

The Good Aspects Of Managing An Organization With An Outsourcing And Subcontracting Strategy


Thongphon Promsaka Na Sakolnakorn, Prince of Songkla University, Thailand

ABSTRACT

This article aims to present the benefits of using an outsourcing and subcontracting strategy to manage an organization. In this paper, it is concluded that governments, especially in developing countries, must encourage this strategy by establishing policies to support and encourage their enterprises because this strategy can boost the economic growth of the organization, region, and country. In addition, the knowledge transfer from large organizations to SMEs can help SMEs to develop a better organization.

Keywords: organization; development; outsourcing; subcontracting; management

INTRODUCTION

 rganization development (OD) is a planned, organization-wide effort to increase an organization's effectiveness and viability. OD helps an organization develop by applying knowledge of behavior science to improve organizations and prepare them to face both internal and external challenges (Schermerhorn, Hunt, & Osborn, 1991). In addition, Harvey & Brown (1992: 6) suggested that organization development is a response to change, a complex educational strategy intended to change the beliefs, attitudes, values, and the very structure of an organization – changing for the better through use of new technologies, redesign of the organization's structure, marketing, and strategies to meet challenges. Draft (1994: 65–67) suggested eight characteristics of successful organizations: 1) emphasis on working operations more than concerns about documentation; 2) concern for customer satisfaction; 3) management with team-building and a readiness to change; 4) emphasis on human capital and management with participation; 5) clear in-organization value and using this value to drive the organization to its target; 6) operations in accordance with the organization's expertise; 7) good organizational structure; and 8) flexibility.

Thus, outsourcing and subcontracting are administrative principles that are used widely by many organizations to develop and manage themselves today, and this integrated work will help the organizations to manage the business environment and the changed industries smoothly. Shi, Kunnathur, and Ragu-Nathan (2004) stated that outsourcing helps an organization adapt to the different production modes in each country because each country has a different culture, law, and political culture. For instance, the software industry in the U.S. has changed its production management to develop production capability and decrease the amount of production capital required. They have outsourced some of their work to subcontracting companies in India.

This outsourcing has become widely known over the last couple of decades in Thailand and around the world. Small and large industries in countries around the world have made outsourcing contracts with countries that are advantageous with respect to wages and production capital. If the wages in the area where an industry have settled tend to increase, that industry then will tend to engage in the outsourcing process. For instance, in India, a country known for its professionals in the software industry and information technology, companies are subcontracting with companies that receive some work from companies in the U.S. and manufacture for them. The same has occurred in China; the automobile and electronics industries have outsourced to factories in China a lot because China is advantageous over other countries with respect to wages (Graf & Mudambi, 2005).

Thus, this paper presents how outsourcing and subcontracting can positively affect an organization, especially enterprises and/or SMEs in rural areas. This paper should benefit all developing countries that are similar to Thailand in developing their organizations using an outsourcing and subcontracting strategy for economic growth in the near future.

OUTSOURCING AND SUBCONTRACTING

Outsourcing takes place when organizations moved jobs in fields such as accounting to other organizations that are experts. Magnezi, Dankner, Kedem, & Reuveni (2005) stated that outsourcing is the process of moving some activities to other organizations to achieve effective production. There are a number of examples of outsourcing and subcontracting. Khamanarong (2000) described the outsourcing process in the Northeastern region of Thailand, stating that outsourcing in the area is a process through which medium-sized or large industries outsource some work to subcontractors who are local villagers. They usually are hired by urban industries. Outsourcing has been done through contracting with subcontractors. The outsourcer provides technology and skills to the subcontractors in the village. When the villagers have finished the training, the outsourcer provides raw materials or tools of production to the village to produce goods. When the village industry has finished the contracted work, the work is returned to the main production line for assembly.

