BUSINESS RESOURCE PLANNING MODEL – A FRAMEWORK FOR THE OPTIMAL SOURCING DECISION

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Abstract:

Outsourcing can offer numerous benefits including increased corporate flexibility, the ability to focus on core business and as a result build sustainable competitive advantages. To harness the benefits of outsourcing to its fullest potential and avoid common errors and failures it is of a vital importance to follow a strategic planning and decision-making process involving careful analysis of a wide range of internal and external factors, which results in a proper sourcing decision. For that purpose the authors have developed a business resource-planning model (BRP) - a comprehensive sourcing framework and analytical tool for sourcing analysis and implementation.

The proposed model integrates the key elements of the sourcing decision-making process consisting of the value chain perspective, core competency appraisal and the impact of the company's supply base. To meet the successful sourcing decision it is an imperative to analyze the process from the activity perspective within the company's value chain. Looking from a value chain perspective it is possible to recognize the activities that add value to the company and in that manner fortify the company's competitive position. In order to adapt to the shifting basis of competition it is in a company's interest to engage in the process of strategic flexibility and adaptability based on the value chain reengineering.

The Business Resource Planning model (BRP) is a generic model that commences with the analysis of the company's business including the analysis of the market the company is in. It is worth noting that this phase determines the criteria upon which a sourcing decision for the non-core activities is made. The derivation of the initial stage is the value-chain activity benchmarking that implies the analysis of the company's core competencies vs. the wide spectrum of external sources. To maintain the long-term competitive advantage it is of major importance to reorganize the company's value chain and focus on core activities. Core activity is benchmarked against the capabilities of all potential providers of that activity but they need not necessarily come from the same industry. Benchmarking enables a company to look beyond the basic product line and focus on management and operating skills. Core activities C/B analysis as the following stage measures all costs involved in the sourcing decision be it outsourcing or keeping in-house confronting them with the outsourcing benefits.

Vendor analysis should supplement the decision-making process to reach the final choice on the sourcing strategy. The results of the model implementation can vary between outsourcing or further internal investment in the company's processes and activities. When outsourcing is the selected strategic decision arrangement with vendors can vary from shared services to partnerships. The model involves the philosophy of strategic flexibility and adaptability in order to monitor trends, identify the drivers of change, develop possible scenarios, assess current business arrangements and create strategy alternatives.

Key words: *outsourcing, core competency, value chain analysis, flexibility*

INTRODUCTION

A company's resources represent its strengths and weaknesses. In the sourcing decision making process companies engage in outsourcing relationships. Sourcing policy should be integrated in a company's overall strategy and provide guidelines for its implementation. Sourcing decision-making addresses the dilemma: to invest and perform internally or to outsource. Outsourcing is a powerful, strategic business tool and the outsourcing contracts have grown ever more important and complex through the last decade. It provides certain leverage that can have many dimensions: economies of scale, process expertise, access to capital, superior technology and best practice etc. Some surveys indicate that a third of all outsourcing contracts are set for seven years or more, and more than 25% of then amount for 100 million US$. When executed using a thorough strategic perspective, considering the long run competitiveness of the organization, and basis of competition, outsourcing arrangements can have major impact on a company's profitability, contributing to the financial stability. However, many companies are neither implementing any methodological approach in the sourcing decision-making process nor do they have any firm basis for evaluating the "make or buy decision". Even though companies may find numerous benefits to outsource activities or functions, it is of major importance to develop and follow guidelines that lead to a proper outsourcing decision or in other words make outsourcing a strategic decision. Outsourcing arrangements must be carefully planned and executed in order to avoid many potential traps.

The aim of the paper is to provide a business resource-planning model offering a strategic perspective to the sourcing decision making process and providing guidance in the "make or buy dilemma". The strategic approach makes a sourcing strategy an integrated part of the overall strategy. The suggested model attempts to reveal problems associated with the sourcing decision by integrating several approaches to outsourcing, including a core competency approach, basis of competition, value chain and supply base approach.

The generic model consisting of several sequential stages and accompanied by the theoretical discussion focuses on key problems encountered by companies in their effort to formulate an effective sourcing decision. The model is specially suited for companies, which have inherited certain sourcing decisions from the past resulting in an unbalanced combination of vertical and horizontal integration. If previous sourcing decisions have been made in a series of short-term decisions with no consideration for the long-term strategic direction for the company, the management can follow the stages suggested by the model and discover the sourcing drawbacks. The model can help a company create a more balanced combination of vertical and horizontal integration contributing to the competitive cutting edge.

However, concerning its generic character, the model is not a panacea for all situations and issues emerging in the quest for an effective sourcing decision.

BUSINESS SOURCING CONTEXT

The conceptual foundation for outsourcing was created in 1975 by O.E. Williamson (1975) and his transaction cost analysis theory. Williamson's theory combines management and economic theory to determine the best sort of relationships a company should develop in its environment and represents the foundation for determining the optimal internal and external boundaries of a company.

The emerging transaction difficulties and costs are emphasized when transactions are characterized by (Williamson, 1985): 1. Assets specificity: assets that require high investments that are specific to the requirements of particular exchange relationships; 2. Uncertainty: ambiguity about transaction definition and performance; 3. Infrequency: transactions, which are seldom undertaken. According to the transaction cost analysis low transaction frequency and high asset specificity and uncertainty will lead to the vertical integration inside the company. In the case of frequent transactions and low asset specificity and uncertainty, the best governance form will be by the market. Medium level of transaction frequency and asset specificity will lead to cooperative relationships varying from subcontracting to strategic alliances. The sourcing decision of the two extremes involving asset specificity, uncertainty and transaction frequency can take the form ranging from vertical integration to outsourcing.

