

## Structural Relationships of Predictors Influencing Outsourcing Decision in Malaysian Hotel Industry

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### *Abstract*

*This study investigates the structural relationships of cost, activities and size of the organization towards outsource decision in Malaysian hotel industry. Questionnaires that consist of cost, activities, size of the organization and outsource decision were distributed 300 respondents that are department managers in Klang Valley hotels. Findings showed that the significant relationships between cost, activities, size of the organization and outsource decision are confirmed in Structural Equation Modelling (SEM). Implications and suggestions for future research are also provided.*

**Key Words:** *Cost, Activities, Size of the Organization, Outsourcing Decision, Malaysian Hotel Industry, Structural Equation Modelling.*

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### Introduction

Trend of outsourcing has been implemented on three phases starting way back at the era of the Big Bang, the Bandwagon and the Barrierless Organizations (Hatonen & Eriksson, 2009). These three eras give a big impact towards many organizations in term of crucial strategy development which brings profits and victory. The Outsourcing Revolution book written by Corbett in 2004 expresses that the occurrence of

outsourcing is not a new thing and had gone through few revolution and transformation since its introduction.

Outsourcing is defined as the procurement of products and services from sources that are external to the organization (Lankford & Parsa, 2009). This allows the outsiders to take responsibilities for some aspects of management of activities in the organization (Winterton, 2000). According to Hoetker (2005), outsourcing has become a vital and complex activity in strategic decision area of organizations throughout the years. Complex organizations are interested to be a part of outsourcing activity because they believe that outsourcing can contribute to cost reduction as well as efficiency improvement which can be adapted in various mechanisms (Blumberg, 2008). Zhu, Hsu and Lillie (2001) also state that outsourcing has become an important strategic tool in today's competitive business environment. Moreover, Morgan (2012) mentions that industries nowadays need to experience the new era of convenience sourcing and not assume that outsourcing is all about cost reduction in service market.

The hotel outsourcing activities mainly involved in production, distribution of product as well as services to customers. In relation to that, Verginis and Wood (2009) express that outsourcing is a part of the fabric in hotel operations. Lamminmaki (2011) also supports that the nature of hospitality industry indicate the suitability of this industry to perform outsource. Sieburg (2002) also agrees that outsourcing has become an important aspect of modern hotel management.

Malaysia is one of the most popular tourist destinations in the ASEAN region. According to Ministry of Tourism Malaysia (2012), international tourist arrivals in Malaysia will grow at a Compound Annual Growth Rate (CAGR) of around 8% during the forecast period from year 2011 to year 2013, thereby, surpassing RM 70 billion by 2013. The rising of hospitality business have been shown through the total tourist arrivals and receipts in Malaysia. In order to accommodate the anticipated rise in business, hotels have to focus on their core operations hence outsourcing could be an alternative way to manage their non-core processes and activities such as human capital, information management, accounting and housekeeping (Sani, Dezdar & Ainin, 2013).

Nowadays, the outsourcing activities are widely practiced by many organizations. Outsourcing define as an approach to obtained the service from an external providers to perform their internally activities in an organization (Domberger, 2008). Kadir (2007) points out that Malaysia is a leading destination for the establishment of shared services and outsourcing hubs due to its low costs, modern infrastructure, business environment and high levels of global integration.

Major problems happen to an organizations is when they try to do everything themselves and this may incur vastly higher operating, training, research and marketing expenses. Besides, it will also increase the deployment expenses which are expenses that have to be passed onto the customer. Besides that, some organization does not have expertise or the skills needed to perform specific task or activities, so they have to turn to outsourcing. Sometimes when the organization expands their operations especially into a new geographic or location, the problem is they do not have access to the required resources within their organization. Because of all this reasons outsourcing is considered to be very important to an organization to be successful in their businesses.

