Managing Risks for Small Startups in Outsourcing

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Managing Risks In Outsourcing

**Abstract**

Title of this dissertation: Managing Risks For Small Startups in Outsourcing

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Keywords: Outsourcing, Risks in outsourcing, Production, Action plan for outsourcing.

Purpose: This purpose of this thesis is to explore UnikPlast’s risk management in its outsourcing strategies.

Research method: The research method is a qualitative case study. Semi-structured interviews were conducted with people directly involved in the outsourcing activities.

Empirical study: The empirical research was conducted at UnikPlast in interviews with the CEO and with the Product Manager.

Conclusions: The primary conclusion of this thesis is that an outsourcing model can help early startups when they engage in outsourcing activities. In addition, we found that UnikPlast manages the risks of outsourcing by the use of back-up suppliers, which reduces the consequences of a halt in the supply chain. Loss of expertise is reduced through joint product development and problem solving as well as by good communications with suppliers. In this way, UnikPlast has greater flexibility that further decreases its risks with outsourcing.
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1. Introduction

In this chapter we describe the background of our research and present the topic of outsourcing and the risks associated with it. The chapter also describes the problem discussion and presents relevant definitions. The chapter concludes with our research question.

1.1 Background

Outsourcing became increasingly common during the 1980s. By the latter half of the 1990s, outsourcing had become a very popular practice for companies. Outsourcing can be defined as “the act of obtaining semi-finished products, finished products or services from an outside company if these activities were traditionally performed internally” (Dolgui & Proth, 2013, p. 6770).

Initially, companies outsourced simpler module assemblies at the end of the production chain to a local supplier. Today companies outsource complex processes at the beginning of the production chain to suppliers who may be located in other parts of the globe. Outsourcing partners no longer just produce goods or services. They also contribute special expertise for product and process improvements. In this way, such partners are closely integrated with a company’s strategy.

Innovation, flexibility, cost reduction, and speed in the development of new products or services are increasingly relevant for companies. These elements allow companies to maintain their market share and to meet customer demands. Thus, many companies focus on their core competencies, which can be defined as the internal skills that differentiate a company from its competitors (Prahalad & Hamel, 1990). Outsourcing parts of its business allows a company to focus on its core activities by transferring existing activities, which are not core activities, to an external third party. These authors emphasize that core activities, which are essential for a company’s competitiveness, should not be outsourced. The transfer of certain responsibilities and certain decisions to third parties through outsourcing allows a company to focus on developing its core activities with the expectation that it can increase its profitability and still meet customer demands.

The benefits of outsourcing are mainly the reduction in costs and the increased flexibility in, as well as the focus on, specialization (Dolgui & Proth, 2013). For these reasons, outsourcing is a common practice in both international and domestic marketing. However, outsourcing does not always bring these benefits or increase profitability because of the many problems associated with the practice. Examples of such problems are the following: hollowed out core competencies, loss of control, and less innovation and learning (Embleton & Wright, 1998; Insinga & Werle, 2000).

At one time, when companies hoped outsourcing would result in new successes, managers and leaders sometimes ignored the risks associated with outsourcing essential activities. Too little was understood about the possible adverse effects of outsourcing strategies (Abrahamsson et al., 2003; Embleton & Wright, 1998; Insinga & Werle, 2000).

Small, startup companies (hereafter, startups) have a very different agenda than large, established companies when they use outsourcing. Often startups do not outsource an internal process. Rather, they outsource certain activities in order to acquire expertise in the outsourced area. Startups also often lack the time and/or the funds for the activities that other parties can perform. For example, startups often cannot purchase all the necessary machinery or hire all the necessary personnel. Therefore, they turn to providers who have these resources.
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The subject company in our thesis is UnikPlast, a startup that develops innovative products in the plastic industry. Like most startups, UnikPlast has limited investment capital and a small staff. Its products are the latest in the industry and require advanced production knowledge. UnikPlast first developed its products through simple prototype manufacturing. When the prototype was well received by the market, customer demand increased to the point that UnikPlast had to increase its production capacity and at the same time increase the quality of its products without compromising their functionality. At that point, UnikPlast realized it needed to outsource some production.

In this thesis we analyze UnikPlast’s use of outsourced production. Based on this analysis, we develop a model that other startups can use for successful outsourced production. We also describe the risks UnikPlast faced and the difficulties it encountered following initial poor decision-making. We describe how UnikPlast might reduce such risks and avoid such difficulties.

1.2 Problem discussion

Since the late 1980s outsourcing has become a commonly used economics term in business (Greaver, 1999). Researchers and commentators have written a great deal about the topic in the following years. In the literature, the primary emphasis is on the benefits that outsourcing brings – reduced operational costs, a stronger focus on core activities, and reduced capital investments (Dolgui & Proth, 2013). However, much of the recent literature focuses on the disadvantages of outsourcing. When companies transfer parts of their business to one or more external parties, their risks increase. They must evaluate these risks before decisions are taken on outsourcing and/or on the outsourcing partnerships (Beasley et al., 2004). Some companies have even begun to reverse their outsourced operations using the so-called practice of insourcing.

One reason for insourcing may be that it is no longer relevant or strategic for a company to outsource because of changing market conditions and new technology development (Quelin & Duhamel, 2003). However, companies spend a great deal of time and money when they choose, negotiate with, and monitor suppliers as they restructure their organizations using outsourcing. It is very costly to cancel supplier contracts (i.e., turn to insourcing) after having invested so much in the outsourcing cooperation – investments that cannot be recovered (Hoecht & Trott, 2006).

Risks in organizations have increased as a result of increasingly complex supply chains and networks. Four factors explain this increase in complexity: more complex products and services, e-commerce, outsourcing, and globalization (Harland et al., 2003). Problems also arise because of delivery delays and downtime. Another significant risk in outsourcing is that a company may become too dependent on a single supplier who may then exploit the relationship. This scenario is likely if the outsourcing company does not divide its outsourced production among different suppliers (Aron et al., 2005).

Hence, company management must identify, analyze, and manage the risks in its organizational outsourcing strategy (Harland et al., 2003). In a small startup, when outsourcing is essential, it is important to know the risks and how to handle them. We think that risk management in outsourcing is an important issue, especially for startups. While most companies know the benefits of outsourcing, it is not clear that they know how to identify and manage the risks associated with outsourcing.

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1 UnikPlast is a fictitious name.
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1.3 Purpose
Our main purpose in this thesis is to explore the potential risks in outsourcing of production by examining how startups can actively manage these risks. Therefore, we develop an outsourcing process model that can be used as a tool for forming an outsourcing strategy for UnikPlast and, more generally, for other startups facing the same kind of risks that UnikPlast does. Our research question is the following:

How can a small, startup company manage the risks associated with its outsourcing strategy and activities?

1.4 Delimitations
Although our expectation is that our research results are generalizable, our study focuses on a single startup in Sweden. We have also limited our research in that we exclusively take the outsourcing startup’s perspective.

1.5 Disposition
This thesis has six chapters.

Chapter 1: The background, problem discussion, research question, and research delimitations are presented.

Chapter 2: The theoretical framework is presented. Theories on core competencies, outsourcing, and the risks of outsourcing (which underpin our results analysis) are described.

Chapter 3: The research methodology and approach are presented. Also discussed are the case selection, data collection, data analysis, and the research trustworthiness.

Chapter 4: The empirical data collected at UnikPlast are presented.

Chapter 5 The empirical data are analyzed in terms of our theoretical framework. The research question is answered.

Chapter 6: The most important findings are presented in this concluding chapter. Implications and contributions of this research are described. Suggestions for startups and for future research are proposed.
2. Theoretical framework

In this chapter we define the main subject of this paper: outsourcing. We begin with an explanation of how outsourcing can be coupled to a company’s core competencies and strategy. We also explain how outsourcing activities can be categorized. Next we describe the motives behind the decision to outsource production/services as well as the risks associated with outsourcing. We use this theoretical framework in the analysis of our empirical data in Chapter 5.

