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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	**A STUDY ON THE IMPACT OF UNETHICAL CORPORATE PRACTICES ON CORPORATE BRAND EQUITY** *DR. R. SATISH KUMAR & ATULSEN SINGH*	1
2.	**FACTORS AFFECTING MANAGERIAL CREATIVITY** *DR. RISHU ROY & SUPRIYA GUPTA*	7
3.	**THE IMPACT OF CELEBRITY ADVERTISEMENT ON INDIAN CUSTOMERS** *CHAITRA BOCHEER .K.S & DR. H. NANJEGOWDA*	15
4.	**INNOVATIVE BANKING SERVICES IN RURAL AREAS WITH SPECIAL REFERENCE TO SALEM** *DR. A. JAYAKUMAR & G. ANBALAGAN*	20
5.	**THE EFFECT OF CHANGING ORGANIZATIONAL CULTURE ON TQM PRACTICES IN ISO CERTIFIED COMPANIES** *BHAKTA BHUSHAN BISWAS*	24
6.	**THE RELUCTANCE OF JORDANIAN WOMEN IN WORKING IN THE TOURISM SECTOR: CASE OF JORDANIAN FEMALE** *AMEEN AHMED MAHBOB AL MOMANI*	30
7.	**A STUDY ON CONSUMER BRAND PREFERENCE TOWARDS HEALTH DRINK PRODUCTS IN TIRUVARUR DISTRICT (TN)** *DR. N. UDHAYAKUMARI & G. T. VIJAYALAKSHMI*	37
8.	**AN EMPIRICAL ANALYSIS OF FRIDAY EFFECT IN NSE NIFTY COMPANIES** *DR. S. POORNIMA & V. CHITRA*	41
9.	**ANALYSIS OF WAGE BURDEN AND EMPLOYEE PRODUCTIVITY OF STATE BANK OF INDIA AND ICICI BANK** *DR. ASHOK JHAWAR & ROBIN THOMAS*	45
10.	**OUTSOURCING AND COMPETITIVE ADVANTAGE** *V. K. RANJITH & BIJUNA C MOHAN*	49
11.	**FINANCIAL IMPACT OF HRM ON PRODUCTIVITY AND PROFITABILITY IN PUBLIC AND PRIVATE SECTOR ORGANISATIONS: A STUDY** *MOIRANTHEM MOMOCHA SINGH & DR. D. GOPALAKRISHNA*	52
12.	**ROLE OF SMALL AND MEDIUM ENTERPRISES IN INDIA'S MANUFACTURING SECTOR** *DR. NASIR ZAMEER QURESHI, ADIL AMIN BHATT, ZUHAIB AHMAD BAZAZ & NASREEN KHAN*	55
13.	**CELEBRITY ENDORSEMENT INFLUENCING CONSUMER BEHAVIOR** *DR. M. L. GUPTA & SHAILESH VERMA*	61
14.	**COMPETENCY MAPPING: AN EFFECTIVE TOOL FOR HRM** *MANISHA CHOUDHARY, DR. DIPTI SHARMA & DEEPENDRA MAHALAWAT*	64
15.	**INNOVATION IN FINANCIAL SERVICES: A STUDY OF FINANCIAL INSTITUTIONS** *AMANDEEP KAUR SHAHI & KRITI AVASTHI*	67
16.	**SERVICE QUALITY OF BAJAJ ALLIANZ LIFE INSURANCE IN SOUTH INDIA USING SERVQUAL INSTRUMENT** *SUBHAN BANDE*	72
17.	**CAPITAL STRUCTURE DETERMINANTS FOR SUSTAINED PERFORMANCE IN THE ENERGY SECTOR OF INDIA** *DR. SUNITA PANICKER*	77
18.	**FINANCIAL INCLUSION IN INDIA - A ROAD AHEAD** *K. THIRUMAMAGAL & DR. TI. M. SWAAMINATHAN*	82
19.	**LOANS AND ADVANCES OF COMMERCIAL BANKS: A CASE STUDY ON JANATA BANK LIMITED** *FARJANA SALAM, FAHIMA SALAM, ASHUTOSH ROY & MD. HALIMUZZAMAN*	88
20.	**THE EFFECTS OF CREDIT FINANCE ON THE NIGERIAN AGRICULTURAL SECTOR'S PERFORMANCE** *AKINSEYE OLOWU & DR. ONIMOLE SOLOMON*	94
21.	**INFLUENCE OF CREDIT ADMINISTRATION ON FARMERS OPERATIONS IN OSUN STATES OF NIGERIA: A REVIEW OF THE NIGERIA MICROFINANCE POLICY** *OLADEJO MORUF & SOYEMI KENNY*	102
22.	**APPRAISAL OF FACTORS INFLUENCING TAX AVOIDANCE AND EVASION IN NIGERIA** *AKINYOMI OLADELE JOHN & OKPALA KENNETH*	107
23.	**LEVEL OF WORKERS` JOB SATISFACTION AT JUTE MILLS: A CASE STUDY ON NARSINGDI DISTRICT** *MD. GHULAM RABBANY, ABU ZAFAR AHMED MUKUL, SHARMIN AFRIN & AIRIN RAHMAN*	112
24.	**MEASURING SERVICE QUALITY AND CUSTOMER SATISFACTION USING SERVQUAL: AN EMPIRICAL STUDY IN HOSPITALITY INDUSTRY OF BANGLADESH** *MD. SHARIFUL ALAM*	116
25.	**WORKER CHARACTERISTICS AND COMPLIANCE TO OCCUPATIONAL HEALTH AND SAFETY OF WOOD WORKERS IN NAJA DAVID WOOD INDUSTRY LIMITED IN KUMASI, GHANA** *DR. KOFI OSEI AKUOKO, DR. MARTIN KWAKU YEBOAH, VINCENT DE PAUL KANWETUU & ELIZABETH ADWOA KWANKYE*	121
26.	**PERCEPTIONS OF RETAILERS ON FDIS INTO INDIAN MULTI BRAND RETAILING** *N. SURESH*	128
27.	**LOAN ASSETS CLASSIFICATION OF SCHEDULED COMMERCIAL BANKS IN INDIA** *M. ANBALAGAN*	131
28.	**EXAMINING FACTORS AFFECTING DIVERSITY IN THE WORKPLACE** *ARSLAN AYUB, MUHAMMAD SALMAN ASLAM & ADEEL RAZZAQ*	136
29.	**A STUDY ON CONSUMER AWARENESS ABOUT BANKING SERVICES IN MADURAI CITY** *S. RENUGADEVI*	139
30.	**EVA AND MVA: WHICH METRIC IS EXTREMELY EFFECTIVE IN EXPLAINING REPORTED EARNINGS? – AN EMPIRICAL STUDY ON SELECTED INDIAN FIRMS** *MAHESH KUMAR KURMI*	143
	REQUEST FOR FEEDBACK	147

