Effect of Outsourcing on Organisation Performance among Commercial Banks in Mombasa County, Kenya

Rehema B. Kigwe[1], Rugami Maina[2]

Correspondent Author, School of Business, Kenyatta University[1]
Lecturer, Business Administration Department, Kenyatta University[2]

ABSTRACT

Outsourcing can be of benefit to a company provided it enters the right relationship with the right vendor, evaluated and managed appropriately. Improvements such as high productivity, efficiency and cost reduction and control may be achieved through outsourcing. However, it is possible that there will be the problem of lack of loyalty from the employees of the outsourced companies. Mistakes in identifying core and non-core activities can lead organisations to outsource their competitive advantages. However, what is core one day may not be so the next. Moreover, once organisational competence is lost, it is difficult to rebuild. This study sought to investigate the effects of outsourcing on organization performance among commercial banks in Mombasa County. The specific objectives of this study were; to determine the influence of outsourcing risks, outsourcing costs, quality of service and functional department on the performance of commercial banks in Mombasa County, Transaction cost theory and resource-based view theory will be used in this study. This study used descriptive research design. The target population for this study was strategy managers in all commercial banks in Mombasa County. The study sample was 90 strategy managers who were selected through census survey. The study made use of questionnaires to collect data. Descriptive statistics such as (mean and standard deviation) were used to analyse quantitative data. The study established that outsourcing risks, outsourcing costs, quality of service and functional departments had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya. The study concludes that Risks in outsourcing may arise due to possibility of weak management, inexperienced staff, business uncertainty, outdated technology skills, environmental uncertainty, hidden costs, lack of organizational learning and loss of innovative capacity. Costs associated outsourcing may be due to cost of unplanned and unforeseen risks. Service quality shows partially positive effects on operating performance in the performance of commercial banks. Functional departmentalization enable commercial banks to better manage change in the marketplace, including consumer needs, government regulation and new technology. The study recommends that commercial banks when drafting a contract should make sure to include all the expected services, and read carefully for any surcharges or extra charges. Before negotiations even begin, they should have providers sign a confidentiality agreement promising to safeguard the banks' secret. Commercial banks should minimize cost of outsourcing and also to allow staff to concentrate on the core activities of the institutions that are profitable. Commercial banks should choose the best source sourcing, cost benchmark to the current market and be careful on hidden costs that might arise. Commercial banks should make service offerings better with high quality deliverables and decrease the lead time it takes for the product to reach the marketplace. Thus you would be faster in getting organizational ideas converted into products and better at delivering the value-added proposition.

Key Words: Outsourcing, Organisation Performance, Commercial Banks, Mombasa County

1. INTRODUCTION

Outsourcing is defined as an act of a firm to subcontract part of its processes which otherwise would have been performed by in-house employees (Aten & Howard-Grenville, 2012). Outsourcing has been identified as a growing global trend in the new millennium (Kai et al., 2007). It has been viewed to be growing at an exponential rate, as companies recognize the increasingly vital role of competitive factors such as cost, speed, quality, volume, flexibility and innovation (Aubert, Rivard&Patry, 2004). Globally, regulators concern is how banks manage risks associated with a third party offering certain essential services. In Australia, various companies have augmented their outsourcing of mechanisms and finished products to developing countries, particularly to Mainland China where local businesses in China primarily offer lower labour and other production costs (Hrebiniak, 2006). In 1999, Federal Reserve Bank of New York conducted a survey on banking industry practices for outsourcing arrangements. Findings suggest that banks outsource financial services for some reasons, such as enhanced performance; costs reduction; access to superior expertise; and strategic reasons.

Similarly, a survey conducted by European Central Bank in 2004 reveals that although the benefits of outsourcing are evident, in practice, many banks believe that outsourcing introduces new challenges and risks. The study highlights the benefits of outsourcing, suggesting; cost reduction; access to better technology and infrastructure and strategy of focusing on core activities; economies of scale which leads to improvement in synergies achieve diversification benefits or streamline services; focusing on core activities; free scarce resources; quality services; and flexibility. Outsourcing risk is manifested in loss of control on some key functions and the likelihood of opportunistic expropriation by vendor (Leiblein & Miller, 2003). According to Insinga and Werle (2000) outsourcing implementation problems in the banking segment are common in many emerging economies. Circumstantial proof from Uganda's commercial banks reveals that there have been contracting outsourcing deficiencies and violations, weak relational norms, little trust and commitment and defect in outsourcing performance. In Standard Chartered Bank, the outsourced service providers for cleaning and security services violated their contractual obligations and provided poor services. There are frequent complaints about contract duration, and some have pressurized the bank for payments before fulfilling their contractual obligations. Some outsourced providers withdrew before the expiry of their contracts, complaining of the bank's unfavourable standard terms. Employees also complain over long lead-time and poor quality of outsourced canteen services

