

CHAPTER 9

Outsourcing

Pornpissanu Promsivapallop

*Faculty of Hospitality and Tourism
Prince of Songkla University
Kathu, Phuket, Thailand*

Introduction

In most industries, the concept of outsourcing is considered from the perspective of firms considering the outsource decision. But in the hospitality industry, there are whole sectors of the industry that exist to supply outsourced products and services, namely hotel management companies, contract foodservice providers and inflight caterers. Many of these firms are large, global companies, such as Four Seasons, Sodexho, Compass and Aramark. Whilst in flight catering, two companies – LSG Sky Chefs and Gate Gourmet – have a combined global market share of 55% (Jones 2004). Hence in this chapter, outsourcing is considered from both the client firm and the supplier perspective. However, the discussion of the supplier perspective will be limited, as almost no operations research into this has been conducted.

The chapter begins with a review of alternative definitions of outsourcing and then explores different types of outsourcing. This is followed by a discussion of the benefits, cost and risks of outsourcing. Two alternative theories of outsourcing – transaction cost economics (TCE) and resource-based view (RBV) – are then compared, before evaluating the research that has been conducted into outsourcing in the hospitality industry. The chapter concludes by considering the provision of outsourced service, through management contracts and franchising, by hospitality companies.

Definition of outsourcing

There is much debate in the management literature concerning the definition of outsourcing. Many agree that the core idea surrounding the outsourcing concept involves moving some of the firm's activities to outside providers. Lankford and Parsa (1999), for example, put forward a simple definition referring to it as the procurement of products or services from sources that are external to the organization. In addition, many authors go on to emphasize that outsourcing should involve only activities that have been performed in-house. Semlinger (1991), quoted in Jenster and Pedersen (2000: 148), defines outsourcing as the market procurement of formerly in-house-produced goods and services from legally independent supplier firms. According to Domberger (1998), Lonsdale (1999) and Bailey et al. (2002) outsourcing is concerned with the transfer of production of goods and services that have been carried out internally to an external provider.

Espino-Rodriguez and Padron-Robaina (2004) explain that the word outsourcing has widely been used, but often as a synonym for the traditional concept of subcontracting, externalization, make-or-buy decision, and disintegration of activities. However, Fan (2000: 213) stresses the fundamental difference between outsourcing and these other concepts, arguing that outsourcing involves only an existing internal activity. Embleton and Wright (1998) and Oates (1998) argue that the creation of a long-term relationship is key to the outsourcing philosophy. Building on the same principle, Greer et al. (1999) maintain that this long-term perspective differentiates outsourcing from subcontracting. They explain that outsourcing possesses a temporal dimension involving long-term and even permanent arrangements, whereas subcontracting and contracting out are rather short-term or temporary contractual interactions between two parties.

Furthermore, some emphasize management strategy as being a significant aspect of outsourcing. In their study of outsourcing strategy in hotels in Shanghai, Lam and Han (2005: 42–43) refer to outsourcing as a management strategy in which a hotel utilizes and forms strategic alliances with specialized outsourcing supplier to operate certain hotel functions, in an attempt to reduce costs and risks and to improve efficiency. The strategic nature of outsourcing is supported by experience in the flight catering industry. In the early 1990s two airlines, Lufthansa and Swissair, decided that the provision of meals onboard was core to their business, and they set up their own flight catering companies, LSG Sky Chefs and Gate Gourmet. At the same time, other airlines were deciding to outsource catering and disposed of their own flight kitchens – usually by selling them and then contracting out to these two firms. For instance, British Airways transferred its two kitchens at London Heathrow to Gate Gourmet. It seems in this sector at least, the strategy was either to get into outsourced services in a big way or to get out completely.

Another essential element put forward by scholars is the tendency of asset transfer from the firm to the outside partners. Quelin and Duhamel (2003: 648) define outsourcing as the operation of shifting a transaction previously governed internally to an external supplier through a long-term contract, and emphasize the transfer of ownership of a business function, often including a transfer of personnel and physical assets, to the vendor. Likewise, McCarthy and Anagnostou (2004) underline that outsourcing not only purchases products or services from sources that are external to the organization, but also transfers the responsibility of the physical business

function and often the associated knowledge to the external organization. Chase et al. (2004: 372) explain outsourcing as the act of not only moving some of a firm's internal activities but also including decision responsibility to outside providers. The terms of agreement are established in a contract. It goes beyond the more common purchasing and consulting contracts because not only are the activities transferred, but also resources that make the activities occur, including people, facilities, equipment, technology, and other assets, are transferred as well. This is usually the case when a firm outsources its employee feeding to a contract foodservice company or when a hotel outsources its restaurant to a well-known restaurant brand.

