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DIPLOMA THESIS

Outsourcing in the Vietnamese environment

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DIPLOMA THESIS ASSIGNMENT

Declaration

I hereby declare that this diploma thesis called “Outsourcing in the Vietnamese environment“, I assessed on my own with the usage of the knowledge that I got from the listed literature and practical experience with the help of the supervisor of the diploma thesis.

In Prague, 13th April, 2009

.....
Dung Pham Tien

Acknowledgement to the Supervisor

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Author: Dung Pham Tien

OUTSOURCING IN THE VIETNAMESE ENVIRONMENT

OUTSOURCING v vietnamském oblasti

Souhrn

Pojetí outsourcing vzniklo již před několika století. Tato tematika však není žádnou novinkou. S jejím definicí se věnovali vědci už od roku 1980. Všechny operace outsourcing byli používány především v amerických a anglických firmách.

V polovině 20. století a po rozvoji informační techniky se všechny operace outsourcing vyvíjelo v rozsáhlém šíře. Proto se dostálo i do asiických firmách.

Outsourcing můžeme považovat za velice rozumnou událost, protože přináší pro ekonomiku výrazné vývoje. Tím, že umožňuje zaměstnancům více pracovních míst a zlepšuje jim plat. To je taky jedním z důvodu, proč tato diplomová práce bude zkoumat všechny pohyby outsourcingu ve všech zemích v Asii a konkrétněji pro Vietnamskou socialistickou republiku.

Z teoretického a praktického pohledu tato diplomová práce bude popisovat vývoje outsourcingu, dále bude hledat všechny výhody i přes všechny její změny pokud by nastaly. Ze zkušenosti mezinárodních firem se bude snažit najít všechny způsoby jak nejlépe se přispůsobovat vietnamským ekonomice.

Summary

The concept of outsourcing has been extensively studied for decades. This is not a new concept, it was clearly defined since 1980s. Outsourcing operations were applied mostly by companies in the United State and in United Kingdom. In the middle of 20th century and after the Information Technology revolution

Outsourcing operations have been increasing dramatically and also widely applied by Asian companies.

Outsourcing has been a welcome development as it benefited developing economies by increasing employment and income level of workers. This is also a reason for this thesis to go to research outsourcing operations in Asian countries, particularly in Vietnamese environment.

On the basis of literature research and empirical research, the thesis will describe the process of outsourcing, find out common benefits from outsourcing, any changes if any in outsourcing trend and give out some suggestions for application of outsourcing to Vietnam situation from experiences of international companies in developed countries.

Klíčová slova

Outsourcing, on-shoring, off-shoring, service supplier, contractual agreement, multi-sourcing, outsourcing partner, insourcing, backsourcing, resourcing

Keywords

Outsourcing, on-shoring, off-shoring, service supplier, contractual agreement, multi-sourcing, outsourcing partner, insourcing, backsourcing, resourcing

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1. Introduction

In this thesis outsourcing refers to the outsourcing of new product development and business activities for developing new products (goods and/or service) and business process outsourcing, where all or the innovative part of the new product development process is purchased externally according to a contract from organizational units separate from the outsourcing firm. This definition implies that the activity shall be an innovative part of the new product development process, the activity shall earlier have been conducted internally, and the activity shall be purchased in a contractual agreement between the organizations.

The focus of the thesis is the outsourcing of activities in the new product development process, where an activity is a part of a process, with a limited scope, starting with an input and delivering an output. The unit to be outsourced is therefore the effort and competence needed to develop the substance from an input to an output. This is important to understand as most research on outsourcing deals with outsourcing of the production of the products (artifacts) and not the effort or work as in this thesis. In this introduction I will show that there is a need of more research on outsourcing of product development activities, especially in the Vietnamese environment particularly in scale of several Vietnam-based companies.

In the automotive industry 75% of the product development hours for a new Toyota are undertaken by suppliers (The Economist, 1998). Toyota is a multinational company and supplier involvement is a well-known phenomenon. However, not only in multinationals but also in medium-size firms, as many as 67% outsourced their product development activities (Rundquist and Chibba, 2004). Medium-size firms in manufacturing industries in Vietnam have difficulties staying competitive today. They often lack resources due, for

example, to higher costs in comparison with competitors abroad or higher costs compared to larger firms. Therefore it is hard for medium-size firms to perform competitive product development on their own. To increase resources, to share risks or to lower costs, many firms choose to collaborate with other firms or organizations in product development. This collaboration can be in the form of, for example, partnership, joint ventures, networks, research contracts or alliances. Outsourcing is one of many ways to reach the goals in new product development. Firms use outsourcing of new product development and business processes to lower costs, to cut peaks in new product development efforts, or to get access to resources which did not previously exist within the firm.

New product development is a knowledge-intensive activity that requires a lot of ability to handle insecurities and which is very dependent on the individuals involved in the process. That makes it different from production, which (especially when producing standard items in large scale) is easier to control, monitor and to evaluate costs of. Therefore, some considerations connected with knowledge acquisition and insecurity need to be addressed.

Cost reduction has been the dominant motive for outsourcing (e.g. Ford et al., 1993), and outsourcing of new product development can be a method to reduce costs for new product development. If, for example, a firm can find product development competence with an external partner at a cheaper price, the in-house product development department could be smaller and costs could be saved on salaries and appliances. A present example of this phenomenon is development of new software products that is today frequently outsourced to, for example, Indian companies while in-house software departments become less common.

1.1 A literature review of the research

Outsourcing of new product development and business process is an area with little research. When I started this approach in I got only a few hits directly addressing this search phrase. However, in order to obtain a picture of the research in the area a more detailed literature review should be conducted. The purpose of the literature review is mainly to get a quantitative picture of how much work is conducted and published, but of course the data base has also contributed many interesting articles that I have used more actively during the process. The literature review was conducted during the spring of 2009, but complementary articles have been selected from different sources of database. The search for articles was performed in the following databases:

- ABI-inform (Scholarly journals)
- Emerald Science Direct
- IEEE (Journals not proceedings)
- SAGE publications

Database	“outsourcing”	Outsourcing + product development
ABI inform	2823	39
Emerald	507	19
Science Direct	599	23
IEEE	145	8
SAGE	1577	9

Table 1: Number of hits in the literature review

Source: Jonas Runquist/Outsourcing of new product development 2007

As shown in Table 1, only a small number of the articles on outsourcing deal with outsourcing of product development. In the sample of databases presented above, only 1.7% of the articles on outsourcing also included outsourcing of

product development. In the hits presented in table 1, for example, all articles dealing with outsourcing of production and a product development aspect are included. But for the present purpose, that is, to find a quantitative measure of the number of articles in the field, the result works.

In the research of the thesis many of articles relating to outsourcing of new product development was addressed. Most of articles were selected from different journals which are listed in the table below in the area of technology management and close areas.

Journal name	No.
International Journal of Technology Management	6
IEEE Transactions on Engineering Management	4
International Journal of Operations and Production Management	3
Strategic Decision	3

Table 2. Journals where most articles on outsourcing of product development are published.

Source: Jonas Runquist/Outsourcing of new product development 2007

1.2 Research questions

The summary of above discussion on outsourcing of business process and new product development could be suggested with several questions:

Q 1: What factors affect the decision to outsource a business process in medium sized or large sized firms in Vietnam?

Q 2: What factors affect the choice of outsourcing partner when a business process is outsourced in medium or large sized firms in Vietnam?

1.3 Outline of the thesis

Chapter 1 presents a brief introduction to outsourcing of new product development and business process, initially mentions to new product development and cost reduction. It also refers to the literature review showing some different sources of database. It is ended by the part of Research questions including 2 raised questions for research and answering.

Chapter 2 presents objectives and methodology of the thesis where the methodology consists of literature study, interviews and validation.

Chapter 3 presents the history of outsourcing, defining outsourcing, a table describing organizational modes, define outsourcing partner. There are also comparisons between outsourcing and contracting, outsourcing and insourcing, outsourcing and offshoring, four various approaches to outsourcing including a model of five maturity levels. Additionally six theoretical perspectives are discussed and included by models for each theory.

Chapter 4 presents reasons for outsourcing, the process of outsourcing and the model of process describing 6 steps of outsourcing. It is followed by the critical considerations on deciding outsourcing. Additionally there are 2 case studies referring to interviews with two companies: Hanjin shipping Vietnam and Samsung vina Electronics. This chapter is ended by Reconnection to research questions where some questions raised in the first chapter will be answered.

Chapter 5 presents the implications and recommendations to outsourcing in the Vietnamese environment. But this is started with current outsourcing situation in Vietnam and SWOT analysis of outsourcing for Vietnam.

Chapter 6 addresses the conclusion of the thesis. This will be followed by bibliography.

2. Objectives of thesis and methodology

2.1 Objectives of the thesis

The thesis basically describes the process of outsourcing in general for both business processes and new product development of medium and large sized firms. The thesis objectives are also related to expected effects and contributions from outsourcing activities.

The target groups of the research are both sides of the outsourcing context – the outsourcer as well as the partner. The partner would have an interest in knowing how outsourcers make their decision(s) to outsource and how they choose their partner(s). The results will enable the partner to better understand why the decision to outsource is made, what factors influence the decision and how they do so. Results can be used in negotiation or marketing of new product development services to potential customers.

For the outsourcing firm, the results will be of interest to show the benefits and risks and to create an awareness of a decision that can result in outsourcing action, another form of collaboration, or an in-house action.

A framework for Managers dealing with outsourcing of new product development is suggested as practical implications from the thesis. The developed decision framework will be useful as a practical concept for managers, for future research aiming to investigate relations between outsourcing firms and outsourcing partners.

2.2 Method of study

2.2.1 Literature study

I have started my research with a literature study on outsourcing. I have read relevant books, publications and articles in order to gain a more in-depth knowledge of these subjects. The literature study provides the foundation for my research and is the basis for the introductory chapters and the interviews which took place later on during my research.