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   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

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OUTSOURCING AND COMPETITIVE ADVANTAGE

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ABSTRACT

Based on empirical analysis of selected case studies this paper makes an attempt to appreciate the use of value chain analysis in outsourcing decision. The primary activities and support activities are analyzed for selected companies to arrive at conclusions on applicability of value chain model to increase the effectiveness of outsourcing decision. The analysis and evaluations are made on broad based strategic choices relating to scope, organizational design and ownership. The finding of the study supports the view of treating outsourcing decisions as strategic choices. The expectation of single benefit of low cost advantage, scale economies have considered as a narrow mindset in to the broad based strategic choice. The variables like deepened supplier relationship at effective cost and significant improvement in R&D and Customer satisfaction emerge as important variables that build competitive advantage to the firms in the long run.

KEYWORDS

Outsourcing, Value chain analysis, Case method research, Competitive advantage, Core competence.

INTRODUCTION

Once upon a time majority of large American and Japanese corporations appeared to have vertically integrated, they were not actually so in real sense. Many of them had extremely diverse product offerings and were successful in redeploying skills from one market to another. It is also known that most of these corporations contracted out significant support activities opening new avenue of outsourcing. The myth associated with the vertical integration paved a way for outsourcing. The choice between two different sets of strategic alternatives has a far reaching impact on organizational strategy. At some point in time, when organizations fail to achieve scale of operations, they arrive at outsourcing.

REVIEW OF LITERATURE

Outsourcing as a decision can be traced back to (Coase,1937) theory of the firm. Coase discusses the trade off between manufacturing or outsourcing. If the transaction cost of manufacturing is high it is advisable for the companies to buy rather than manufacture.

The transformation of industries have changed the very structure of industrial corporation today. Research suggests that very few companies will be able to develop internally all the technologies which may lead to competitive advantage. The source of competitive advantages are derived out of a firms own technologies or processes, but such instances are few in the present industrial context. (Porter, 1985).