To sum up, although the definition of outsourcing is still debatable, the generally agreed principal philosophy of outsourcing can be drawn from the existing literature. The key elements presented in the outsourcing conception are outlined below:

- externalization of internal activities previously carried out in-house to outside independent suppliers
- the decision is strategic in nature
- it may involve the transfer of assets
- the production responsibility of the activity given to the outside expert can be partial or whole

Types of outsourcing

The outsourcing definition provided by Gilley and Rasheed (2000) includes two types of outsourcing: substitution-based outsourcing and abstention-based outsourcing. This classification is based on the characteristics of activity to be outsourced whether it is the one previously produced in-house or a new activity. Substitution-based outsourcing involves the external purchases for internal activities, the one previously produced in the company. This type of outsourcing may be viewed as vertical disintegration. Another type, abstention-based outsourcing, relates to the purchase of new activities which never occur in-house.

On the other hand, Bounfour (1999: 133) categorizes outsourcing into three types for the purpose of his study about outsourcing of intangibles. These three groups of outsourcing, according to him, are as follows:

- resorting to external sources for carrying out (intangible) activities (mostly professional services)

- putting an activity, until now internalized, on the marketplace
- organizing an internal market within the organization for the supply of (intangible) activities (for instance, via setting up an ad hoc structure dedicated to general accounting for different members of a group)

The third group may apply to a large corporation that consists of a number of groups or companies within it. However, some may question whether the third type of outsourcing fits the concept, since the activity is still produced internally.

Fill and Visser (2000: 43–44) quote Hiemstra and van Tilburg's (1993) classification of outsourcing that includes capacity outsourcing and non-capacity outsourcing. The first refers to activities which are also performed by the company. The reason for capacity outsourcing is that internal production capacity becomes temporarily insufficient perhaps due to seasonal demand fluctuation. Non-capacity outsourcing, on the other hand, concerns the outsourcing of activities which are no longer pursued by the organization itself.

Furthermore, they cite Mylott's (1995) views of different types of outsourcing. According to him, outsourcing takes place in three different forms, namely full outsourcing, selective outsourcing and everything-in-between outsourcing. In full outsourcing, the external supplier is responsible for the whole operation of the activity. Selective outsourcing involves the supplier to provide selected services within the whole activity. Everything-in-between outsourcing falls between the first two types.

Mylott (1995) in Fill and Visser (2000: 44) therefore propose a continuum of outsourcing. At one extreme, outsourcing can be seen in the form of hiring temporary labour or machines to relieve capacity overload for short-term purposes. At the other extreme, complete responsibility is given to the supplier who becomes strategic partner. Various forms of consultancy and skills provision fit in the middle of the continuum. Time is reflected across the continuum with short-term market exchanges at one end and long-term, relational exchanges at the other.

Webster et al. (1997: 829) propose three types of outsourcing as follows:

- Capacity – short-lived and unstable; is set up to meet unexpected or exceptional increases in demand.
- Specialized – long-term and enduring; established by the principal to access specialized expertise or technology which is not available in-house.

- Economic – cost benefits can be obtained by subcontracting work out.

In addition, a more comprehensive classification is provided by Espino-Rodriguez and Padron-Robaina (2004). They distinguish various types of outsourcing according to a range of criteria. Different types of outsourcing can be classified depending on the degree of decision analysis, the range, the degree of integration, the property relationship, the level of administrative control and the ownership, as outlined in Table 9.1.

Espino-Rodriguez and Padron-Robaina (2004) provide a clear explanation to the classification based on the level of decision analysis. According to them, analysis made in the case of tactical outsourcing is very simple. The decision is usually taken intuitively and is based on costs, with no consideration of the other benefits and risks involved in the decision. However, the analysis made in strategic outsourcing is more detailed, and it involves all levels of management and follows a sound process of decision. This creates a long-term co-operation with the supplier. It takes other aspects apart from costs into consideration, including factors such as achieving improved

Table 9.1 Types of outsourcing

Classification criteria	Types of outsourcing
Depending on the level of decision analysis	<ul style="list-style-type: none"> ● Strategic outsourcing ● Tactical or traditional outsourcing
Depending on its range	<ul style="list-style-type: none"> ● Total outsourcing ● Selective or partial outsourcing
Depending on the level of integration	<ul style="list-style-type: none"> ● Outsourcing ● Quasi-outsourcing
Depending on the property relationship	<ul style="list-style-type: none"> ● Group or internal outsourcing ● Non-group or external outsourcing
Depending on administrative control	<ul style="list-style-type: none"> ● Outsourcing of performance ● Outsourcing of resources
Depending on ownership	<ul style="list-style-type: none"> ● Private outsourcing ● Public outsourcing

Source: Espino-Rodriguez and Padron-Robaina (2004).

quality operations and accessing capabilities and knowledge of outside experts. Therefore, strategic outsourcing is a broader, more complete concept of the process. It is regarded as a strategy that becomes part of the company's strategic management.