2.1 Outsourcing

Outsourcing is a practice that companies use to externalize parts of their business to an outside partner or partners (Bengtsson et al., 2005). By outsourcing, companies can gain cost advantages as well as increased sales opportunities, access to new expertise, lower annual costs, and more time to focus on core business strategy. Outsourcing can also provide major competitive advantages (Brown & Wilson, 2007). Outsourcing can be viewed as the practice of converting fixed costs to variable costs (Hoecht & Trott, 2006). By outsourcing certain manufacturing and production, a company can then focus on activities closer to its customers (Bengtsson et al., 2005).

Nordigården et al. (2014) state that the transfer of an activity also includes the transfer of the control of that activity. Today, however, because outsourcing is more often viewed as a way of achieving strategic objectives, the decision to make or buy a product or service should be carefully evaluated (Abrahamsson et al., 2003). McIvor (2005) concludes that an outsourcing strategy should be developed that is integrated with the company’s overall strategy. This means that taking a long-term perspective is essential in the outsourcing decisions. It is crucial that startups know and plan for the risks of outsourcing.

2.2 Core competencies

One definition of a core competence is the following: “The collective knowledge of the production system concerned, in particular, of knowledge of procedures and how to best integrate and optimize them” (Dolgui & Proth, 2013, p. 6770). In other words, core competencies differentiate a company from its competitors. Walsh and Linton (2001) add that a core competence provides potential access to a wider range of markets and industries.

When companies consider outsourcing parts of their business, it is essential that they identify their core competencies that give them a competitive edge. Ignoring the risks in outsourcing core competencies can have devastating effects on a company’s competitiveness (Alexander & Young, 1996). It is important, however, to note that the practical work of identifying core competencies is typically complicated because many risks are complex and poorly defined. In addition, core competencies vary over time. Prahalad and Hamel (1990) emphasize that unique, difficult-to-imitate skills associated with core competencies directly contribute to customer value and to competitive advantage.

After a company identifies its core competencies it can allocate (or reallocate) resources to the related activities and thus create a "unique value" that its competitors lack. In this way, the company works to ensure its competitiveness over the long term (Dolgui & Proth, 2013). Additionally, a company should look ahead and identify the activities that may lead to core competencies in the future. Mintzberg and Quinn (1992) claim that companies should focus on the activities they do best and outsource the others to external actors who can

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2 Various terms are used interchangeably in the literature and in this thesis to identify the entities that companies use for outsourcing of goods and/or services: partners, providers, and suppliers. All terms refer to the entity that performs the outsourced activities/services.
managing better. The difficulty, however, is in identifying a company’s core competencies.

According to Prahalad and Hamel (1990), one can identify the core competencies of a company in three different ways. The first way is to look at a company’s particular markets because core competencies provide access to a variety of markets. The second and most common way to identify a core competency is to look at customer value provided by the company’s product/services. The third way is to look at the company’s combination of skills in a context that is difficult for a competitor to copy. The skills individually may not create a core competence, but in their context, in combination, they may. While a competitor may be able to imitate some of these skills, it will likely be unable to imitate the comprehensive pattern of internal coordination and learning. Core competencies interact and develop products/services that ultimately result in the final product/service (Prahalad & Hamel, 1990).

Long and Vickers-Koch (1995) claim that a company's core competencies consist of two elements. The first element is the company's know-how, ability, and knowledge. This element is associated with the company's staff and the technology needed to improve the company's ability to create value. The second element is the company's processes—the processes it uses to deliver products in a way that benefits customers.

Outsourcing should focus on areas far distant from the company's core competencies. The strategic risks of outsourcing increase when activities close to the core competencies are outsourced.

Long and Vickers-Koch (1995) designed a model that can be used to identify the core (and non-core) activities that are especially valuable to the company. They emphasize in this context that it is always a combination of skills and processes that create a company's core competencies. They rank these activities on a scale from high importance to low importance to the core business. (See Figure 1). We next describe the model’s activities.

1. "Cutting edge" activities maintain the company’s future competitiveness. These activities must be developed continuously because they are the source of tomorrow's development and profits.
2. Core activities are the company's main processes that are the reason for its existence. They support the company’s other activities.
3. Support activities are directly connected to the core activities. Support activities are required to support the company’s core competencies.
4. Separable activities are activities that, although related to main processes, are easily detached and are unrelated to the core competencies.
5. Peripheral activities are not included in the main processes. They can be outsourced. An example is web design in a product engineering company.

If a company’s sorts its activities using these five categories it is better able to determine which activities are most important and which are less important. The model offers guidance on whether activities should be outsourced or not.
2.3 Pre-study

The purpose of a pre-study on the outsourcing decision is to examine every outsourcing idea. This involves an understanding of the company’s core competencies. A core competency refers to a company’s unique expertise and contributes to the product’s customer value.

According to Brown and Wilson (2007), the first step in the decision-making process is to identify a company’s needs by defining its strategic interests and overarching objectives. Which processes can be outsourced? Why should these processes be outsourced?

Product complexity influences the activities considered suitable for outsourcing. The difficulty is in understanding the design and the context of an activity considered for outsourcing (Kremic et al., 2006). The more complex the product, the more difficult it is to define the requirements and conditions of a contract with the outsourcing supplier. Products that require special equipment or tools may mean that the supplier has little incentive to upgrade its equipment if it has little to gain other than profit from this single project. In addition, the outsourcing company now finds itself in a dependent position because it needs the supplier’s special equipment. It then becomes difficult to change suppliers. Products that require special equipment, therefore, are less attractive outsourcing candidates.

Because the outsourcing decision may be controversial in a company, especially if it leads to staff terminations, a company should manage the process in a neutral environment and in the group with the mandate to influence the decision. According to Brown and Wilson (2007), a systematic and structured decision-making process leads to reduced costs, fewer delays, and a better work climate.

The second step in the pre-study is to analyze the goal of outsourcing activities. It is important that all stakeholders understand what is expected of them and what the company expects to achieve by outsourcing. A clear explanation of the scope of an outsourcing activity should be specified in the contract that will be signed with the supplier. The contract is a critical part of the partnership because it governs how the relationship should
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work in various situations. According to Brown and Wilson (2007), outsourcing projects based on the following four key points have the greatest possibility for success:

1. Strategic focus on core competencies
2. Management of issues related to employees, unions, and society
3. Identification of the lowest total cost or best value
4. Investigation of the effect on the internal processes

By focusing on these key points, the relevant data can be collected and decisions can be made consistent with the company’s strategic objectives and the conditions identified in the pre-study.

2.4 Desired benefits of outsourcing

Three main benefits of outsourcing are the following: (1) an increase in competitive advantage through cost reductions (Abrahamsson et al., 2003; van Weele, 2009); (2) the motivation to focus on core activities; and (3) access to knowledge and resources in the supplier’s market (Ellram & Billington, 2001). Suppliers can produce cheaper goods and services through economies of scale because they have much of their capital invested in machinery and other fixed assets (Quélin & Duhamel, 2003). The outsourcing company requires less investment in machinery and warehousing and can also employ fewer people.

Although outsourcing can provide significant benefits, there is always a threat to competitive advantage when activities are outsourced. A survey of outsourcing costs expressed as a percentage of revenues revealed that as much as 50 percent of some companies’ revenues is spent on outsourcing (Wu et al., 2005). This fact should be considered when outsourcing decisions are taken.

Moreover, when documents and drawings must be translated, language problems and misaligned goals create high risks. Product quality may also suffer if the supplier uses cheap labor. Travel and other transportation costs can also be significant when outsourcing. These problem areas should also be investigated prior to making an outsourcing decision.