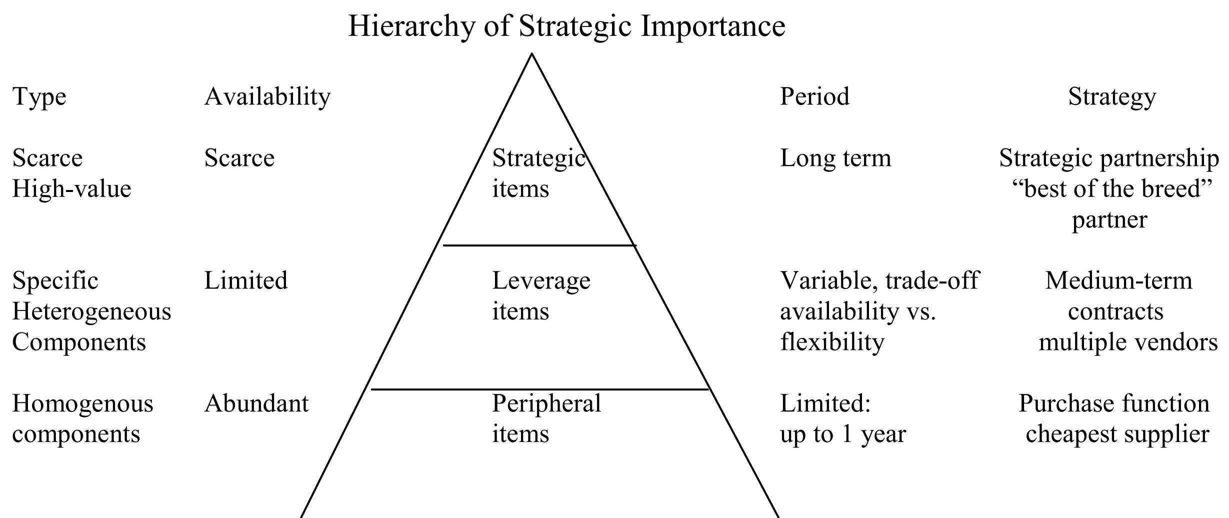
Companies face market demand for quality products at low cost delivered quickly. Competition and technology are shortening product life cycles. In the last decade, a high-tech product had a life cycle of about two years. In 2002 the average was between 5 to 10 months (Yallof, Morgan, 2003). For a company to be able to compete efficiently and gain market share it is crucial to develop and produce products quickly and in sufficient volumes to ensure profitability. Any lags will rapidly erode profits due to imitation from low-cost competitors. To be able to compete in today's market, companies need to develop business models that are flexible enough to take advantages of productivity improvements doe to rapid advances in technology.

Outsourcing an activity ad-hoc can also serve as a magical remedy for getting rid of a problematic activity or a way to a cheaper product, but it does nothing to create system integrated knowledge and skills that are vital for sustaining product/market leadership in the future.

Many companies invest heavily in non-core activities but neglect the activities that if managed properly can become sources of competitive advantage. The reason behind this is that companies do not know the clear distinction between core and peripheral activities.

Distinction between core and peripheral activities is crucial in order to match purchasing strategy with the purchased activity. Not taking into account such an approach while making sourcing decisions can result in neglecting core and overemphasizing peripheral. Basic distinctions between core and peripheral elements of the value chain are given in figure 1:

Figure 1. Hierarchy of Strategic Importance



Source: Venkatesan (1992)

Venkatesan (1992) introduces the concept of linking product differentiation, analysis of component families and manufacturing capability as a way of deciding which activities should be carried out internally and which externally.

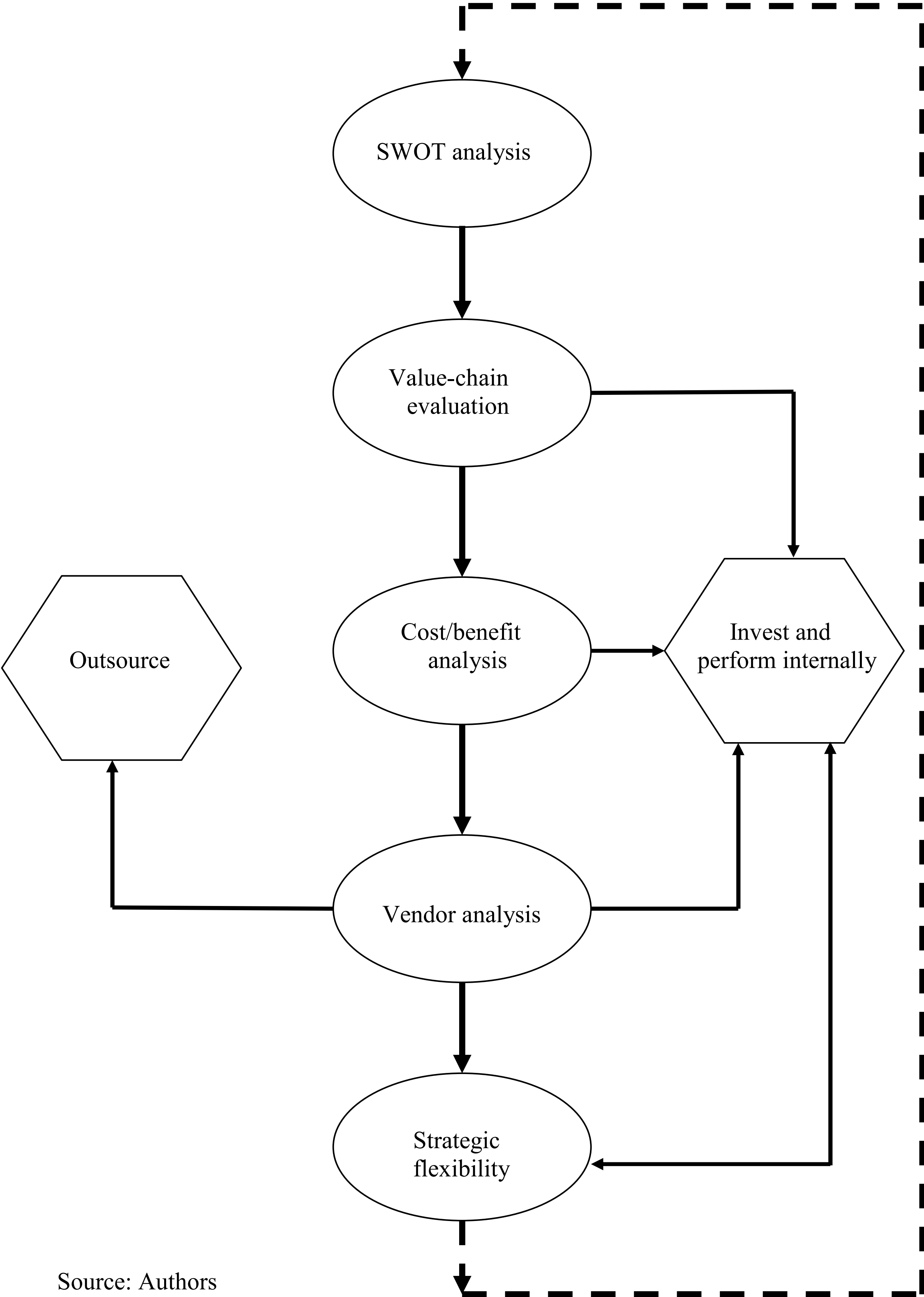
Probert (1996) tested his four-stage sourcing model on six manufacturing companies in the US, which reported positive business results in terms of 20 to 40% increase in return on assets and 30 to 60% stock/lead-time reduction.