Another example is garment manufacturing, such as the example brand A, which has a factory located in the Samut Prakarn province in the central region of Thailand and outsources some parts of the production of shirts and pants to community enterprises in the Ban-Phai district (Khon Kaen province) as subcontractors sewing pockets and buttons. When local enterprises finish their work, they return it to the manufacturer in the Samut Prakarn province. Then, the manufacturer completes production of the final product. The outsourcing process not only reduces production costs but also increases the value to the business. Moreover, outsourcing also provides the advantage of fast production, resulting in a positive effect with respect to the objectives of the organization's practices.

Subcontracting means that an enterprise has received work from employers outside of the local community to produce tools, equipment, or industrial goods for them. For instance, a community enterprise in the Ban-Phai district (Khon Kaen province) receives the work of sewing shirts and pants from the employer (outsourcer) brand Tangmothai in the Samut Prakarn province. Likewise, some village enterprises in the Ban Phai district (Khon Kaen province) produce T-shirts under a contract with the Tangmothai Garment Company Limited in Samut Prakarn under the Tangmothai brand. Outsourcing and subcontracting is illustrated in Figure 1.

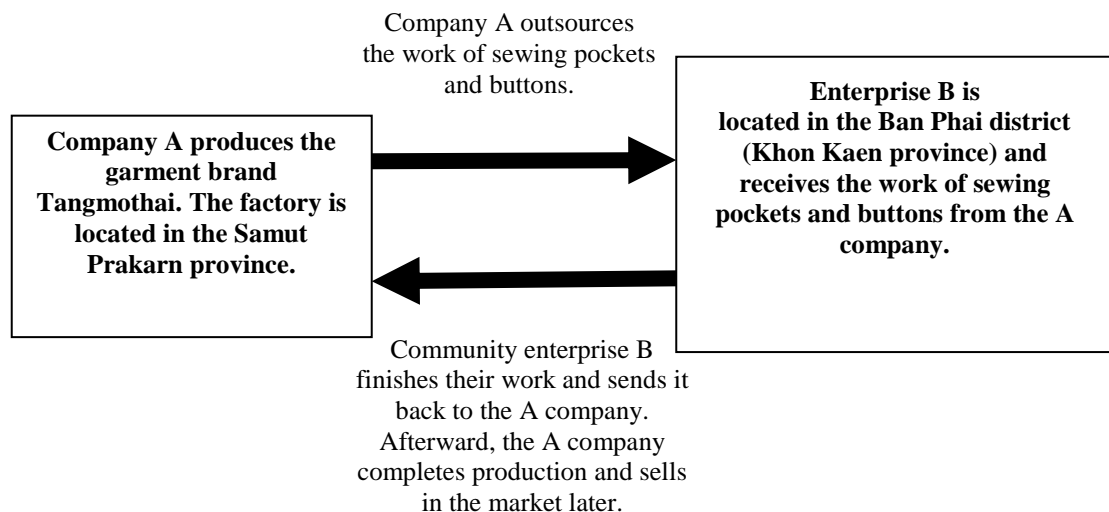


Figure 1: The Outsourcing and Subcontracting Process

A CASE STUDY OF OUTSOURCING AND SUBCONTRACTING

In-depth interviews were performed in industries involved in outsourcing and subcontracting in many cases between 2008 and 2010 in Northeast Thailand. However, in this article, only a few case studies are provided for an overall understanding.

First, it is apparent that outsourcing may involve quite complex chains of subcontracting. Several people interviewed were, themselves, subcontractors supplying larger enterprises in, say, Bangkok or China. They then used outsourcing to shift some elements of their production to subcontractors in villages. It was not uncommon for this level of subcontractor to also use outsourcing arrangements locally to help meet spikes in demand or gain access to particular skills.

Second, there was a noticeable diversity in scale, even within this small sample. Two of the cases, in footwear manufacturing and fishing net-making, were large enterprises with 2000 employees of their own, but they used an equal number of workers in outsourcing arrangements. On the other hand, outsourcing was also used by very small enterprises based in villages; in one case, a business involved in footwear subcontracts used only family labor directly but drew in 30 others from the village through outsourcing.

