

Outsourcing Strategies for Small Businesses: Issues, Theoretical Bases, and Guidelines

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An emergent strategic trend among small businesses is to outsource some of the company's peripheral business functions, a strategy previously taken primarily by medium- and large-sized enterprises. This article reviews discussions of this trend, both in the general practitioner literature, and furthermore in the empirical and theory-based academic journal literature. In line with the mission of the *Small Business Institute® Journal*, pertinent issues are considered and guidelines are offered, both to small business owners and managers, and to those who advise and assist such businesses.

Outsourcing has been a basic strategy for larger American businesses for many decades (Outsourcing Institute, 2014; Quinn, 1999). Consumers are most aware of this practice when they have telephone or on-line communication with the customer service offices of large companies and when it is clear that the service person is located in another country. Similarly, people working in larger businesses and other organizations often must deal with external parties for their health insurance and other benefit claims, or eat in company cafeterias managed by separate food service businesses.

There is a clear economic logic for larger companies and organizations contracting out certain business activities. Many necessary business functions are peripheral to the central mission of the business (such as health insurance and food services), and/or are labor intensive yet not complex (such as telephone customer service) and thus appropriate for delegation to external service firms, often in countries with significantly lower wage rates. Similar in nature and corporate strategy would be the outsourcing of manufacturing to foreign low-cost locations, such as in the clothing and footwear industries, leaving the primary in-house business activities of the company to its core strengths, such as product design and marketing (Caggiano, 1997; Tully, 1993).

However, until recently, small business owners and managers did not consider such an outsourcing strategy for their own businesses. Either the outsourcing process seemed too complex and time-consuming, or the potential financial benefits did not appear to be significant enough to warrant the effort. Yet smaller businesses are now seeing possible value in such strategies, with a growing number of small business owners and managers beginning to outsource certain business activities (Cardon & Stevens, 2004; Gilley, McGee & Rasheed, 2004; Heneman, Tansky & Camp, 2000). Still, as discussed below, this small business development has received relatively little treatment in the literature, especially in journals targeted toward those who research and/or assist such businesses (Gilley, McGee & Rasheed, 2004). Therefore, this article reviews and analyzes this trend and offers conclusions and recommendations to small business owners and managers, and to those who study and aid them.

First, the general and practitioner literature will be reviewed to provide a basic overview of this phenomenon of small business outsourcing, and then the academic empirical and theoretical literature will be examined for more complex issues and nuances, thus allowing better in-depth discussion which should be of value to the interested reader. (For the general and practitioner literature review, the search methodology utilized basic non-academic search engines such as *Google*, while for the academic literature search, academic search engines such as *Business Source Premier*, *Proquest*, *LexisNexis Academic*, and *Google Scholar* were used. These searches used key words, in particular "outsourcing," "small business," and "entrepreneurship." While of course using any one key work alone generated a very large number of "hits," when used in combination the number of truly relevant results were very limited, thus supporting the value of this article)

REVIEW OF THE GENERAL AND PRACTITIONER LITERATURE

Recent non-academic, practitioner-oriented literature focuses on current trends for small American businesses to move toward outsourcing certain business activities which are not central to their business mission, or which are beyond the owners' or managers' areas of expertise. While small businesses have often retained external accountants for tax preparation and outside attorneys for certain legal necessities that arise, this trend goes beyond those services to additional business activities not previously considered by small business owners and managers. Discussion of this trend can be found in the business sections of newspapers, in business periodicals, and on business advice websites. A primary point raised in this literature is that outsourcing is no longer limited to the business strategies of large and medium-sized companies (Carmona, 2008, Korkki, 2014, Null, 2013).

The reasons for this trend are both practical and economic. Small business owners and managers constantly find themselves under pressures of time – there simply is not sufficient time in a day or week to do all that is needed to maintain and grow one's business. Furthermore, certain necessary business tasks may not be truly managerial in nature and/or may be better performed by someone who is a specialist with regard to that task, rather than having the generalist skills necessary for small business management. From a cost factor, small business owners and managers are realizing that certain tasks may be more efficiently performed by an external specialist, and thus be less costly to the small business. This is especially true when the work is outsourced to a country with a less-developed economy and with lower wage rates than that of the United States. For outsourced services which require English language skills, certain developing countries having an English language historical background, such as India and the Philippines, may be especially appropriate (Korkki, 2014; Mosakowski, 1991).