McIvor *et al.*(1997) describe a generic make-or-buy model without clearly stating the way that cost analysis should be included in the decision making process. Their model laid the basis for the development of our model, but lacks the flexibility and progressiveness needed to take advantage of future market trends.

Reviewing the literature, we found a lack of a generic model integrating strategic sourcing decision-making process with the strategic flexibility. Business resource planning (BRP) model tries to overcome these shortcomings.

BUSINESS RESOURCE PLANNING (BRP) MODEL

In the figure 2 key elements of the BRP model are presented:



Source: Authors

SWOT ANALYSIS

Every company should periodically evaluate its strategy and examine the bottom line of the current strategic and financial performance. The most useful indicators in that process include the assessment of the firm's market share trends, profit margin figures, trends in net profits and return on investment, sales figures and assessment of the competitive advantage and competitive position. The company's overall performance scanning and examination can drive the need for strategy changes.

An audit of internal strengths and weaknesses can be viewed as an essential prelude to the strategy formulation as well as the strategy evaluation. To achieve a more accurate and quick overview of a company's strategic position, it is beneficial to engage in the SWOT analysis on regular basis (Thompson, 1992). A company's internal strengths represent competitive assets, its internal weaknesses competitive liabilities. A company should create a strategy that would enhance assets and outweigh liabilities by a significant margin. Strength can be a skill, competence, valuable organizational resource or competitive capability that gives the company a competitive advantage. A weakness is something a company lacks or does poorly. It should be noted that some strengths are more important that the others because they are more important for the performance quality of the strategy. Company's strengths are cornerstones of a strategy and basis on which to build competitive advantage. A company should build its strategy where it has a proven ability to enhance its competitiveness. It is easier to build competitive advantage when a company has a core competency in an area important to market success, and when it is costly for rivals to copy such a competence.

Opportunities and threats of the environment also point to the need for a strategic change. A strategy should be aimed at pursuing opportunities well suited for the company's capabilities and provide a defense against external threats. However, different opinions appear on what the corporate strengths and weaknesses *i.e.* company's competencies are. An empirical study conducted by Howard Stebenson (1976) found very little consensus on the company's strengths among managers: higher level managers tend to be more optimistic about the company's capabilities than lower level managers.

One of the most important features is a company's cost position relative to competitors. Even in industries where competition is based on factors other than price, companies have to keep costs in line with their rivals. Differences in costs stem from the differences paid for raw materials, energy or other items, differences in technology and plants, differences in operating costs due to the economies of scale, learning and experience curve effects, different wage rates, different administrative costs, differences in marketing costs, sales and promotion expenditures, transportation costs and the like. Costs of every company in an industry do not have to be equal, especially if products are differentiated, but higher costs as a rule make the market position vulnerable. Strategic cost analysis involves comparing a company's cost position relative to key competitors, activity by activity, from raw materials purchase to the price paid by ultimate customers. This activity reveals the background of the firm's cost competitiveness and indicates which cost components have a striking importance. Such information is vital in crafting strategies to eliminate cost disadvantage and create a cost advantage. This is the basic idea behind the business resource planning decision-making process. After a company finishes this step of the model it can proceed to the next one of the value chain evaluation. No decision about sourcing should be made at this point in time, because even if a company now knows its strengths and weaknesses, the position and importance of a particular activity in the company's value chain is still unclear.

VALUE CHAIN EVALUATION

Resources make the basis of a company's competency to execute a strategy. Authors use numerous terms do refer to such resources: strengths, skills, competencies, capabilities, and intangible assets. In literature the outsourcing framework is often discussed with the connection to the "core competency" concept. Kenneth Andrews uses the term "distinctive competence" to define not just what an organization does, but what it does particularly well (Andrews, 1980). The idea of the core competencies concept in companies derived from the work of C. K. Prahalad and Gary Hamel (1990). They introduced the term "core competence" as an integrated bundle of skills and technologies; "a messy accumulation of learning" which contributes to a company's competitive success. In their opinion core competencies are not physical assets or technologies. No matter how innovative physical assets may seem in the present circumstances they can very easily be replicated by the competition or become obsolete. Competencies are therefore skills, knowledge and technologies that a company possesses and on which its success is dependable. Prahalad and Hammel argue that the real source of sustainable competitive advantages is the management's ability to consolidate the company's technologies and production skills into competencies that allow frequent and rapid adjustment to changing business opportunities. Core competencies underpin the ability of a company to outperform the competition and therefore must be kept under control, nurtured and developed.