Outsourcing is also apparent in a range of activities. In garment manufacturing, it is evident in perhaps predictable ways, with villagers working at piece rates to assemble garments for medium-sized or large companies, sometimes as part of a chain that links to global brands and markets. These are the sort of arrangements that might be expected to be more mobile, seeking out ever more low-cost locations in archetypical forms of globalization. However, outsourcing was also found in established local industries, such as gem-cutting, fishing net-making, or traditional handicrafts, where local skills and reputations have evolved over a long period of time and where locality is much more important to the overall enterprise complex.

Finally, even from this limited number of interviews, we can discern an emerging global web of industry relationships. It is not simply a Thailand-centered process, with large Bangkok-based firms seeking provincial subcontractors to supply them with labor-intensive components, though this is in evidence in some cases. Outsourcing firms in Northeast Thailand, rather, are linked to larger companies in China (as in garment manufacturing) and to multinational companies and brands whose footwear is made in the region. Furthermore, Northeast Thailand firms, themselves, are extending their subcontracting relationships across borders, to Laos and Vietnam, to take advantage of large reservoirs of labor.

WHY ENTERPRISES PREFER TO ENGAGE IN OUTSOURCING

Enterprises prefer to engage in outsourcing for the following reasons:

1. They want to reduce production costs. For example, if enterprises employ permanent laborers, they will have a lot of employment costs, such as wages per day and health insurance, but if enterprises outsource to outside enterprises or subcontractors, they will pay only for finished goods, and if some of the goods are not of sufficiently high quality, enterprises can refuse to pay.
2. When factories receive a large number of orders from customers, they often outsource to increase the number of products made without expanding their facilities or buying more machines. Swenson (2004) explained that new production requires substantial investments, which small enterprises can rarely make. Thus, they will look for new business partners to produce for them or reduce their cost of investment.
3. Factories will outsource a part of production that is a waste of time to them. In such cases, engaging in this production themselves would not even allow them to break even. Through outsourcing, such enterprises can focus on what they do best.
4. According to Noorbakhsh & Poloni (2001), enterprises often outsource work if they have access to a large pool of skilled workers with the capacity for production.

5. Enterprises will outsource when they do not have access to a large pool of permanent workers. Laborers in Northeast Thailand leave factories when it is time to grow crops, such as rice and corn. Consequently, factories in Northeast Thailand have a high turnover rate during the growing season. To solve this problem, factories will outsource some part of their production to ex-laborers who have resigned to work on their farm. These laborers can then do work for the factories anytime they are free from farm work, such as during the afternoon and night.

When deciding whether to subcontract, the following issues must be considered:

1. People should manufacture products that they are good at making, and they should expand their business but with less investment, such as by subcontracting with a company that will provide raw materials, tools, and training.
2. They should engage in production in their free time after finishing their main jobs, such as agriculture, so that they can use their production capacity and time to earn more income.
3. They have to consider what jobs they can do with less capital than the employer (the factory) requires. Take, for instance, a factory that produces shirts with seven buttons. It pays an employee 180THB daily, and the employee can produce 40 shirts per day. Thus, the capital required for an employee hired by the factory is 4.5 THB per shirt (excluding compensation such as social security). However, if a subcontractor can produce such that the capital per shirt is 2 THB, the capital required for a subcontractor is 80 THB/40 shirts, and there is no compensation cost for the outsourcer because the subcontractor is classified as an informal worker. Consequently, if the subcontractor can produce goods at lower prices than an employee, he or she has a greater chance of getting a job from the outsourcer.

WHY BECOME A SUBCONTRACTOR?

The researcher found that community enterprises or villages earn more income in their free time working as subcontractors after their agricultural activities are complete (most people in Northeast Thailand have to work on their own farms during the rainy season). This work causes growth in the local economy and has a positive effect on quality of life. People who can work as both farmers and subcontractors will have more money to pay for necessities, such as motorcycles, TVs, washing machines, house repairs, house additions, food, and agricultural investment.