Small business activities appropriate for outsourcing may include one-time or infrequent projects in technical areas such as software development, website design and setup, legal advice, and language translation services. More on-going services suitable for outsourcing might include website maintenance and routine telephone or on-line customer service. Although more often outsourced by larger companies, small manufacturing businesses may find some of their components, products, or packaging supplies worthy of outsourcing (Korkki, 2014, Null, 2013, Zimmerman, 2014).

The consensus of the practitioner literature is that certain small business activities are especially appropriate for outsourcing- those functions that are not part of management's core focus or competence – the suggested policy being "stick to the competitive differentiator." Most often these outsource-appropriate functions might include: marketing services; financial services; human resources functions such as employee benefits and healthcare packages; legal services; and IT and website management activities (Hughes, 2010).

Although somewhat tangential to the focus of this article, it should be noted that business outsourcing to foreign countries serves not only the American company choosing to outsource and the foreign company performing the outsourced service, but also benefits the country and its economy in which the outsourcing takes place, providing an inflow of capital into that country, raising the standard of living there, and reducing the country's unemployment levels (Korkki, 2014).

Central to this practitioner-oriented coverage of this trend in the general literature are guidelines for small business owners and managers – how does one assess the appropriateness of outsourcing for a small business, how does one find the right person or company to perform the outsourced service, how should control of the activity be maintained, and how will outsourcing impact the small business, its managers and its employees?

The consensus is that the implementation of outsourcing for a small business should entail slow and careful analysis. This is common-sense advice. Potential outsourcers should be fully researched and vetted, with many questions asked and information obtained. Meet the potential partner face-to-face if possible. Obtain and check referrals. Do not focus on *cost* as the primary criterion when choosing an outsourcer – the potential personal relationship is more important than finding the least expensive service supplier, especially for longer-term arrangements. If English language skills are important in the outsourced service, it is important to speak to those who will actually be providing that service. Develop a written contract spelling out the duties and responsibilities of both parties (Carmona, 2008, Lorber, 2007, Null, 2013).

For certain types of business activities, a variety of on-line marketplaces and finding services can assist in identifying and recommending potential outsourcing service providers to a small business owner or manager. For example, several on-line services post individuals' and service businesses' specific skills and portfolios, publish reviews, and often arrange for the payments to the outsourcer, taking a fee in the form of a commission or percentage. Some services of this nature include www.elance.com, www.guru.com, and www.odesk.com. These three on-line marketplaces list freelance individuals or small service businesses which can offer services, generally short-term project work, and they can also connect an American small business with foreign manufacturing or customer service firms for longer-term outsourcing. For example, oDesk's website lists typical freelance services including "web development, software development, networking and information systems, writing and translation, administrative support, design and multimedia, customer service, sales and marketing," and many more.

Some of these small business–outsourcer connection services specialize in specific forms of business activities. For example, Priori Legal (www.priorilegal.com) specializes in legal services for small businesses. Attorneys can apply to be listed with Priori Legal, and are then vetted – only 20% of lawyers' applications are eventually accepted by Priori Legal. When an individual or small business submits a request for legal services, Priori Legal will supply a list of three to five attorneys who best fit the needs of the requestor. Priori Legal's services extend beyond the matchup, offering tools and analytics to help small businesses track and manage the relationships they arrange with one or more lawyers. The chosen attorneys pay a commission on their legal fees to Priori Legal (Zimmerman, 2014). A Google internet search will identify a number of websites offering similar services to those offered by Priori Legal.