Lonsdale and Cox (1997) found that some companies identify their core competencies as things they do best. This can lead to wrong decisions because companies may end up outsourcing activities they have problems with measured by poor performance. At the same time, such activities can have a significant value adding potential in the value chain currently and in the future, contributing to the company's competitive advantage. Maintaining control of the critical skills within the company will enable the company to sustain its competitive advantage in the determined product market.

Core competence thinking has become a synonym for "focus". Successful companies concentrate their energy and resources on a limited number of activities they view as the core, that they can perform especially well, or have the competence for. This view can be limiting. If a company's core competence is a source of competitive advantage, it must contribute to the company's ability to deliver improvements that relate to the current basis of competition in an industry. There is no point in concentrating and developing a set of activities that result in a product that customers do not value or want to pay for. Distinguishing between core and non-core activities can prove difficult, but care must be taken to ensure the long-term strategic implications and benefits are considered. Top managers, along with the participations of lower level team members, should carry out this process. A key issue in the sourcing decision concerning core activities is whether a company can achieve a sustainable competitive advantage by performing a core activity internally on an ongoing basis (McIvor, 2000). If a company can perform an activity uniquely well, this activity should continue to be carried out internally.

The core competence concept is therefore a crucial rational behind the strategic positioning of a company. When creating business strategy, it far more important to think in terms of core competencies instead of developing strategies based on dominating market conditions. The driving force behind the outsourcing decision is the ability to focus on core competencies, while performing more efficiently, more effectively, and with reduced costs through external supply. With prudent outsourcing strategy and by leveraging the outsourcer's core abilities,

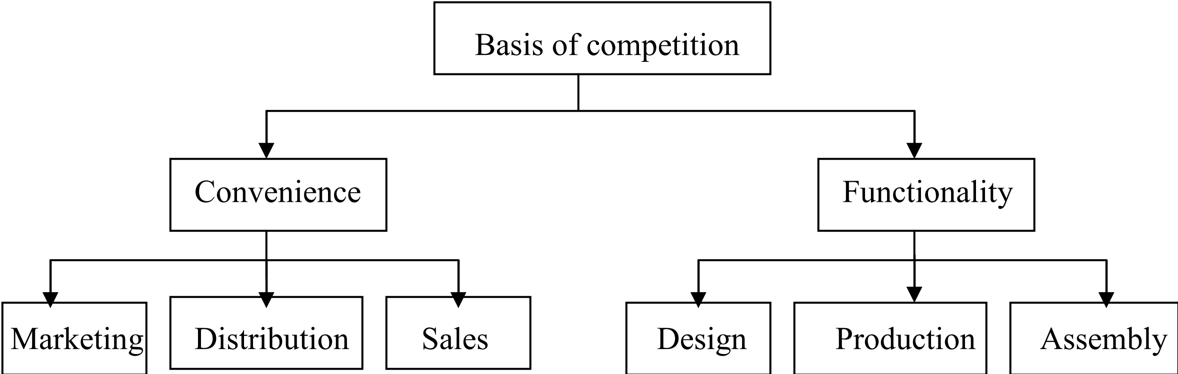
the buyer can enter new markets, improve its operational effectiveness and gain access to top-level professionals, state of art technology and industry's best practices without further investments or exposure to more risk than necessary.

To maintain the long-term competitive advantage it is of major importance to reconfigure the company's value chain and focus on core activities. This approach can be misleading. A company can end up basing the sourcing decision on what it thinks it is good at instead of what it should be good at. To determine its core activity, a company should start by identifying its competitive requirements defined by the market the company is in. Identifying competitive requirements of the market starts with identifying the basis of competition of the market. The performance of a company's products or services is multidimensional and is valued and measured in a number of ways. Markets generally value only one or two dimensions of a product above all others. The dimensions of performance that customers value the most and are prepared to pay for form the basis of competition of a given market.

To be successful in using the basis of competition to its own advantage and continuously improving its performance, a company must control the elements in the value chain that drive the improvements. Performance improvement means interlocking the identified elements and creating interdependencies between them, which finally results in a synergy of elements and makes it very hard to copy for competitors. The interdependent elements and the support functions of the company's value chain must be kept in house where the company can harvest all the benefits.

Figure 3 illustrates an example of interdependence between basis of competition in a particular market and parts of the company's value chain.

Figure 3: Basis of competition – a value chain perspective



Source: Anon (2002)

Different dimensions of performance are driven by different elements and interactions between them within the value chain. When convenience is the basis of competition in an industry, integration across marketing, distribution and sales is required. When functionality is the basis of competition in an industry, integration across design, production and assembly is required.

To be a source of competitive advantage, a company's core competence must contribute to the company's ability to produce improvements that are in line with the market's present basis of competition. Companies do not posses a competitive advantage if they continuously deliver

improvements nobody is willing to pay for. In order to fortify and maintain competitive advantages, a company must adopt new skills and competencies required by customers.

The basis of competition changes over time. Companies compete to provide improvements for customers they value and are willing to pay for. In the end, companies may even exceed the requirements of consumers. As a result, customers are no longer willing to pay for improvements along that particular dimension of a product or service. As demand changes, some other dimension or characteristic becomes important in which improvements are desirable, but until now had been marginalized by the drive for enhancements in the now former basis of competition. In order to be in the position to follow the source of a shifting basis of competition a company should constantly engage in the continuous course of strategic flexibility and adaptability based on the value chain reengineering. This can sometimes mean bringing back in-house processes and/or activities that have formally been outsourced.