2.2.2 Interviews

Subsequently I have interviewed a relevant selection of outsourcers, service providers in order to examine their opinion about the definition of the problem and the different questions of my research. I have used oral interviews with open questions because this method provides the opportunity to reach consensus with the interviewee about the terms used. Next to that open questions provide the interviewees with much space for their own explanation and clarification. Although I do not have chances to directly interview them, just do via telephone interview, this gave the interviewee the possibility to have a look on their current business situation as well as have good awareness of any changes in outsourcing trend.

I have used the results of the literature study, the interviews and my personal vision to understand more about outsourcing in my own way based on models from many authors and help to provide an answer to questions of my research.

2.2.3 Validation

The research was tested by validation interviews performed with two outsourcers' representatives. The selected outsourcers are Hanjin Shipping Vietnam company (interviewee: Mr. Minh Nguyen Cong, Logistics Manager) and Samsung Vina Electronics company (interviewee: Mr. Phong Le Vu Hoai,

Assistant Purchasing Manager). The results of this validation are described in two case studies of chapter 4 regarding to point of views of interviewees about the outsourcing situation in their companies, practical criteria for choosing partners...

3. Theoretical study

The following chapter aims to define the most important concepts of the thesis. Several concepts will be discussed and defined to form a basis for the thesis: “outsourcing”, “outsourcing on new product development”, “business process outsourcing”, “outsourcing partner”... Also the chapter will include the approaches to outsourcing and finally mention to the perspectives of outsourcing.

3.1 The history of outsourcing

Outsourcing, defined as the “purchase of an externally produced goods or service that was previously internally produced” (Lacity and Hirscheim, 1993, p. 74), is an activity much older than the terminology. Outsourcing is not a new phenomenon but it has been developed since thousands of years, starting with the production and marketing of food, tools and different household supplies. If we go back far enough in history, every person or family provided all resources needed for the family or tribe by itself. People gathered fruits and nuts, hunted their own game, grew their own wheat, skinned leather for personal usage and gathered fuel for heat. Soon, villages began to develop, and people started to specialize in one area. One person proved to be especially skilled in the arts of leather while another learned how to work metals. As such, they began to barter with each other for goods and services instead of making their own product for every necessity. Eventually money was invented to simplify the trade process. The result was that each person or family outsourced some of their activities to other professionals instead of producing their own needs internally as was previously the case.

During the industrial revolution, there were no developed external markets. Therefore organizations, out of necessity, produced in-house a wide range of activities upstream or downstream. Only a few firms, if any, during the 1800s and in the early 1900s outsourced parts of their processes; they were totally

vertically integrated organizations. This means that they produced or mined raw materials (steel, wood, or rubber), converted their raw material to finished products in plants owned by the firm, and then shipped all the finished goods on firm-owned trucks to firm-owned retail stores for marketing. They owned their own insurance companies, did their own taxes, employed their own legal services, and had their own architects to construct their buildings without assistance from other firms (Piore and Sabel, 1990). This means that they actually outsourced very few activities.

Development of special services led to increased contracting, which is a form of outsourcing. The first wave of outsourcing began during the second industrial revolution in the late 19 century, and started the growth of services such as insurance companies, tax consultancies, accounting services, lawyers, and engineering services, and others. The companies performing this work were normally located in the same region, often the same city, as their customers (Piore and Sabel, 1990). In essence, this was a form of local outsourcing.

The next development step came with outsourcing manufacturing of low-tech items such as toys, metal parts, shoes, and construction goods and later, more high-tech manufactured items like complex mechanics components and consumer electronics. Manufacturing was the first type of activity that began to move to a longer-distance location in search of lower productions costs. As logistics and transportation improved through better infrastructure and the increasing use of computer technology, the cost of transportation decreased, and abroad manufacturing increased as a phenomenon. At the same time education, competence and skills improved drastically in low-wage countries, offering the possibility to provide more and more advanced production services in the low-wage countries.

More recently, outsourcing has moved also to intangible activities or knowledge-intensive activities such as information technology, product development or R&D. Outsourcing this type of activities is necessary in order to gather enough knowledge and handle the insecurities of a rapidly changing world (Quinn, 2000). Reasons for this can be explained by two major factors: (1) the outsourcing of production has led to a knowledge concentration with the suppliers, and therefore it is a natural cause of action to find the technology expertise among the suppliers; and (2) the high costs of being world-class in every field of technology has led to a need of seeking technology competence in centers of excellence such as universities, institutes or small R&D firms.

3.2 Defining outsourcing

Outsourcing is a relatively new term. In Merriam-Webster's Online Abridged Dictionary (<http://webster.com/home.htm>) I found the following entry: outsourcing (1982) is "The practice of subcontracting manufacturing work to outside and especially foreign or nonunion companies". Though the term is relatively new in the English language, the phenomenon of outsourcing has been around for a rather long time, as indicated in the previous section.

It is possible to find many different definitions of the term outsourcing. Ellram and Maltz (1995) define outsourcing simply as "moving functions or activities out of an organization". Outsourcing could be a means to expand an operation or to rationalize an existing operation. For example, if insufficient production capacity would stop expansion, outsourcing of production could be a way to expand. Or if production costs are lower in another organization, outsourcing of production could be a means to rationalize an existing operation. Major (1993) suggests that outsourcing is a new term for an old concept: to make an agreement of external work. He suggests that if an external part can produce the activity

more efficiently and at less cost, then the external part should accomplish the activity.

Renaud (1997) supported this perspective and suggested that “...firms have always outsourced, in the sense that they purchased services that they might otherwise have provided themselves”. These definitions stress that an external actor is accomplishing the activity. Further developed definitions add that the activity should also have been previously accomplished internally. Outsourcing could therefore be defined as purchase of an externally produced good or service that was previously internally produced (Lacity & Hirscheim, 1993; Reilly & Tamkin, 1996).

Outsourcing is one of many organizational modes to access external sources of technology or knowledge. Examining organizational modes such as acquisition, joint venture, alliance or networking, it is difficult to discretely and distinctly define outsourcing. Chiesa et al. (2000) discuss outsourcing as a specific and distinct form of interfirm collaboration. Based on earlier research (such as Roberts & Berry, 1985; Quinn and Hilmer, 1994; Chatterji, 1996; Millson et al., 1996), organizational forms of collaboration are listed (see Table 3).

Organizational mode	Description
Acquisition	A company acquires another company in order to access a technology (or technological competence) of interest.
Merger	A company merges with another one that possesses a technology (or technological competence) of interest, and a new company emerges from the two existing companies.

Licensing	A company acquires a license for a specific technology.
Joint venture	A company establishes a formal joint venture with equity involvement and a third corporation is created with a definite objective of technological innovation.
Alliance	A company shares technological resources with other companies in order to achieve a common objective of technological innovation (without equity involvement).
Consortium	Several companies and public institutions join their efforts in order to achieve a common objective of technological innovation (without equity involvement).
Networking	A company establishes a network of relationships, in order to keep the place in a technological discipline and to capture technological opportunities and evolutionary trends.
Outsourcing	A company externalizes technological activities and, then, simply acquires the relative output.

Table 3. Typology of forms of inter-firm collaboration, adopted from Chiesa et al. (2000).

Source: Jonas Runquist/Outsourcing of new product development 2007

Chiesa et al. (2000) categorize some of the most common organizational modes of collaboration and classify the different forms based on “level of integration”, which is an issue separated into six variables (Chiesa et al., 2000):

- Impact on the firm, i.e. on its organizational structure, financial position and human resources;

- Time horizon, i.e. the period of time in which the relationship with the external sources of technology is planned to go on;
- Level of control over activities, i.e. the possibility/right of the company to define the way in which the output is to be achieved and the resources to be used for this aim;
- Level of control over results (output), in terms of property and exploitation rights;
- Start-up time and costs needed for selecting the partners, defining their relative contribution, determining the game rules;
- Level of reversibility, i.e. the extent to which the characteristics of the relationship can be modified and the easiness to abandon the collaboration.

These variables form, according to Chiesa et al. (2000), a very clear pattern, where the different organizational modes of collaboration have a very distinct position in the dimension “Level of Integration”. However, it is possible to evaluate in a specific case which organizational mode of collaboration would be the most appropriate under given circumstances.

Outsourcing defined as when “a company externalizes technological activities and, then, simply acquires the relative output” is, according to all variables, detected as the extreme form on each variable of cooperation. The definition implies that the firms/institutes in cooperation are well separated and formally connected by contract to acquire “a definite output”. This distinction is important, as many studies using the term outsourcing refer to any kind of external sourcing.

Definitions of outsourcing therefore contain three parts:

1 Transferring activities to an external part,

2 which was previously accomplished internally,
3 under prearranged performance measures (contractual agreement) and time
schedule, and under a cost agreement.

3.3 Definition of outsourcing of new product development

Outsourcing of new product development refers to the development of new products (goods or service), where all or the innovative part of the new product development process is purchased externally according to a contract with organizational units separate from the outsourcing firm. This is a definition used in the collection of the empirical material and in the analysis of the present study, and its objective is not to be an overall valid definition of outsourcing.

3.4 What is an outsourcing partner?

If outsourcing is defined as purchase of an externally produced good or service that was previously internally produced (Lacity and Hirschheim, 1993), this means that a purchase operation between two parties must take place. One party is buying the service of conducting a new product development activity and the other party is selling the same service. In this thesis the term “Outsourcing firm” refers to the firm buying the service, while the term “outsourcing partner” refers to the firm that is supplying the same service. According to the definition used in this thesis, a contractually regulated agreement shall be set up between the two parties.

3.5 Outsourcing vs. contracting and Insourcing

Outsourcing takes place when an organization transfers the ownership of a business process to a supplier. The key to this relationship is the transfer of control. This differentiates outsourcing from other business relationships in which the buyer retains control of the process or, determines how to do the work. In outsourcing, the buyer does not instruct the supplier on how to perform the

task but, instead, focuses on communicating what results it wants to buy; it leaves the process of accomplishing those results to the supplier.

