

## ADAPTABILITY OF VIETNAMESE SMEs TOWARD OUTSOURCING TREND

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### ABSTRACT

*This article is to determine the adaptability of Vietnamese SMEs (small and toward international outsourcing trend). Organizations in developed countries usually find some less developed countries within which they may outsource operations. Outsourcing has become an effective good way for companies to increase profits by reducing production costs. This is attractive to less developed and developing countries as it encourages economic growth. However, to become an attractive destination of outsourcers, these developing countries need to possess high level human resources, attractive policies and business climate in conjunction with excellent infrastructure but low operation costs. Vietnamese SMEs only focus on labor-based outsourcing services which can bring about much lower benefits than knowledge-based services. A survey was done to get the viewpoints of Vietnamese SMEs' managers about outsourcing requirements. After that we use the zero-sum method to determine which factors Vietnamese SMEs' managers think the outsourcers should consider the most important when seeking outsource destination. Beside, we also base on background knowledge to understand Vietnamese SMEs' entrepreneurship basing on this aspect. The result shows that Vietnamese SMEs think costs, especially labor costs, operation costs and administration costs are most important elements encourage outsourcers choose an outsourcing place.*

**Key words:** *outsourcing, priority factors, entrepreneurship, Vietnamese SMEs.*

### INTRODUCTION

In the current global economy of increasing complication with consumers' demands accelerating day by day, and with so hard competition, companies must find reasonable ways to survive. To be able to remain in existence, companies can restructure and upgrade their technology. However, it is often the case that restructuring is usually applied when the company faces difficulties within its management and the problem-solving capabilities of its work force. The prohibitive costs of upgrading technology mean that restructuring is seldom viable. For these reasons, together with today's strong knowledge and service based economy, companies are offered a chance to increase profits through strategic outsourcing.

Outsourcing is the contracting or subcontracting of noncore activities to free up cash, personnel, time, and facilities in which a company holds competitive advantages to reduce average unit costs. Outsourcing activity also means that companies pass some unnecessary tasks to outsourcees so that the outsourcees can help parent companies conduct those works at lower cost and less time. With the advantages of outsourcing, companies can save money and deliver their goods and services to the right people at the right place promptly. In addition, outsourcing can provide access to skills that may not be available in the local or domestic workforce and sometimes to deal with new and different labor challenges (Parker, 2005).

Outsourcing activity can be done on the local scale or overseas scale. For local outsourcing, as all operational climates are almost the same between the outsourcer and outsourcee, so the outsourcers need

only care about the cost of the service. However, when thinking of outsourcing some activities to partners overseas, the company should take into account the differences in business climate, human resource, infrastructures and government policy. Those elements will directly influence the result of outsourcing businesses (Nguyen *et al.*, 2014).

Outsourcing helps the host country in solving unemployment problems; increasing GDP by collecting taxes, fees and charges; upgrading the standard of living; attracting new technology; encouraging innovation and working skills. Therefore, many countries, particularly developing and emerging ones are now trying to attract the investment of outsourcers. Although there are many articles on the subject of outsourcing, analyses of its pros and cons and a large number of papers concerning the characteristics of this activity, there is still not on the prioritization of factors which affect outsourcing decisions. Furthermore, for developing countries with limited ability, especially in Vietnam, to provide all factors demanded by investors is an almost impossible task. Consequently, we raise two big questions: how can a country effectively attract outsourcers? Which factors will be taken to be priority areas of improvement? By analyzing and calculating evaluation scores from questionnaires, we will point out the most important factors to which investors pay attention when they decide the outsourcing destination. Our research results will provide some thoughts of Vietnamese SMEs' managers of factors affecting outsourcing decisions to know about entrepreneurship of Vietnamese SMEs.