Benefits of outsourcing

Outsourcing has been reported to provide numerous benefits to the organizations. Clearly, cost savings is the prime reason for outsourcing. Outsourcing firms often achieve cost advantages relative to vertically integrated firms. This view has been supported by an extensive body of literature both conceptually (such as Kakabadse and Kakabadse 2000; Domberger 1998; Blumberg 1998; Jennings 2002) and empirically reported as the top benefit (Outsourcing Institute 1998; Bailey et al. 2002; Kakabadse and Kakabadse 2003; Quelin and Duhamel 2003). It is important to clarify the meaning of costs. The type of costs that tends to fall as a result of efficiency inherent in outsourcing is the operation cost (see the section 'Mechanisms for achieving outsource benefits'). Another type of costs, transaction costs, or the costs of using the market to purchase goods and services, usually increase as firms decide to outsource (Williamson 1979, 1981).

However, outsourcing primarily for cost savings is of concern to a number of scholars. Lonsdale and Cox (1998) and McIvor (2000) view cost saving purpose of outsourcing as a short-term perspective, taking place in an ad hoc fashion. The authors link the increasing failures as a result of outsourcing with this motivating factor. Nevertheless, it is argued here that outsourcing on the basis of cost savings is not necessarily tactical. Increasingly, outsourcing has been employed as the top-corporate-level strategy in many large companies in order to maximize their operation efficiency, and hence minimize costs (Quelin and Duhamel 2003). Furthermore, outsourcing for short-term purposes might not be considered outsourcing in the first place but merely the practice of subcontracting.

The second most often mentioned benefit is the ability of companies to focus on their core business (such as Quinn and Hilmer 1994; Dess et al. 1995; Oates 1998). This is indeed an important benefit since the resources each firm possesses are limited. When freed from devoting resources to areas that are not in its expertise, the company can focus its entire energy and resources on the activities that truly reflect their core competencies.

Another reason for outsourcing is access to external competencies (Quinn and Hilmer 1994; Quinn 1999; Jennings 2002;

Quelin and Duhamel 2003). This argument has been strongly emphasized by Quinn and Hilmer (1994) and Quinn (1999) as the most strategically important benefit the company can gain from outsourcing. Outsourcing presents opportunities for companies to fully leverage the expertise, innovation and investments of the suppliers in the market. These capabilities may be prohibitively expensive or even impossible to duplicate internally.

Being flexible is also frequently claimed as a reason that drives outsourcing decision (Domberger 1998; Jennings 2002; Quelin and Duhamel 2003). Outsourcing allows organizations to quickly response to customer's needs and changes in the dynamic environment. This is particularly true in the case where the company experiences great demand fluctuations (Jennings 2002). In the efforts to optimally manage business upturns and downturns, outsourcing is used as a means to gain flexibility. Furthermore, as explained by Domberger (1998), the company's external suppliers in the form of networks of small organizations can adjust quickly and at lower cost to changing demand conditions compared to integrated organizations.

In addition, outsourcing includes other possible benefits, though less frequently mentioned. For example, it tends to promote competition among outside suppliers. Competition may also result in the availability of higher-quality goods, and services in the future can be reassured (Kotabe and Murray 1990). Cash infusion is another advantage the firms stand to gain from outsourcing (Embleton and Wright 1998; Outsourcing Institute 1998). This is because outsourcing often involves the transfer of assets from the firm to the supplier (Quelin and Duhamel 2003). This asset transfer may result in significant income for the firm, and thus it can use the cash to fund the investment to enhance its core activities. Finally, outsourcing reduces risks (Quinn and Hilmer 1994; Outsourcing Institute 1998). As the business environment is changing extremely quickly, significant investments exhibit tremendous risks. Firms must therefore think carefully not to get into big investments in the areas they lack expertise in order to reduce risks. Indeed, the risks that the firm does not wish to take can be shifted to the outside suppliers who are specialized in the area, willing to invest and more capable of managing the risks inherent in the particular areas. Jones (2002) found that following 9/11, the impact of the decline in demand for air travel affected flight caterers more than airlines. There was 25% fall in passenger numbers, but a 30% fall in demand for airline meals. This was because the fall in demand was significant on long-haul flights, which serve more than one meal, but

minimal on short-haul, low-cost airlines that do not provide a complimentary meal service.

