

Factors Determining Outsourcing Effectiveness: with Reference to the Sri Lankan Apparel Sector

By W.W.M. WEWALA¹, S.K.N.H. DAYAWANSHA², M.D.S.A. MAHAPATUNA³, R.P.P.S.
RAAJAPAKSHA⁴ AND W.D.H. DE MEL⁵

Over the last two decades, organisations have given tremendous attention to outsourcing to improve operational efficiencies. Necessity has risen for organisations to continuously focus on core activities to remain competitive in the marketplace. Outsourcing has become a common business strategy in many industries, including Textile and Apparel. The extant literature has predominantly focused on how outsourcing influences the overall production process and the outsourcing of production activities to developing countries by well-known apparel brands. The present study aims to identify factors determining the outsourcing effectiveness in the Sri Lankan Apparel sector. The data collection for this study was carried out using qualitative methodology and in-depth interviews. Seven employees in senior executive and managerial levels were interviewed using a semi-structured interview guide. The data were analysed using thematic analysis. The findings revealed four main themes: the quality of the product, labour cost, lead time and responsibility. The findings of this study provide practitioners with information on the essential components to consider when selecting outsourced parties and managing outsource agreements.

Keywords: *Labour cost, Lead time, Outsourcing, Quality*

INTRODUCTION

In the past decade, organisations have shown drastic improvement in terms of creativity and rivalry. This is primarily because extremely competitive business environments compelled organisations to pursue various methods in order to achieve competitive advantages. Traditionally, manufacturers used

^{1,2,3,4,5} Department of Management and Finance, Faculty of Management, Social Sciences and Humanities, General Sir John Kotelawala Defence University. Corresponding author: danishademel@kdu.ac.lk

to undertake the process of converting raw materials into finished products within the premises (Epitawela, 2014). In most organisations, the business model was such that they could own, maintain, and directly regulate all the activities. Eventually, along with globalisation, companies have begun to outsource some of their services instead of keeping them in-house. Among the many definitions for outsourcing, McDonagh and Haywards (2000) defined outsourcing as the total or partial contracting out of an organisation's activity, function, or process to a third-party service provider. According to Momme (2002), outsourcing is defined as vertical integration to a low level in the supply chain. Outsourcing is also defined as the process of shifting some of the company's responsibilities and activities to an outside organisation (Chase, 2004).

For the leading apparel brands in the world, outsourcing has become a lucrative trend, which is primarily backed by the cost aspect (Teng & Jaramillo, 2005). In the global apparel industry, outsourcing production to low-cost regions has become the standard practice (Kumar & Arbi, 2008). Accordingly, many Asian countries, including China, India, Pakistan, Sri Lanka, Bangladesh and Vietnam have gained the opportunity to cater to the high-end brands, thereby marking a global presence. Outsourcing activities related to textile and apparel brands by the developed countries to developing countries have been studied in academic literature in various contexts (Epitawela, 2014; Handfield et al., 2020; Kumar & Arbi, 2008). The focus of this study is set in the Sri Lankan Apparel sector.

Textiles and apparels being the major commodity export in Sri Lanka, the industry is one of the most significant contributors to the economy. The industry's export revenue earnings were reported as \$5 billion in 2018, thereby contributing 44% to the country's national exports (BOI Sri Lanka, 2019). However, the industry was severely affected by the COVID-19 pandemic with a global reduction in the demand.

Sri Lanka is well-known for world-class apparel manufacturers such as Brandix, MAS Holdings and Hidaramani, catering to various top-notch brands which include Adidas, Nike and Victoria's Secret (Bolonno, 2020). Backward integration of the apparel sector is another concern that has tapped the attention of previous researchers in the Sri Lankan context (Gunathilake & De Mel, 2016; Rathnayake et al., 2020). Even though the Sri Lankan Apparel Industry consists of many Small and Medium Scale Enterprises (SMEs), the country's apparel exports mainly lie in the hands of giant players. Most of the

SMEs, therefore, are involved in undertaking subcontract orders on behalf of the larger firms. The apparel sector faces immense challenges, such as unpredictable product demand during seasonal time, increasingly diversified inventory, and stringent product pricing etc. Hence, to overcome these issues, apparel organisations use outsourcing strategies which significantly affects the organisational performance (Mirza & Ensign, 2021).