Outsourcing differs from contracting in that when an organization contracts out for a good or service, the buyer still controls the process. In outsourcing, the buyer transfers control of the process to the supplier. The buyer tells the supplier what results it wants the supplier to achieve, but the supplier decides how to accomplish those results. In outsourcing, the supplier has expertise in a certain process (such as software development), and it has economies of scale. If the buyer were to dictate to the supplier how to do the job (as in contracting), the buyer would be destroying an important aspect that makes outsourcing work – the value that is created by using the supplier's expertise and economies of scale. Telling the supplier how to do the job also eliminates accountability on the part of the supplier, this accountability is important in an outsourcing relationship.

Outsourcing vs. Insourcing

Outsourcing differs from insourcing in that the supplier replaces the need for the buyer to maintain an internal staff of software developers by providing a group of skilled and trained individuals to perform software development work on the buyer's site under the day-to-day supervision of the buyer's program managers. The buyer benefits from this relationship by maintaining a smaller workforce, and then quickly adding or subtracting software developers based on business needs. The supplier benefits from this relationship by gaining expertise in different business processes, and economies of scale to spread costs over larger contracts.

3.6 Outsourcing vs. offshoring

Outsourcing and offshoring are used interchangeably in public discourse despite important technical differences. Outsourcing involves contracting with a

supplier, which may or may not involve some degree of offshoring. Offshoring is the transfer of an organizational function to another country, regardless of whether the work is outsourced or stays within the same corporation/company.

3.7 The various approaches to outsourcing

It is important to understand the various approaches to outsourcing so that we can choose the most appropriate approach. The broad categories of outsourcing can be listed as below:

1. Application software outsourcing
2. IT Infrastructure outsourcing
3. Business Process Outsourcing
4. Manufacturing outsourcing

3.7.1 Application software outsourcing

This may be the most sophisticated and skilled category of outsourcing and has been popular over the last two decades. The reason is that software development has helped firms become more efficient and productive by reducing time and expenditure. At the first time, Western Europe and America companies carried on development of application software internally, soon later the demand for software resources became huge. While in developing countries like China and India, a lot of software engineers and computer scientists were available. They were cheaper than their counterparts in Europe and America were. Outsourcing to these countries was the smartest solution.

In the framework of application software outsourcing, the companies that want to outsource, have to decide on the various options that have evolved over a period. Companies can outsource either their complete software application needs or just a part of their needs to the vendor. They may even resort to outsourcing as means of strengthening the software resources already at their disposal. Most companies

usually rely on their own resources to develop and create software, while they outsource the maintenance of the traditionally used software to vendors.

Another choice the outsourcer can make is the location of the vendor. The outsourcer and the vendor may work from the same premise or at a place not so far from the outsourcer. Usually it is a combination of both these options.

The software outsourcing firms have to provide a variety of services like maintenance and enhancement of the older software, developing new ones, and quality assurance testing.

3.7.2 IT Infrastructure outsourcing

This involves operating a network connecting various sites of a company. The outsourcer will be responsible for relevant software and hardware components, their installation and maintenance, data communication, data storage and recovery, security, internet connection, printers, laptops... Commonly, IT infrastructure outsourcing companies are located on shore (near the client company's location).

3.7.3 Business Process Outsourcing

Perhaps this is the broadest form of outsourcing, it almost relies on information technology. A variety of activities are commonly performed in Business Process Outsourcing as below:

- Processing of tax transactions, checking tax claims
- Accounting bills (receivables and payable billing)
- Customer support
- Telemarketing
- Medical transcription
- Market research and analyses

- Language translations
- Warehousing
- Keeping track of human resources- their recruitment, training, and payment.

3.7.4 Manufacturing outsourcing

Perhaps this is the oldest and traditional form of outsourcing. Manufacturing outsourcing relates to the production of semi-finished or finished goods. They are done either on shore or offshore. We can easily see that big companies in U.S.A depend on companies located in other countries for components used in manufacturing certain goods. They may outsource the manufacture of such components or even set up their own factories in other countries for this purpose.

<http://www.roseindia.net/services/outsourcing/various-approaches-outsourcing.shtml> (30.03.2009)

3.8 Theoretical perspectives

The outsourcing of new product development has been described through a number of theories such as transaction cost theory, resource-based theory, resource dependence theory, knowledge-based theory, agency cost theory, and institutional theory. Four perspectives were analyzed by Jonas Rundquist in the paper “World class or good enough: the choice of partner when outsourcing new product development in medium sized firms” (Sweden, 2006). This section include shorter summaries of these four perspectives, and adds an analysis of the two new perspectives (Agency cost theory and institutional theory).

3.8.1 Transaction cost theory

Transaction cost theory (TCT) has been developed to facilitate an analysis of the “comparative costs of planning, adapting, and monitoring task completion under alternative governance structures” (Williamson 1985, p. 2). The unit of analysis in TCT is a transaction, which “occurs when a good or service is transferred

across a technologically separate interface” (Williamson 1985, p. 1). Transaction costs arise for pre-transaction reasons (drafting, negotiating, and safeguarding agreements between the parties to a transaction) and post-transaction reasons (bad adoption, haggling, establishment, operational and bonding costs). Managers must compare the sum of production and transaction costs associated with executing a transaction within their firms vs. the sum of production and transaction costs associated with executing the transaction in the market (outsourcing).

Williamson (1985) discussed two human and three environmental factors that lead to higher transactions costs. The two human factors are:

1. Bounded rationality: Humans are not likely to have the abilities to consider every possible outcome associated with a transaction.
2. Opportunism: Humans will act to increase their own self-interests.

Williamson’s three environmental factors are:

1. Uncertainty: Uncertainty makes the problems that arise because of bounded rationality and opportunism worse.
2. Small numbers trading: If only few players exist in a marketplace, a partner to a transaction may have problems in influencing the other partners to the transaction by threatening a withdrawal of the deal and use of an alternative firm in the marketplace.
3. Asset specificity: The value of an asset may be connected with a particular transaction that it supports. The partner who has invested in the asset will incur a loss if the partner who has not invested withdraws from the transaction. The threat of this partner acting opportunistically leads to what Williamson called the “hold-up” problem.

Williamson (1981, 1985) argues that three dimensions of a transaction affect the choice of governance structure for the transaction:

- asset specificity,
- uncertainty, and
- frequency.

As asset specificity and uncertainty increase, the risk of opportunism increases. Thus, managers are more likely to choose an in-house structure. As frequency increases, the comparative advantage of using outsourcing decreases because the costs of hierarchical governance structures can be paid from more instances of the transaction. A summary of the transaction cost perspective can be seen in figure 1.

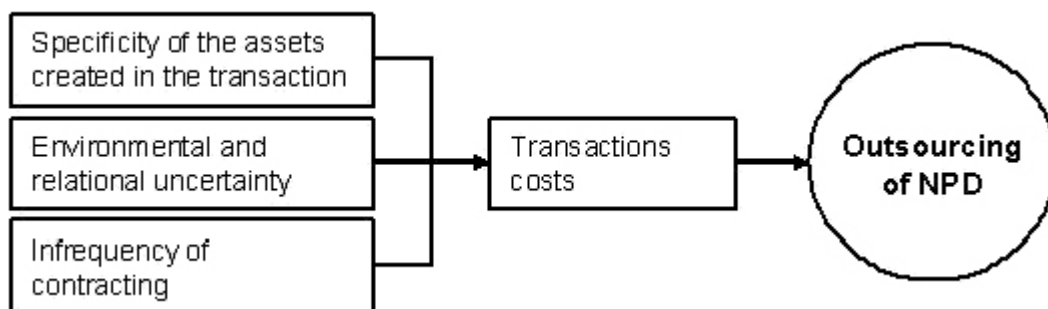


Figure 1. A Transaction Cost perspective of the outsourcing decision

Source: Jonas Runquist/Outsourcing of new product development 2007/Theoretical perspectives.

3.8.2 Resource-based theory

The resource-based theory (RBT) of the firm weighs up with transaction cost theory to account for the sourcing decisions made by organizations. While TCT focuses on the costs associated with conducting transactions between two separate units, the RBT concentrates on those factors that enable firms to win competitive advantages. The TCT and RBT were compared empirically by Poppo et al. (1995).

Unless the resource is valuable, a competitive advantage will not arise. By definition, more valuable resources will generate higher returns. If the resource is not rare, many competitors can obtain it. Thus, the advantages obtained by using the resource will not be sustained. Strategic resources are also difficult to imitate.

Factors like ambiguity, social complexity, and cultural history can make it harder for a competitor to fully understand how a certain set of resources can lead to a competitive advantage, thereby making it harder to copy the resources. Finally, strategic resources must be difficult to substitute.

The value of different resources affects the boundary decisions of a firm (Barney, 1999). Firms will want to retain in-house activities that make use of their strategic resources (Grant, 1991). Where resources have a lower strategic value, however, firms will rather seek to outsource them, according to resource-based theory. A resource-based perspective can be a way to question the economic value of outsourcing and to warn of a knowledge drain. A summary of the resource-based perspective can be seen in figure 2.

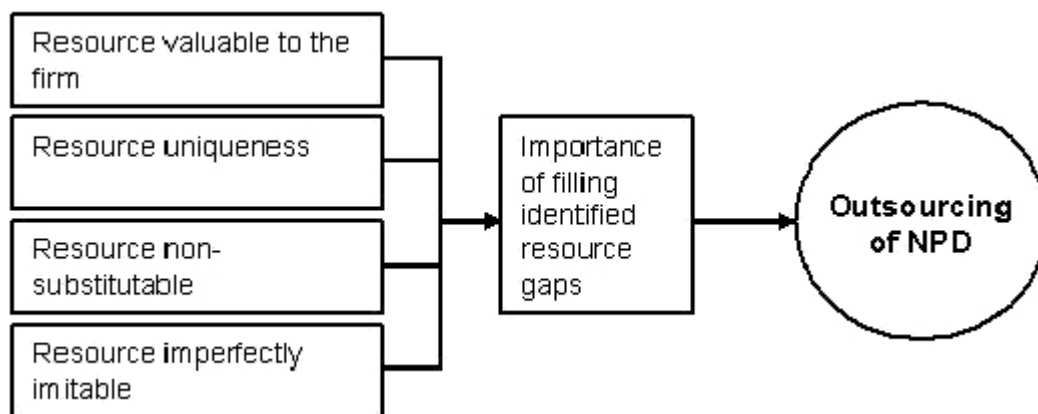


Figure 2. A Resource Based perspective of the outsourcing decision

Source: Jonas Runquist/Outsourcing of new product development 2007/ Theoretical perspectives.