2. STATEMENT OF THE PROBLEM

In recent years, globalization and advances in information technology have revolutionized the way companies conduct business. Outsourcing of business processes is one of the key outcomes of the technological advancement. There are some studies which have focused on outsourcing (Kakabadse & Kakabadse, 2000). Outsourcing services are recognized as a strategic tool for organizational performance; the more an organization outsourced, the higher it organizational growth and productivity. Insinga and Werle (2000) consider peripheral activities as the most outsourced with the cost reduction being the primary cause. Kerandi et.al (2014) on commercial banking crisis in Kenya found out non-core services in Kenyan banks are most outsourced to enable them to concentrate on the core activities. It is unclear on the criteria used for establishing core and non-core activities in the Kenyan banking sector. Hence influencing outsourcing in commercial banks in Mombasa County.

According to Robinson (2005) outsourcing implementation problems in the banking segment are common in many emerging economies. Circumstantial proof from Uganda's commercial banks reveals that there have been contracting outsourcing deficiencies and violations, low relational norms, low trust and commitment and deficiency in outsourcing performance. In Standard Chartered Bank, the outsourced service providers for cleaning and security services violated their contractual obligations and provided substandard services. There are frequent complaints about contract duration, and some have pressurized the bank for payments before fulfilling their contractual obligations. Some outsourced providers withdrew before the expiry of their contracts, complaining of the bank's unfavourable standard terms. Employees also complain over long lead-time and poor quality of outsourced canteen services. However, despite some studies being carried out in Kenya on the above topic none has come out clearly to focus on the effects of outsourcing practices of commercial banks in Mombasa County. This study sought to explore this fundamental question. Does outsourcing practices affect the performance of commercial banks in Mombasa County?

3. OBJECTIVES

The general objective of the study was to establish the effects of outsourcing on organizational performance among commercial banks in Mombasa County.

The Specific objectives were;

1. To determine the influence of outsourcing risks on the performance of commercial banks in Mombasa County.
2. To determine the influence of outsourcing costs on the performance of commercial banks in Mombasa County
3. To examine how the quality of outsourced products and service affects the performance of commercial banks in Mombasa County.
4. To determine the influence of functional departments on the performance of commercial banks in Mombasa County.

4. THEORETICAL REVIEW

This research study presents theoretical literature on Transaction Cost Theory and Resource-based theory. These theories give an account that shows the relationship between the dependent variables and the independent variables. These theories will be used to explain, predict, and appreciate facts and incidents in the environment. Transaction cost theory was developed by Harland, Knight, Lamming & Walker (2005) developed this framework and identified why costs arise when using the market. The ownership decision in the TCT is concerned with the minimization of costs in transactions and production. Williamson's theory was founded in the decision of the firm to make a good or service in-house or buying it in the market. Those activities define the vertical boundaries of the firm. According to the theory the vertical boundaries of the firm are dependent on the transaction costs related to buying the good in the market. When the transaction costs are high, the company is better of producing the good, by vertically integrate activities, than buying it in the market (Quélin, Bertrand & François, 2003)

Furthermore Qiu and Huo (2007) have made a dynamic analysis on China's transformation period transaction costs. That research has proposed the concept of transaction business and nontransaction business, which perfected the method of industry partition for transaction costs measurement. Nonetheless Peteraf aand Barney (2003) having conducted a research on the industrial transaction costs from 1978 to 2002 and on calculating tertiary industry transaction costs, deemed that public sections transaction costs are represented by public sections added value, while non-trading sections transaction costs is represented by half of employee' whole salary. Transaction costs consist of five major components: searching cost, negotiating cost, contracting cost, monitoring cost and enforcement cost (Kakabadse and Kakabadse, 2000). Evidence has been found showing that companies, which follow the propositions in the transaction cost framework, perform better than companies, which do not (Catera and Pucko, 2010). Further, it was found that companies that follow the basic transaction cost hypothesis, i.e. having high costs of finding and negotiating with partners, tend to use a greater degree of control. Transaction costs in the entry mode literature are mainly concerned with finding and negotiating with a proper partner and monitoring the performance of this partner. According to Bingbing, (2013) a potential partner might have an incentive to free ride or act opportunistic, and this gives the problem of monitoring the performance of the partner.