Researchers observed that there is a dearth of studies examining the effectiveness of outsourcing by giant apparel organisations to small and medium scale apparel manufacturers in the Sri Lankan context. Therefore, against this backdrop, the main objective of the present study is to investigate the effectiveness of outsourcing by the large-scale apparel manufacturers to SMEs in Sri Lanka.

LITERATURE REVIEW

Important strategic decisions in terms of whether to buy or make, and whether to in-source or outsource are often centred on whether the organisation could improve its performance based on suppliers' specific capabilities (Kam et al., 2011). Having outsourced all or a portion of activities outside of the organisation's key capabilities, through an arrangement with a third party, will enable the organisation to focus more on their core competencies (McCarthy & Anagnostou, 2003). Outsourcing may provide significant advantages to organisations. Nevertheless, if an outsourcing choice is not precise and elements impacting the outsourcing decision are not considered, it can cause irreparable harm to organization's image (Nikabadi & Zamani, 2016). Outsourcing is said to be effective since utilising it the organisation experiences improvements in operations such as cost savings, reduction in capital investment, adaptability to changing business environment, enhance competitive abilities, high quality goods and services and reduced risk of changing technology (Agburu et al., 2017). This has led many companies to rethink their strategic decisions with regard to outsourcing. Although many apparel businesses find it challenging to find the right outsourcing strategy for their business, Agburu et al. (2017) stated that organisations, irrespective of the scale, organisations have embarked on outsourcing over the years. This includes, back-office operations, primary activities, accounting activities and other support activities. Such outsourcing has also led to enhanced organisational performance ensuring the effectiveness of outsourcing. These organisations all look for better markets to leverage their products or services, which enhances profitability.

Product Quality

Garvin (1984) posits that product quality can be used as a weapon for product positioning and selling. Product quality is one of the key components that gains customer satisfaction to the brand or the organisation. Product outsourcing is a concept that a company's product processing is fully handed over or shared with another organisation. Outsourcing has become a managerial decision process involving both internal and external parties relevant to the organisation (Jin, 2013). Outsourcing is based on a contract between the two parties who supply the delivery and who receive it in "pre-specified" quality (Lu et al., 2012). Moreover, Berdine et al. (2008) stated that companies use mix outsourcing strategies to minimise the risk and maximise the product quality. Hence, the quality of the product is an important term in outsourcing criteria (Xiao et al., 2014).

Supplier companies maintain their product quality to avoid the risk of business collapsing. If the business is known for bad quality management, it would have adverse impact when forming a contract with another firm. Kaya and Özer's (2009) findings have identified how "quality risk" can reduce the adverse effect on both revenue and product quality for both parties. Moreover, product quality in outsourcing always depends on the implementation of agreements between both suppliers and buyers (Xiao et al., 2014). Furthermore, findings of Kay and Özer (2009) depict how outsourcing can increase the risk in the supply chain because the firm has little interaction with the supplier's quality management process. Accordingly, outsourcing can have both positive and negative effects on product quality.

Labour cost

As determined by Adeleye (2011) outsourcing changes the single employer to multiple employers bringing about complex "inter-organizational" employment within an organisation. Outsourcing also opens the option to hire or form a contract with another firm to perform the required work within a period of time and pre-settled exchange value without having to employ permanent staff. Reduction of the production cost by cutting off variable costs attached to operations is one of the main reasons behind outsourcing. Considering production cost and the product price, global firms look for countries with low labour costs to outsource their production process. According to Kumar and Arbi (2008), during the past two decades, countries such as the USA and the UK have shifted their operations to cities in the Asian continent, due to cheap labour cost and appealing tax incentives. However,

in Sri Lanka, attracting and retaining, for example the youth, in the apparel sector seem to be challenging along with the evolving career aspirations of the younger generation. Thus, many large apparel firms focus on outsourcing to small-scale firms that are coming up in areas with a close proximity to villages, thus attracting human resources at relatively low cost.