2.5 Risk management in outsourcing

Because different organizations have different attitudes to risk, risk management varies from business to business (Harland et al., 2003). The kinds of risk in outsourcing depend on what and how the company outsources. In general, the negative risks of outsourcing decisions include loss of control and expertise, decreased profitability, and decreased quality of goods and services (Dolgui & Proth, 2013; Hallikas et al., 2004; Quélin & Duhamel, 2003).

Many risks can be classified as either operational risks or strategic risks (Beasley et al., 2004). Operational risks include risks related to performance of the outsourced activities (e.g., interruptions in the supply chain) or to problems from over-outsourcing. Strategic risks are the risks associated with suppliers who may try to increase their profit by using unskilled labor or skimping on materials (Aron et al., 2005). Strategic risks can also be the risks that stem from outsourcing core activities.

It is not uncommon in making risk assessments to focus on the potential magnitude of the potential problems rather than the probability that they will occur (Harland et al., 2003). This may be dangerous because single risks and their contributing factors may not pose a major threat, but when combined with other risks they may cause significant harm (Beasley et al., 2004).
2.5.1 Risks in outsourcing

While more and more companies recognize the value of outsourcing some activities, each company must consider how the entirety of its business is affected by an outsourcing decision (Frost, 2000). The problem is that many companies tend only to see the benefits of outsourcing and overlook the risks (Beasley et al., 2004; Juras, 2008). They do not evaluate the extent of the risk based on an evaluation of the outsourced activity / process characteristics. Frost (2000) thinks that the benefit a company achieves through outsourcing largely depends on how the risks are managed.

The main reasons that outsourcing projects fail are that decision-makers have not identified the risks and taken steps to prevent or minimize them. Or they have chosen to outsource the wrong product / process, have chosen the wrong suppliers, have designed a sub-standard contract, have overlooked the hidden costs, and/or have failed to plan for contingency action if the outsourced work is unsatisfactory (Juras, 2008).

We next describe the five most frequent risks in outsourcing based on our literature review.

2.5.1.1 Loss of control

In outsourcing, a supplier assumes control of the outsourced activity (Embleton & Wright, 1998). Thus, outsourcing by definition implies that a certain degree of control is lost. It is therefore important to assess the risk with loss of control. The severity of the loss of control depends to some extent on the nature of the outsourced activity and the outsourcing design. It should always be kept in mind that outsourcing can have a decisive effect on control (Augustsson & Bergstedt-Sten, 1999).

It is very important for a company in its early stage (i.e., a startup) to evaluate its control in order to calculate the effect of loss of control when an activity is outsourced. Von Corswant and Fredriksson (2002) claim that over-outsourcing can cause the company to lose sight of the value a product or activity produces. The separable activities, such as the services for cleaning, security, and occupational health, to name a few, are often relatively simple and have no direct impact on a company’s profitability. The loss of control over more production-related services, such as the critical activities of R&D, manufacturing, cost planning, and staff training, can have serious implications for companies (Dolgui & Proth, 2013; Prahalad and Hamel, 1990).

2.5.1.2 Loss of expertise

Long-term sustainability derives from a company’s core competencies that depend on its unique skills. Thus, when a company outsources certain activities it risks the loss of its expertise (Augustsson & Bergstedt-Sten, 1999) and the associated knowledge and experience (Quelin & Duhamel, 2003). From the company's point of view, it is therefore important not to be too aggressive with its outsourcing. It is essential that a company maintain sufficient expertise in-house when it outsources specific components. For that reason, the company should take care that its knowledge does not stray when it uses outsourcing (Augustsson & Bergstedt-Sten, 1999).

2.5.1.3 Decrease in flexibility

Achieving flexibility in work performance is usually one of the strongest motives for outsourcing. However, outsourcing can also decrease a company’s flexibility (Augustsson & Bergstedt-Sten, 1999) because most suppliers require long-term contracts that provide them with a stable income (Embleton & Wright, 1998). Thus, an outsourcing company is contractually bound to the supplier and a particular solution for several years. The company should, therefore, negotiate a flexible contract to reduce this risk (Augustsson & Bergstedt-
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2.5.1.4 Dependence on the supplier
In outsourcing, a company is more or less dependent on its supplier (Augustsson & Bergstedt-Sten, 1999). After a contrast is signed, it is costly and time consuming to cancel it. By selecting the “right” supplier, the company can reduce the risk of overdependence on the supplier. The “right” supplier is a supplier who is a good fit with the company, both culturally and personally. Mutual trust is essential.

According to Wasner (2000), outsourcing may also result in hollowed-out core competencies when the company outsources certain activities that require particular skills. If the company loses those skills, the dependency on the supplier increases. Insinga and Werle (2000) also warn of dependency-prone situations in which suppliers take a dominant negotiating position.

2.5.1.5 Higher than expected costs
The cost of outsourcing can be higher than expected when the cost of monitoring suppliers is underestimated (Wu et al., 2005). Given the usual give-and-take between the company and its suppliers over costs and quality (Embleton & Wright, 1998), the number of transactions between the two sides can increase the bureaucracy and hence the costs. As Augustsson and Bergstedt-Sten (1999) observe, there is also the risk of hidden costs (i.e., costs that were not anticipated and appear as the work continues). Today, however, the contracts between companies and suppliers, which are very detailed, are more costly to prepare but are intended to reduce future costs in the long run. Furthermore, outsourcing companies today are far more aware of how the system works, which means they make fearer fateful mistakes (Augustsson & Bergstedt-Sten, 1999).

2.6 Assessment of potential outsourcing partners
Companies that fail in their outsourcing partnerships will spend more money than necessary, will receive fewer benefits, and will have more dissatisfied customers (Brown & Wilson, 2007). In evaluating potential outsourcing partners, a company must clearly understand and formulate exactly what it wants, and expects, from the partnership. The most important step in assessing a potential outsourcing partner is to define what is expected of the supplier and its market. A company must decide which partner qualities are critical and which are negotiable. Bragg (1998) states that the most important criteria when choosing a supplier are, in descending order, its quality, its delivery reliability, and its price. In addition, companies should also consider their suppliers’ financial position (Greaver, 1999).

In practical terms, after a company decides on the kind of supplier it wants to work with, it should then identify suppliers who might be suitable (Embleton & Wright, 1998). The company can then ask for bids on the activities it wants to outsource. In this way, the company learns which suppliers are interested in the work. Thereafter, the company should visit potential suppliers to determine if there is a good fit.

According to Brown and Wilson, (2007), it is easier to succeed with an outsourcing relationship if the parties have compatible corporate cultures. Corbett (1996) adds that a supplier’s corporate culture and expertise are important selection factors when choosing a supplier. Similarities in company cultures allow for better collaborative problem solving by the company and its suppliers (Greaver, 1999). However, it can be difficult to assess a supplier’s corporate culture and workplace environment, even when the supplier has a written policy. Therefore, the outsourcing company must evaluate the supplier’s decision-making procedures as best it can. Some relevant questions are the following: Who makes the
decisions? How are decisions made? How are decisions implemented? Is the supplier’s decision-making a formal or informal process? Does the supplier encourage employee participation? Is the focus on profit or quality? Is the work atmosphere formal or casual? The supplier’s culture need not be identical to that of the outsourcing company, but it helps if they each understand the other’s way of working.

2.7 Outsourcing alternatives
The more advanced the manufacturing process, the more difficult it is to outsource it. According to Bengtsson et al. (2005), it may be difficult to recoup an investment in modern production technology with existing investment strategies. When management examines the investment proposals, the focus is often on cost-reducing investments, particularly those that can also increase revenues. However, because new and advanced production technology may be relatively untested, it is difficult to argue for the benefits of such investments.

One alternative is to insource previously outsourced activities of either an operational or strategic nature. The benefits from this policy might be an increase in the utilization rate of the resources, or (in the short term) a lower-cost product or service (Bengtsson et al., 2005).