If a particular function or activity is not part of a company's core competence, it does not mean it should automatically be outsourced. Vice versa, just because an activity is at present company's core competency it does not mean it should be kept in-house forever. As the basis of competition shifts, so should the companies and their core competencies. The risks and challenges of learning and acquiring new knowledge and capabilities are difficult and often seem impossible, but the alternative is competitive insignificance.

Positioning the company for future success means taking into account in which direction and how fast will the basis of competition in the particular market change, because it inevitably will. It is this need to respond to constant and rapid changes that makes the sourcing process so complex and demands a strategic planning approach as well as a well-defined framework.

In the sourcing decision-making process it is an imperative to assess the process from the activity perspective within the company's value chain. Looking from the value chain perspective it is simpler to recognize the activities that add value to the company and in that manner fortify the company's competitive position. For example, if a manufacturing company considers the outsourcing option it is important to analyze all support activities such as logistics and research and development associated with the main processes in the company besides the main manufacturing process activities.

When approached from the strategic and dynamic point of view sourcing decision-making process can serve as means for reengineering the firm's value chain, allowing efficient competition in the present but also maintaining market dominance in the future.

If an activity is truly a company's core competency and it performs it at least equally good as "best of the breed" vendors, such an activity should be kept and performed in-house. Alternatively, it becomes a good candidate for outsourcing to vendors that are more competent and more cost effective. However, it is possible to outsource crucial activities such as production or assembly that comprise the core activity and still gain competitive advantage. This can be achieved if the company acts as a system integrator coordinating vendors' activities, specifying and integrating external inputs rather than performing the actual production.

Many global companies concentrate on pre-production (research and development) and post-production activities (marketing, distribution, sales, servicing), while outsourcing the remaining components of the value chain. Using the value chain approach allows the

company to look beyond products and functions to specific activities, operating and management skills responsible for the company's current performance.

A company considering business process outsourcing should start with a benchmarking procedure to evaluate the best practice for a specified activity. In the internal benchmarking analysis the company monitors and analyzes its efficiency and evaluates the outsourcing option considering the value chain and value adding activities. Internal benchmarking can prove helpful in finding the best practice in each activity. The internal benchmarking analysis should focus also on the production and transaction costs (Franceshini et al. 2003). The product or service manufacturing or delivery directly generates production costs. An external vendor can reduce these costs through scale economies. Transactional costs include: the bargaining costs, related to negotiation between parties in contracting, monitoring costs, market costs related to the limited amount of suppliers and the weak contractual power of a company in renewal or renegotiations of a new contract, as well as the contractual opportunism costs, due to the general opportunistic behavior of a contractor during preliminary phases.

After the identification of basis of competition in a particular market, company's core competencies, primary and support activities in the value chain needed for its functioning, a company can make a basic distinction between activities: are they vital for a company's future success and therefore need to be kept in-house and improved, or are they a potential outsourcing candidate. In the later case analysis continues to the next stage.

COST/BENEFIT ANALYSIS

Outsourcing can evolve from a tactical, cost cutting move to a major strategic business tool. However, the decision should never be met without a thorough cost/benefit analysis of in-house activity performance versus the external supply alternative. A survey by PA Consulting Group (1996) revealed that only 5% of surveyed companies achieved expected levels of benefits from their outsourcing arrangements.

Cost calculations based on quantitative factors in many cases do not produce a clear direction neither *pro* or *contra* outsourcing. More qualitative factors such as the long-term strategic implications and the employee reaction have much greater impact on the decision. Hamel and Prahalad (1994) postulate that companies who measure competitiveness in terms of price only are inviting the erosion of their core competencies. Many companies have relinquished their core competencies by cutting internal investment in what they mistakenly thought were "cost centers" in favor of outside supply. Outsourcing also does not contribute much to the people-embodied skills needed to sustain future product and therefore market leadership.

Beside the purchase costs, complete cost analysis includes all costs associated with the procurement of goods or services through the entire supply chain. These costs include: analysis of vendors and their comparison, benchmarking of performances, setting up of a team responsible for analysis, collaboration with vendors, potential warranty claims on final product etc. Limiting oneself to cost based approach can result in choosing a strategy of neglecting and overpricing a product that is profitable, and/or investing in unprofitable complex products. Basing sourcing decisions sonly on cost basis is inappropriate due to inadequate costing systems of many companies. At this stage two groups of costs are analyzed and compared:

1) Costs of performing an activity in-house,

2) Costs associated with outsourcing of an activity.

Quality is an issue sometimes underestimated in the sourcing decision making process. In the long run outsourcing agreements can offer quality improvements achieved through the vendor's focused speciality. Companies cite the access to the best quality of services as one of the most dominant motives that leads to outsourcing. The situation when a company is lagging in technology must by all means be avoided, either by investing internally, or through external supply. Flexibility is a benefit of outsourcing for companies that face seasonal or cyclical patterns of demand representing the option to free a company's own productive capabilities. In such a situation the in-house and vendor's capacity can be combined to meet the requests of customers in critical situations. Besides the output volume the potential for improved flexibility can be manifested through the ability to change the product range in response to market conditions. Rapid information exchange, rather than ownership of the various stages of production enables companies to respond to the product's short life cycles and abrupt changes in a particular industry (Richardson, 1996).

After the completion of this step a company can assess if a particular activity really is more cost effective than previously thought, and what is a sum of all costs associated with outsourcing. At this stage, a company can decide to invest in a particular activity and keep it in-house or move to the next step of evaluating the suitability of an activity to be outsourced.

VENDOR ANALYSIS

The external supplier is selected upon an external benchmarking analysis. This analysis provides the best selection of vendors that can fulfill the company's selected objectives. Following the core competencies and the value chain approach each core activity must be benchmarked against all potential external providers of that activity. Using benchmarking will allow the company to look beyond the products to the operating and management skills that are crucial for the product manufacturing (McIvor, 2000). The benchmarking process may be time and resource consuming, but it provides detailed external information to validate the company's relative performance. The company should select the appropriate vendor based on the value chain analysis. Just as a company configures its value chain to deliver the outstanding performance desired by the customers, the vendor's value chain should be configured in the way to meet the buyers' requirements. The strategic approach to outsourcing therefore requires taking into consideration two value chains. The key to choosing the right outsourcing vendor is selecting someone with the value chain configured to deliver the performance the buyer needs.