Outsourcing is becoming popular in all spectrum of industry. Outsourcing is purchase of a value creating activity from an external supplier (Hitt, 2007). Firms can avoid risk and can increase the flexibility of their operations by taking up outsourcing alternative. 15% of the 145 large companies surveyed by Forrester research group say outsourcing is permanent part of their strategy. 33.4% of the companies surveyed by enterprise systems are currently outsourcing it projects and 48.2% of the companies are evaluating out sourcing providers. The auto component and electronics industry are foremost players in outsourcing. (Takeishi,2001)

NEED AND IMPORTANCE OF THE STUDY

The firms which have found solace in vertical integration later realized that they were losing their competitive advantage at the cost of vertical integration. The next apparent choice was outsourcing. The outsourcing decision deals with what activities/operations to outsource and which one to keep. A wrong step in this regards may cost competitive advantage for the firm. There is need for a framework which supports an outsourcing choice. The value chain framework answers most of the questions raised in taking up outsourcing as an option. The study suggests a framework with which outsourcing decisions can be made logically.

OUT SOURCING AND VALUE CHAIN LINKAGES

The very essence of value chain is about how a product moves from raw material to final consumer without incurring significant cost. Value chain analysis helps a manager to identify the part or parts of operations that creates value and those that do not. In other words the investment in such investments should earn a return which is more than the funds cost. The outsourcing decision can be traced back to value chain analysis suggested by Porter. The value chain analysis gains its importance with business level strategies. Companies try to concentrate on two or three activities in their value chain which are important to develop competitive advantage. Value chain analysis tries to integrate primary and secondary activities. Primary activities include physical creation, sale and after sales service, where support activities provide assistance for the primary activities to take place. Apart from the variables in value chain, the firms' knowledge of its customers create value to itself. The advent of internet and subsequent e-commerce initiatives has made the task of collecting information on customers relatively easy.

OBJECTIVE AND METHODOLOGY

The literature review has identified the lacuna in making outsourcing decisions. The perceived benefit from outsourcing decision is still matter of doubt in the cases where the organisations fail to gain competitive advantage. The objectives of this study can be listed as follows:

To evaluate the outsourcing decision using value chain analysis.

To identify the strategic initiative taken by the firm using value chain model.

In this paper we make an attempt to establish linkages between outsourcing and value chain through selected case studies. Theoretical sample method is used here which simply means that the cases are selected because they are particularly suitable for illuminating and extending relationships and logic among constructs (Eisenhardt & Graebner, 2007). Case study research in strategy is popularized by Mintzberg and Waters(1982). Building theory from multiple cases makes yield more robust. The argument here is that the firm focuses on evaluating its value chain with respect to its competitors and to perform value creating activity that competitors can not compete. An attempt is made to match the cases with the framework of choices concerning scope, organizational design and ownership structure. An outsourcing becomes non-value added activity then companies realize that they are unable to have competitive advantage. At this point in time they may take up back sourcing. The study showcases cases on both outsourcing and back sourcing based on value chain analysis.

ANALYSIS OF CASES

TOYOTA MOTORS

Toyota motors categorizes its purchases (outsourcing) in to general, special and specialty. Components of general purchasing is bought from any factory. Components of special purchasing can be bought from outsourcer with specified facility and skill and specialty factory purchasing requires special facilities. This identifies the choices related to scope in strategy formulation. The stage of value chain Toyota has chosen to maintain its competitive advantage is related to primary activities. By outsourcing its minor components and selected components it is creating value for its shareholders. When General motors US operations had 3500 suppliers Toyota had only 200 suppliers. This shows the way in which the company has developed deep relationships with reliable suppliers to exploit its value chain.

FEDERAL EXPRESS

FedEx changed its nature of business by reorganizing parts of its value chain. To facilitate overnight deliveries it changed its primary activity of delivery business by reconfiguring outbound logistics, and aligned its secondary activity human resource management to facilitate the effect of reconfiguration. Here we can identify the perfect synchronization of primary and secondary activities.

DELL COMPUTERS

Dell is another player in outsourcing. It outsources most of its customer service activities where it concentrates on its just-in-time inventory and online distribution system to develop firm specific capabilities. Dell concentrated on a direct sales model which competitors felt difficult to imitate. Here dell has outsourced a primary activity, service. Instead it has focused on inbound logistics, where it had capabilities to run into just in time inventory to develop capabilities associated with value chain. Here the value creating potential is more in managing logistics and inventory than focusing on services.