Insourcing is said to be the opposite of outsourcing. A company insources when it recovers the production of previously outsourced activities. Strategic insourcing is often considerably more complex than operational insourcing. In the latter case, in many situations the outsourcing company may already have the needed structure and knowledge. However, with strategic insourcing, the needed knowledge and structure must be built or sometimes even acquired from the previous supplier who may be unwilling to cooperate (Bengtsson et al., 2005).

The potential disadvantages of insourcing are likely the same as the potential benefits of outsourcing. Outsourcing can result in the outsourcing company’s increased focus and specialization, mainly on its core competencies. If production is insourced, then much of that focus and specialization is diverted. The link between production and advanced development is an important interaction that should not be broken (Bengtsson et al., 2005).

2.8 Summary
Kremic et al. (2006) claim there is a tendency to exaggerate the benefits of outsourcing. They base their claim on the likelihood that the supplier is more inclined to perform better at the start of an outsourced activity (to make a good first impression) than later. In addition, outsourcing locks a company into a relationship with a supplier that often creates an unwanted dependency on the supplier. The more complex the outsourced activity, the greater the dependence on the supplier when significant resources are invested in the relationship.

Based on our theoretical framework, we designed a data collection approach that is useful in understanding the full scope of the outsourcing in our case study of UnikPlast. This approach has four main parts, which we describe next.

Core competencies: We first examine how UnikPlast defines its core competencies (which we use to analyze its outsourced activities). We adapt the Long and Vickers-Koch (1995) model of five activities ranked on a scale from high to low strategic importance for this purpose. See Figure 1 and the descriptions in Sub-chapter 2.2.

Assessment of potential outsourcing partners: We next identify and examine the strategy UnikPlast’s uses to select its suppliers. We look for links to the choice of outsourcing suppliers and the effects of that choice on UnikPlast. Linked to the step is our investigation of UnikPlast’s motives for outsourcing activities.
Success factors for outsourcing: We analyze UnikPlast’s relationship with its suppliers in terms of the success of outsourcing, in particular in the context of its expectations. For example, we look at various factors: cost reductions, knowledge access, sales and distribution, flexibility, supplier resources, etc.

Risks of outsourcing: We examine the risks UnikPlast’s faces with its outsourcing practice and how it manages them. The main risks we examine are the following: 1) Loss of control, 2) Loss of expertise, 3) Decrease in flexibility, 4) Dependence on suppliers, and 5) Higher than expected costs. (See Sub-chapters 2.5.1.1 to 2.5.1.5 for explanations of these risks).

In Figure 2, we present the first draft of our model of the outsourcing process based on the four main parts of our data collection approach.

Figure 2: Structure of outsourcing process (first draft) (Authors’ model)
3. Methodology

In this chapter we describe the methodology used in this thesis. We follow the Research Onion model developed by Saunders et al. (2006, 2009).

Based on the Research Onion model developed by Saunders et al. (2006, 2009), we explain our research methodology. See Figure 3. We work from a theoretical perspective to develop a practical method for data collection.

Figure 3. The Research Onion: Methodology choices from the model by Saunders et al. (2006).

3.1 Research approach

Qualitative vs. quantitative

According to Saunders et al. (2007), two commonly approaches in information gathering are qualitative research and quantitative research. In quantitative research, researchers use quantified (or numerical) data, also called hard data. In qualitative research, researchers use non-quantitative (on non-numerical) data, also called soft data (Malhotra & Birks, 2007).

In qualitative research, the focus is on a deeper understanding of the research problem using various information-gathering techniques in order to describe the totality of the context (Holme & Solvang, 1997). Fewer samples are collected in qualitative research because the researcher’s intention is to gain insights, understanding, or profiles (Gephart, 2004; Patel & Tebelius, 1987). In quantitative research, by contrast, researchers often use statistical analysis with their larger (and numerical) samples (Malhotra & Birks, 2007).

We use the qualitative research approach in our study since our purpose is to acquire a deeper understanding of a particular problem. We do not use the mathematical calculations or statistical analyses that are typically used in quantitative research.

Consistent with this choice of research approach we take a holistic perspective on our subject (i.e., UnikPlast and its outsourcing strategy). This means our research addresses areas and issues that cannot be studied separately and individually (as would be the case if quantitative research were used). For example, we examined UnikPlast’s strategy and core competencies in order to identify and analyze the effects of outsourcing from a holistic
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These effects can influence the outsourcing results. Therefore, the qualitative research approach was better suited to our purpose than the quantitative research approach.

**Deductive vs. inductive reasoning**

Two main ways of drawing conclusions are inductive reasoning and deductive reasoning (Saunders et al., 2007). Inductive reasoning, which is grounded in empirical data, draws conclusions from the facts established by the empirical investigation (see also Thurén, 2007) and are not anchored in theories. Deductive reasoning, which is based in theory, uses general principles to reach conclusions and permits more specific conclusions to be drawn from the empirical evidence (see Patel & Tebelius, 1987).

In part, we use deductive reasoning in this thesis. We began with the study of outsourcing theory in the literature that gave us a base for collecting and analyzing our empirical data. We relied on our theoretical framework (see Chapter 2). However, the literature is limited as far as our specific topic: outsourcing at Swedish hi-tech startups. Therefore, in part, we use inductive reasoning as we sought to draw conclusions from our empirical data.

**3.2 Research strategy**

Researchers’ choice of research strategy should enable them to respond to their research question(s). Thus, their research strategy should fit their methodological approach and their research purpose (Saunders et al., 2007). Among the many research strategies used in qualitative research (e.g., case studies, grounded theory, and experiments) case studies are a much-used strategy (Gephart, 2004). Case studies are often used in early exploratory investigations in which the variables are unknown and the phenomena are not well understood (Voss et al., 2002).

Case studies are a form of empirical inquiry that investigates a contemporary phenomenon in a real-life context (Yin, 2003). They are commonly used when boundaries between the studied phenomenon and the context are not clearly visible. Given this description of case studies, we think the case study is a methodological strategy well suited for this thesis on outsourcing at a particular startup.

Two kinds of case studies are often used: single case studies and multiple case studies (Yin, 2009). Single case studies are commonly used to investigate a critical or specific event. In contrast, multiple case studies are used to gather findings based on the ability to replicate predicted similarities or differences when one case is compared with other case studies (Voss et al., 2002; Yin, 2003). Because we are examining risk management in startup’s outsourcing, we selected the single case study strategy so that we could look specifically at outsourcing at UnikPlast.

Case studies can be cross-sectional or longitudinal. Longitudinal case studies are studies in which the researchers investigate change and development over a longer period of time. Cross-sectional case studies are studies of a particular phenomenon during a specific (usually shorter) timeframe (Saunders et al., 2006). We use a cross-sectional case study for two main reasons. First, we examine a single phenomenon (the risks of outsourcing) at a selected startup. Second, owing to time and budget constraints, we are unable to study this phenomenon over a number of years.

**3.3 Case selection**

It is necessary to define the scope of a case study in qualitative research (Eisenhardt, 2002). Budget and time constraints, which are common problems in academic research, limit the scope of research when using cases and conducting interviews. We also had these constraints. Therefore, we subjectively selected our case study subject (see Saunders et al., 2007).
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UnikPlast, our case study company, is in Halmstad, Sweden – the city in which the authors’ university (Halmstad University) is located. Convenience and accessibility motivated this case study choice (see Collis & Hussey, 2009; Saunders et al., 2007) in addition to the following four factors:

1. Size and complexity: The more complex the outsourcing process, the greater the need for a thorough risk management study.
2. Available information: People involved in the project are available for interviews; company documentation is available.
3. Project type: A project with some form of production relocation.
4. Project completion: Near to completion with available results.

UnikPlast made the strategic decision to use outsourcing suppliers. This decreased production costs and resulted in outsourcing the production of its main product, Unique Spoon. An examination of UnikPlast’s core competencies led to the outsourcing of this product to a supplier.