Lead time

Lead time includes the time between the receipt of raw materials and delivery date of the finished goods to the customer or the buyer, including job time in the workshop (Tatsiopoulos & Kingsman, 1983). Furthermore, lead time refers to “the time between ordering the merchandise and having it arrived in the store” (Dickerson, 1998). In their findings Kumar and Arbi (2008) point out that outsourcing is a viable option for long seasonal orders more than the short-term market. This is because it usually takes more time to produce and deliver the product to the buyer when it is outsourced rather than an in-house production. Apparel industry is one of the largest industries in the world (Sardar & Lee, 2013), and so, apparel firms choose outsourcing. They usually have sub firms all over the country to distribute their products. Lead time has become one of the key features to demonstrate the capability of the firm’s production and quality control. However, one of the most prominent characteristics of the apparel industry is that it is unpredictable. Hence, the suppliers should be highly responsive. Quick response has evolved to shorten delivery time, and thus provide other efficiencies in the production and marketing chain (Hathcote & Nam, 2010).

Company Responsibility

In the past two decades organisations in the apparel industry have progressively turned to outsourcing or the externalisation of activities that are usually performed in house, this has respectively enhanced the competitiveness, firm performance, effectiveness of the business operations and reduce the level of responsibility towards the company (Adeleye, 2011). Outsourcing began with low end activities such as security, catering services, cleaning, mailing, which have now moved into customer service operations, design, manufacturing, marketing, clerical positions, fleet management, administrative activities and secretarial activities, distribution, human resources, and sales (Adeleye, 2011). The company is responsible for procurement or possession of materials that may include designers, outsourcing specialists, buyers, merchandisers and/or purchasing agents. For increasing the efficiency and effectiveness of the manufacturing process,

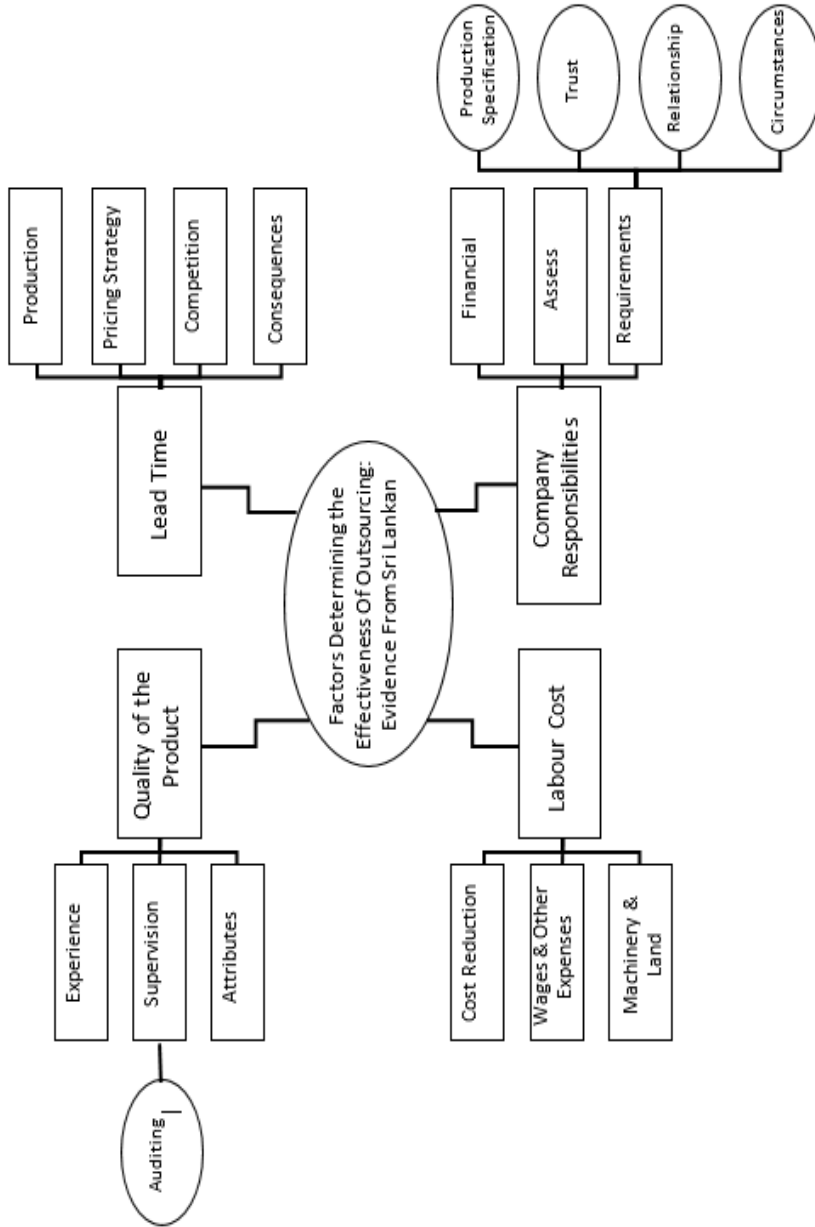
the company should issue a continuous flow of necessary materials and services (Kathirvel, 2020).