Instantly and openly sharing information important for the product, among supply chain partners is a *conditio sine qua non* of ensuring timely delivery of needed product parts and quick reaction to product changes. Through the creation of global interlocking supply chains, companies have created a virtual "spider web" that is more flexible to any change in demand and more attune with customer's needs than any traditional vertically integrated organization could have ever been. Such wide spread "spider webs" can link the headquarters of a company on one end of the globe with suppliers on the other end, to serve the customer anywhere in the world. Traditional outsourcing focuses on clearly peripheral and non-core activities or custom made parts, but with the introduction of new telecommunication technologies companies can develop relationships with outside suppliers that allow them to outsource near to core or core activities. This is only possible if all partners are able to keep

track of real time changes in products and availability of components as well as assure their timely delivery.

To earn the potential rewards of such an organization partners must develop a tight, integrated and real time communication system, as well as build collaboration and trust between them. Technology can easily be purchased but trust and loyalty are "commodities" one needs considerable time and effort to develop and nurture.

With production costs making a large portion of a company's revenue, managing supply chain becomes critical. Inventory values decline quickly due to obsolescence. Balancing low inventory costs with quick response to customer demands implies a complete knowledge of what component of a product is being built where and when will it arrive while maintaining high quality standards. It is estimated that a company, not being able to consolidate buying orders to secure volume discounts, increases it's production costs by 5 to 20% (McIvor, Humphreys, 2000). Developing a collaborative network reduces production costs by:

- stocking orders to create volume discounts and automation of purchasing process,
- reducing time needed to achieve sufficient production volumes to start earning profits,
- rapidly reacting to changes in the market.

In the today's market, companies need to take advantages of early market opportunities, because the majority of the profit margin is generated in the early stages of product's lifecycle. By reducing time to achieve sufficient volumes to ensure profitability, companies are complemented by periods of sales with higher profit margins because of limited competition.

New, start-up companies as well as companies facing turnaround situation are faced with specific problems such as: lack of resources, incomplete and inaccurate documentation and inadequate personnel. All of these problems can hurt a company once it begins to grow quickly. At the same time, new companies are not bounded by established practices and traditional views that often lengthen the development of products. Developing a flexible supply chain with the outside providers, focusing on core activities, developing quick and flawless communication channels with providers and thinking out of the box are the rune stones of turning perceived limitations and drawbacks into competitive advantages. Using external part of a company's supply chain enables leveraging of top suppliers and partners to respond rapidly to changes in market demand as well as changes in customer's taste.

No single provider can be the best outsourcing partner in all situations. A partner should be picked based on its *modus operandi* that best suits a company's current competitive needs and that is flexible enough to adapt its value chain and facilitate the reconfiguration of a company's value chain as the basis of competition changes.

An outsourcing contract represents a vehicle by which company and vendor agree on the modus they will cooperate to deliver the contracted service. The only way an outsourcing contract can be successful in the long run is when it benefits both sides. In order to make an outsourcing arrangement mutually satisfactory, it is essential to specify every aspect of the outsourcing relationship and guide it by the contract clauses covering provisions for every imaginable contingency.

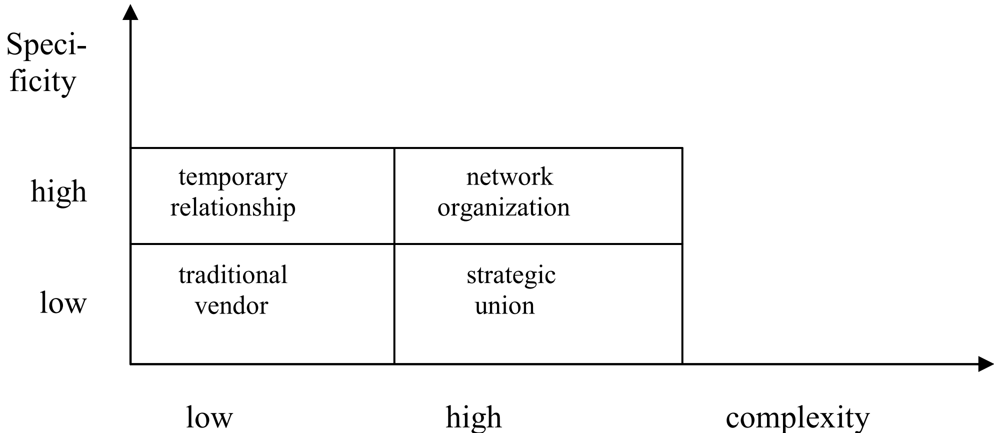
Nevertheless, flexibility should be built into obligations of both contractual parties with the full understanding of the vendor's limitations to secure the contracted level of quality in

changing conditions, ensuring adjustments to market developments (Yallof, Morgan, 2003). If performance criteria required by the company fail to anticipate changes in the level of market demand, the contract will result in the mismatch of expectations.

A company can choose to cooperate with a single provider, more independent suppliers, or integrated suppliers coordinated by a single vendor leader. When a company works with a single vendor, the vendor understands the client's needs and offers better services. Multiple vendors managed by the company is an approach that implies a significant effort to monitor and co-ordinate more vendors, allows better services and lower costs. The approach of integrated suppliers managed by a single vendor leader presents the same benefits, however, the company has less co-ordination problems due to the interaction with only the main outsourcer responsible for the performance of all suppliers. The selection of a number of vendors depends on the combination of factors such as market positioning, price, technical superiority, ability to manage a number of contracts, and possible previous experience.