The individuals interviewed for this research wanted to remain anonymous. We have given them fictitious names in our thesis. “David Johansson,” UnikPlast’s founder and Product Manager, has been at the startup since 2011. Our interviews with him were conducted in Halmstad on June 13 and July 7 of 2015. “Lisa Nilsson”, the CEO of UnikPlast, previously worked at other companies in the same industry. We interviewed her in Halmstad on July 2, 2015.

3.4 Data collection
Primary data and secondary data are the two main types of empirical data (Myers, 2009). The researcher’s questions and purpose generally dictate which type of data is relevant for a research project (Yin, 2009). Primary data are information that has not been collected or published previously. Secondary data are data previously published, for example, in documents, newspapers, journals, the Internet, etc. (Warren, 2001).

We collected our primary data in interviews with decision-makers at UnikPlast: the CEO and the Project Manager for the outsourcing projects. We also collected data from internal project materials, presentations, and project reports. We specifically selected respondents who could answer our inquiries related to our research question.

Three types of interviews are used with the collection of primary data in interview situations: structured, semi-structured, and unstructured interviews (Collis & Hussey, 2009; Myers, 2009). We used semi-structured interviews because this format allows the researcher to ask additional and follow-up questions as needed. Semi-structured interviews also allow the respondents to speak more openly about their experiences and to offer their opinions more freely. In this way, more detailed data may be collected than if the researcher used a structured interview format.

We collected our secondary data from the literature on outsourcing (e.g., articles, research papers, and books). We identified this literature on the Internet and in pamphlets.

3.5 Interview guide
Warren (2001) states that qualitative interviews require open-ended questions in which the respondents are encouraged to tell their stories related to the area of interest. These questions do not have a predetermined goal. Researchers, in designing their interview format, should

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3 Unique Spoon is a fictitious name.
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c onsider the time available, the access to respondents, and the financial and emotional costs of conducting the interviews. (See our Interview Guide in the Appendix).

We designed eight questions based on our theoretical framework and nine company-specific questions on UnikPlast’s outsourcing strategy. We also asked each respondent to state his/her name, age, and position in the company. Our Interview Guide had three sections:

1) background questions, which framed the conversation;
2) probing questions, which clarified answers or requested further explanations; and
3) follow-up questions, which sought additional commentary on previous answers.

In addition, as stated previously, the interviews were flexible and left open the possibility that some questions would result in answers that made other questions irrelevant (Warren, 2001).

3.6 Data analysis

According to Saunders et al. (2007), researchers have to honor the respondents’ meaning when analyzing the data gathered in qualitative research. It is appropriate, in this analysis, to conceptualize the data.

We audio recorded, transcribed, and analyzed the interviews. (See the Analysis in Chapter 5). We translated the respondents’ statements from Swedish to English carefully so as not to miss or misrepresent valuable data (Bryman & Bell, 2015).

We began our data analysis after we had summarized and transcribed the interviews. We transcribed the interviews as soon as possible after the interviews in order to ensure that we had not missed important insights or misunderstood comments. We listened to the tapes several times to be sure we did not miss important facts (Trost, 1997)

To proceed with the analysis of data after transcription, Bryman and Bell (2015) caution that the data must be decoded, compared, explored, and tested in order to become a theory. According to Bryman and Bell (2015), coding is the allocation and labeling of empirical data into components that may be significant to the theoretical framework. When a theoretical framework is used to classify data, the data are linked to an existing body of knowledge in the field (Saunders et al., 2007). For this linkage, we took the following two steps:

1. Interpretation of the empirical data with a search for meanings and causes. Presentation of key research results in summarized, simplified form.
2. Search for correlations, similarities, and differences between the theoretical framework and the empirical data so as to produce a greater understanding of the studied phenomenon (i.e., risk management in startup outsourcing).

3.7 Trustworthiness

The trustworthiness of our research results can be evaluated on the basis of four important criteria: credibility, transferability, dependability, and conformability (Bryman & Bell, 2015).

3.7.1 Credibility

Credibility refers to the consistency of the findings when compared with reality (Shenton, 2004). To increase credibility, one can use multiple data sources, record the interviews, and compare primary data with secondary data (Cowton, 1998). In addition, key individuals can strengthen the credibility of empirical data through their questions, critiques, and feedback
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(Tracy, 2010). In our study, we supported the research credibility by using dual sources of data (primary and secondary) and by the authors’ joint review of the data. We also gave copies of our results to the respondents and to our thesis supervisor for review.

3.7.2 Transferability
Transferability refers to the generalizable of the research results to other situations. The difficulty in generalizing results, according to Yin (2009), is particularly problematic for case studies because the results are often context-specific. However, our results are broad enough that they may have application to outsourcing in other industries.

3.7.3 Dependability
Dependability refers to the replication of the research. If others conducted the same research would the results be the same? (Thurén, 2007). Dependability, therefore, requires that such research is properly documented and all documents, etc. are saved (Yin, 2003). The replication research must also state whether the results are coincidental and how accurate the measurements are (Andersen, 1998). A risk with dependability is that the research does not demonstrate a well-defined approach; in that case, replication studies are unable to use the same approach. The two authors of this thesis were present at all interviews, the documentation was recorded correctly, and no important information was lost. We also saved all our research materials.

3.7.4 Conformability
According to Shenton (2004) and Bryman and Bell (2015), conformability refers to whether the research results can be confirmed or corroborated by others. As we jointly conducted this research, we could immediately confirm our understandings with each other. We also asked the respondents for confirmation that we had understood them correctly. Moreover, as we explain in our methodology description, readers can evaluate the conformability of the research results (see Shenton, 2004).

3.8 Research ethics
A number of ethical issues may arise during the research process. Heron (2007) says that research, as an open form of communication, should reveal empathy. In our research, we were careful to be empathetic towards the respondents in our interviews. We also respected their privacy, confidentiality, and anonymity.

Given the participation of UnikPlast’s CEO, the purpose and subject of our research were clear to the respondents. We asked for their opinions of our intentions and methodology. We emphasized the importance of transparency and open dialogue so as to create a trusting research environment. We were always careful to respect the facts of the case as revealed by our interviews.

We were given almost unlimited access to UnikPlast. This allowed us to gather a great deal of detailed information. Anonymity was offered and guaranteed to the respondents. This ensured that proprietary information did not leak to competitors.

We discussed the relevant literature in discussions with our supervisors and other staff members.
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4. Empirical data – UnikPlast

In this chapter, we describe our empirical data related to UnikPlast, beginning with a brief description of its activities. We present the views and opinions of the respondents we interviewed at UnikPlast in the context of our theoretical framework.

4.1 Case: UnikPlast

David Johansson, the founder of UnikPlast and its present Product Manager, saw a need in the market for a better plastic component. After UnikPlast was founded, the company developed this component in several stages until it reached a final design stage. At this point, UnikPlast fashioned the design in several variations. During the development work a small manufacturer was used as a supplier because UnikPlast lacked the necessary production knowledge, and the supplier had offered very good ideas during the development process. However, as production on a large scale began, the supplier, unused to manufacturing in large quantities, experienced problems.

This problem meant that UnikPlast had to look for a new supplier that could produce its product in larger quantities. UnikPlast then found two suitable suppliers (here identified as Supplier A and Supplier B) who were accustomed to mass production and could meet the requirements for traceability in production for the units produced.

Supplier A wanted to produce the product using a new production method. Supplier B could produce the product using the same production method that UnikPlast’s original supplier had used. Therefore, UnikPlast chose Supplier B because it was thought continuing with the same production method would lead to faster serial production. However, UnikPlast still stayed in contact with Supplier A because of its capacity for large-scale production.