Outsourcing involves hiring of services that covers the entire process, from an external organisation, not just to add to the company's strength, but as an enduring replacement of the in-house function where this arrangement is ruled by an acquiescence or an agreement between two companies in a buyer-supplier relationship (Rochester & Rochester, 1995). To preserve the advantage of outsourcing, companies should strengthen long-term relationships on trust, managing broad exclusive partnerships, initiating a standardised, disciplined surrounding for outsourcing, exercising required attentiveness, before choosing a vendor (Kam et al., 2011). Invading into a long-term agreement with an external company could reduce the original company's flexibility. This could happen due to differences in business needs, requirements or technologies which may provide contractual terms that are outdated, could reduce responsiveness, and could increase the risk of estranging customers (Kam et al., 2011).

Theoretical Framework

Resource Based View (RBV) evaluates and interprets organisational resources to understand how firms gain long-term competitive advantage. Accordingly, RBV focuses on the notion of the firm's difficulty-to-copy characteristics as sources of superior performance and competitive advantage. In order to give a competitive advantage, a resource must have four attributes, which RBV identifies as heterogeneous resources and are classified as Valuable, Rare, In-imitable and Non-substitutable. This is commonly referred to as the VRIN framework (Barney, 1986; Hamel & Prahalad, 1994).

Figure 1: Thematic Map



Source: Developed by the author

RBV is crucial in the study of outsourcing since superior performance in organisational activities compared to rivals explains why such activities are absorbed into the company (McIvor, 2009). The concept of core competence developed by Hamel and Prahalad (1994), which emerged from RBV, has had a remarkable impact on outsourcing practice, with the distinction between core and non-core activities firmly entrenched in the lens of many practitioners. RBV of an organisation is based on the assumption termed as inside-out perspective, which is described by Hamel and Prahalad (1994) as a perspective where organisations should be aware of the availability of internal resources before they seek it outside of the organisation. Moreover, outsourcing decision is also based on the client company's ability to invest in internal capabilities and thereby sustain the competitive advantage.

METHODOLOGY

The study adopted a qualitative approach to gain deeper understanding and to bring in new insights concerning the study context. The present research was carried out as a cross-sectional study and manager/executive level employees in leading apparel companies were the unit of analysis. Large scale apparel organisations in Sri Lanka undertake international orders, thereby experiencing the need for outsourcing to small scale apparel manufacturers. Respondents were selected based on convenient sampling technique and taking the experience and the position of the respondents into consideration. Sample size was determined by the researchers when the data collected were at saturation, where the respondents had given similar responses. Accordingly, the study gathered primary data from seven in-depth interviews (with two managerial level employees and five senior executives) using a semi-structured interview guide.

Moreover, these interviews were recorded with the prior consent of the interviewees to enhance the quality and accuracy of data analysis. Following the code of conduct, the researchers ensured the confidentiality of the respondents, and the interview data were used within the research maintaining interviewees' anonymity.

ANALYSIS

According to Guest et al. (2012), responses gathered should be rearranged, categorised and simplified enabling the researchers to draw precise conclusions. Hence, the interviews conducted for the present study were transcribed and the transcripts were coded gradually. Thematic analysis was

employed as the main analysis technique. Through coding, main themes and sub themes were identified, and the thematic map is presented in Figure 1. The themes will be presented in detail in the proceeding section along with its analysis.