## Literature Review

### Outsourcing Decision

Outsourcing is defined as contracting out the organization activities to third party where the responsibility of the outsourced activity is taken by vendors (Takac, 2003). Hatonen and Eriksson (2009) state that this activity was formulated in the 1950's but only adopted in organizations during 1980's. In

order to make an effective decision, an organization must also identify its needs and understand why outsourcing may or may not be appropriate to the organization.

The most common forms of outsourcing are information technology outsourcing (ITO), knowledge processing outsourcing (KPO) and business process outsourcing (BPO). Ghodeswar and Vaidyanathan (2008) categorise drivers of outsourcing into four types which are organizational drivers, improvement drivers, financial and cost drivers and revenue drivers.

Organization may decrease the risk associated in creating in-house specialization with the chances to get knowledge and information from the specialist in this area (Costa, 2001). In addition, outsourcing can be seen as a medium to gain new profit, increase efficiency of organization, as well as improve productivity. Blumberg (2008) also state that in order to offer products and services which cannot be offered in profitable motives, organization can contract out with vendors. This author then describes outsourcing in accurate meaning as contracting out the function in management and related elements to vendors who can produce high quality output.

Furthermore, outsourcing also can reduce the risk in testing demand for product or services and will be more effective in cost rather than producing a particular output with scarce resource. Besides, outsourcing also can be an alternative way to produce complementary product with other organization that in the same area of business. Blumberg (2008) adds that outsourcing brings various advantages in economic includes providing high quality and efficiency of services and also the prime motives, cost savings.

In the other hand, by contracting out, organization may improve in getting through functional specialist and provide more time and space for management to have clear visual in management priorities. Rao, Nam and Chaudhury (2006) mention that the primary drivers of outsourcing are cost, new market, flexibility, expertise, quality and supplementing in-house workers. In contrast, today economic reality has changed this decision from a strategic consideration to a tactical analysis and cost evaluation and advantages of managing an organization internally versus outsource to third party.

In addition, outsource strategic direction shows that sufficient average performance and not having enough resources to achieve world-class performance. On the other hand, Blumberg (2008) remarks in-house have sufficient capabilities and resources to achieve performance of world-class standard. This shows that outsourcing also has disadvantages towards business. As mentioned by Lonsdale and Cox (2000), the main risks of outsourcing are the loss of core activities, being leveraged by suppliers, sustaining interruptions to supply and receiving low quality of supply.

### **Cost**

In the case study conducted by Lacity and Willcocks (2001), it shows that cost reduction is a major factor to outsourcing. According to the study, 71 percent of successful outsourcing was measured in terms of cost expectations. Skinner and Bond (1997) agree that outsourcing also viewed as cost-reduction method in support services. Outsourcing will brings various advantages to organization includes improve efficiency and profitability, cost savings as well as increase return on assets (Blumberg, 2008) which are the reasons why organizations outsource.

Furthermore, the research done by Caves (2000) and Hymer (2006) reveals several motives why organization outsource includes controlling and saving cost, lowering operational cost and get resources from many alternatives. Soltani and Wikinson (2010) view hospitality industry outsourcing is about minimizing labour costs and this study was supported by other author. Nature of hospitality industry that always related are the broad range of activities, high labour intensity and unpredictable demand which make this industry suitable to adopt outsourcing activity. Lamminmaki (2011) states a claim that a chef from one hotel always prefer to get a cheaper and good quality product.

The other element that will draw up further investigation in this research is cost transaction. Theory that synonym with this element is Transaction Cost Economics (TCE). Williamson (2007) declares that TCE is a reliable theory in world of outsourcing. The three critical attributes in TCE includes asset specificity, uncertainty and frequency. Williamson (2006), states that the attributes will influence the activity of outsourcing.