In addition, subcontracting can increase family closeness, as most heads of household (fathers) in Northeast Thailand will move to big cities (such as Bangkok and the surrounding area) to find work. This means that they must be away from their homes and families to make money to support their families. However, if they become subcontractors and work both to grow crops and to produce goods for factories, their income will increase, and they need not leave home. Thus, fathers can help to care for their children, help their wives with the housework, and assist in caring for older family members.

BENEFIT FOR ECONOMIC AND SOCIAL DEVELOPMENT

Outsourcing and subcontracting can benefit a region's economy and society. If SMEs use an outsourcing and subcontracting strategy, they can help secure business as they will get production orders from large enterprises (Outsourcer). Fleisher & Chen (1997) stated that outsourcing and subcontracting can boost both agriculture and industry in rural areas and, therefore, residents' ability to survive and even thrive. This management strategy can boost a rural region's economy because residents can engage in both agricultural and industrial work. In fact, Promsaka Na Sakolnakorn et al. (2009) stated that the revenue/income of entrepreneurs or villagers, especially in rural areas and, thus, their contribution to the region's economy, increases mostly through the strategy of becoming subcontractors. For instance, farmers spend their free time in the afternoons or at night doing piece work for factories (e.g., sewing pockets and/or buttons onto shirts). They are paid for each product finished; for example, they may be paid 2 THB per shirt. Consequently, outsourcing and subcontracting in community enterprises can facilitate social and economic development:

1. With respect to economic development, becoming a subcontractor to manufacture products for a large enterprise provides villagers with a second job, allowing them to earn income at home beyond that which they derive from farming. Local companies also derive greater revenue from taking orders from larger companies, which leads to sustainable community enterprise. In a study of outsourcing and area development, Promsaka Na Sakolnakorn et al. (2010) found that large and medium-sized industries' outsourcing production to community enterprises in rural areas aids in the development of those regions' economies, as farmers who have part-time jobs working for factories have more money to buy TVs, vehicles (motorcycles and cars), clothes, and all other necessities of life. Thus, everyone in the supply chain benefits from outsourcing and subcontracting.
2. With respect to social development, since villagers who engage in both farming and subcontracting have more income, they need not leave home to find work (e.g., traveling to big cities). This leads to stronger family relationships. Parents can work at home and raise their children or care for their elders at the same time. Their improved economic status then allows the villagers to have a better quality of life.

HOW ORGANIZATION BENEFIT FROM AN OUTSOURCING AND SUBCONTRACTING STRATEGY

This strategy can be used to develop an organization, such as by allowing SMEs in rural areas and/or community enterprises to work as subcontractors. Community entrepreneurs also launch enterprises to assist in manufacturing products (e.g., sewing pockets). They may increase their production line by agreeing to manufacture shirts for medium-sized or large companies, thereby increasing their revenue and providing stronger employment in the community. Promsaka Na Sakolnakorn et al. (2008) found that entrepreneurs give priority to capital in deciding whether to outsource or subcontract. Outsourcing is good for an industrial entrepreneur who wants to reduce production costs. Moreover, villagers, particularly farmers, also have a chance to earn larger incomes by working as subcontractors to produce goods for factories in their free time. If a village is not far from an outsourcing factory, outsourcing will be more advantageous to both the village and the factory. The factory will be able to increase its production without expanding its facility. This allows it to avoid risky investments. At the same time, villagers have a chance to increase their income and accumulate savings to invest in their agricultural activities. In addition, outsourcing and subcontracting increase villagers' buying power, which encourages the expansion of local industry.