3.8.3 Resource dependence theory

Resource dependence theory (RDT) has its roots in an article by Emerson in 1962 where he discussed the connection between power and dependence in forms of social relationships (Emerson, 1962). Emerson argued that the dependence of a firm B on firm A is directly comparable to the power of firm A over firm B. The theory of Emerson was later developed by Pfeffer and Salancik (1978) to analyze the relationship between organizations and their external environment. The three most basic structural characteristics of the environment are concentration, munificence, and interconnectedness.

Concentration is the level of diffusion of authority and power within the environment. Munificence is the level of shortage or availability of critical resources. Interconnectedness is the configuration and number of connections between organizations.

The RDT acknowledges that a firm can make or own all the resources required for its operations. The firm is forced to acquire these resources from many other actors and firms in its environment. Therefore, a successful firm is a firm that can satisfy the demands of its stakeholders such as shareholders, employees, and customers. To acquire this insight, the firm can choose from three alternative actions in order to deal with the demands of the environment: it can (1) avoid them, (2) comply with them or (3) try to modify them in order to acquire a better set of demands, which can be more easily fulfilled. RDT asserts that firms will take actions to reduce their dependence on other firms and to reduce the risk that is stemming from these dependencies. This means that either a make decision (in-house) can be reached to take away dependencies, or that, for example, alternate suppliers can be contacted to have freedom of changing supplier if a buy decision is made.

The firm will try to reduce its dependence on the environment by constantly balancing the two contradictory forces of certainty and autonomy (Davies et al., 1992). A resource dependence perspective will always point to a certain degree of dependence in an outsourcing contract. The situation for the firm to deal with and to consider is (a) how much dependence the firm finds bearable and (b) how to minimize the dependence. A summary of a resource dependence perspective can be seen in figure 3.

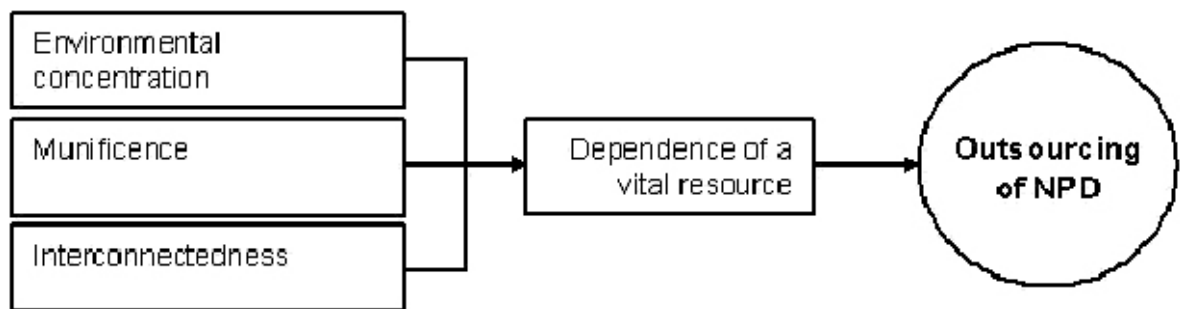


Figure 3. A Resource Dependence perspective of the outsourcing decision
Source: Jonas Runquist/Outsourcing of new product development 2007/Theoretical perspectives.

3.8.4 Knowledge-based theory

Knowledge-based theory (KBT) is a development of RBT; both question whether cost (TCT) is the most important factor to explain strategic sourcing decisions. Empirical studies comparing TCT and KBT were conducted by Poppo et al. (1998). Using a knowledge-based theory, the three functions of a firm are development, application, and integration of related technical knowledge necessary to provide the strategic activities of production and/or services (Pisano, 1994; Nonaka, 1994; Grant, 1997). A firm may more effectively acquire and learn this technical knowledge by outsourcing (Tidd and Trehwella, 1997; Lane and Lubatkin, 1998). The perspective of knowledge-based theory suggests that an unbounded pattern of organizational learning can establish and enhance a firm's internal capacity by acquisition of external knowledge. This capability can also improve the competitiveness of a firm.

The characteristics of the knowledge can affect the outsourcing decision, as knowledge easier to transfer will support a positive outsourcing decision. The choice of organizational mode for knowledge acquisition is determined by whether the optimal mode can maximize firm learning (Kogut and Zander, 1992; Grant, 1996; Steensma and Corley, 2000). Concretely, a firm should carefully evaluate its internal and external organizational conditions, choose the best knowledge-acquisition mode (outsource or develop in-house), and increase the performance of knowledge acquisition through its learning pattern. The conditions for learning include at least: (1) the characteristics of knowledge itself, (2) the firms' characteristics, and (3) the organizational learning condition in the process of knowledge acquisition (Hamel, 1991; Barney, 1999). A summary of a knowledge based perspective can be seen in figure 4.

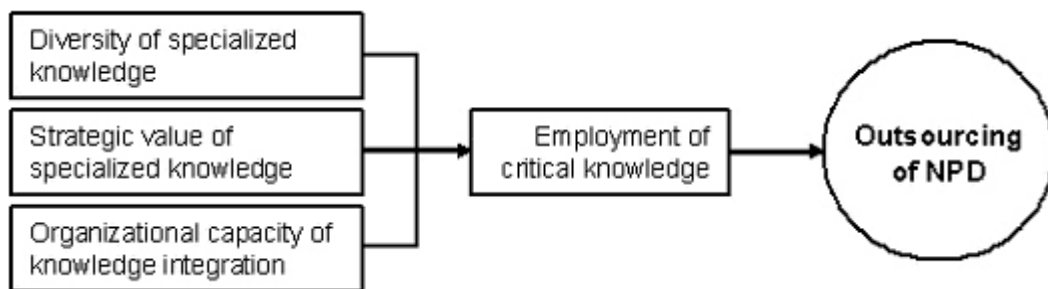


Figure 4. A Knowledge Based perspective of the outsourcing decision
 Source: Jonas Runquist/Outsourcing of new product development 2007/Theoretical perspectives

3.8.5 Agency cost theory

Agency cost theory (ACT) expands on one aspect of TCT, as it deals with the different perspectives of risk that the firm (principal) and the outsourcing partner (agent) have. Agency cost theory was discussed and formed by Jensen and Meckling (1976), Mitnick (1975), and Ross (1973). The theory investigates the effective contract regulation on the relationship between principals (the partners who receive inquiries or services) and agents (the partners who provide inquiries or services). Jensen and Meckling (1976) defined an agent relationship as a

contract relationship which is associated with a commitment of an agent to service deliveries to a principal.

The theory differentiates between outcome-based contracts and behavior-based contracts. If the firm distrusts the outsourcing partner, then the extent of monitoring required will be greater for the firm than it would be if the firm could wholly trust the partner to deliver quality in goods and service. The firm has two main choices: a contract which stipulates payment by results (an outcome-based contract), or a contract which states that the partner should do certain things at stipulated times, or spend a specified amount of time on specific functions. If one cannot trust a partner to deliver a good or service according to agreement, an outcome-based contract then can ensure that at least the detailed actions are conducted. On the partner's side, a behavior-based contract at least allows them to claim that they did spend a specific amount of hours on the activity, even if the outcome could not be achieved as originally intended. Agency cost theory helps to distinguish the most productive and fairest method of minimizing risks for both firm and outsourcing partner.

ACT argues that the key issue of management is to choose an efficient type of contract: an outcome-based contract versus a behavior-based contract, to govern the relationship between principals and agents (Eisenhardt, 1988). Agency costs, caused by discrepancies between benefits of principals and those of agents, consist of three parts:

- the monitoring cost of the principal,
- the residual cost of the principal, and
- the bonding costs of the agent.

The principal's monitoring costs come out when a principal monitors an agent's performance. The principal's residual costs are incurred when a principal buys a

function from an agent with a limited ability. The agent's bonding occurs when an agent commits to service deliveries for a principal but fails in fulfilling the contract. Overall, five factors (Eisenhardt, 1988) impact agency cost: uncertainty, risk aversion, programmability, measurability, and length. Uncertainty is affected by economic, technological and political environments. Risk aversion is the agent's and principal's perception of risk-taking. Programmability is to what extent an agent's behavior can be predicted. Measurability refers to the extent to which the result can be evaluated. Length refers to the time duration of a contract.

Improved contract management can reduce the agency costs for both outsourcing firm and partners, and increase the chances for a buy decision. When uncertainty is high, risk aversion is high, outcome measurability is low, programmability is low, and length of relationship is short, then agency costs for the outsourcing contract costs will increase due to higher monitoring costs and bonding costs. Higher contract costs increase the probability for a negative outsourcing decision. A summary of an agency cost perspective can be seen in figure 5.