In addition, the aspects that should be considered in cost transaction are monitoring, controlling and managing the transactions (Williamson, 2009). He also comments that, vendors may take for granted in production cost if they identified the products and services are standard. Thus, the cost of in-house production will be decreased in situation of high modification. Hence, TCE's uncertainty characteristics will lead to high contracting cost when it is hard to control the unpredictable activity. This characteristic is supported by the statement of "There are many activities that we do not outsource because there are unpredictable and therefore difficult to contract for" (Lamminmaki, 2011).

There have been a lot of benefits by involving or embarking into outsourcing. One of it as listed in the strategic benefits that firms will enjoy is to reduce the operating cost. Firms are increasingly viewing outsourcing strategy for reducing or controlling costs (Smith, Mitra&Narasimhan, 1998). Outsourcing may extend the firm's value creation opportunities by supplementing internal resources that are more costly to develop internally (Barney, 2001). Outsourcing behaviour typically compares the degree of productions cost savings from outsourcing, to the reduction in transaction costs from producing in-house, and to study make-or-buy decisions (Hecker &Kretschmer, 2010). Therefore, the first hypothesis is developed.

H1: There is a relationship between cost and outsourcing decision making.

### Activities of Organization

Blumberg (2008) states that outsourcing is about delegating the burden, responsibility and risk to an outside party for a business survival. He said that, when cost be an issue in business, "make versus buy" decisions will make activity as an agenda. Alexander and Young (2006) mentioned four attributes that are related with core activity:

- 1) The activity is in-house performance in traditional way.
- 2) The activity is crucial to business operation.
- 3) Potential competitive advantage and latest activity created in organization.
- 4) The activity will lead to expansion rejuvenation and innovation.

A non-core activity is defined as factors that lead an organization's competitive advantage (Lamminmaki, 2011). As suggested by Gilley and Rasheed (2005), there are several causes of organizational performance improvement in hotel that includes outsourcing lead to greater focus on organizational core competencies which bring advantages. In example, many organizations in hospitality industry succeed by contracting outtheir activities of support service for instance security, maintenance, laundry and baking (Hemmington & King, 2000).

Furthermore, there are opinions that suggest organizations should contracting out the non-core activities to vendors and retain their in-house core activities which crucial to the competencies of firm (Barney, 2001).This indicates the scarcity of consistency and subjective comparativeness between core and non-core activities. In addition, Cooke, Shen and McBride (2005) acknowledge that non-core activities believed to have fewer consequences on the organization performance.

In agreement to Quinn and Hilmer (1994), the core competencies of organization should be developed strategically by managers to compete with other organization. Managers also need to avoid contracting out

their competencies or let the vendors to get through the critical knowledge bases or skills. Hotel management has recognised the importance of core basis of outsourcing (Bolat & Yilmaz, 2009).

The outsourcing of non-core activities allows the hotel to increase managerial attention and resource allocation to those tasks that it does best and to rely on management teams in other firms to oversee tasks at which the outsourcing firm is at a relative advantage. This focus can improve results by allowing the firm to be more effective, more innovative and more skillful in those activities. The outsourcing of non-core activities allows the hotel to increase managerial attention and resource allocation to those that it does best (Bolat & Yilmaz, 2009). Increased outsourcing of non-core activities can improve service quality (Dess, Rasheed, McLaughlin & Priem, 2005). Non-core activities are considered to have a lower impact on the overall performance of the organization (Cooke et.al, 2005). Hence, the second hypothesis is developed.

H2: There is a relationship between activities of the organization and outsourcing decision making.

### Size of Organization

The other factor is the size of organization. According to the theory of Transaction Cost Economic (TCE), the size of organization will affect its frequency. Frequency is related with the economies of scales (Lamminmaki, 2011). In example given, full usage of facility usually influenced by the size of the organization. Large hotel will have own laundry to cater the high frequency of laundry activity day-to-day. Lamminmaki (2011) also includes statement of the ability of gaining in-house economies of scales due to many activities which need large scales of work. This is the reasons why some hotels do not practise outsourcing.