After five months, Supplier B was still unable to meet the quality standards that UnikPlast expected. Several items did not pass the early tests. One production problem was the quality of the plastic material. Further testing revealed that the majority of the items failed the tests. In addition, UnikPlast experienced communication issues with Supplier B’s production staff who were not transparent about the deficiency in the quality of the materials.

After much discussion, UnikPlast decided to see if Supplier A, with its more costly and complicated production method, could manufacture products of satisfactory quality. Within a few weeks UnikPlast received its first samples from Supplier A. Tests showed that Supplier A’s production method produced stronger, better quality, and longer-lasting products than Supplier B’s production method. UnikPlast’s decision-makers unanimously agreed to shift production to Supplier A and to terminate the contract with Supplier B.

Ultimately, the entire process of choosing a supplier cost UnikPlast far more time and money than expected. If UnikPlast had chosen Supplier B to begin with, much time and money would have been saved, to say nothing of the stress to UnikPlast’s management. The lesson is that a startup needs to develop a detailed action plan when making outsourcing decisions.

Today UnikPlast concentrates on developing and selling its products and accessories. David thinks these are the most important core activities at UnikPlast. As of the conclusion of our research, UnikPlast still does not do any of the manufacturing.
4.2 Core competencies
According to Lisa Nilsson, UnikPlast’s CEO, UnikPlast’s core competencies derive from its product developers and its strong sales force. Depending on the kind of products, UnikPlast requires its sales personnel to have high technical expertise, selling experience, and knowledge about the product. She says that all employees in the organization have extensive product knowledge.

Furthermore, Lisa says the construction of a network, which includes users, customer engineers, distributors, and other sales channels, is the basis of UnikPlast’s innovative development. This network give UnikPlast the ability to spot new business opportunities, to gain new insights, to sell more products, and to market products to high-end customers, thus leveraging "word of mouth" in a much more valuable way in the industry. UnikPlast’s R&D work and its networking activities are essential elements in the company’s core competencies. Lisa states that UnikPlast is always looking at customer complaints so that the company can solve these problems innovatively.

High quality production of UnikPlast products is a support activity to the core competencies. In part, high quality safeguards the users because UnikPlast’s products must bear high loads exerted by active users. If the products break, UnikPlast has major problems. Production, which follows somewhat hand in hand with development and innovation, should not be neglected for many reasons including the fact that efficient production means that UnikPlast can compete on price.

UnikPlast must deliver its products in a maximum of five days after an order, and preferably sooner. Engineers supply the products to the end users. Accounting and management, on the other hand, while necessary, are activities that less important.

4.3 Business strategy
David says that UnikPlast’ overall strategy is a differentiation strategy with its focus on user-friendly products and a skilled sales force. UnikPlast also maintains close relationships with its Scandinavian customers and users in order to receive fast feedback. The highly skilled sales force means higher salaries are necessary. However, David thinks this is a worthwhile cost because the sales force adds value that users are willing to pay for. David says UnikPlast is forced to adapt to the other suppliers in the market in order to maintain its competitiveness. He also thinks that the decision to outsource was a strategic one from the beginning. UnikPlast wants to be best at development and sales, while leaving production to others with more and better manufacturing competencies. He also intends to keep the production in Sweden or elsewhere in Scandinavia so that UnikPlast can maintain the entire value chain in close geographic proximity.

4.4 Choice of outsourcing partner
A supplier who works with highly automated and high quality mass production, in high volume, manufactures all UnikPlast’s plastic products. After the initial and unfortunate supplier experience, UnikPlast has exercised great care in choosing its suppliers. Many factors are considered: product quality, delivery reliability, and price. In addition, UnikPlast checks its suppliers' financial position. Furthermore, UnikPlast prioritizes the close geographic proximity to its suppliers, which is an important contributor to cost reductions. David also states that a supplier's corporate culture is a consideration because UnikPlast is dependent on the supplier’s responsible attitude towards technological development and performance.
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4.5 Motives for outsourcing
David says there are several reasons that companies outsource their various activities. Companies may want to focus more on their core business or perhaps compensate for their lack of skills in a certain area. Moreover, companies want to reduce costs and to acquire greater flexibility. David also thinks that some companies want to avoid particular problems although they rarely advertise this reason for outsourcing.

David says that UnikPlast's main motive behind its outsourcing decision was to increase its focus on its core competencies that do not require the equipment and know-how needed for effective mass production of 2000 to 5000 Unique Spoons annually. Another motive was to reduce the labor force, thereby reducing costs. David says that UnikPlast had reached a critical phase in its early stage, which meant, as a startup, it did not have the resources to hire the needed expertise for in-house manufacturing. Outsourcing, according to David, was the necessary alternative. By sharing resources with a supplier, UnikPlast acquired access to more skilled personnel and advanced equipment and, at the same time, kept costs low. Through outsourcing its production, UnikPlast can demand the highest quality and select the most skilled supplier.

4.6 Risks of outsourcing

4.6.1 Loss of control
UnikPlast has lost some control of the production processes and the potential for efficiency improvements because of its outsourcing strategy. It has also lost control of traceability through production. According to David, UnikPlast must therefore establish some very firm requirements for its supplier. Because of this loss of production control, UnikPlast has also lost control of learning about production knowledge. Thus, UnikPlast emphasizes developing close ties to its supplier. In this way, UnikPlast can access this learning in case of future needs. With the outsourcing of production, UnikPlast has also lost control of a part of the development process needed to improve and simplify product designs. Therefore, it is important for UnikPlast to maintain good communications with its suppliers in order to offer ideas and propose improvements.

4.6.2 Loss of expertise
The biggest risk in outsourcing in the long term, according to Lisa, is the so-called skills drain in which new skills are not created and former skills are not developed in-house. Even former skills diminish over time when there are no honest or natural feedback loops from suppliers.

UnikPlast’s focus has moved from production to purchasing and marketing as a result of its outsourcing strategy. However, UnikPlast still must retain some expertise and ensure up-to-date information on the outsourced production. David says UnikPlast requires an open dialogue with its suppliers, especially in the area of expertise. One way to acquire and update such expertise is by benchmarking companies with similar activities.

UnikPlast does not now partner with any supplier although it does not rule out future partnerships. Lisa takes a positive view on partnering with a strategically important supplier. She thinks this may be a way to improve UnikPlast’s core competencies. Nevertheless, given its close relationship with its highly competent supplier, UnikPlast is today a market leader in its field.

4.6.3 Decrease in flexibility
UnikPlast forecasts its production needs 12 months in advance, and shares this information with its supplier. This results in lower prices. When a company makes changes in its products,
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problems may arise because older designs will not sell. The risk of consumer rejection is greatest when a new product is introduced and the demand for the old product disappears. David says this is not an issue for UnikPlast because, given its flexible arrangement with its suppliers, it can wait to introduce a new design until after it has sold the pre-ordered products. UnikPlast, however, tries to inform its supplier before changes in production are introduced. This is possible because of UnikPlast’s good, almost daily, communications with its suppliers. If a supplier does not receive information in a timely manner, the relationship with the outsourcing company can become problematic. However, UnikPlast has flexible suppliers who can adapt to changes and meet new requests.

UnikPlast is always looking for more skilled fiber composite manufacturers should it need to move production. This results in increased flexibility if issues with any supplier occur. A larger supplier network would give UnikPlast more leverage in price discussions with existing suppliers. However, because UnikPlast wants to work only with suppliers who are in close geographic proximity, this limits the size of its supplier network.

4.6.4 Dependence on the supplier

According to David, a catastrophic event with its fiber composite supplier would mean disaster for UnikPlast. The supply chain would be broken because only certain specialized suppliers can manufacture UnikPlast’s products. Today UnikPlast has no back-up supplier for the plastics production because there are only a few manufacturers in Sweden who have the special capability needed. However, UnikPlast is well aware of this risk and is searching for a back-up supplier. In the manufacture of UnikPlast’s metal components, the risk of error is not as great as there are many potential suppliers in the area.