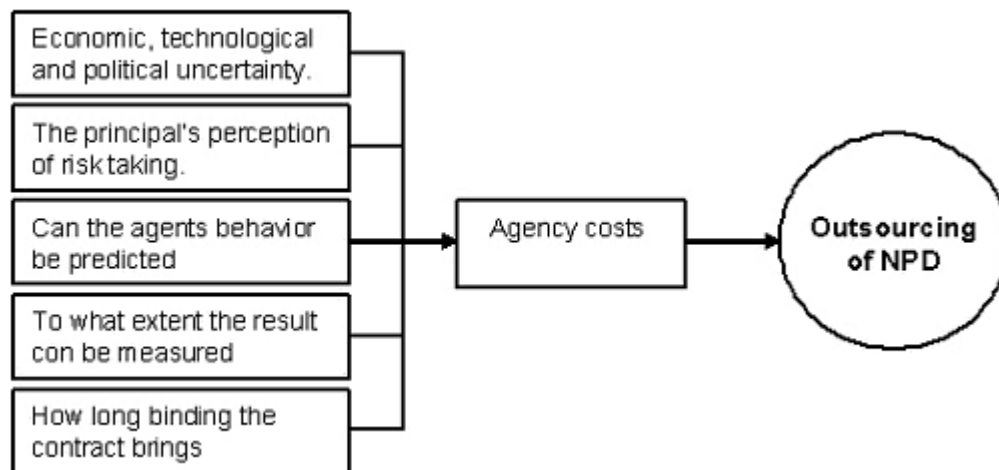


Figure 5. An Agency Cost perspective of the outsourcing decision

Source: Jonas Runquist/Outsourcing of new product development 2007/theoretical perspectives

3.8.6 Institutional theory

Institutional theory focuses on how external forces lead organizational actions (DiMaggio and Powell, 1983). Institutional theory seeks to explain homogeneity of organizational forms and practices. According to institutional theory, organizational environments "...are characterized by the elaboration of rules and requirements to which individual organizations must conform if they are to receive support and legitimacy..." (Scott and Meyer, 1983). As a result, values and beliefs external to the organization play an important role in determining the internal norms of the organization.

Applied to the outsourcing context, institutional theory pinpoints to what extent outsourcing practices should reflect the participants' unique characteristics versus mimicking industry best practices. This means focusing on the contingency factors that give the necessary balance between industry's best practices and participants' unique characteristics. A practical example is presented by Loh and Venkatraman (1992), describing how information-systems outsourcing became legitimated as a best practice after the Kodak-IBM arrangement on outsourcing was presented.

DiMaggio and Powell (1983) suggested four institutions that influence the organization: suppliers, customers and competitors, and regulatory bodies. The first three institutions are part of the supply chain. According to Kondra and Hinings (1998), closer contacts between institutions lead to stronger conformity. This means that the closer and more trustful the institutions, the more conformity. Regulatory bodies affect the industry in two ways; with their rules and with their presentation of the rules.

Trade agreements between countries or economic regions, and a stable political situation in the country of the partner firm, are examples of institutional factors

that increase the probability for a positive outsourcing decision. A summary of an institutional perspective can be seen in figure 6.

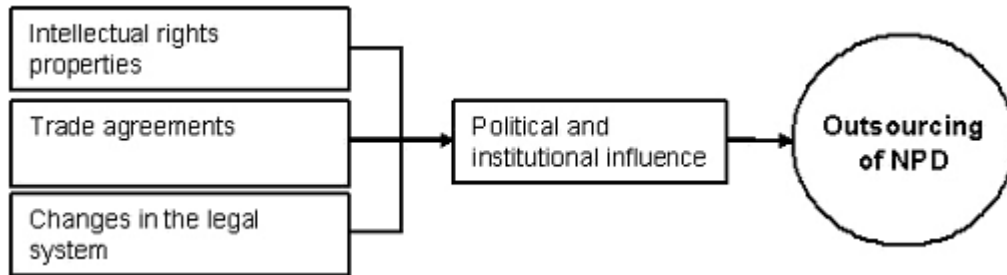


Figure 6. An Institutional perspective of the outsourcing decision

Source: Jonas Runquist/Outsourcing of new product development 2007/theoretical perspectives

4. Outsourcing: Practical criteria for selecting outsourcing

4.1 Reasons for outsourcing

Different firms have different specific business situations that call for outsourcing. Some organizations take to outsourcing just because they are hard pressed for time, or because they believe outsourcing can save them money. Careful planning and assessment of one's requirements are absolute musts for any organization before it goes for outsourcing. Here are some of the 'right reasons' for which a business may consider outsourcing.

Reengineering at Lower Risk

When a firm goes for reengineering, it is looking to improve crucial performance aspects like cost, quality, speed and services. However focusing on efficiency can take away resources and attention from the core business needs. If on the other hand these functions are ignored, they result in poor productivity. Outsourcing these non-core functions to a specialist can thus bring the best of two worlds together for the company.

Access to Latest Technologies

There are many outsourcing vendors today that invest in world class technologies, systems and people. These vendors have gained expertise working with many clients facing different challenges. By outsourcing work to such vendors, a firm can access their facilities and expertise without having to purchase them. Here is a clear case for comparative advantage. The personnel the firm transfers to the vendor also benefit with all the training.

Cash Flow

When an organization outsources work, it often sells the assets associated with the transferred work to the vendor. This could be equipment, facilities, vehicles

or licenses. The vendor uses these assets to manage the services for the client. As an evident, this transfer can bring money to the client, depending on the value of the assets thus sold. The sale often happens for book value, which could be higher than the market value.

Redirect Resources

By outsourcing, an organization can focus its resources on the most crucial aspects of the business at the time. This in turn adds greater value to the most essential of the business activities. This could be building better customer relations, revamping the market strategy or anything that needs more attention in the current phase of the company's growth.

Outsource Difficult Functions

This one reason is easy to misunderstand. This does not mean that outsourcing is a way to shirk off management responsibilities. When a firm finds a particular area difficult to manage or out of control at the moment, it should first of all analyze the situation and identify the causes. Outsourcing is not an option when the organization cannot identify the requirements, since it cannot state clearly what is needed.

Focus on Core Business

A company can outsource its operational aspects to an expert in the concerned area and give more attention to the core business.

Free up Capital Funds

Many organizations have trouble deciding which areas they should invest more in. Different departments and functions often vie for more resources allocated to them. With outsourcing, the company does not have to purchase infrastructure

for non-core functions. Thus it has more capital at its disposal. Outsourcing also benefits the overall financial measurements of the firm as it does not have to show return on equity on capital investments, in non-core functions.

Bring Down Operational Costs

When a company tries to carry out all its activities in-house, it incurs higher expenditure- on everything from research and development to marketing and deployment. These higher costs have to be then passed on to the customer. The outsourcing vendor can often do the work for a much lower cost based on either economy of scale or other advantages. This in turn reduces the buyer's costs and facilitates competitive advantage.

Lower Risk

Investments are always risky for an organization. Rapid changes in the market, competition, legal regulations, financial situation and technology can all influence where the organization needs to focus its resources. It can be quite tricky to keep pace with these changes. Tying up with an outsourcing vendor who has already made the investment could thus be the best bet. The shared investment thus reduces the risk for the individual company.

Lack In-House Resources

Sometimes an organization may not have at its disposal the necessary resources for a particular function. Building the required resources from the scratch takes considerable time and money while the same function can be performed more easily by outsourcing. A start-up organization, a new division, expansion into a new geographical territory etc are such cases.

(<http://www.roseindia.net/services/outsourcing/why-outsourcing.shtml>)

(31.03.2009)

4.2 The process of outsourcing

Because the sourcing process encompasses many different activities and responsibilities it has to be planned with care. In order to make it more controllable the sourcing process is often divided in different phases. These phases can be planned to the level of a few weeks. The use of phases makes it possible to divide and describe the different roles and responsibilities that are important for a successful sourcing deal. Many consultancy firms and service providers use their own phasing model to describe the sourcing process. The taxonomy study Group of the PON (Platform Outsourcing Nederland) has used these models to create an integrated model: the sourcing life cycle.

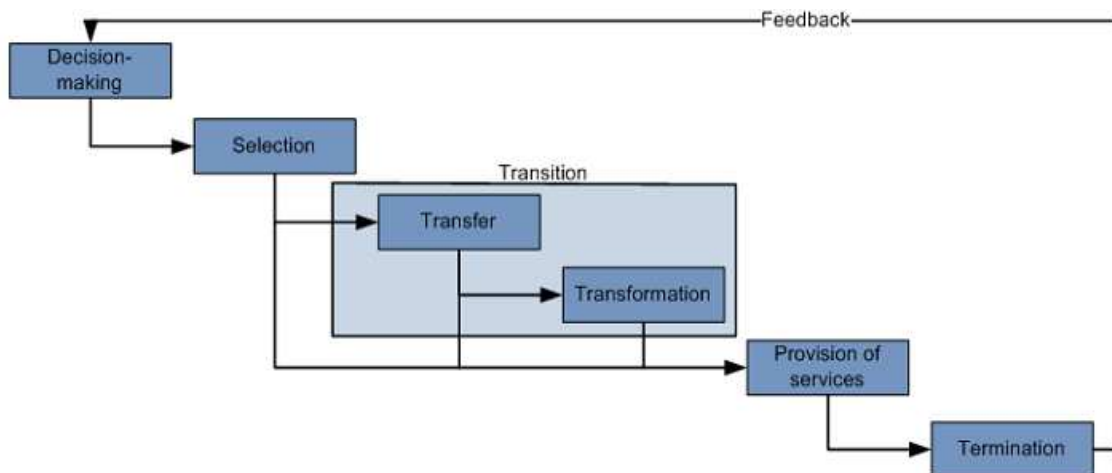


Figure 7: Sourcing Life Cycle, PON

Source: Mark Van Liefland, Radboud University Nijmegen, *Digital Architecture in the context of outsourcing/2007*

Decision-making

Before an organization decides to outsource one or more services it has to formulate a sourcing strategy. By means of this strategy the organization should examine which services can be outsourced and consider the advantages and disadvantages of this decision. There are many different types of relationships between an outsourcer and one or more service providers. An organization can decide to outsource the entire business process (full outsourcing) or it can decide

to outsource part of the business process (selective sourcing). An organization can outsource to a single service provider (single sourcing) or use more than one service provider (multiple sourcing). Furthermore an organization has to decide if the services will be provided by one or more service providers that are located in the same region as the outsourcer (nearshoring), a different region (offshoring) or even in multiple regions (global sourcing).

Selection

When an organization has formulated its sourcing strategy and decides that outsourcing is preferable it should select one or more service providers. The selection of service providers is often divided in three successive iterations; the Request for Information (RFI), the Request for Proposal (RFP) and the Request for a Best and Final Offer (BAFO). In the RFI phase the organization approaches potential service providers to inquire into their willingness, their ability and their proven experience to take on the service in question. By means of this information a first selection of potential suppliers is made. It is common to select up to five providers after the RFI phase. In the RFP phase these providers are asked to hand in a proposal and an offer for the provisioning of the services. After this phase it is common that the two best service providers are asked to make a definitive, final offer. This offer is used to make the final choice for a service provider. Before the contract is signed both parties will perform a Due Diligence examination. This examination is used by the service provider to verify the quality and the value of the portfolio of services, assets and employees of the outsourcer. The outsourcer uses the Due Diligence to verify the quality and durability of the service provider. Reference visits are often used by both parties during the Due Diligence.