APPLE COMPUTERS

Apple had long back realized that it can not make boxes, chips, monitors, cables, and keyboards. So it outsourced 70% of its costs and manufacturing. It outsourced design, printers and key marketing responsibilities. It consistently earned revenues through 80's.

It concentrated on its own disk operating system and the supporting software that played a major role in creating that "apple feel "to its customers. Apple has out sourced a primary activity operations as the value creating potential associated with the activity is less than that of manufacturing them in-house.

NIKE

Nike is a household name for athletic footwear. It has 100% outsourcing in shoe manufacturing. It outsourced manufacturing to contractors in South Korea, Taiwan, China and Indonesia, who built shoes in exact specifications and delivered a high quality good in accordance with a effective delivery schedule. This made Nike to reduce costs significantly. Company had no obligation to invest in raw-material inventory and work in progress inventory. All it had finished goods inventory in its book. It concentrated on product design and product marketing but did not actually produce the shoes. Out sourcing primary activity of manufacturing has helped Nike to develop capabilities which are needed to develop sustainable competitive advantage as it concentrates on pre production activities related to R&D and post production activities related marketing and sales and went on to have a 20% compounded annual growth with 31% ROE to its share holders. In this case Nike has added new activities like preproduction R&D to its value chain and successfully skipped logistics and manufacturing oriented activities as it realized low value creation potential of these activities. Nike follows multi tier outsourcing strategy involves categorizing its outsourcing partners in to Developed partners, Volume producers and Developing sources. Wherein developed partners produce Nike's statement products, volume producers produce 70,000 to 85,000 units per day, and developing resources involve low labor costs.

MNC PHARMACEUTICAL MAJORS

Large pharmaceutical companies outsource 40 to 60 percent of their R&D operations to specialized companies in India and china. Pharma companies keep their strategic activity with them and outsource non-strategic activities. Many of the pharmaceutical companies even outsource their R&D activities. Other areas of outsourcing are clinical trials on animals and human volunteers etc. Pharma companies are trying to build capabilities in development of new molecules, which can be considered as a strategic activity to them. Whereas concentrating on clinical trial can be a non value added activity.

Out sourcing has both pro's and con's . When outsourcing is not able to generate desired value, then firms take the route of back sourcing.

OUTSOURCING Vs. BACK SOURCING

JP MORGAN

Back sourcing is the process of bringing back the outsourced process back under firms arm. Few case studies illustrate the firms effort to take up back sourcing when the hidden costs bring down the cost advantages in the long run. JP Morgan Chase had outsourced its IT operations to IBM under a 5 billion contract. All assumed that this is going to reduce costs and boost innovation. But for companies surprise cost did not come down instead the firm incurred significant costs which led to the termination of most celebrated outsourcing deal

DIEBOLD

Diebold is popular for its automatic teller machines, voting machines and security systems. Diebold hired Deloitte to outsource IT enabled services over a seven year contract in implementing Oracle based ERP systems. After four years Diebold realized the cost of implementation has significantly raised. It terminated the contract before falling prey for it. The out sourcing plan did not help Diebold in developing the capabilities it wanted to develop.

FINDINGS AND DISCUSSION

The above cases identify the typology of capabilities firms build to have competitive advantage. The identification of right stage of value chain is more important to create competitive advantage. The right type of coordination across business units or divisions is the key for outsourcing success. The capability of corporate office to facilitate right coordination between suppliers and operations is the matter of debate here. The appropriate level of ownership is another factor governing success.

Factors which are important for competitive advantage according to value chain analysis and basic strategy analysis framework of choices relating to scope, structure and ownership can be summarized as follows:

Company	Primary activities outsourced/alligned	Support activities outsourced/alligned	Strategic initiative
Toyota	Manufacturing	Not applicable	Deep supplier relationship
Dell	Customer service activities	Not applicable	Direct sales model
Apple	Components	Not applicable	Apple touch
Nike	Manufacturing	Not applicable	Design related R&D

Source: Authors

Out sourcing can be a source of competitive advantage if this decision is evaluated based upon value chain analysis. The analysis is not one time affair it should be continuous process in organizations as external both micro and macro environment of business changes may impact these decision variables forever. Outsourcing finally emerges as a strategic decision with far reaching implication on organizations.

CONCLUSION

It may appear to firms that the outsourcing decision is an easier one to make. But unfortunately it is not so. Firms need to give careful thoughts on evaluating their outsourcing decision. Value chain analysis identifies the relative importance of primary and secondary activities in deciding upon the outsourcing decision and perceived advantages.

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