The resource-based theory was developed by Barney (1991) and is based on the factors that enable a firm to gain competitive advantage. The theory argues that firms earn sustained competitive advantage because they have access to strategic resources. These resources have four characteristics; they are rare (competitors can't obtain them) valuable (generate high returns), cannot be imitated, and have no close substitute. When these conditions are met, competitive advantage has been created (Odunga, E.W. (2008). This has led to firms drastically changing the manner in which they conduct business and thus coming up with ways of exploring various means of organizing their operations. All these actions cannot be explained from the perspective of reducing or eliminating transaction cost alone. The decisions to outsource may be driven by the need to focus on the core competencies by engaging more specialized firms to carry out peripheral operations. Outsourcing influences the resources allocated to business units as well as the level of vertical specialization of the firm's activities, both of which are the corporate strategy (Jiang & Carpenter, 2013).In that respect, strategic outsourcing modifies the firm's boundaries and so is also considered a business strategy. In the same respect, Raps (2005) conclude that specific assets and uncertain demand increase the dangers of exchange, and so decrease the probability of outsourcing activities. More so Peteraf and Barney (2003 show that the technical skills necessary to develop an activity are more decisive than business skills are at the time of outsourcing. The RBV approach predicts that the company will perform its marketing and production activities in a place where it enjoys the competitive advantage. This as default is assumed to happen in the home market. If the company should enjoy the same competitive advantage in the host country, it is required to establish it on the firm-specific resources about the relevant host country factors (Pryor, Anderson, Toombs& Humphreys, 2007).