In addition, a study using TCE shows that large organization may give more chances to increase the power of purchase among hotel and vendors which result to contracting. Lamminmaki (2009) also stated that large company can negotiate with vendors and adopt outsourcing activities in their organization. Plus, the attributes of TCE includes low asset specificity, low uncertainty or low frequency may lead to greater outsourcing (Williamson, 2006).

Benefits of outsourcing can be experienced by all sizes of organizations because of the recent developments of international suppliers. As supported by Peslak (2011), outsourcing will be used if affected by size of organization. Different size of organization for instance small and medium-sized firms (SMEs) may face different challenges and issues compare with large scale organizations (Hatonen & Eriksson, 2009). Lamminmaki (2007) acknowledges that small hotels have more tendencies to outsource their activities. He states several characteristics of small size organization as followed:

- 1) Less production compare with other outsourcer provider.
- 2) Lack of negotiation power towards supplier.
- 3) Low volume of business and brings low profit to organization.

On the other hand, small organizations have more chances to globalize the business by using outside resources. Business of these organizations may expand faster as mentioned by Madsen and Servais (2007). In contrast, the disadvantages of outsourcing may exist among SMEs when they are lack of experience in international outsourcing. Small organization also may face challenges to survive in outsourcing in term of fighting with fluctuating cost trend in business and also in maintaining as well as operating equipment in services.

Williamson (2006) mentions that larger organizations may lead to greater volume of activities This situation occurs because of the ability of large organizations to cope with all challenges in business, for instance in controlling and monitoring costs. Large organization also may have more power in negotiating contract with vendors and they will be able to minimize the risk of outsourcing. For example, large hotels

may outsource their activities because they have a solid financial background compare with SMEs. This is a big opportunity to local or international vendors to join venture with large hotels that may bring more benefits to them.

Size of firm plays an important role in outsourcing decision. Outsourcing will be greater in the presence of low asset specify, low uncertainty or low frequency (Williamson, 2006). Outsourcing is higher in hotels that are smaller (Lamminmaki, 2007). Larger hotels conduct most activities in larger volume (Williamson, 2005). Thus, the third hypothesis is developed.

H3: There is a relationship between size of the organization and outsourcing decision making.

## Methodology

### Participants and Procedures

The participants of this research comprised of department heads of 3 and 4-star hotels in Klang Valley that their departments practice outsourcing in their operations. Data was collected by self-administered questionnaires to 300 participants and all questionnaires were found useful and were used for further analysis.

### Measures

A 10-item instrument was used to measure cost (C) that was adapted from the work of Lacity and Willcocks (2008), Soltani and Wikinson (2010), and Sani, Dezdar and Ainin (2013). Next, a 10-item instrument was used to measure activities (A) that was adapted from the work of Bolat and Yilmaz (2009), Blumberg (2008), and Guerrier and Lockwood (2000). A 10-item instrument was next used to measure size (S) that was adapted from the work of Hatonen and Eriksson (2009), Lamminmaki (2011), and Halim and Che (2009). Lastly, a 10-item instrument was used to measure outsource decision (OD) that was adapted from the work of Lamminmaki (2011), Bolat and Yilmaz (2009), and Blumberg (2008). All of the elements were measured by using the 5-point Likert Scale.

### Data Analyses

The demographic information turned into used to offer an overview of respondents' profile. Principal factor analysis was performed to reduce the number of factors or elements from each variable. The final results from this factor analysis were then used for additional analysis using Structural Equation Modelling (SEM) with AMOS 22.0 program. It aims to locate the most optimal model or mixture of the variables that suits nicely with the data on which it is built and serves as a purposeful representation of the reality from which the data has been extracted, and gives a parsimonious explanation of the data (Kline, 1998). In this research, the SEM method was applied to detect the impact of cost, activities and size of the organization towards outsource decision in Malaysian hotel industry.