Quality of the Product

Experience within the industry is a crucial factor when it comes to outsourcing, thus ensuring the quality of the products. Especially in the apparel industry, expertise to maintain good quality is an asset from the Resource Based View. In line with this, Senior Executive 1 mentioned that they select their outsourcing companies depending on the experience in the industry and technical knowledge, a fact that was further confirmed by Manager 2.

“We use maturity and the experience in the industry, technical knowledge and expertise, financial stability of the company, capability and credit term as our indicators; when we are selecting an outsourcing partner.”

Senior Executive 4 further highlighted the importance of experience stating that they hire third party companies for production only on special occasions such as meeting urgent orders after ensuring that the outsourced parties have sound knowledge and the capability needed to carry out the production.

“We consider their knowledge about the field and capability of their manpower to finish our task in time.”

In increasing the quality of the product, supervision is an important factor. Senior Executive 1 stated that his company hires external authorities to audit the manufacturing process of the outsourcing company.

“We hire external authorities in auditing quality control. Our company arranges internal managers to make visits twice a week to evaluate the manufacturing process and to supervise the quality of the products”.

Other respondents also confirmed that they use internal audit departments and in-house quality control managers to monitor the quality of the production process and the final product being outsourced. To ensure that their third-party outsourcing companies are following agreed manufacturing processes and procedures, companies have to conduct audits which are regularly arranged on annual basis (Holbrook, 2016).

Attribute is a quality or feature regarded as a characteristic, and all respondents stated that responsibility for the quality of the final product lies completely with their company. Manager 2, for instance, stated that:

“Before we release a product to the market, we check the production samples, and our company takes full responsibility for the quality of the final outcome.”

It demonstrates the fact that the employees are aware of their responsibility towards the customers in terms of the quality of their products, even though they may be produced outside the company.

Labour Cost

When certain operations are outsourced, a company does not need to hire additional skilled employees especially when handling seasonal demand patterns. Senior Executive 2 declared that his company does not keep additional operators to do the basic activities in the manufacturing process, which will be costly.

“If we keep employees in-house for every task, we have to spend more money even without a project. But when we outsource certain tasks to a third-party company, we can reduce our labour cost and get improved performance because of their specialty in the field”.

Outsourcing can also reduce certain other expenses that are incurred in the manufacturing process, together with the labour cost (Giertl et al., 2015). According to Senior Executive 2, outsourcing can reduce unnecessary expenses for stationary, cleaning services, and wastage. Senior Executive 4 said that:

“(...) most of the time we can reduce our cost by outsourcing and there are instances we face performance problems with the company because of technical equipment failures.”

Hence, outsourcing enables the company to avoid additional investment in machinery and more land to establish manufacturing plants, which might even be underutilised due to demand fluctuations (Giertl et al., 2015).

Lead Time

In outsourcing, delivery of the products within the right time is very important. All the respondents agreed that working within the given time period can reduce pressure on transportation and other costs such as penalty fees. Hence, organisations have to ensure the ability of the outsourcing company to fulfil the order requirements in a timely manner. Accordingly, Senior Executive 5 mentioned that the capacity of the outsourcing company is a factor they consider.

“(...) capacity per day should be higher in the outsourcing company, so that they should be able to cater to our requirements.”

Palaka et al. (1998) point out that firms must pay lateness penalties corresponding to the exceeded lead time. Senior Executive 3 said that from the beginning of the order they agree upon a timeline with the customer but if they are unable to finish the order on time, the company must pay for the delays.

“In that case we discuss with the customer to extend the delivery time, if we're unable to do that we have to pay a penalty for that order.”

Senior Executive 1, 2 and Manager 1 highlighted that there is always a probability that competitors would snatch their business partners from them. Even in the apparel industry, it is very important to keep the customers satisfied. In their findings Kumar and Arbi (2008), found that outsourcing is not a viable option to fulfil orders in a short lead time.