At the heart of every outsourcing deal is a contractual agreement that defines how the client and the supplier will work together. This is a legally binding document and is core to the governance of the relationship. There are three significant dates that each party signs up to the contract signature date, the effective date when the contract terms become active and a service commencement date when the supplier will take over the services.

Transition

During this phase the desired provision of services will be implemented. The transition phase starts with the signing of an agreement of intention, the precursor of the final contract. The transition phase is divided in two sub phases; the transfer phase and the transformation phase.

During the transfer phase the actual provision of services, including the accompanying employees and resources, is transferred to the service provider. During the transformation phase the provision of services is adjusted to the standards of the service provider in order to benefit from the specific knowledge and scale of the provider. The taxonomy workgroup of the PON distinguishes three types of transformation:

- An “as is” transition: the service provider continues the processes and tooling of the outsourcer: no transformation takes place.
- Integration of the processes and tooling to the standards of the service provider: transformation at the service provider’s side.
- Transformational outsourcing: transformation of the processes and tooling in order to significantly improve the quality of the provision of services: transformation at both sides of the sourcing deal.

Provision of services

The provision of services can continue for several years, depending on the contract. During this phase the service provider provides one or more services for the outsourcer. The outsourcer will regularly assess the provision of services in order to determine whether the quality of the services meets the agreements of the contract. This assessment is supported by the implementation of a consultation structure and regular reportages of the service provider. In some cases the contract can be altered during the provision of services. Matters that can lead to the altering of the contract are for example important technological changes or changes in the wishes and possibilities of the outsourcer or the service provider.

Termination

When the contract ends the outsourcing organization has to make an important choice. The outsourcer can decide to renew the contract with the current service provider (resourcing), to transfer the contract to a different service provider (follow-up sourcing) or to bring the provision of services back within the own organization (backsourcing). The outsourcer has to evaluate the past outsourcing period and the contract before making this decision. Follow-up sourcing as well as backsourcing requires a retransition.

4.3 Critical considerations on deciding outsourcing

Outsourcing work is an important business decision that can make or mar your prospects. There are several questions and issues the company needs to address in the decision making process. Apart from integrity and efficiency, the client and the service provider should be able to establish an effective communication system.

In this section I would mention to some of the important components that help the company to take the right decisions. Next parts will be followed by the analysis of two case studies of two multinational companies: Samsung Vina Electronics Co., Ltd. and Hanjin shipping Vietnam Co., Ltd. Both of these companies are joint ventures between Korean and Vietnamese side. The analysis of these two companies will focus on some certain important components contributing to the decision making process to outsourcing. The analysis is based on the interviews with representatives or the person in charge of the companies relating to outsourcing issue. Here are some important open questions or issues from which the point of view of interviewees will be reflected that help to take the right decisions.

Reliability of the Vendor: The outsourcer needs to know how long the vendor has been in the business, how many employees they have and how sound their financial background is. In other words, the client should have as complete a picture as possible

Quality: The vendor should ideally be able to provide references from previous/current customers. They should also describe the quality assessment processes followed within the company. It is helpful if the vendor has certifications like ISO 9000, CMM etc from independent agencies.

Costs: Every outsourcer wants the outsourced work to be cost effective. They should check on the hidden costs from maintenance, training, infrastructure and so on.

Ability to Meet Deadlines: Take care that the company is entering a realistic agreement with the vendor on deadlines and that the terms do not cause quality to go down.

Data Security: This is an important concern in the current times of internet hacking. The company should check on the security measures the vendor has

adopted, like firewalls, access control systems, data encryption and so on. Also have a clear picture of the security checking the vendor adopts in terms of human resources- like pre-recruitment verification and non-disclosure agreements.

Risk Mitigation: Does the vendor have a thorough system of business continuity/ disaster recovery? What are their risk mitigation procedures? We should choose a vendor who minimizes business risks with a proper plan.

Employee Attrition: How well equipped is the vendor to handle employee attrition? Do they have employees who are cross-trained? Do they have enough buffer capacity?

Vendor Transparency: How fair and transparent can the client expect the vendor to be? The invoicing has to be clearly segregated, especially when time and material are involved. This can be gauged only by references from previous clients or current clients who have worked with the vendor long in enough.

Compliance with Laws and Regulations: Make sure that the vendor complies with statutory laws and regulations. If this is not the case, it is very well likely that the client will be held responsible for the violations of the law. In the current scenario, the client company will be morally, if not legally, responsible for violations especially with regard to the environment and human resource factors. Good and legally safe working practices are essential for the vendor.

Culture: Last but not least, it is important that the client and the vendor are culturally compatible. This is important for a common understanding of work ethics and smooth interaction. First impression is often the best impression here - analyze the vendor's initial communications and this will probably indicate how hassle free your future relationship is going to be.

4.4 Case study 1: interview with Samsung Vina Electronics Company

At Samsung vina I have spoken to Mr. Phong Le Vu Hoai, assistant purchasing manager, the purchasing department, who is taking care of a list of service providers for the company. I have got records of the interview and will report

some important issues relating to daily outsourcing practices at Samsung vina and the point of view of Mr. Phong about the company's outsourcing activities as follows:

[contact person: Phong Le Vu Hoai hoaiphong.le@samsung.com]

Brief introduction of Samsung vina

Samsung vina is a joint venture specializing in producing and trading electronic parts such as fridge, Color TV, LCD, washing machine and air conditioner. The company totally has 600 workers where the Purchasing department has 70 staff. Some of commodities that Samsung vina regularly outsources are cabinet, carton, cushion, and speaker.

Issues of interview:

Reliability of the vendor

Samsung vina has consideration on this matter, it normally choose big vendors with large size and large number of employees.

Quality

Samsung vina do not need quality references from vendors, but it is the Quality Management team who will make evaluation before deciding to work with any vendor. Generally vendors have certificates on ISO, CMM and environment.

Costs

Cost is one of key factors to consider a vendor. Samsung's goal is to purchase goods at lowest expenses, keep inventory at lowest level, and reduce input costs at lowest level. Also maintenance cost is mutually agreed by Samsung and vendors.

Ability to meet deadline

All of vendors go for business with Samsung by contracts. Thus in case of failure to meet deadline, there will be a penalty to the violating party.

Compliance with laws and regulations

Certainly all of vendors work in compliance with laws and regulations of Vietnam. In outsourcing deals, all terms and conditions are mutually agreed by both parties and one will be fined if fails to fulfill its obligations.

Culture

Samsung pays attention to communication of vendors before deciding to work with them. In no doubt, Samsung normally choose Korean vendors who have the same working and business culture.

4.5 Case study 2: interview with Hanjin Shipping Vietnam Company

I have spoken to Mr. Minh Nguyen Cong, Logistics Manager in Hanjin shipping Vietnam, who is in charge of negotiating and signing contracts of outsourcing services. He well understands the importance of outsourcing activities to the performance and business effectiveness of the company. He is willing to share his point of view and vision on the outsourcing work with people for knowledge and experience.

[contact person: Minh Nguyen Cong ncminh@sg.hanjin.com]

Brief introduction of Hanjin shipping Vietnam

Hanjin Shipping Vietnam company is a joint venture between a Korean company Hanjin and a Vietnamese shipping company SGN starting operation in Vietnamese market since 2004. The company with the number of employees of around 70 people is second ranked in the Vietnamese shipping market. Main business activities of the company include provision of sea transport services,

logistics services to customers around the world. Daily business operations of the company are concerning to many other organizations such as customs office, sea port administration office, container yard or ICD (Inland container depot) service providers and container repairing services. The Logistics department consists of around 10 people. Apart from the sales department, the Logistics department has an important role in outsourcing operations of the company. The Logistics department is responsible for studying, examining and deciding which vendor to be chosen. So which of business processes does the company normally outsource to service providers? They are some activities: customs clearance, equipment controlling, equipment cleaning and repairing...

Issues of interview:

Reliability of the vendor:

Before deciding to outsource a business activity to another provider, the Hanjin company conducts a selecting work where the logistics staff will send service proposal documents to service providers, the service quotations then will be sent to the Logistics department from providers. Through such quotations together with some of necessary information relating to the potential vendors collected by the Logistics department themselves, there will be a summary and a list of expected vendors for the upper management's references and considerations. The norms of reliability of the vendors from the company are based on some following criteria: how long has the vendor been doing business? How large the vendor's business size is and how well is the vendor's financial status?

In general, after analyzing the table of norms of the vendors, Hanjin company chose the vendors with good establishment, reliable financial status and those with large size and experience will be a priority. Also the inter linkage and geographical position of the vendors are critically important for making decision.

Quality

This is one of key components for the company to make right decision on choosing the eligible vendor. It would be helpful if vendors manage to provide certain certifications on quality like ISO or CMM. However, in the transportation industry in Vietnam there are few logistics vendors who can meet the high requirements from big shipping companies especially from multinational companies. Those vendors who have business with Hanjin company are mostly operating on port administration, container controlling and reparation, customs service provision... they perform daily work based on experience and work habits. Thus there are few vendors who are certified by international quality organizations.

However, some of Hanjin's vendors are internationally certified and can describe their advanced work processes as well as providing useful proof of their previous and current clients. Only the problem may occur is that their work processes sometimes could not meet the expected schedule.

Costs

It is certain that Hanjin company consider the cost relating to outsourcing work as the most important factor. The costs may be the training cost for staff, maintenance cost... it is inevitable that the company have to allocate their workforce to the outsourced work. At least 2 or 3 staff will be appointed to the Logistics department and be in charge of following up the daily work and maintain working relationship with the vendor. However, some these costs are still low comparing with the cost arising from non-outsourcing of this business process.