Companies can choose between different types of partnerships with outside providers considering two main characteristics: specificity and complexity (Downey, 1995). Specificity refers to the level of reutilization of the considered goods/process for many different users. Specificity can depend on physical location or unique skills in terms of resources and techniques. Complexity refers to the difficulty of monitoring and defining contract terms and conditions of the outsourcing process. Given the low and high levels of their evaluation, the given combinations give rise to four types of relationships:

Figure 4: Types of relationships



Source: Franceshini et al. 2003

The types of relationships differ in many ways as well as their objectives. Traditional vendor type has an objection of immediate problem resolution. Temporary relationships aim at reaching better competencies, strategic union at joined value creation and network organization at achieving better future market position. Strategic union and network organizations are based on the partnership between the vendor and the company. Temporary relationships form a hybrid between customer/supplier relationship and partnership, while traditional vendor type is only customer/supplier based. This relationship is short termed, strategic unions and network organizations are both long-termed, while the temporary relationship is a combination of medium to long-termed relationships. There is very little strategy thinking involved in the traditional vendor relationship. In temporary relationships

partners join to objective of “sourced” process. Strategic union formation follows the strategy of the company, while in the network organization companies share the common vision. The level of trust is also relationship dependent: it is not essential in the traditional vendor relationship; it is connected to competencies in temporary relationships; high and reciprocal in strategic unions and maximum and reciprocal in network organizations. Traditional vendor relationships are based on the cheap price model, temporary relationships on cost and shared risk, while strategic unions and network organizations are win-win oriented when it comes to pricing. In such context the traditional vendor relationships evaluate productivity, cheapness and the reaction time. The evaluation in the temporary relationships is based on effectiveness and process improvement. Strategic union and network organizations value more sophisticated issues: competitive advantage and profit, and innovation and new market creation, respectively.

Communication between partners should reflect the nature of the contract and the complexity of services being delivered. As the complexity of services increases, more dynamic communication is required. This may include joint problem solving and planning of service delivery, discussions on innovations and marketing strategies. Daily reports required for simple arrangements are supplemented at higher stages by monthly reports indicating potential problems through performance assessment against predetermined criteria. Senior management must stay involved during the implementation of the contract at the operational level to address the outcomes and potential problems of the contract.

If a suitable vendor is found a company can proceed with outsourcing of an activity, if not the activity should continue to be performed internally until a suitable vendor is found.

STRATEGIC FLEXIBILITY

Business environment does not stand still, technology changes rapidly, unexpected events shock the market, regulation changes, customers taste changes, innovations are introduced and the basis of competition shifts. All of the stated factors can ruin even the most meticulously planned and executed outsourcing arrangement if flexibility is not rooted in its very core. Uncertainty about future events concerns two issues: what will happen, and when will it happen. Existing tools for strategy formulation and implementation are limiting because they rely either on stable future conditions or on the presumptuous assumption that they can make accurate predictions of what the future brings (Anon, 2002). In a world where in a matter of months a basis of competition inside an industry can change dramatically, pursuing a particular course of action that is adequate for current situation seems a waste of time and resources. What is required to navigate in turbulent markets is an approach that acknowledges uncertainty and even embraces it, but at the same time learns from experiences and formulates plans for potential contingencies.

The quest for flexibility should include a thorough assessment of the outsourcing process of the overall performance, inquiry of the level of integration of sourcing strategy with the corporate strategy, analysis of the functions involved in the sourcing decision-making process, permanent C/B and partnership analysis.

When making a sourcing decision, as well as any other important, long-term decision a company has to anticipate possible changes that can occur. A company should maintain flexibility of the in-house production, flexibility of the vendor relationships implemented in

the contract, and flexibility to anticipate and react to market trends as well as strive to establish its own best practice in the given industry.

Scenario based planning provides an opportunity to understand the drivers of change in a particular industry, market or organization. By analyzing the drivers of change and determining how they may evolve over time and interact, a company can develop a number of scenarios. These scenarios define possible futures in which a company could compete and provides a context for companies strategy and required flexibility to successfully compete in tomorrow's market. Developing scenarios enables the company to practically observe what could be the consequences of its sourcing decision under various future scenarios.

After the scenarios are built, a company should create suitable strategies to accompany each scenario. To determine the best strategy for each scenario a company can use different approaches, such as: Porter's five forces, core competency approach (Hamel and Prahalad), Christensen's disruptive technologies or Brandenburger's co-opetition (Raynor, 2002). Each scenario has a set of unique strategies suited for its needs, but some initiatives will be consistent with all or most of the developed scenarios. Elements that are common to all or most scenarios form a core strategy for a company. If a particular activity forms an element of company's core strategy, it should be invested into and performed internally or acquired through a tight partnership with the supplier, best answer, where possible, would be an acquisition of a supplier.

With a determined strategy for each scenario, and identification of the core and contingent elements, a company can begin to acquire or develop resources and activities needed for each strategy. For implementation of the core strategy the company should immediately start the process of acquiring needed activities. It means investing in internal development of this activity, learning from the best, forming partnerships and joint ventures with suppliers or if possible acquiring them. An equally difficult challenge represents securing the access to capabilities that are regarded as contingency elements. For example, a company in Croatia can regard expansion to Serbia as a contingency strategy that depends on changes of political climate and regulatory regime in that country. Establishing a distribution channel and a relationship with a local supplier are key elements of that contingency strategy. With such a move a company buys an option, a right, not the obligation to expand into that country via existing relationship. The company tries to lock up the right partners without currently committing the investment necessary to expand operation. In this case, a company can take a real option on its distributor in Serbia through contracting or partial ownership. Either way, the cost of controlling a partner can be viewed as the cost of an option on using that partner to expand into a new market. Diversification – based either geographically or on product markets, creates option value on future business opportunities.

