *ABC: An Introduction to Outsourcing*. CXO Media Inc.
- Probst, G.; Raub, S.; and Romhardt, K. (2000). *Managing knowledge: Building blocks for success*. England: John Wiley & Sons Ltd.
- Quinn, J.B., and Hilmer, F.G. (1994) Strategic outsourcing, *Sloan Management Review* (35), pp.43-55.
- Radding, A. (1995) Outsourcing options for help desks, *Computerworld* (29:32), pp. 100.

- G., Barney, J. B., and Muhanna, W. A. (2004), Capabilities, business processes and competitive advantages: choosing the dependent variable in empirical test of the resourcebased view, *Strategic Management Journal*, 25, pp. 23 -27.
- Resource. 2012. In *Merriam-Webster.com*. Retrieved May 25, 2012, from <http://www.merriam-webster.com/dictionary/resource>
- Rogers E. M. (1995) *The adoption of innovations: the free press*
- Roy V., Aubert B., (2001). A Resource-Based Analysis of Outsourcing: Evidence from Case StudieS, *Scientific Series*, CIRANO
- Rubesch, E. and Banomyong, R. (2005) Selecting suppliers in the automotive industry: comparing international logistics costs, *Asia Pacific Journal of Marketing and Logistics*, Vol. 17, No. 1, pp.61–69.
- Rumelt, R.P.(1984) Towards a strategic theory of the firm, In *Competitive Strategic Management*, R. B. Lamb (ed.) Prentice-Hall, Englewood Cliffs, NJ, pp. 556-570.
- Saga V. and Zmud W. (1994) The nature and determinants of outsourcing acceptance, adoption and Routinization. *Proceedings of Transfer and implementation of technology conference*. Pg 11-13
- Sharpe, M. (1997). Outsourcing gains speed in corporate world. *Journal of Labor Research*: 535-549.
- Sengupta, K. and Zviran, M. (1997). Measuring user satisfaction in an outsourcing environment. *Engineering Management, IEEE*, 44(4), 81-103.
- Sun, S-Y; Lin, T-C; Sun, P-C. (2002). The Factors Influencing Information Systems Outsourcing Partnership –A Study Integrating Case Study and Survey Research Methods. *Proceeding of the 35th Hawaii International Conference on System Sciences*, 235.
- Tian, Y., Lai, F. and Daniel, F. (2008) ‘An examination of the nature of trust in logistics outsourcing relationship – empirical evidence from China’, *Industrial Management & Data Systems*, Vol. 108, No. 3, pp.346–367.
- Westphal, J.D., Gulati, R., Shortell, S.M., (1997). Customization or conformity? An institutional and network perspective on the content and consequences of TQM adoption. *Administrative Science Quarterly* 42 (2), 366-394.
- Williamson, O. (1985) *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, the Free Press, New York.
- Yin, R. K. (1994). *Survey research: design methods*. Sage Publications, Thousand Oaks.
- Zacharias, R (2009) *New approach to measuring importance of items under investigation*, MAIXGmbH, Germany.
- Zmud, W and Apple, L. (1992). Measuring Technology adoption and acceptance. *Journal of product innovation and management*. pp 148-155