UnikPlast has relatively few outsourcing suppliers, but it still would like to have a greater choice in complementary suppliers.

_We want a long-term partner for production of our composite parts. But if our supplier raises prices, we want to put pressure on that supplier by using other suppliers. We also want to be confident that we can move production at any time._

(David Johansson, Product Manager, UnikPlast)

4.6.5 Higher than expected costs

Lisa thinks that UnikPlast miscalculated the risk in transferring knowledge when it first began to outsource production. UnikPlast had some manufacturing methods and other requirements that were not fully documented. All its drawings should have been updated with these requirements before the outsourcing process began in order to prevent problems in production. This led to an unnecessary waste of time and money because the outsourcing supplier made changes to the product in areas where UnikPlast had not specified the requirements. As a result, UnikPlast had to redo its requirements, acquire new production technology, and scrap all previously developed products that did not meet those requirements. UnikPlast also had to change suppliers because of the friction between the managements of the two companies. Since then, UnikPlast has improved the drawings it gives to its suppliers. UnikPlast has also learned to specify exactly what they want and how they want it.

UnikPlast avoids the risk of information leakage by its use of supplier contracts. Moreover, Lisa does not think data leakage is a risk for UnikPlast because its supplier’s other customers are not direct competitors to UnikPlast. Furthermore, because UnikPlast is an important customer for its suppliers, they have little to win and much to lose if they leak information or mishandle proprietary information. The suppliers do not want to risk their reputations. Nor do they want to lose UnikPlast’s business.
5. Analysis

In this chapter we use deductive reasoning and our theoretical framework to make comparisons and draw parallels between our empirical data and theory. We follow our conceptual model, which means that we identify and analyze the sources, effects, and risks of outsourcing at UnikPlast.

5.1 Core competencies

"Cutting edge" activities – UnikPlast’s cutting edge activities are found in its network that includes users, customer engineers, distributors, and other sales channels. These activities, which are essential for maintaining future competitiveness, allow UnikPlast to be innovative, to sell more products, to market its products to high-end customers, and to develop continuously. These cutting edge activities are the sources of its future growth.

Core activities – UnikPlast’s core activities relate to its R&D work/capability and its network. The network is useful for identifying user complaints. R&D supports the innovations that solve these problems.

Support activities – UnikPlast’s support activities are the outsourcing processes for the high quality production. These activities allow UnikPlast to deliver high quality products to its users and to increase its cost competitiveness.

Separable activities – UnikPlast’s separable activities are the delivery systems that set a maximum of five days’ delivery time. These activities are easily detachable and do not relate to any of the active parts of the core competencies.

Peripheral activities – UnikPlast’s peripheral activities are the accounting and management activities that are peripheral to its main processes. These activities can be outsourced.

Model update:
No relevant update as far as the core competencies activity.

5.2 Assessment of potential outsourcing partners

UnikPlast places great importance on the selection of outsourcing suppliers. The approach used in selecting a fiber composites manufacturer as an outsource supplier is similar to the approach Embleton and Wright (1998) propose: Select supplier candidates; send requirements to the candidates; and make visits to the candidates’ facilities.

What is important in this research is that UnikPlast initially selected a supplier based on price. According to Corbett (1996), this selection criterion may pose some risk if it is the only criterion used. However, considering that UnikPlast, as a new startup, wanted to
keep costs down, it is not surprising that it would use price as the basis for its first supplier
decision.

David says that the supplier’s corporate culture and expertise were also
also list these two factors as important to the selection process. David also points to other
factors such as the opportunity to keep up with technological developments and expertise in
the area.

UnikPlast is now very careful when choosing suppliers. As advocated by Bragg
(1998), it takes into account more factors than just price. The most important factors are the
supplier’s guarantee of quality, delivery reliability, and price, in that order. UnikPlast also
checks a potential supplier’s financial position (Bragg, 1998; Greaver, 1999). UnikPlast uses
collaborative problem solving with its suppliers, as also advocated by Greaver. According to
Bragg, it is important to look at more than the price in the choice of a supplier. While
UnikPlast is still concerned about price, it now takes a comprehensive view of a number of
factors, including geographic proximity.

Model update:
Most of the changes in the structure of the outsourcing process were made in the early
assessment of the outsourcing suppliers. This is the critical period when changes can still be
made that can significantly improve the chance of selecting a reliable supplier. After this
assessment, we then added a call to action in our model with the title ‘Choose an outsourcing
partner’. ‘The assessment of potential outsourcing partners is an ongoing process that can get
out of hand and take far more time and resources than necessary. Following this action, we
added an option with the following question: ‘Are prospects suitable potential outsourcing
partners?’ This question gives the outsourcing company the chance to proceed with the
selected supplier, terminate the supplier, or save a potential supplier for additional or future
review in case assessments of other prospects are proven erroneous.

We found a great potential at UnikPlast for wasting time and money if the
associated risks of outsourcing decisions are not fully understood. A back-up supplier,
therefore, was a lifesaver for UnikPlast. At this point we added an additional call to action in
our model with the following title: ‘Send request with requirements and specifications to
suppliers’ to make direct contact with the potential outsourcing partner and to obtain
additional data before a final decision is taken.

To conclude, for the entire assessment process we added an additional
checkpoint in the model to examine the viability of the outsourcing candidate. This
checkpoint gives UnikPlast the opportunity to correct mistakes by re-evaluating the
outsourcing supplier based on new information gathered after the initial contact. (See Figure
5).
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5.3 Success factors for outsourcing

The UnikPlast respondents stated, with one exception, the use of outsourcing had reduced costs. UnikPlast reduced its costs probably because it chose suppliers with lower cost structures (Abrahamsson et al., 2003; van Weele, 2009). The exception related to costs in the initial phases of the outsourcing. The respondents explained that personnel, who lacked skills in developing the specific products, had to learn these skills from scratch. In addition, there were deficiencies in monitoring resources.

UnikPlast also had less capital tied up as a result of the outsourcing. UniPlast’s fixed costs decreased with outsourcing since it was no longer engaged in production.

Model update:
No relevant update as far as the expected success factors
5.4 Risks of outsourcing

Juras (2008) and Beasley et al. (2004) observe that companies tend to see only the benefits of outsourcing and thus overlook the risks. Frost (2000) states that these benefits from outsourcing depend largely on how the risks are managed. Therefore, we asked the UnikPlast respondents about their perception of risk given their outsourcing strategy. We next present the risks UnikPlast experienced.

5.4.1 Loss of control

Augustsson and Bergstedt-Sten (1999) state that the risk of loss of control varies depending on the nature of the outsourced object or activity. Loss of control can be extremely important for the outsourcing company if the activities outsourced include the company’s core competencies. UnikPlast experienced loss of control to some extent when it outsourced production. In particular, UnikPlast realized that it lost some control of the quality of the product because the supplier controlled the production process. UnikPlast’s supplier seemed to take charge of the overall strategy and the direction of the work.

UnikPlast also experienced loss control of some competencies related to its production skills. The respondents said these skills would be difficult to rebuild. Competence, according to Augustsson and Bergstedt-Sten (1999), leads to long-term sustainable competitiveness. Losing control of core competencies can have very negative consequences for a company that outsources certain skills.
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5.4.2 Loss of expertise
Although outsourcing is undertaken in order to increase overall competence, it may lead to the deterioration of the outsourcing company's learning. If outsourcing suppliers take over the expertise (i.e., learning) necessary for creating complex products and their component parts, the outsourcing company soon loses this expertise. The company’s personnel forget how to develop and innovate the products. For UnikPlast, this loss of expertise may mean in the future its personnel will be less likely to innovate and test new products.