The support of the small business' existing employees is important to assure the success of an outsourcing decision. A small business' employees will naturally be concerned that outsourcing activities which were previous performed internally will result in layoffs or disagreeable changes in internal employee assignments and responsibilities. Business consultants who specialize in outsourcing issues conclude that outsourcing rarely results in a reduction of the business' internal staff, but rather allows that staff to focus more effectively on what they do best – perform the company's core business activities (Carmona, 2008). Still, assurance for existing employees is very important, and top management must focus on this issue.

And once the outsourcing decision has been finalized and implemented, strong follow-up by top management is critical. Outsourcing does not mean washing one's hands of the need for supervision and monitoring – rather it becomes even more important, since the activity is being performed by a non-employee, often at a distant location (Carmona, 2008, Khan & Khan 2013; Null, 2013).

The preceding discussion should allow a small business owner or a consultant to such businesses to understand the basic issues and guidelines regarding small business outsourcing. However, a major readership target of the *Small Business Institute® Journal* is business administration academics who

specialize in experiential student team consulting. This readership should find that the *academic* literature on small business outsourcing, beyond the *general and practitioner* literature, can further strengthen their understanding of this phenomenon. Therefore, the next section of this article reviews the *academic theory and research* literature related to this topic, which may offer more nuanced guidance to small business owners and their advisors.

There is certainly an overlap between these two areas of literature – general/practitioner and academic. Yet much of the academic articles on this topic have been published in journals which de-emphasize the *applied* value of research and emphasize the *theory-building* value; and the general/practitioner literature on outsourcing rarely relies on academic research in its discussion of this issue. The *Small Business Institute® Journal* is among a minority of university-published journals that successfully bridge this gap between *theory-based research* and *applied research*, and this article's purpose is to strengthen that bridge.

REVIEW OF THE ACADEMIC LITERATURE

The academic literature includes a variety of research-based *theories* and findings which have relevance to this topic of small business outsourcing. These theories and research findings allow small business owners and managers, and those who advise or consult to small businesses, to further refine and sharpen their understanding of small business outsourcing and the nuances and implications which this literature offers. Since many small business owners or managers may not be comfortable with the nature and form of academic writings, it is especially important for advisors and consultants to pursue the following discussions and citations, so that they can expand and strengthen their service to their small business clients (Street & Cameron, 2007). Furthermore, many small businesses are *family businesses*, and some of these theories are especially relevant where the family and its members are added to the components of the business system. This too will be discussed in this section of this article. And because each of these theories is substantial and complex, and because each has generated a sizable body of literature on its own, this article can only briefly present the most relevant theories and their relationship to small business outsourcing.

One of the most relevant theories for small businesses and entrepreneurs is *agency theory*. This theory relates to business situations where two or more parties or groups of individuals are central to a business' activities, and where issues of common interests versus self-interests, and conflicting objectives and values, have significant impacts upon the organization and its performance (Eisenhardt, 1985; Seven Pillars Institute, 2014). The *agency* issues relevant to outsourcing are between the small business and the outsourcing party or parties, and can be substantial and significantly weaken or threaten the potential value of the outsourced activity and its benefit to the small business. To reduce the opportunities for such issues to arise and damage the small business, legal experts recommend formal written contracts to insure that the outsourcing party and the small business managers fully understand each others' expectations, responsibilities, and obligations (Geis, 2007). Furthermore, for small businesses which are *family businesses*, *agency theory* adds *additional* parties and complexities: family businesses often involve family member owner/managers and also non-family-member managers (Sonfield & Lussier, 2009).

Another relevant theory, *Core competency theory* strongly relates to outsourcing (Hancock & Hackney, 2000; Ljungquist, 2007). This theory suggests that some business activities should be performed in-house and other activities are better performed by outside contractors or suppliers. This must be based not only on the competencies or key and fundamental skills and strengths of the business, but also on other factors, such as maintaining employee morale or upholding the firm's defenses and competitive advantage.

Resource-based theory relates to small business strategy and outsourcing (Barney & Clark, 2007; Pettus, 2001). Businesses and their management identify those resources which are critical and specific to their activities and performance and develop strategies to renew and enhance these resources. Where resource and capability gaps are recognized, strategies are generated to fill these gaps. Yet, central to the issue of outsourcing, some gaps are too difficult or expensive to fill, due to major internal resource deficiencies – thus the need for outsourcing.