Responsibilities

Financial stability seems to be a key feature when selecting an outsourcing partner of an organisation. All of the respondents were either looking for financial stability or they intended to give financial support that the partner needed. Manager 2 mentioned that:

“We provide partner companies with necessary requirements like financial support for the time being.”

Pomykalski (2013), stated that, in the apparel sector both external and internal factors affect financial standing of the company. Outsourcing certain

activities would free up resources which can be devoted into better projects or orders (Lair, 2012).

All respondents agreed that their respective companies take complete responsibility for the outcome, and that they consider their customers' requirement about the product a priority. In the selection of outsourcing, respondents claimed that they have looked for companies which can handle both the production aspect properly as well as undertake responsibilities. Every respondent thought that it is important to treat the outsource company as a partner. Senior Executive 3 claimed that:

“In order to deal with an outsource company we have to consider them as partners because two of us are forming a contract and agree upon some conditions to deliver the end product.”

DISCUSSION

Findings of the study revealed that an outsourcing company's experience in the industry is an influential factor in the quality of the final product. Since quality is a relevant factor in the manufacturing process of a product, not only inspection and auditing, but also quality conditions apply in every feature of the outsourcing process (Ramu, 2008). Accordingly, the findings highlighted that supervision is a vital factor to maintain the required product quality. Conducting regular audits in companies is also important to ensure that outsourcing companies are following the agreed manufacturing processes and procedures (Global, 2017; Holbrook, 2016).

Sardar and Lee (2013) stated that firms utilise outsourcing to reduce costs. Inside-out perspective with respect to the Resource Based View indicated by Prahalad and Hamel (1992) highlights the importance of organisations clarifying the availability of resources within the organisations before outsourcing. Findings of the current study further revealed that firms are willing to outsource production to avoid extra investment in new machinery and labour cost. Researchers had discovered that delivering products on time is an essential component of outsourcing, which helps to reduce the damage to the organisation in both finance and reputation status. This can be enhanced by better understanding between manufacturers and distributors. According to researchers, outsourcing is not a smart alternative for most short-term orders with shorter lead times because it is both expensive and has a high delivery cost. Organisations develop good outsourcing

relationships through strengthening trust between the two parties to gain strategic and technological benefits. When there is trust in a business relationship, it has an impact on the overall performance, and higher satisfaction that drives the manufacturing process to produce a high-quality product.

CONCLUSION

The current study explored the factors determining the effectiveness of outsourcing within the Sri Lankan apparel industry by investigating the quality of the product, lead time, labour cost and responsibility. As per the findings, it is essential to have strong supervision to evaluate the manufacturing process of the outsourcing company to ensure the quality of the product in required standards which ultimately impacts on the effectiveness of outsourcing. The main purpose of outsourcing is to increase organisational performance and to successfully address seasonal demand patterns. It is clear that outsourcing production related activities are considerably cheaper than investing on land and machineries to produce them in-house. The study also highlighted that lead time plays a crucial role in maintaining the effectiveness of outsourcing since the products should be delivered on time which is essential for achieving competitive advantage in the industry. Though it is the company's responsibility to manufacture quality products, outsourcing strategy helps to distribute the responsibility between both the client organisation and that of the outsourced company. It is a responsibility of the company to develop trust among the company and the outsourcing party to increase benefits.

RECOMMENDATIONS

As evidenced by the study, outsourcing is an advisable strategy to practice. However, it is crucial to find a suitable third-party outsourcing company, which has to be kept under supervision throughout the manufacturing process. It is prudent to select certified outsourcing companies as it will reduce the risk of quality compromise of the product and other factors as well.

This study provides many insights for further studies. As the study area only focussed on outsourcing strategy of several leading apparel companies in Sri Lanka, there is room for investigating outsourcing vis-à-vis other medium scale companies which practice outsourcing strategy for their operational processes. Future studies can empirically analyse the association between the outsourcing of non-production-related activities and organisational performance. The present study was limited to the qualitative approach,

whereas future research may employ both qualitative and quantitative approaches for more in-depth analyses. Moreover, further research may be carried out from the viewpoint of outsourcing companies which are mainly in the SME category (Mirza & Ensign, 2021).

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