Outsourcing is a practice used by different companies to reduce costs by transferring portions of work to outside suppliers rather than completing it internally. Increasing globalization and fierce competition in today's market has made companies focus more on outsourcing decisions (Ahearnea and Kothandaramanb, 2009). This activity has also become the trend in which every firm from multinational to domestic, from big to small has tried to engage with. One of the most important reasons for this tendency is that the rising imports reflecting the outsourcing of production activities can lead to the reduction in the relative employment and wages of unskilled workers and can help the companies increase profit not by increasing product prices but by reducing costs (Feenstra and Hanson, 1995).

International outsourcing depends on the situation of the domestic and foreign market for input suppliers. Besides, the relative cost of searching in each market, the relative cost of localized operations and the economic environment in each country are the main outsourcing considerations (Grossman and Helpman, 2005). Thus, the greater local demand for a given input promotes the entry of suppliers into a city; the increased number of suppliers then results in lower outsourcing prices and a higher use of outsourcing by final producers (Ono, 2001). With a good outsourcing strategy and decisions, companies may easily get high outcomes, cost savings and levels of satisfaction (Feeny *et al.*, 2005). By outsourcing, companies can learn many specialist skills and experience to improve their activities (Clegg *et al.*, 2005). Another point of view holds that outsourcing also allows companies to focus on other business issues while having the details taken care of by outside experts. Outsourcing is still favorable therefore as it function as a protective operational measure of many firms and helps build up competitive advantages (Bettis *et al.* 1992).

There are some risks existing along with benefits. And due to the fact that in outsourcing business, transaction cost economics and core working skills are compatible (Arnold, 2000) and knowledge sharing and outsourcing success have a significant relationship (Lee, 2001). So, before deciding on place to outsource business, the company should consider carefully many factors such as human resource, government policy, business climate, infrastructures and operation costs in the host countries. Human resource has an important and unique influence on an organization performance (Becker and Gerhart, 1996). Moreover, international labor and environmental standards could mitigate some intense concerns with outsourcing (Doh, 2005). Therefore, high performance work practices significantly impact a firm on turnover and productivity (Huselid, 1995). In other words, outsourcing is not only undertaken by the firms to solely satisfy the pressing need for cost discipline but also to achieve good practice, quality, human resource and stable development (Kakabadse and Kakabadse, 2002).

Beside the workforce requirement, in outsourcing transaction, companies also care about the business climate and government policies of the host country. These issues have a certain influence on outsourcing decisions. As Weidenbaum (2005) described governmental policymakers play an important role in attracting foreign companies to outsource more business activities to the country (Weidenbaum, 2005). The business and legal environment are somewhat trouble come to outsourcers (Kennedy and Clark, 2006). However, companies can balance benefits and risks if those issues are well understood.

Although the economics of outsourcing can always make a remarkable contribution to economic growth (McCarthy and Anagnostoub, 2004) it is not easy for a country to become an outsourcing destination. On

one hand the pressure on local labor markets is suitability to the international demand (Jones, 2005), and political ideology and management style. These are the two factors affecting economic logic and competition which alter the outsourcing (Hendry, 1995) on the other. In addition, exchange rate deviation, flexible tax policy, free trade economy, stable polity and concentrating manufacture have a positive relationship with foreign investment (Woodward and Rolfe, 1993). Lower inflation, good infrastructure, an educated population, openness, less corruption, political stability, and a reliable legal system really have influence on foreign investment (Asiedu, 2006). So, countries that are small or lack natural resources can attract investment by improving their institutions and policy environment (Asiedu, 2006).

Pursuant to the requirements employers, outsourcing operations can be classified into two main categories: labor-intensive outsourcing (labor - based outsourcing) and knowledge-intensive outsourcing (knowledge - based outsourcing) (Görzig and Stephan, 2002). For the first type of outsourcing, this can also be considered as traditional outsourcing, in this type, provider primarily provides activities using mainly labor that does not require professional knowledge ( e.g. security services, processing in clothing, footwear, and furniture industries) (Gilley and Rasheed, 2000; Scott, 2005). Main purpose of providers of this kind of service is labor costs or processing costs from the contractors, and normally, the outsourcers will find outsourcees in a low-wage countries (Liu *et al.*, 2006; Gilley and Rasheed, 2000). Meanwhile, knowledge - based outsourcing is only mentioned much since the 90s of the 20th century, this activity requires providers to have deep expertise, bringing professionalism and specific abilities to solve problems better buyers. Knowledge - based outsourcing services mainly concentrated in either a job as legal litigations, tax reports, auditing, and counseling) (Quinn, 1999) and this type of outsourcing is also considered one of the long-term development strategy to achieve strategic benefits but not only to reduce costs as labor – based outsourcing.