5.4.3 Decrease in flexibility
UnikPlast maintains its flexibility by forecasting its production needs for 12 months in advance. However, UnikPlast has negotiated a flexible supplier arrangement that permits cancellation of orders on a monthly basis (Augustsson & Bergstedt-Sten, 1999).

UnikPlast’s suppliers are also flexible. They are responsive to UnikPlast’s requests. David says that UnikPlast also maintains good flows of information with its suppliers through almost daily contact. Furthermore, UnikPlast is constantly looking for potential suppliers and has a supplier network that is continuously increasing. UnikPlast lets its current suppliers know it has a list of potential competitor suppliers. This is useful when negotiating prices with the suppliers and is also a deterrent to the expensive situation of supplier-change (Ininga & Werle, 2000).

5.4.4 Dependence on the supplier
Augustsson and Bergstedt-Sten (1999) conclude that outsourcing can lead to a company’s dependence on its suppliers. This situation may pose a risk when the outsourced product is not delivered, not delivered on time, or delivered but of unacceptable quality. UnikPlast had been in this unfortunate situation with a supplier that prioritized its own activities over the outsourced activities. The upshot was costly and time-consuming for UnikPlast, especially when it had to replace the supplier.

5.4.5 Higher than expected costs
Augustsson and Bergstedt-Sten (1999) state that companies should build an organization that has knowledge of reasonable pricing structures for outsourced production. For UnikPlast, the risk is that it will lose this knowledge and be somewhat at the mercy of the suppliers. This situation can mean excessive costs if disreputable suppliers take advantage.
Model update:
No relevant update as far as the risk management activity.

Figure 7. Structure of outsourcing process (Authors’ model)
6. Conclusions and suggestions for startups and researchers

In this chapter, we summarize the effects of outsourcing on UnikPlast. We answer the research questions presented in Chapter 1. We conclude with suggestions for outsourcing startups and suggestions for researchers who conduct investigations of the topics and themes described in this thesis.

6.1 Conclusions

Final model
Figure 8 is our final model outsourcing process model. The model is based on the four main points from Chapter 5:

1. Core competencies
2. Assessment of potential outsourcing partners
3. Success factors for outsourcing
4. Risks of outsourcing
**Our research question:**

How can a small startup company manage the risks associated with its outsourcing strategy and activities?

UnikPlast can better manage its outsourcing activities in the following ways:

- Use back-up suppliers. UnikPlast can reduce the ill effects of a halt in the supply chain.
- Sign exclusive contract for technology with the supplier. UnikPlast can reduce the risk of information leakage.
- Make full-year production forecasts. UnikPlast can reduce the chances of cancelled orders month-by-month.
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- Engage in joint product development. UnikPlast can work with suppliers on problem solving.
- Establish good communication channels throughout the supply chain. UnikPlast can learn of problems and increase its flexibility in solving them.
- Maintain frequent contact with suppliers. UnikPlast can reduce the risk of loss of control and loss of expertise.

Decreased internal competence is an inevitable problem for UnikPlast because it has outsourced its development and production. Although UnikPlast has not paid sufficient attention to this risk, we think it has reduced the risk somewhat because of the efforts it has made to establish sound, cooperative relationships with its suppliers.

UnikPlast, as a potentially large client for any supplier, should use competing back-up suppliers. This action would reduce the risk of opportunistic behavior by the current suppliers. It may also be useful if a current supplier does not meet UnikPlast’s quality standards. By using back-up suppliers, UnikPlast can also reduce the consequences of a halt in its supply chain. Geographic proximity is always an issue in supply chains. Therefore, UnikPlast should find back-up suppliers that are relatively near its offices.

There is always the risk that suppliers may leak sensitive information about the products they produce for companies. UnikPlast may reduce this risk by choosing suppliers that have no other customers working with its particular technology.

In order to maintain flexibility in long contractual periods, UnikPlast uses full-year production forecasts with the possibility to cancel orders month-by-month. Moreover, through joint product development, good communications, and combined problem solving, UnitPlast has obtained greater flexibility with its suppliers.

UnikPlast manages the risk of lost expertise by maintaining frequent contacts and good communication channels with its suppliers. This is very necessary and should be continued because UnikPlast has access to its suppliers' knowledge even if it does not internalize that knowledge.

We think UnikPlast has outsourced part of their core competencies because of the lack of capital (e.g., for production capability) and of in-house production skills. For example, outsourcing for UnikPlast cost more than the supplier first stated. Outsourcing has also taken longer than expected, and the quality of the produce has been less than expected. UnikPlast has, however, now dealt with these issues with the help of outsourcing theories, and is intent on preventing the reoccurrence of such issues in the future.

We also recommend that UnikPlast enter a partnership with its supplier in which quality and production efficiency are rewarded, as well as integrate more of its activities with the supplier. In this way, UnikPlast can acquire the skills needed to build its internal production competencies and can reduce the occurrence of risks, thus saving time and money. A reasonable expectation is that at some point UnikPlast will regain greater control of its outsourced strategy and activities.

6.2 Suggestions for the startup company
One suggestion is to examine carefully the relationship between the startup and the supplier. If these companies have similar company cultures, the cooperative progress to serial production will be much smoother. For the hi-tech startup, it is essential to receive direct feedback on a weekly basis as far as product quality, construction updates, and future developments. We recommend that strong bonds be created and maintained between the two companies.
We also suggest that startups experiment with our model (in its final form; see Figure 8) as a guideline for initiating outsourcing activities. In this way, startups may minimize the risks and problems that are probable if the partnership is too hastily established.

6.3 Suggestions for future research

A research avenue of interest is a comparative study in which the earliest outsourcing activities of two or more startups (in other industry sectors than hi-tech) are examined. Startups have special requirements, limited available investment capital, and little experience in outsourcing. It would also be interesting to do an in-depth empirical study of one or several startups that have insourced previously outsourced activities.

References


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Appendix

Interview Guide

A1. Background questions
   Name: 
   Company: 
   Age: 
   Gender: 
   Position in the company: 

A2. Company-specific questions
   - Number of employees?
   - Vision?
   - Ownership ratio?
   - Describe your organization.
   - What are your long-term goals for your customers?

B. Outsourcing at UnikPlast

Questions on core competencies:
   - What is your main activity?
   - In which parts of the day-to-day activities are you active?
   - Which resources are required for you to function well?
   - Who are your key partners and what do they offer?
   - What are your core competencies?
   - What is your company's competitive advantage?

Questions on strategy:
   - How do you define the company's strategy?
   - Is outsourcing a strategic decision?

Questions on the motives for outsourcing and the selection of outsourced function/service:
   - Which parts of the business have you outsourced?
   - In which of the following categories do you place your outsourced function/service?
     - Cutting edge
     - Core activities
     - Support activities
     - Separable activities
     - Peripheral activities
   - Why did you choose to outsource a function/service?
   - How long have you outsourced a function/service?
   - Which motives were decisive when you made the outsourcing decision? Rank them from most important to least important.

Questions on the outsourcing provider and your relationship to this provider:
   - Which outsourcing provider(s) do you use?
   - How do your describe the outsourcing provider(s)?
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- What is the extent and nature of your outsourcing provider(s) work? Full? Partial?
- What is your relationship with your outsourcing provider(s) today?
- What are the consequences of outsourcing on your staff?

Questions on the risks of outsourcing:
- Do you see any risks with outsourcing? If so, which ones and why?
- Which measures do you take to reduce the risks?

Questions on the expectations of outsourcing:
- What did you expect of outsourcing?
- What have you experienced as far as the effects of outsourcing?
- What unexpected effects have arisen as a result of outsourcing?
- Do you think that outsourcing affected the company's competitive advantage? If so, how?
- Do you have any concrete evidence why outsourcing has been positive or negative?
Christoffer Lindhe and Meron Goitom both have a B.sc. degree, Meron in Mechanical engineering and Christoffer in product development. Today Christoffer works with product and business development and Meron is working in Halmstad as a data analyst.