Looking further at outsourcing by small businesses, additional issues arise. Memili, Chrisman and Chua (2011) focus upon *transaction cost theory* as a basis for examining the issues in outsourcing. Transaction cost theory helps to explain managerial decisions and strategies, with the primary factors being *asset specificity*, *opportunism* and *risk preference*. Transaction costs are both quantitative and qualitative, and negotiation and other managerial actions are utilized to minimize these costs. This team of academic researchers investigated how family businesses and non-family businesses differ in their outsourcing decisions and activities, and their research indicates that a) human asset specificity, opportunism, and risk aversion will make family firms less likely to engage in outsourcing, while b) the availability of kin-controlled suppliers, the importance of economic goals, and lower control concentration will be positively associated with family firm outsourcing. Thus, there are additional issues that must be considered when a *family* business considers or implements outsourcing, which by its nature may reduce the control and power of the *family*.

These four research-based theories are only a few of those which have relevancy to small business outsourcing. A discussion of *all* potentially relevant theories is beyond the scope of this article, but the interested reader might wish to investigate some additional theories: *neoclassical economic theory*, *partnership and alliance theory*, *rational exchange theory*, *social exchange theory*, *theory of firm boundaries*, and *stakeholder theory*. A good overview of these various theories, as they relate to small business outsourcing, can be found in Gottschalk and Solli-Saether (2005).

Beyond academic theories, some specific research studies and conceptual presentations are also of value with regard to small business outsourcing. For example, offering insight as to why *some* small businesses are more likely to engage in outsourcing than are other small businesses, Gilley, McGee, and Rasheed (2004) studied possible antecedents to manufacturing outsourcing by small businesses, and found that a) higher levels of perceived environmental dynamism and higher levels of managerial risk aversion are both associated with increased outsourcing activity by the firm. Furthermore, firm maturity acts as a modifying factor, so that b) mature firms are more likely to engage in outsourcing than younger firms when their top management has stronger attitudes of risk aversion. Both small business owners and their advisors should be aware of these factors that might impact the decision to outsource or not.

Another issue with regard to outsourcing involves the need to analyze the potential value of outsourcing versus keeping the business activity internal to the small business. Baxendale (2004) has provided a detailed explanation as to how *quantitative* methods can be utilized to perform this analysis. While Baxendale, who is a professor of accounting, recognizes that both qualitative and quantitative analyses are required to best determine the likely value of outsourcing, he stresses the value of quantitative analysis. His suggested evaluative methodology involves “relevant costs,” which will differ between the alternatives of in-house versus outsourced activity, and he offers a variety of methods including *learning curve analysis*, *indifference analysis*, *Monte Carlo simulation*, and *economic value added analysis*. Detailed explanations of these methodologies are beyond the scope of this article, but interested readers might choose to pursue these methodologies further.

Summarizing the rationale for small business outsourcing, Belcourt (2006), focusing specifically on the outsourcing of human resources management, engaged in scholarly empirical research and found a number of factors supporting outsourcing. These factors can be generalized to apply to most other potentially outsourced activities as well:

- Financial – the outsourced service provider, utilizing economies of scale, can often provide the service at a lower cost. Also, small businesses may be more conservative in their spending on a service if it is outsourced and invoiced to the business than if that service is performed in-house as part of the business' total expenses.
- Strategic Focus – small businesses which outsource certain functions can then focus on their core competencies.
- Technical – outsource providers often possess the technical skills and systems which are not available within the small business (such as computerized interactive voice responses for employee benefit questions and services).
- Improved Service – often quality control can be achieved when performance standards are written into an outsourcing contract, while performance improvement may be more difficult to attain from long-tenured internal employees with established work habits.
- Specialized Expertise – “outsource when someone can do it better than you.”
- Organizational Politics – when outsourcing enables a business to eliminate a troublesome in-house department.