The objective of this study was to reconsider the priority order of factors which affect outsourcing destination decisions. Specifically, this study determines the rank of each factor that investors usually take into consideration when choosing outsourcing destination.

## RESEARCH METHOD

A survey was conducted to get the evaluation from managers in 200 SMEs. The main context of the questionnaire is to ask participants to make a pair comparisons among five mentioned factors and sub-factors in each group. Those questioned marked the more important factor. After delivery of all questionnaires we received complete feedbacks from only 117 participants making the response rate of 58.5 percent.

To compute these results we used the matching pennies idea of Gibbons (1992). Different countries have different regulations, conditions and positions. It would be difficult for any country to have all things that are necessary for investors. With this being the case, an enterprise which wants to choose a destination country to outsource some activities must trade-off between some factors. For that reason, we assume that when the two factors are put in pairs, people can choose only one by marking a tick by the more important factor. As all factors are paired and there are five in total, then each will receive four marks indicating they are more important or less important than others. After getting completed questionnaires from participants and based on Zero-Sum theory we carefully coded all marked information with one of three values: positive (+1) to represent the acknowledgement of more important value, negative (-1) to denote the less important role and zero (0) to stand for equal importance.

## RESULTS AND DISCUSSION

Viewpoints of Vietnamese SMEs concerning the most important factors affecting outsourcing decision considerations are summarized in Table 1. Cost (C) and HR are the two factors which can receive the highest and the only positive value from evaluations of participants, so, C and are domains in group 1. This means Vietnamese SMEs' managers think when an enterprise would like to outsource their activities to other countries the most important thing they care about is the costs. There are two kinds of costs which are fixed costs and variable costs including foundation setting costs, material costs, production costs, salary, costs of transportation, electric expenses, water expenses and telecommunication costs. Therefore, those countries which provide low cost services can more easily attract investment from outsourcers. Among mentioned costs, labor cost is the most important. When deciding place to outsource, the outsourcers refer some place with lower labor cost to maximize firm's benefits and profit. Following labor cost (with average point of

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Table 1. Average point of factors

Element	Average point
Cost (C)	0.7
Human resource (HR)	0.04
Business climate (BC)	-0.04
Infrastructure (Inf)	-1.5
Government policy (GV)	-0.31

5.37), production cost (4.3) is the second thing that investors pay attention because production cost is one of the two main factors (high in-house production costs and the advantage of scope economies) encouraging firms to outsource to other companies (Nia *et al.*, 2009). Less important than those two costs are administrative costs (0.6), setup costs (-5.33) and shipping costs (-6.19). Administrative costs also received positive value expressing a certain care about this element.

The second factor which needs be taken into consideration is the HR. Human resource (HR) concerning high education, foreign language-influence, machine-using ability, worker's skills and problem solving ability is ranked as the following C. This is one of the complicated matters of the company. The company need face the decision of what proportion of workforce to keep the works effective on one hand and to keep down salary costs on the other (Hisrich, Peters, and Shepherd, 2005), hence, to overcome the pressure of management of employees and companies. However, Vietnamese SMEs see worker's skills and machine-using ability are the most essences of outsourcing providers. This is reasonable in production outsourcing activity only because these two factors are necessary for operating production lines which require basic skilled/ low skilled workers (Díaz-Moraa, 2008). If one country can provide advantages in both elements C and HR that country could easily become the arrival station of outsourcers in both labor-based and knowledge-based outsourcing services.