In addition, if enterprises work as subcontractors under contract with large enterprises, they will have their own products and goods, giving them good security and allowing them to avoid worrying about marketing management. In addition, most outsourcers that want to use an outsourcing strategy will offer training to the subcontractors, giving subcontractors the opportunity to learn from large enterprise, leading to knowledge transfer from large enterprises to them, which can encourage small enterprises to use the knowledge they gain to develop their organizations through, for example, learning how to make high-quality production, how to manage the organization, what quality control is, and maybe even how to manage the marketing of their goods and engage in marketing themselves. Knowledge is a necessary and sustainable source of competitive advantage. Knowledge allows the organization to solve problems and seize opportunities (Earl & Scott, 1999; Zack, 1999). Organizations that manage knowledge can evaluate core processes, capture insights about what they find, combine their skills and experiences, innovate, and apply new ideas quickly.

Promsaka Na Sakolnakorn et al. (2008) found that industries lack skilled employees because most factory employees in northeast Thailand also work on their own farms. Another problem is the rural culture of Thailand. During festival periods, many rural workers take extended vacations that interfere with factory production and deadlines. For example, the Song-kran festival is the traditional Thai New Year, which starts on April 13 and lasts for three days. Vacation times and personal days off can disrupt a factory's ability to generate revenue. Furthermore, religious ceremonies, such as weddings and funerals, can also interfere with production, making it difficult for a company to survive. If enterprises use an outsourcing and subcontracting strategy during the agriculture season, it will encourage them to still take orders from customers when laborers leave to work on farms while outsourcing some part of production to their former workers at home, and the workers can work for the factory when their farm work is finished.

In terms of financial security, large organizations that use an outsourcing strategy will not have to invest much money to explain their production line or buy new machinery. In the same way, a rural enterprise that becomes a subcontractor and works both on a farm and for the factory (outsourcer) will have more income. Moreover, this strategy gives security to organizations with respect to labor management; enterprises that adopt an outsourcing strategy can reduce the cost of buildings for the use of employees. Labor law requires employers to pay high wages and provide housing and medical care. However, with this outsourcing system, employers need not do so. This strategy also benefits villagers who work as subcontractors, allowing them to continue working agricultural jobs while also working for factories when they are free from farm work. In addition, subcontractors can reduce their costs of living because they do not have to pay for transportation, allowing them to earn more income and improve their quality of life.

DISCUSSION AND CONCLUSION

Most small and medium-sized enterprises in Northeast Thailand gain sustainability by engaging in subcontracting. They produce their own branded products while also working as subcontractors for larger enterprises to increase their revenue (Promsaka Na Sakolnakorn et al, 2010). By outsourcing to subcontractors who are local entrepreneurs or single workers, large enterprises encourages economic growth where the subcontracting jobs are offered. Local enterprises increase their revenue, and villagers earn more income. Moreover, outsourcing and subcontracting reduce the villagers' rate of migration from rural to urban areas to find jobs. This allows for closer-knit families and stronger communities. Thus, outsourcing and subcontracting allow families to live together. Working-age villagers do not have to move to big cities to find jobs; they can work at home and take care of their children or parents at the same time.

Therefore, industry outsourcing and subcontracting is one strategy for the administration and use as an intervention tool for organizational development in all aspects such as marketing, HRM, quality control, production planning, and so on. In addition, outsourcing and subcontracting strategies are related to raising sustainable economic and social development in rural areas. The government should seek out ways that such a policy can support village enterprises and encourage farmers to become subcontractors. Moreover, government should engage in continuous training and transfer of knowledge. By doing so, the government could help to solve many social problems such as poverty.

AUTHOR INFORMATION

Dr. Thongphon Promsaka Na Sakolnakorn is a lecturer at the Prince of Songkla University, Thailand. He received his first Ph.D. in development science from Khon Kaen University, Thailand, and his second doctoral degree in Ancient Indian and Asian studies from Magadh University, India. He specializes in outsourcing management, organization development, and SME management. His contact e-mail is: deaw_t@hotmail.com, thongphon.p@psu.ac.th.

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