5. CONCEPTUAL FRAMEWORK

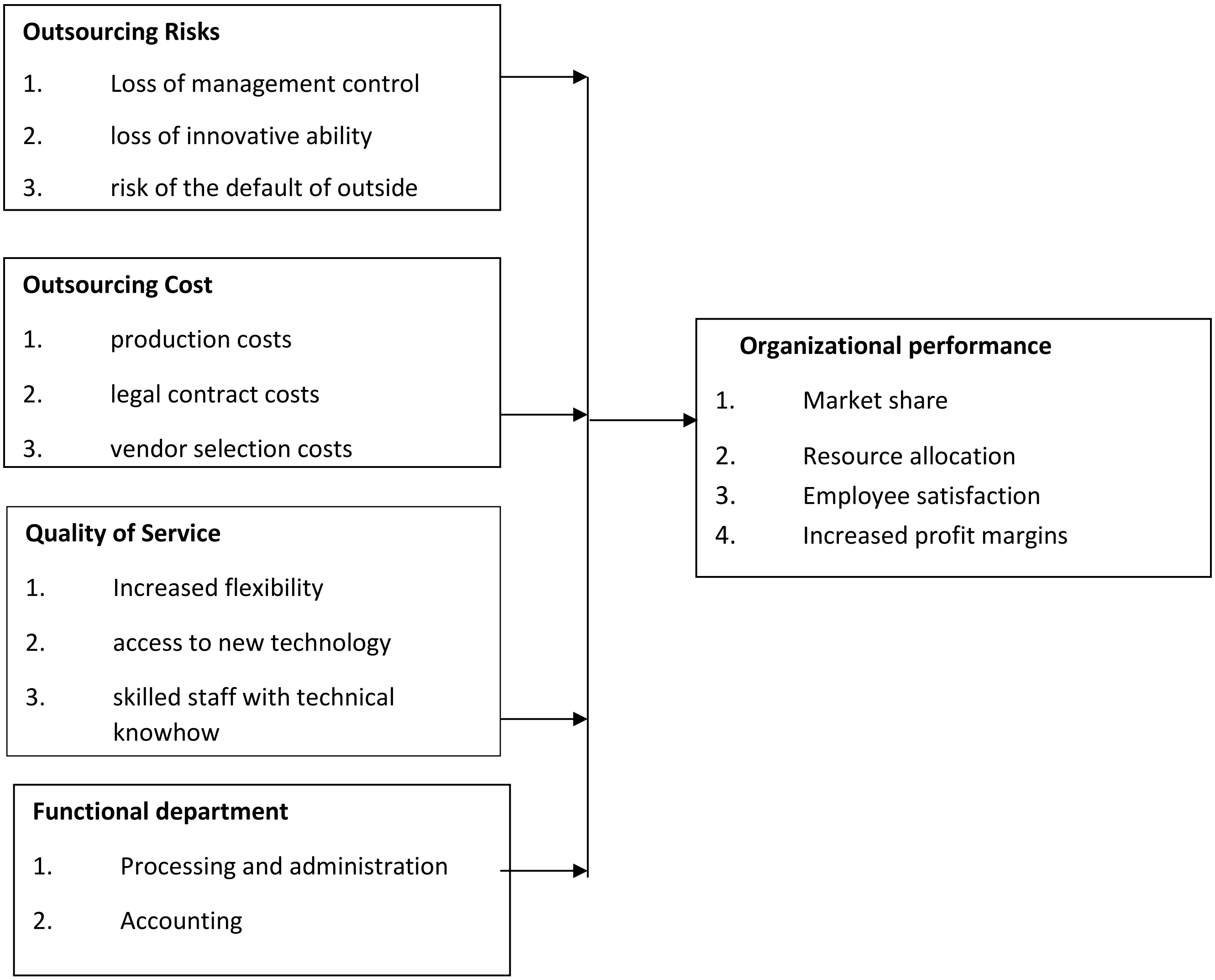

Figure 1 Conceptual Framework

6. RESEARCH METHODOLOGY

This study employed a descriptive survey design where data collection process was executed through the administration of questionnaires to a sample of the study population. The study targeted all commercial banks in Mombasa County that are licensed by the Central Bank of Kenya. According to the Bank Supervision Annual Report of the Central Bank of Kenya (2011), there were 43 commercial banks in Kenya. The respondents of this study were 90 managers in charge of strategy departments of all the commercial banks in Mombasa County. Census survey technique was used to select the sample since the target population is small and manageable. This is because these managers are in a good position to provide the required information on the strategic position of the bank.

The study made use of questionnaires as they are most preferred data collection instruments for they are easy to give out to the respondents at their workstations. Questionnaires can gather data over a large sample and can be administered to many people at the same time. The data collected was cleaned, coded and entered into a computer database in readiness for review. Statistical package for social sciences (SPSS) version 22 was used for analysis. Descriptive statistics such as (mean and standard deviation) were used to analyse quantitative data. Quantitative data was presented in the form of tables, charts and bar graphs. Computation of percentages and frequencies was also done. Qualitative data was coded according to themes identified from the research questions and analysed using content analysis. The following regression equation was used. P= a + b1X1 + b2X2 + b3X3 + b4X4 +e Where: P= Bank Performance; a= the P intercept, b1, b2, b3, and b4 are regression coefficient of respective variables; e is the error term; X1= cost of outsourcing; X2= risks associated with outsourcing; X3= quality services in outsourcing X4= functional departments.

7. RESULTS FINDINGS AND DISCUSSIONS

Inferential statistics was carried out to show the extent to which variables relate to each through the use of correlation analysis and regression analysis.

Table 1: Correlation Analysis

		Outsourcing Risk	Outsourcing Cost	Quality of Services	Functional Department
Outsourcing Risk	Pearson Correlation	1	.214	.721	.627
	Sig. (2-tailed)		.012	.000	.002
	N	82	82	82	82
Outsourcing Cost	Pearson Correlation	.214	1	.614**	.295*
	Sig. (2-tailed)	.012		.000	.029
	N	82	82	82	82
Quality of Services	Pearson Correlation	.721	.614**	1	.755**
	Sig. (2-tailed)	.000	.000		.000
	N	82	82	82	82
Functional Department	Pearson Correlation	.627	.295*	.755**	1
	Sig. (2-tailed)	.002	.029	.000	
	N	82	82	82	82

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Survey Data (2018)

The Pearson correlation for outsourcing risks was found to be r=0.721 ($p<0.05$) which showed a very strong correlation and a positive significance with quality of services as compared with the rest of the variables at 0.05 level of significance. P value was 0.000 less than 0.05 which showed that the relationship was significant. The Pearson correlation for quality of services was found to be r=0.614 ($p>0.05$) which showed a strong correlation and a positive significance with outsourcing costs as compared with the rest of the variables at 0.05 level of significance. P value was 0.00 less than 0.05 which showed a significance relationship.

The Pearson correlation for functional department was found to be r=0.755 ($p>0.05$) which showed a strong correlation and a positive significance with quality of services as compared with the rest of the variables at 0.05 level of significance. P value was 0.00 less than 0.05 which showed a significance relationship. The Pearson correlation for functional department was found to be r=0.627 ($p>0.05$) which showed a strong correlation and a positive significance with outsourcing risks as compared with the rest of the variables at 0.05 level of significance. P value was 0.002 less than 0.05 which showed that there was significance relationship.