Ability to meet deadline

This criterion plays an important role for the Hanjin company to decide the vendor. Every outsourcer always wants the vendors to fully meet the work deadline. In the field of transportation and logistics especially in Vietnamese environment, the matter of time is sometimes seen flexible and may be overdue. Hanjin also took this issue into consideration with their vendors but they still failed to meet the deadline for sometimes. Although we have realistic agreement on this, it is not easy to blame them about this because it is the general situation in the field of logistics in Vietnam. For example, the port operator who has responsibility to monitor the container equipment for the company and keep informed of the container status to the logistics staff in necessity. In case of overloaded volume of cargo at the port causing the slow response of the port officials to the logistics staff, they take this excuse as an absolution.

Compliance with laws and regulations

Before coming into an agreement with the selected vendor, the company has well studied the legal status of the vendor, their field of business as well as their legal background. The Hanjin company strictly regulate by mutual agreement that any legal violations arising from the vendor will belong to their responsibility and Hanjin will be exempted from such responsibility.

Culture.

Last but not least, this is also a factor to consider selection of a vendor. It is important that the outsourcer and the vendor are culturally compatible and have working ethics. However, in Vietnamese business environment the matter of corruption and bribery is inevitable, especially from Vietnam-originated companies, this is not a strange issue if we think of that in other countries like China, India, Russia... Although corruption and bribery may exist in business

within Vietnamese companies, this matter is extremely prohibited in Hanjin company, a Korean company with high discipline. Thus the outsourced work between Hanjin and the vendors has been still smoothly going.

4.6 Reconnection to research questions

Q 1: What factors affect the decision to outsource a business process in medium sized or large sized firms in Vietnam?

It seems like most medium-sized and large-sized companies mainly seek knowledge when making the decision to outsource a business process. Research on outsourcing in general was historically based on the assumption of outsourcing as a cost saver. This has changed over time to a resource/knowledge focus, but it seems even more important when outsourcing a business process or a new product development.

The study of two above case studies and the figures in the Exhibit 1, chapter 5, together with some theories in the theoretical perspectives of chapter 3 show that the firms refer to costs as the main reason for outsourcing a business process. The second is the high effectiveness or the quality of the production phase/the outsourced work, which is a kind of competence variable as it refers to integration of product knowledge or process knowledge.

Q 2: What factors affect the choice of outsourcing partner when a business process is outsourced in medium or large sized firms in Vietnam?

The empirical findings indicate that the main arguments when choosing outsourcing partner for business process outsourcing are nearby locations and strong inter linkages between the firms. This is not completely in line with the mainstream of literature, where expert knowledge of the partner is often emphasized as a motive to choose a certain partner.

The medium-sized and large sized firms tend to choose their outsourcing partners in their inter-linked or geographically close areas, this is well supported by the two case studies in the chapter 4.

5. Implications and recommendations for outsourcing in Vietnam

5.1 Current outsourcing situation in Vietnam

5.1.1 Political, social and economic features of Vietnam

From a political standpoint, Vietnam has enjoyed over thirty years of political stability. The current government has been in place since the reunification of Vietnam in 1975. Vietnam also has not experienced any major conflicts or tensions with its neighbors in almost thirty years.

From an economic standpoint, Vietnam has a strong and robust economy. Vietnam's gross domestic product (GDP) growth has averaged 7% over the past five years (up to 2008, source CEIC). Vietnam's GDP growth is the second fastest in Asia (see: *Vietnam's Roaring Economy Is Set for World Stage* in the New York Times).

(http://www.nytimes.com/2006/10/25/business/worldbusiness/25vietnam.html?_r=3&oref=slogin) (03.04.2009).

In 2008, foreign direct investment (FDI) in Vietnam was estimated to have reached nearly USD 60 billion. This economic growth and investment compares favorably with other outsourcing destinations. Almost 95% of the country is ethnic Vietnamese and over 80% of the population has no declared religion making Vietnam none of social and religious conflicts.

5.1.2 Current outsourcing trend in Vietnam

Since after 1990s Vietnam as well as some countries The Philippines, Hong Kong, India, Malaysia... started delivering outsourced services. The trend was started with manufacturing outsources from Japan, China, the United State, Taiwan... and it has been fast moving to information technology outsourcing. According to the evaluation of Ben Trowbridge, CEO of an outsourcing advisory firm predicting about outsourcing trend in 2008, companies will choose to locate into new countries after careful evaluation, the sustainable and accepted locales

for outsourcing will grow with Mexico, Vietnam and Bulgaria among others making new headway.

(<http://www.outsourceit2philippines.com/news-oussource/Outsourcing-Tsunami-will-be-the-Major-Outsourcing-Trend-in-2008.htm> 02.04.2009)

Labor costs in Vietnam are relatively lower than that in other outsourcing destinations. For example, Vietnam's salaries are over 30% less expensive for both IT outsourcing (ITO) and business process outsourcing (BPO) than India, other Asian countries and Eastern European countries. (source: neoIT as reported in Global Services, August 2006).

96% of Vietnam's population is literate, well educated and technically savvy. Vietnam has embarked upon business-friendly policies and laws to attract foreign investments, most notable are Vietnam's efforts to protect intellectual property. Vietnam has largely been in TRIP (WTO Trade Related Aspects of Intellectual Property) compliance since 2002. As recently as the summer of 2006, Vietnam enacted legislation to come into full compliance with TRIP.

Examples of outsourcing companies in Vietnam: LogiGear Corporation, US-led software testing center in Vietnam (source: *LogiGear Expands Software Testing Facility in Vietnam*).

http://www.logigear.com/about_us/news/press_release.asp?prId=27(03.04.2009);

Intel Corporation (is building a \$300 million chip assembly and testing factory in Vietnam's Ho Chi Minh City (source: *Intel invests in Vietnam software company.*); FPT Software (Vietnamese); Glass Egg (USA); Nike (USA)...

5.2 SWOT analysis of outsourcing for Vietnam

In this section I would suggest a matrix of SWOT analysis on factors of strengths, weaknesses, opportunities and threats regarding to internal as well as

external relations in Vietnamese outsourcing environment, then we have a better overview on the outsourcing environment in Vietnam.

<p style="text-align: center;">Strengths</p> <ul style="list-style-type: none"> • Cheaper workforce than their Western counterparts (wage difference of 70-80% compared to Western counterparts). • Highly skilled, technically savvy workforce • Low attrition rate than in the West • Dedicated workforce aiming at making a long-term career in the field. • Round-the-clock advantage for Western companies due to the huge time difference. • Lower response time with efficient and effective service. 	<p style="text-align: center;">Weaknesses</p> <ul style="list-style-type: none"> • Poor developed infrastructure • Shortage of manpower at management level • Recently workers have shown a tendency not to pursue ITES (Information Technology Enabled Service) as a full-time career • Political opposition from developed countries about human rights.
<p style="text-align: center;">Opportunities</p> <ul style="list-style-type: none"> • Cooperative relationships Vietnam-India between Nasscom and Vinasa (Vietnam software association) will enhance business cooperation on software services and IT. • Vietnamese software companies have chance to learn experience and key to success from Indian 	<p style="text-align: center;">Threats</p> <ul style="list-style-type: none"> • The anti-outsourcing legislation in the US state of New Jersey. Three more states in the United States are planning legislation against outsourcing Connecticut, Missouri and Wisconsin. • Other ITES destinations such as China, Philippines and South Africa could have an edge on

<p>companies.</p> <ul style="list-style-type: none"> • Vietnam can be known as low-cost destination in software outsourcing in the world. 	<p>the cost factor.</p> <ul style="list-style-type: none"> • Slowdown of demand
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5.3 Implications to outsourcing in Vietnam

Before suggesting some implications to outsourcing in Vietnam environment I would refer to 3 principle insights that have emerged from the 2006 research conducted by Duke and Booz Allen Hamilton and the associated business and policy implications:

1. Labor arbitrage is giving way to accessing talent as the primary driver of next-generation offshoring.
2. Where you offshore depends on what you offshore
 1. The obstacles to successful offshoring are increasingly internal and organizational.

Insight 1: Labor arbitrage is giving way to accessing talent as the primary driver of next-generation offshoring.

If there is one thing that the critics and proponents of offshoring can agree on, it's the fact that most companies first consider offshoring because they are looking to lower costs, specifically labor costs. Cost reduction was the predominant driver of offshoring in the 2004 and 2005 surveys (see Figure 8).

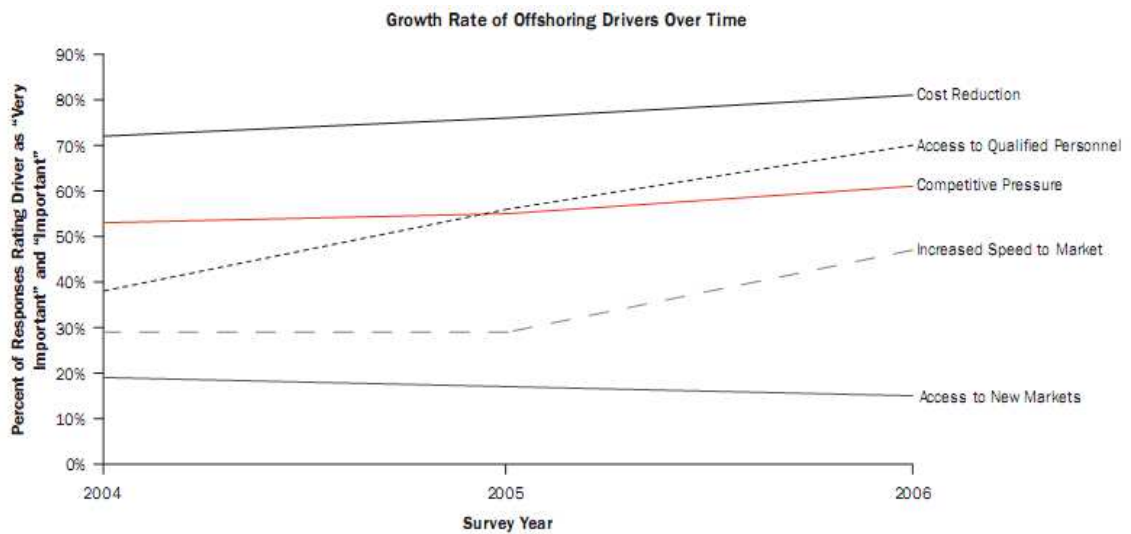


Figure 8. The key reasons offshoring has evolved beyond cost reduction
 Source: Duke university/Archstone consulting offshore research network 2004 and 2005 surveys; Duke university/Booz Allen Hamilton offshoring research network 2006 survey.