Mechanisms for achieving outsource benefits

To begin with, outsourcing contributes to increasing the firm's cost efficiency due to two key factors: market competition (Domberger 1998; Vining and Globerman 1999) and specialization (Domberger 1998; Jacobides 2005). As stated earlier, outsourcing allows firms to focus on its core activities and shift non-core activities to outside suppliers in the market. At the macro-level, this leads to numerous business opportunities to various businesses. For example, many businesses, today, have started to adopt outsourcing strategies by deciding to focus on only their main activities, and thus outsource less important activities such as cleaning and security. This creates significant opportunities to catering, cleaning and security service providers to enter into the market to provide services to all other companies in the area. The higher is the business opportunities for these contract service providers, the more firms will enter this market. Subsequently, this leads to higher competition. Competition forces firms to constantly innovate in order to dominate its competitors and exceed customer's expectations by simultaneously raising productivity and improving quality. Furthermore, in a competitive market, companies are normally forced to price at the lowest possible marginal cost (Vining and Globerman 1999). These pressures leave the firms no options but to keep innovating and investing to maximize efficiency and thus offer the lowest price possible. This was the case in the flight catering industry. The growth of LSG Sky Chefs and Gate Gourmet led to competition for contracts between them, which over a course of five years contributed to a reduction of 15–20% in prices (Jones 2004).

In contrast, producing multiple activities in-house may cause operational inefficiencies in a number of ways. First, the level of competitive pressures faced by the suppliers in the market is not present within the company (Domberger 1998) since the internal production units may act as monopolists who provide services to captive internal customers (Porter 1990). Therefore, internal production units have fewer incentives to be efficient. Secondly, if too many activities are organized within the company, it will experience diseconomies of scope in management (Coase 1996).

Cost efficiency is also created by specialization (Domberger 1998). Apart from increasing business opportunities, outsourcing changes the way firms compete by transforming the entire

industry from comprising generalists to specialists (Jacobides 2005). In the past, companies used to vertically integrate to carry out most activities in-house. This self-sufficient practice encouraged organizations to be able to produce everything – but nothing well. However, once outsourcing has become more popular, companies – both the outsourcing firms and suppliers – are presented with opportunities to focus and be best at producing their selected main activities. All firms in the economy, therefore, have evolved to focus and increase specialization in their areas of business.

The link between specialization and cost efficiency is clearly explained by Domberger (1998). He argues that outsourcing enhances specialization in two ways. First, the outsourcing organization can focus on a narrowed range of internal production. Secondly, on the supply side of the market, the suppliers can increase its focused production to serve the entire market once more companies outsource the activity supplied by the supplier. The second point addressed by Domberger is particularly significant because it allows suppliers to undertake an activity in a much greater scale. This directly leads to economies of scale where costs per unit of production declines as a result of an increase in production volume. As mentioned earlier, suppliers, under competitive pressures, are willing to invest in the development of their core capabilities in terms of both technology and human resources development. They, however, need not reinvest in these set-up costs in each transaction they serve the customer. Being a customer, outsourcing firm, therefore, stand to gain from the cost savings offered by the outside specialists who operate at scale economies.

The second group of benefits companies gain from outsourcing is product quality. On the one hand, quality provided by the external specialists is realized by the ongoing innovation forced by market competition as previously explained. Hence, the first source of quality improvements comes from market. It is the organization's leverage of the best supplier's innovations and competencies (Quinn 1999). On the other hand, quality is attained from the specialization within the organization itself. An increased focus on an organization's core competencies and outsourcing non-core activities allows the firm to increase managerial attention and resource allocation to the core activities (Quinn and Hilmer 1994). The firm is permitted to become truly specialized and produce its core activities at a level superior to its competitors. The combined sources of quality attained from the market and that generated within the company lead to an achievement of best performance in both core and non-core activities.

In the UK in the 1980s, the government began requiring all public sector organizations – schools, hospitals, military establishments and others – to put their catering services out to competitive tender. This policy was based on the view that outsourcing this to contract foodservice companies would lead to significant cost savings and improved quality. A number of studies seem to support this view.

Costs and risks of outsourcing

The benefits discussed in the previous section make outsourcing a promising strategy for companies seeking competitive edge. Nonetheless, outsourcing comes with costs. As mentioned in the previous section, there are two main types of costs associated with outsourcing. The first category, production cost, has been proved in favour of outsourcing since outsourcing drives operational cost efficiency. The second category, transaction costs, however increase. As explained by Coase (1996), there are costs of using the price mechanism in the market. These costs include the cost of searching for prices, negotiating and concluding a separate contract for each transaction. Based on this principle, Williamson (1979, 1981) developed the theory of transaction cost economics (TCE) in deciding whether to produce each activity within the company or purchase it from the market based on the costs of each transaction. TCE is frequently used to explain outsourcing and thus requires clarification.