Yet Belcourt's research also recognized the potential *negative* factors regarding small business outsourcing:

- Risks and Limitations – will the anticipated financial savings be realized? Might service suffer if outsourced? Might internal employees' morale be negatively affected? Does outsourcing reduce the value of the internal organization?
- Projected Benefits versus Actual Benefits – surveys have found that sizable percentages of owner/manager respondents reported that the expected benefits of outsourcing did not materialize. Costs were higher than expected and/or in-house oversight of the outsourced activities became more of a task than expected. Many outsourcing arrangements are not renewed in the long run.
- Service Risks – the quality of outsourced services may be lower than expected, or the service needs of the small business may change over time but the outsourcing contract may not provide for or accommodate such changes.
- Employee Morale – If and when the outsourcing results in displaced internal company employees, morale and performance will often suffer among the remaining employees, as their sense of identification and job security is weakened.

Given this combination of both positive and negative factors, it should not be surprising that Barzcyk, Husain, and Green (2007), investigating the outsourcing of human resource functions by very small enterprises, found that, even with the current trend toward small business outsourcing, most small business owners and managers still prefer to *not* outsource such functions, and only do so when they perceive such outsourcing as a *necessity* – because they feel uncomfortable or perceive themselves unqualified to perform the function internally. Asked specifically about 17 human resource management activities, respondents in a sample of 323 businesses generally preferred to keep such functions in-house when possible. Thus the “in-house” versus “outsource” decision was generally made by these small businesses for *subjective* reasons rather than for *objective* cost-based reasons, while the decision criteria for larger companies tend to be largely *objective*.

Going beyond a specific focus on outsourcing, other academic researchers have investigated the broader issue of small businesses’ *external relationships*. Such relationships and the resources they can provide can be important in moving a small business toward increased success and profitability (Street & Cameron, 2007). As with the research studies cited above, this *external relationship* research goes far beyond the scope and objectives of this article, and therefore can only be summarized. Street and Cameron developed a conceptual model of external relationships for small businesses, focusing on *antecedents*, the relationship *processes*, and the performance *outcomes*. Each of these three components is then broken down further, so that, for example, the antecedents include a) the individual characteristics of the entrepreneur, b) the individual characteristics of the manager, c) the organizational characteristics of the enterprise, d) the organizational characteristics of the external partner, e) the relationship characteristics, and f) the environmental characteristics. Clearly a conceptual model such as this may be too complex for most small business owners or managers to understand and utilize, but a professional or academic consultant should have the ability to translate this type of model into usable advice and guidelines for his or her client.

DISCUSSION

In summary, this article offers readers, both small business practitioners and those who assist such businesspeople and their companies, an overview of both the general and practitioner literature relating to the developing trend of small business outsourcing, and of relevant research-based academic theories, concepts and methods applicable to this trend. While the general literature, found in business newspapers, periodicals, and trade books, may be sufficient to inform and assist the small business owner or manager, the academic literature can offer more in-depth and intricate ideas and concepts of additional relevancy and value to the implementation of successful small business outsourcing. In bridging the gap between these two generally separate areas of literature and information, this article should prove of value to the reader.

CONCLUSION

As the owners and managers of small businesses move toward understanding the potential viability and value of outsourcing or contracting out some of their non-central business activities, it is important that they fully understand the positive factors, negative factors, and guidelines relevant to such strategic decisions.

And it is especially imperative that consultants and advisors to such small business owners and managers educate themselves fully with regard to the academic literature containing research findings, theory development, and resulting guidelines which are relevant to small business outsourcing. Understanding the implications of such research-based theories as *agency theory*, *transaction cost theory*, *core competency theory*, *resource-based theory* and others, and also relevant quantitative

analysis methods as well as the research findings of the other academics cited above should provide these advisors and consultants with the in-depth knowledge to best understand the specifics of their clients' situations and needs, and thus enable them to provide informed and valuable assistance.

In conclusion, this article provides the reader with both a basic discussion of the issues, and furthermore points the way, through more complex discussion, references and citations, toward a more advanced and academic treatment of this topic. The potential benefits of outsourcing for small businesses are often indeed significant.

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