Table 2: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**St. Error of the Estimate**
1	0.854	0.729	0.718	0.799

Source: Survey Data (2018)

The four independent variables that were studied, explain 71.8% of the performance of commercial banks in Mombasa County as represented by the adjusted R square. This therefore means that other factors not studied in this research contribute 28.2% of the performance of Commercial Banks.

Table 3: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	24.453	4	6.113	1.759	.001[a]
	Residual	72.527	80	1.543		
	Total	96.981	82			

Source: Survey Data (2018)

The significance value is 0.001 which is less than 0.05 thus the model is statistically significance in predicting how various factors affect performance of commercial banks in Mombasa County, County, Kenya. The F critical at 5% level of significance was 1.759. Since F calculated is greater than the F critical (value = 7.656), this shows that the overall model was significant. The relationship ($p < 0.05$) indicated a linear relationship among the variables under the study meaning there was 95% chance that the relationship among the variables was not due to chance.

Table 3: Determination of Coefficient

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	**Std. Error**	**Beta**		
Constant	0.542	0.542		4.123	0.001
Outsourcing Risks	0.756	0.300	0.211	3.978	0.002
Outsourcing Costs	0.841	0.399	0.354	2.745	0.000
Quality of Services	0.613	0.284	0.362	3.461	0.004
Functional Department	0.706	0.461	0.245	2.999	0.003

Source: Survey Data (2018)

According to the regression equation established, taking all independent variables studied into at zero, performance of Commercial banks in Mombasa County, Kenya will be at 43.1%. The multiple regression represented as ($\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon}$) resulted to: $\mathbf{Y= 0.542 + 0.756\ X_1 + 0.841 X_3 - 0.613\ X_3 + 0.706 X_4}$

Where Y= Organizational Performance

X_1= Outsourcing Risks

X_2= Outsourcing Costs

X_3= Quality of Services

X_4= Functional Department

The study revealed that outsourcing risks had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya by t-values ($t= 3.978$, $p < 0.05$). Felix and Shale (2016) study examined effects of Outsourcing risks on Organization Performance in Manufacturing Sector in Kenya and established that there was an insignificant positive weak relationship between risks and organization performance.

The study revealed that outsourcing costs had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya by t-values ($t= 3.978$, $p < 0.05$). Jyoti, Arora and Kour (2017) study investigated the effects of outsourcing on organizational performance: Role of Cost Leadership, Differentiation and Innovation Strategies and found that cost leadership strategy act as moderators between outsourcing and organizational performance.

The study revealed that quality of services had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya by t-values ($t= 3.978$, $p < 0.05$). Cheng and Lin (2014) study examined the effects of service quality on organizational performance and the study established that service quality shows partially positive effects on operating performance in organizational performance. The study revealed that functional department had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya by t-values ($t= 3.978$, $p < 0.05$). Csaszar (2012) study examined on the influence of organizational structure as a determinant of performance: Evidence from mutual funds. The findings suggest that organizational structure has relevant and predictable effects on a wide range of organizations.

8. Conclusions and Recommendations

The study concludes that outsourcing risks had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya. Risks in outsourcing may arise due to possibility of weak management, inexperienced staff, business uncertainty, outdated technology skills, environmental uncertainty, hidden costs, lack of organizational learning and loss of innovative capacity. The study concludes that outsourcing costs had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya. Costs associated outsourcing may be due to cost of unplanned and unforeseen risks. These selection costs include documenting requirements, evaluating the responses and negotiating a contract. The study concludes that quality of services had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya. However, service quality shows partially positive effects on operating performance in the performance of commercial banks in Mombasa County, Kenya. The study concludes that functional department had a positive and significant effect on the performance of Commercial Banks in Mombasa County, Kenya. Functional departmentalization enables commercial banks to better manage change in the marketplace, including consumer needs, government regulation and new technology.

The study recommends that commercial banks when drafting a contract should make sure to include all the expected services, and read carefully for any surcharges or extra charges. Before negotiations even begin, they should have providers sign a confidentiality agreement promising to safeguard the banks' secret. Commercial banks should minimize cost of outsourcing and also to allow staff to concentrate on the core activities of the institutions that are profitable. Commercial banks should choose the best source sourcing, cost benchmark to the current market and be careful on hidden costs that might arise. Commercial banks should make service offerings better with high quality deliverables and decrease the lead time it takes for the product to reach the marketplace. Thus you would be faster in getting organizational ideas converted into products and better at delivering the value-added proposition.

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