TCE holds that, in certain situations, the costs of market exchange may increase substantially and surpass the production efficiency provided by the market. This is due to two behaviour assumptions: bounded rationality and opportunism of the individuals in the marketplace who are involved with the transactions. Bounded rationality is the assumption where individuals intend to be rational but are limited in solving complex problems and in processing information. Opportunism, on the other hand, assumes that individuals seek to make allowance for self-interest, with guile.

Building on Williamson's assumptions, outsourcing costs have been put forward by several scholars. Vining and Globerman (1999) propose two main costs of a transaction, including bargaining costs and opportunism costs. Both cost circumstances occur when at least one party acts self-interestedly but in good faith in bargaining situations and in bad faith in opportunisms. Bargaining costs include costs of negotiating at pre-contract and post-contract stages to make changes to the

contract when unforeseen circumstances arise, costs of monitoring of the performance and costs of disputes. Opportunism costs, on the other hand, are the costs of the outsourcing partner's behaviour to change the agreed terms of a transaction to be more in their favour. Domberger (1998) adds to this the explicit costs of transaction which are the costs of searching for and selecting suppliers, writing specifications, drafting contracts and bidding before the bargaining costs, explained by Vining and Globerman, would occur. Furthermore, because of the risks of the supplier's opportunistic behaviour leading to the dangers of being exploited by the suppliers, the outsourcing company may experience a hold-up risk when they get locked into the disadvantaged contract. This leads to a greater cost of monitoring the supplier's performance to guard against the opportunistic behaviours.

However, these opportunistic behaviours are believed to be present within the organization as well as in the market. The levels of opportunisms by the company's own employees are believed, nonetheless, to be lower than the market since distribution of profits is more relevant in dealings between organizations (Vining and Globerman 1999). Yet this point is not completely convincing (Domberger 1998). He postulates a lack of theory to explain why it is easier to monitor and control internal staff than external suppliers.

Then again, the supplier's opportunistic behaviour assumption seems to dispute the view of several academics who advocate for trust as a key success factor in collaborative relationship (Rugman and D'Cruz 1997; Blomqvist et al. 2005). Furthermore, it can be argued that the opportunism assumption becomes less relevant when outsourcing increases. As explained in the previous section, outsourcing drives market competition and thus suppliers must raise quality to survive. In the competitive market, suppliers need to find their way to delight the customer at a higher level than its competitors. Clearly, outsourcing companies are dissatisfied by being exploited and want to avoid suppliers who exhibit high level of opportunisms. Thus, suppliers are forced to minimize the opportunistic behaviours in order to sustain its business.

Furthermore, the cost of transaction is determined by a number of factors. As explained above, the level of competition in the market is one of the factors that determine the level of opportunisms. Other factors include the level of asset specificity (Williamson 1979, 1981), which refers to the degree of specialization of the asset required for a particular transaction or user. High specificity creates sunk costs and thus raises potential for opportunisms. Another factor is the production/activity

complexity level (Vining and Globerman 1999). This refers to the degree of difficulty in specifying and monitoring the terms and conditions of a transaction as a result of uncertainty and information asymmetry. The transaction that exhibits a high degree of complexity leads to high transaction costs.

The majority of outsourcing disadvantages fall into the categories described under the umbrella of transaction costs. The first six types of disadvantages – being exploited, loss of control, dependence on suppliers, confidentiality and security issues, and transfer of know-how that encourages new competitors – are directly related to the fears of supplier's opportunism. Another group of outsourcing pitfalls including loss of critical skills, risk of service provider's deficient capabilities, and being difficult and costly to bring back in-house all happen due to the organization's own false decision made when outsourcing. This is attributed to a number of factors such as inability to identify the correct types of activities to outsourcing. This is a significant problem faced by managers since distinguishing core activities from non-core ones is highly problematic (Kakabadse and Kakabadse 2000; Alexander and Young 1996; McIvor 2000). Failure in market search for true experts could be another factor that leads to receiving inadequate services. Outsourcing in the market that lacks quality suppliers is dangerous (Lonsdale 1999; Gronhaug and Haugland 2005), and thus organizations should not outsource if they cannot identify suppliers that can provide quality service up to the agreed standards.