The recent completed 2006 study reveals that companies are leveraging offshoring strategically to create competitive advantage. As a result, “access to qualified personnel” has increased substantially (by approximately 75% in the past two years) as a major driver of the decision to offshore. It means that companies are placing more and more emphasis on sourcing talent as a decisive factor in their offshoring decisions. A growing number of companies the world over are drawing the qualified talent they need from an increasingly global labor pool.

Insight 2: Where you offshore depends on what you offshore

Companies are becoming more sophisticated in assessing and integrating a variety of factors of selecting offshore location. Increasingly these factors include availability of qualified labor, access to technology clusters or academic institutions, political stability, robustness in infrastructure, and the hospitality of the local business environment. Figure 9, maps offshore markets according to the

two most important factors that emerged from our analyses: relative cost of labor and potential access to qualified talent.

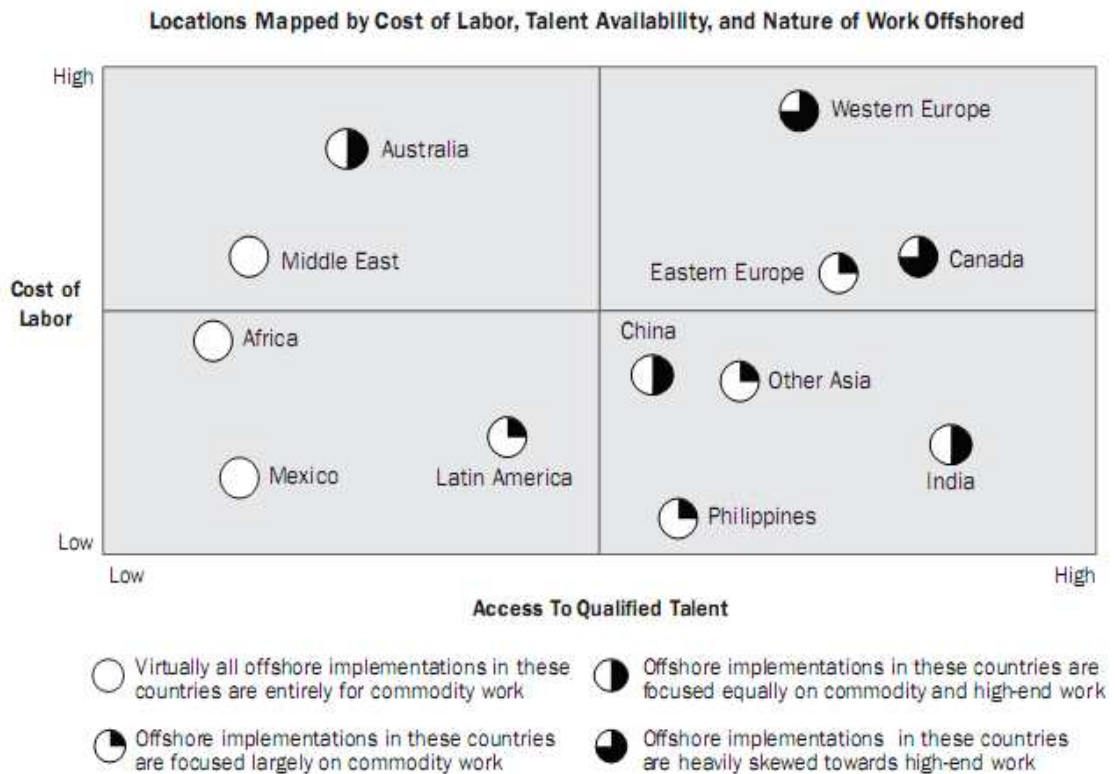


Figure 9: shading of circles indicates degree to which high skilled work is currently offshored to the specific country.

Source: Duke university/Booz Allen Hamilton offshoring research network 2006 survey.

On the lower left are Mexico, Africa and Latin America, where companies offshore simple functions in order to reap the benefits of low labor costs. Companies do not look to these markets to offshore highly skilled work. In contrast, India's placement in the lower right indicates that it rates well on the both dimensions: access to qualified talent and low cost of labor. Canada, on the other hand, rates well in terms of access to highly skilled, English speaking, geographically proximate talent, but it is no bargain.

Although much of recent literature on offshoring highlights China as a favored destination alongside India, our research confirms that India still perceived to be

in a league of its own when it comes to attracting high skilled offshored work. Its talent pool is rated as both less expensive and more qualified than China's by our survey respondents (see Figure 9).

The most recent findings indicate that the Philippines is emerging as a closer competitor to India for contact centers and administrative and back-office capabilities, although its smaller size naturally constrains the growth of the Philippines as a major offshoring market.

Insight 3: The obstacles to successful offshoring are increasingly internal and organizational.

The survey sample provides a basis to also examine why some companies have not yet initiated offshoring strategies or why they have decided not to offshore at all. In the 2004 and 2005 surveys, concerns about the achieving desired service quality and the ability to assure data security were cited as the most important perceived risks and the 2006 findings are proving to be no exception. In contrast to prior years, however, internal organizational constraints are also emerging as very clear impediments to offshoring. Specifically “operational efficiency”, “loss of managerial control”, and “lack of acceptance among internal clients have emerged as hot issues – all increasing significantly.

How do these insights translate into an action plan? Below are the suggested business and policy implications.

5.3.1 Implication 1: Develop a global workforce sourcing strategy now.

An effective global talent management strategy starts with knowledge of the new worldwide labor and talent landscape with a smart approach to making specific decisions about where and when to locate key processes and people. It combines the capacity to see the global big picture with the ability to translate it into action

in each individual labor market - and to do it over and over again as circumstances change.

Workforce deployment decisions, therefore, need to take into account likely trends in wage rates and availability of talent over the medium and long term. But that is not all, a country's labor rates need to be weighed against the skills, productivity and education levels of its workforce, the transportation and telecommunications infrastructure of its cities, and the receptivity and stability of its government, all of which influence relative competitiveness.

5.3.2 Implication 2: Erase organizational boundaries

Work is now increasingly mobile, and management rules and practices are mutating. No longer does the employee move to the jobs; the job moves to him in Bangalore or Beijing or Budapest. Manager have to adapt their practices and beliefs to work effectively with employees who may be 10 time zones away, rather than expecting employees to adapt themselves to a far-away manager's style or the organization's long-standing culture.

Firms need to adopt new management processes and organizational structures to incorporate effectively a larger offshore presence and an increasingly multinational workforce. Objectives such as collaboration between disparate workforces, efficient information flows, properly delegated decision rights, and appropriate incentives will rise in importance as significant organizations are built offshore. Management and organizational practices will necessarily need to adapt to address these priorities.

5.3.3 Implication 3: promote policies that cultivate innovation

Developing nation like Vietnam should continue to evolve and business climate and infrastructure that is more and more attractive to companies that are at the forefront of executing global innovation strategies. The country should retain its

labor cost advantage for the foreseeable future. Moreover, educating numbers of scientists and technologists is essential, spawning the next wave of competent, capable, and hungry young engineers, software developers, innovators, and managers.

Innovation demands not only a trained corps of scientists and engineers to fuel the enterprise but a literate and numerate group to run it. The government role is to provide facts and analysis, not issue-specific policy prescriptions, but it is clear that government needs to partner with business in creating the conditions for future economic success. That means improving the overall standard of education (particularly in science and math), encouraging and supporting the pursuit of higher education, establishing incentives for innovation, and revisiting immigration policies that have made it increasingly difficult for foreign-born engineers to study and contribute to countries with advanced economies.

5.4 Recommendations

Differentiating from China will be a critical success factor for Vietnamese companies. So far, China has not been taken as a major competitor for service offshoring works. In addition, Vietnam also needs to keep up with China in investment into infrastructure, English language and Internet connections.

Vietnam needs to expand its qualified talent pool in the coming period by making college education accessible to more people, especially high-school graduates. A larger pool will help to alleviate bidding up cost of labor by competing offshoring and domestic demand, while keeping a critical mass to make the country attractive.

Vietnam needs to create a good environment for and encourage the development of offshoring agents, especially ones led by Vietnamese overseas due to their

connections and understanding of both sides. The government should step back from the agent role and focus more on environmental development issues, where spillover is critical.

For companies, developing and retaining talents are as important as keeping a low cost to be successful in the long run. Software businesses should form regional associations to make better use of the Government's trade promotion support programs, particularly trademark development programs.

6. Conclusion

The thesis “Outsourcing in the Vietnamese environment” has basically achieved its main goals. Main goals of the thesis can be once reminded as describing the process of outsourcing, helping the sides of the outsourcing activity – the outsourcer and the partner – understand what should be outsourced, how to outsource and what factors affect the decision to outsource. Furthermore, the thesis aims at helping businesses in Vietnam have a better look on the current outsourcing situation and recognize the strengths and opportunities as well as be aware of threats and weaknesses from such situation.

In general, the thesis is seen to be successful through the research particularly after the research questions have been raised and answered based on the facts, figures and interviewed results. Resulted from study, some recommendations have also been given to Vietnamese businesses and government so as to improve outsourcing activities in Vietnam and make outsourcing deals more effective.

In sum, Vietnam should put an eye on investing into infrastructure, improve educational system making accessible to many people, create good environment for and encourage the development of offshoring agents, especially ones led by Vietnamese overseas due to their connections and understanding of both sides. Software businesses should form regional associations to make better use of the Government's trade promotion support programs, particularly trademark development programs.

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