From cost reduction perspective, such actions do not appear reasonable when comparing the cost and performance of such a supplier with the "best of the breed" supplier. This is because conventional business appraisal does not take into account the option value of an asset. The real value of such a relationship lies in the flexibility and potential benefits it could create. This simple example indicates that without taking a truly strategic perspective on the sourcing decision a company may end up outsourcing a core element of its future strategy and damaging its competitive advantage. Other extreme is the dismissal of strategically flexibility and business opportunities because of strict cost concerns.

Relating these strategic guidelines to outsourcing arrangements require precise planning and expert management team. The vital part of the outsourcing contract is the service level agreement that specifies the service level of the activity outsourced as a commitment between process owners and parties involved in the contract. In companies the service level management (SLM) completes that task (Downey, 1995) and consists of a group of experts that monitors, controls and evaluates service levels and manages supplier relationships. The evolution of a suppliers' performance can me measured by the so-called efficiency curves. When drawing the efficiency curve two curves should be identified: the first indicates the targeted, ideal level of achievement, the second shows the actual activity performance in the business outsourcing process. Both curves are confined with two axes: time axis showing scheduled control checking moments and the SLA index of performance. If tolerated gaps are exceeded the company must look for its causes and provide corrective actions. If the curve gaps continue in the longer period of time, the company should reconsider the arrangement, possibly re-insourcing the activity (*backsourcing*) or finding another vendor.

The relationship between a company and vendor is truly put to the test when a need for a change in the agreed services has been perceived and identified. The tighter the relationship between a company and vendor, the easier will it be to realize required changes. A planned and structured process is required to enable the realization of needed changes and preserve a sound relationship (Yallof, Morgan, 2003).

Well-structured processes for implementing changes minimize the risk of misunderstandings and disillusions between partners and consist of the following steps:

- Prompt and open communication of changing market demand and imposed requirements on outsourcer as well as the vendor
- Joint staff meetings concerning newest market and technology developments, scanning for potential threats and opportunities in the business environment, development of scenarios and models of future trends and its' impact on all stakeholders
- Joint problem solving
- Documentation of all required changes along with accompanying fees and determination of plan time frame.
- Schedule of plan implementation
- Constant monitoring of performance criteria and prompt corrective action.

Such a process results in a well-documented revision of the original outsourcing contract for needed changes in delivered services. Following the stated steps allows for precise determination of problems, possible solutions, implementation time frame and fees, even before the revision of a contract begins and any costs are incurred. It also enables joint problem solving and synergy effects that can arise from the company and vendor's specialization in their fields of expertise and results in innovative and progressive solutions that would otherwise likely be overlooked. Documentation for implementing changes should include following components:

- General information about the needed changes: requesting party, delivery date, service area impacted etc.
- Project description: general information on required service changes, involved parties and assignment of tasks and responsibilities

- Cost estimation: separate estimations for implementation costs and ongoing fees, amount discounts, agreement on type of payments (fixed fees, variable fees, a combination of two), billing specifications (payment terms, amounts, payment deadlines)
- Implementation schedule: setting of implementation milestones and required time frame, ensuring the mutual understanding of all phases and implications of incompliance

The final step of BRP model should be implemented continuously over a longer period of time to ensure that the company is constantly aware of all changes in its surrounding, and implications for future performance and market developments.

CONCLUSION

Outsourcing is a strategic business tool providing leverage that can have many dimensions. Many companies are neither implementing any methodological approach in the sourcing decision-making process nor do they have any firm basis for evaluating the sourcing decision. The suggested model reveals problems associated with the sourcing decision by integrating several approaches to outsourcing: a core competency approach, basis of competition, value chain and supply base approach. The model can help a company create a more balanced combination of vertical and horizontal integration contributing to the competitive cutting edge.

The methodological approach suggested by the model starts with the SWOT analysis. A company should creates a strategy that enhances assets and outweighs liabilities. It is easier to build competitive advantage when a company has a core competency in an area important to market success, and when it is costly for rivals to replicate it. The real source of sustainable competitive advantages is the management's ability to consolidate the company's technologies and production skills into competencies that allow rapid adjustment to changing business opportunities. If a company's core competence is a source of competitive advantage, it must contribute to the company's ability to deliver improvements that relate to the current basis of competition. Identifying competitive requirements of the market starts with identifying the basis of competition of the market. The dimensions of performance that customers value the most and are prepared to pay for form the basis of competition of a given market. To be successful in using the basis of competition to its own advantage and continuously improving its performance, a company must control the elements in the value chain that drive the improvements. To be a source of competitive advantage, a company's core competence must contribute to the company's ability to produce improvements that are in line with the market's present basis of competition. Looking from the value chain perspective it is simpler to recognize the activities that add value to the company and in that manner fortify the company's competitive position. After the identification of basis of competition in a particular market, company's core competencies, primary and support activities in the value chain needed for its functioning, a company can make a basic distinction between activities: are they vital for a company's future success and therefore need to be kept in-house and improved, or are they a potential outsourcing candidate.

Decision should never be met without a thorough cost/benefit analysis of in-house activity performance versus the external supply alternative. Costs of every company in an industry do not have to be equal, especially if products are differentiated, but higher costs as a rule make the market position vulnerable.

A company should select the appropriate vendor for activities identified as outsourcing candidates based on the value chain analysis. The vendor's value chain should be configured in the way to meet the buyers' requirements. A company can choose to cooperate with a single provider, more independent suppliers, or integrated suppliers coordinated by a single vendor leader. Flexibility should be built into obligations of both contractual parties with the full understanding of the vendor's limitations to ensure adjustments to market developments. The quest for flexibility should include a thorough assessment of the overall outsourcing performance, inquiry of the level of integration of sourcing strategy with the corporate strategy, analysis of the functions involved in the sourcing decision-making process, permanent C/B and partnership analysis. In that context scenario based planning provides an opportunity to understand the drivers of market change.

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