Business Climate (BC) ranked a little lower than HR on the third place. This implies BC is not as so important as C and HR but has greater priority than infrastructure. Exchange rate, inflation, economic growth of a country has somewhat less influence on outsourcing decisions as almost all outsourcing passes only noncore activities to outsourced countries such as payroll, recruitment, after sales service and packaging. Those actions are not dependent much on BC.

As for GP, as calculation GP received negative value in total. The negative value of GP expresses the fact that many experts believe that GP does not give much of an advantage. So, to choose one destination place to outsource, if there are two suitable countries to consider, in the case that other factors are almost similar but not C and GP, the investor will choose the country with lower activity costs rather than the country with more attractive policies. But, the difficulty herein is how to approach a suitable policy which can help domestic firms develop and encourage foreign outsourcers to invest while balancing economic growth.

The factor of least priority to the outsourcer is infrastructure. This issue is also understandable as there are many activities which need outsourcing but not all fields need excellent infrastructure. Wheeler and Mody (1992) affirmed that good infrastructure development will be necessary for the country to influence the investor's calculations (Wheeler and Mody, 1992). But, comparing with C, HR, BC and GP, infrastructure is not as important.

So, according to Vietnamese SMEs' managers, to become an outsource destination, the country should focus on C and HR first as wage rates, production expenses, managing costs, well-trained workers with a huge number of workforce, inflation rates and profit repatriation restrictions are the main affecting drivers to the probability of country selection (Woodward and Rolfe, 1993). The higher C and but lower HR quality, the lower the probability of the country being a destination of outsourcing demand.

C and HR are the two factors which receive the highest evaluation of extreme precedence in deliberation of outsourcing. Whilst GP and Inf are the two factors that receive the lowest. While we can understand C and Inf, GP is not only recognized as the driver of priority but also the least important one in the thought process of outsourcers. Since that is the case we can realize GP as an intermediate element which seems to affect to other factors rather than outsourcing activity directly.

Based on above analysis, we discovered that the Vietnamese SMEs are driven only provide services in favor of labor-intensive rather than knowledge-intensive services. This somewhat confirms that Vietnamese

SMEs are still not enough confident and lack of knowledge to be able to compete with foreign firms. They also lack the creativity, understanding of new trends to apply innovative strategies to enlarge their activities and make their business develop towards professional, modern, innovative and efficient performance.

The benefits from outsourcing business can help enterprises and countries earn a lot of money and resolve the unemployment situation in the short term. However, in the long term, a country can not sustainably grow based always on outside efforts. So, those countries should save a part of GDP, human resources and infrastructure to develop. However, high human resources and modern infrastructures can lead to high operation costs, which is clearly not an advantage for attracting outsourcing. Thus, each country needs have suitable plans and projects for development which depend on actual state of the countries involves.

According to the survey results, for the Vietnamese SMEs, the costs are defined as the leading factor attracting buyers looking to their services. Vietnamese SMEs think that if their labor costs, production costs, and management costs are low, they will be able to attract more outsourcing contracts. However, this is only true for the first type of outsourcing (labor - based outsourcing) because knowledge-based services, the buyer do not have such deep knowledge as the providers so they have no way but must outsource. By outsourcing some knowledge-based services, companies put all efforts and capabilities to invest in richer innovation (Quinn, 1999)

In addition, in terms of HR, the evaluation criteria of Vietnamese SMEs' points of view also shows evidence that they do not capture or ready for business of knowledge –based services. Almost managers think workers' skills and technology readiness with abundant labor resources will be the main factors to help them survive and grow. Meantime, factors such as language skills, level of education and ability to understand the business culture of the countries of their staff are minor and not focused.

## **CONCLUSION**

In this study, we found that among many factors affecting outsourcing decisions, but not all of those factors are evaluated at the same level by Vietnamese SMEs' managers. Similar to a lot of argument from scholar, Vietnamese SMEs' managers also think costs and human resources are the most important elements. However, while knowledge-based outsourcing is now considered as the business which creates much added value but Vietnamese SMEs still focus on developing resources which create only low added value.

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