In addition, other key negative aspects of outsourcing relate to the human resources issues. Since outsourcing normally involves a transfer of assets and possible staff from the outsourcing organization to the external suppliers (Quelin and Duhamel 2003), this can considerably affect the morale of existing staff and may even in some cases generate internal fears and employee resistance (Embleton and Wright 1998; Venkatesan 1992; Blumberg 1998; Oates 1998; Lonsdale and Cox 2000). This can subsequently lead to a negative public image due to large employee layoffs (Embleton and Wright 1998).

However, as argued by Kakabadse and Kakabadse (2000), this problem depends crucially on how well the outsourcing is planned, implemented and communicated to the employees within the organization. Furthermore, outsourcing can provide, in certain cases, good career development opportunities for the employees who get transferred to the suppliers. This is particularly true because their knowledge and skills should match the external expert better than being in less important business functions of the outsourcing firm. In other words,

they move from working in non-core activity of one company to working in core activity of another company. Therefore, the external supplier should be able to provide them much more promising career development opportunities.

The final risk of outsourcing is raised by Blumberg (1998). He cautions that outsourcing the direct customer contact activities may put the organization at risks of alienating the customers. However, it is argued here that this risk can be managed if outsourcing is well-planned and the supplier has been carefully selected. More importantly, the risk is overshadowed by the benefits the outside experts stand to offer in terms of the best quality of the particular activity available in the market. This way, the renewed supplier may even enhance the company's reputation and can indeed add more value to its customers.

In fact, one critical reason explaining why managers are dissatisfied with the outcome of their outsourcing decisions is due to a deficiency in outsourcing decision-making (Lonsdale 1999; McIvor 2000). Outsourcing is a strategic tool with great potentials to change the way organizations are managed for value maximization. It is argued here that most of the risks presented above, if managed properly, can be limited. This view is supported by Blumberg (1998). He suggests outsourcing organizations need to change the management mindset in order to minimize the outsourcing downsides and make the most of the benefits. This argument is well supported by the empirical study of outsourcing best practice in organizations by Kakabadse and Kakabadse (2003). The findings reveal that high-performance companies report greater benefits than do average-performing companies. One factor distinguishing best practice outsourcing organizations from the rest is the degree of top-management commitment to the outsourcing strategy and because the organizations are well prepared prior to implementing the outsourcing plan.

In conclusion, it is clear from the above discussion that outsourcing can generate tremendous benefits needed by organizations. These benefits are grouped into two categories: operational cost efficiency and product quality. The benefits primarily stem from market competition and specialization spurred by outsourcing and will subsequently drive more outsourcing, the never-ending process. Moreover, all activities even at the non-core level within the organization can be of the best quality level since they are provided by the best external specialists in their areas. Once successfully combined, the company starts offering the best-of-everything product to the market.

Alternative theoretical perspectives

Outsourcing is the question of externalization of activities. It directly involves the decision whether to source activities internally or externally. This relates to the problem of the firm's boundaries. It is claimed that outsourcing behaviour of the companies can be explained by two main approaches including economic perspective of transaction cost economics (TCE) and strategic approach based on resource-based view (RBV).

Transaction cost economics

Most outsourcing research has been explained by the TCE perspective; however, the focus is on the context of non-service industries. Outsourcing in the TCE context is organized for efficiency maximization. TCE theorists view firms as governance structures as opposed to production functions explained by neoclassical economists. It is the efficiency gained from administrative instrument that facilitates exchange between economic actors. Markets and hierarchies (the firm) are proposed as alternative instruments for completing the firm's transactions. It is assumed that the governance exchange between economic actors is costly due to transaction governing and monitoring. Transactions are organized to achieve economic optimum of both production expenses and transaction costs.

TCE posits that firms are faced with different sourcing modes of all activities in their operations either to obtain from the suppliers in the market or to produce in-house. It is imperative for any organization to manage each transaction in the most efficient manner by correctly matching a variety of transactions to different sourcing alternatives. By analysing the costs of transactions of each different activity, TCE suggests managers to carry out all activities that possess high transaction costs and outsource all others whose transaction costs are low. The costs of transactions are determined by three key dimensions including asset specificity, uncertainty and frequency.

Resource-based view

More recently, the strategic resource-based approach has emerged as an alternative to explain outsourcing decisions. From this perspective, outsourcing is treated as a strategy that helps raise the firm's competitive advantage. The RBV sees the firm as an entity

with a collection of resources. It considers that firms own different types of resources which enable them to develop different strategies. The firm's ability to sustain competitive advantage depends on its ability to effectively exploit its resources and to protect its competitors to imitate its strategy. The RBV theorists reject traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, they argue that resources are heterogeneously distributed across firms and are imperfectly transferred among them (Barney 1991; Wernerfelt 1984). This suggests firms deliberately position themselves to create differentiation in the market based on their unique resources.

According to Barney (1991), firm's resources include all assets, capabilities and organization processes that enable it to conceive of and implement strategies that improve its efficiency and effectiveness. However, not all resources within the firm have the potential to be a source of sustainable advantage. Barney (1991) contends that the resources that enable firms to sustain competitive advantage are only those that are valuable, rare, imperfectly imitable and non-substitutable. The author explains that a competitive advantage is achieved when a value-creating strategy implemented by the firm is unique in the market. The competitive advantage is sustained if the firm's competitors continue to find it impossible to duplicate it. Furthermore, the strategic resources contributing to the sources of competitive advantage are ascribed by Prahalad and Hamel (1990) as the distinctive core competencies of the organization.

The RBV authors put forward that, in order to gain competitive advantage, organizations need to focus on their unique sets of core resources and competencies. In other words, activities that are based on the company's core resources and capabilities should be produced in-house and all activities that do not truly reflect the company's unique resources and ability should be outsourced.

However, the core conception of RBV, sources of competitive advantage stemming from the resources and capabilities owned and controlled by a single firm, is challenged by Dyer and Singh (1998). They point out that a firm's critical resources may in fact extend beyond its boundaries. Organizations that combine resources in unique ways may realize an advantage over competing firms who are unable or unwilling to do so.

In addition, RBV invites further criticisms. Gronhaug and Haugland (2005) claim that RBV has a less clear-cut conception of sourcing decisions and firm boundaries than TCE. Although it argues that the direction of firm growth is determined by the firm's existing stock of resources and competencies, the viewpoint does not clearly explain which activities should

be performed within the boundaries of the firm and which should be performed in the market. Defining core competency for any one organization is real problematic (Kakabadse and Kakabadse 2000) and applying the theory is difficult in practice (Domberger 1998).

Hotel outsourcing research

The outsourcing research in the hotel sector has been dominated by the strategic approach. The findings of the studies generally support the core argument of the theory. Through a series of articles, Espino-Rodriguez and Padron-Robaina provide empirical analysis, employing mainly the RBV theory, in various aspects of outsourcing issues. Using 50 hotels in the Canary Islands in Spain in their study, Espino-Rodriguez and Padron-Robaina (2005a) examine outsourcing of the hotel activities in general. The authors emphasize the need to focus outsourcing study in a single location as outsourcing of activities depends greatly on the offer of services existing in the area. The authors argue that any analysis of several locations could bias the results.

The results report activity performance, substitutability and transferability of the activities as the key determinants of the hotel outsourcing decisions. Non-core activities that yield low degree of competitive advantage to the hotels, described as those which offer low performance or generate less value and comprise resources that are easily substitutable and transferable in the market, are more likely to be outsourced. The authors also confirm that an outsourcing of less strategic activities is positively related to the hotel performance both in terms of financial and non-financial perspectives. Even though the level of outsourcing in the studied hotels is currently low, the managers are reported to perceive outsourcing as having a great potential for operations strategy particularly for improving quality, increasing flexibility and providing better service (Espino-Rodriguez and Padron-Robaina 2004, 2005b). Furthermore, loss of control and autonomy together with distrust of suppliers currently limit the use of outsourcing in the hotels.

In addition, Lam and Han (2005) also take the strategic approach by examining the outsourcing strategy as perceived by hotel managers in Shanghai. Similar to the works of Espino-Rodriguez and Padron-Robaina, a single location is adopted in this study. The findings indicate that the outsourcing market in the city is immature as it is hindered by two key factors including the incompleteness of local laws to protect hotel investors

when the outsourcing business conflicts arise and the business cultural incompatibility between hotels dominated by Chinese managers and outsourcing suppliers.

A few studies consider outsourcing of a specific activity or a group of activities in the hotels with a RBV analysis. Within the information systems function, the study by Espino-Rodriguez and Gil-Padilla (2005a) find that hotels tend to retain in-house the critical and differentiating part of IT activity that add more value and improve the hotel's competitiveness. Likewise, the leisure activities that are highly specific to the hotels are found to perform better when they are carried out in-house (Espino-Rodriguez and Gil-Padilla 2005b). Food and beverage operations, normally considered as a key function in hotels, are reported to be increasingly outsourced in both North America and the United Kingdom to well-known branded restaurant chains as this strategy helps the hotel to gain financial stability, know-how and competitiveness (Hallam and Baum 1996). Hemmington and King (2000) found that hotel food and beverage service outsourcing go beyond financial benefits. The results reveal five key dimensions that managers need to take into consideration in relation to the hotel–restaurant outsourcing relationship. These issues include core competencies, brand compatibility, organization culture, operational tension, and systems of review, evaluation and control.

Relatively few outsourcing studies in the hotel industry have adopted TCE in which asset specificity principally explains hotel outsourcing. From the study of Lamminmaki (2005), insourcing is generally preferred in the activities that require high specific asset investments. Likewise, the leisure activities that are highly specific to the hotels are found to perform better when they are carried out in-house (Espino-Rodriguez and Gil-Padilla 2005b). In addition, the findings in Lamminmaki (2007) provide some support for TCE. Other factors found to influence hotel outsourcing decision in this study include managerial risk adversity, availability of specialist suppliers and hotel quality.

Promsivapallop et al. (2007) report on a study of outsourcing in hotels located in Phuket, Thailand. In this study, 22 managers were interviewed using Critical Incident Technique to elicit their opinions about the outsourcing decisions they had made – without any preconceptions derived from TCE or RBV. Analysis of the 64 separate incidents suggests two major influences on outsourcing – asset specificity and capital requirements. Other factors identified include environmental uncertainty, behavioural uncertainty, frequency, prior

experience, guest contact and profitability. Profitability has not been identified as an outsourcing factor in the previous literature. This is not surprising given that outsourcing of revenue-generating transactions has rarely been investigated.

Management contracts and franchising

As was explained in the “Introduction” section, hotel and foodservice companies may also be suppliers of outsourced services. A hotel owner who signs a management contract with a hotel company is outsourcing the operation of that property to the hotel chain. Likewise, the clients of a foodservice management contractor are outsourcing their catering provision. Owners and clients decide to outsource in this way, for the same reasons hospitality companies choose to outsource some of the things they could do, as discussed above. So the question is, does it affect how the operations are managed if the business is operated in assets owned by someone else?

The simple answer is almost certainly. Even though the operator does not own the assets, they will still, under the terms of their contract, have responsibility for maintaining and caring for the physical infrastructure. They may indeed be required to make some investment in this infrastructure in order to secure the contract.

A second kind of business format found in the industry is franchising. In this instance, the hospitality operator neither owns the assets nor runs the operation. The franchisor owns the so-called franchise system and brand, and licences franchisees to manage the operations for their mutual benefit.

Again it is unlikely that there will be any major differences from an operations perspective, in terms of how self-operated and franchisee-operated units are managed. The systems, policies and procedures will be almost identical. Bradach (1997) argues that the four main challenges faced by restaurant chains are growth, uniformity, local responsiveness and adaptation. In each of these areas, company ownership and franchising each has its advantages. For instance, with regard to adaptation, franchisees are fast in identifying opportunities but are slow in implementing these throughout the chain, whereas company-owned chains are slow in identifying opportunities but can implement them quickly.

This same research study goes on to suggest that chains that have both these types of operation may have some advantages over those that only operate their own outlets, or exclusively

franchise. Bradach (1997) calls this the 'plural form'. Within such companies, he proposes five unique aspects of how operations are managed, which maximize the benefits of both company-owned and franchised outlets. These are:

- Additive processes – growth is achieved by the chain seeding new geographic areas with company units, followed by franchisees; hence the chain focuses on selecting locations, whereas franchisees – with their local knowledge – focus on selecting specific sites.
- Socialization – managers who worked for the company are encouraged to become franchisees. They overcome any shortage of suitable franchisees and ensure greater uniformity between operations.
- Modelling – franchisees are encouraged to take on more units, thereby creating mini-chains.
- Ratcheting – system-wide performance benchmarks are established, and healthy competition between company and franchise units is encouraged.
- Learning – managers and franchisees are routinely brought together in order to learn from each other.

Summary and conclusions

It is clear from the above literature review that hotel outsourcing research is scarce. Most of the few existing studies focus on the strategic management perspective. The majority of the studies cover various activities in many hotels and undertake a single area which avoids result bias from an analysis of multiple areas that have different levels of supplier availability.

However, it is apparent that obtaining small sample sizes is one crucial limitation of these studies (such as studies conducted by Espino-Rodriguez and Padron-Robaina 2004, 2005a, 2005b; Lamminmaki 2005; Promsivapallop et al. 2007). Thus, the results from these studies may not permit generalizable assertions of the observed outcomes. Researchers have discussed numerous advantages and applications of outsourcing. Despite this, hotel outsourcing research is limited. This lack of research interest is surprising as outsourcing has become a crucial component of contemporary hotel management (Ruggless 2004; Holm 2003). This scarcity, however, presents research opportunities for a better insight into this emerging phenomenon.

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