## Result

### Profile of Sample

Out of 300 respondents surveyed, 61% of the respondents are from 3-star hotels and 39% are from 4-star hotels. The data are collected mostly from Petaling Jaya area (37%) and Kuala Selangor area is stated as the least respondents which are 4%. For the data of number of employees in the establishment, range of 21-40 employees group is the highest group (81%). Security is the most popular activities to be outsourced (41%) and the least types of outsource activities is information technology (3.5%).

**Structural Equation of Hypothesized Final Model**

Built on the modification index of CFA, the measurement model of exogenous and endogenous and the final hypothesized model confirmed the constructs of C, A, S and OD of the hypothesized paths. In SEM, factor analysis and hypotheses are verified in the same analysis. SEM methods also provide fuller evidence about the magnitude to which the study model is sustained by the data. Goodness of fit indices for the 24 observed variables of C, A, S and OD shows that the reading is right if it arrays from 0.173 to 0.843 for the significance standardized regressions weight. Standard error (SE) for each observation displays the goodness of fit and low level reading from 0.072 to 1.374, and estimate (square multiple correlation) of observation indicate the contribution level to the latent variable (0.033 to 0.692). The standardized regression weight between C and OD is 0.381, between A and OD is 0.286 and between S and OD is 0.299. The final model indicates the model clarified in a substantial part of the variance in all the endogenous variables (square multiple correlations) that shows the three exogenous variables (C, A and S) at the same time described 38.4% variance in OD. Lastly, from the Structural Model the reading for GFI is at 0.90 (acceptable fit criteria) and RMSEA is less than 0.08. The measurement model has a good fit with the data based on evaluation standards consisting of GFI and RMSEA (Bagozzi & Yi, 1988). Table 1 recaps the goodness of model fit of C, A, S, OD and the structural model. The structural models testing of endogenous variables (CDL and WE) fulfill the GFI (GFI > 0.90) and RMSEA principle (less than 0.08).

Table 1: Summary of the Goodness Fit of Cost (C), Activities (A), Size of the Organization (S), Outsource Decision (OD) and Final Model

Model Fit Indicator	C	A	S	OD	Final Model
( $\chi^2$ )	210.322	17.203	13.558	158.489	208.236
DF	3	2	4	3.4	134
CMIN/DF	1.441	1.601	2.331	1.779	1.554
P	0.016	0.027	0.005	0.000	0.000
GFI	0.990	0.992	0.944	0.945	0.901
RMSEA	0.076	0.078	0.064	0.080	0.053

**Discussion**

This study has identified factors that influence outsourcing decision in Malaysian hotels including cost, activities and size of the organization. Based on the results, factor that affecting outsourcing decision is cost. As discussed, Smith et al. (1998) state that organizations nowadays are increasingly viewing outsourcing strategies for reducing or controlling costs. Soltani and Wikinson (2010) view hospitality industry outsourcing is about minimizing cost which related with the broad range of activities, high labour intensity and unpredictable demand which make this industry suitable to adopt outsourcing activity. Most of the respondents agree that if the cost is high, then the organization will outsource. Similarly, most of the respondents agree that by contracting out they are able to reduce operational cost.

This study also shows that activity of organization also acts as a factor influencing outsourcing decision in hospitality. As suggested by Gilley and Rasheed (2005), there are several causes of organizational performance improvement in hotel include outsourcing lead to greater focus on organizational core competencies which bring advantages (Gilley & Rasheed, 2000). In example, many organizations in hospitality industry succeed by contracting out their activities of support service for instance security, maintenance, laundry and baking (Hemmington & King, 2000). These statements are consistence with the hypothesis where the non-core activities have more tendencies to outsource than core organization activities. Most of the organizations that participated in this study mention that they are usually outsourced their non-core activities which make management may give more attention towards core activity of the organization.

According to the finding of this study, size of organization also is one of the factors influencing outsourcing decisions. Most of the organization is small scale which tends to outsource because of the constraints of space, expertise and fund. Lamminmaki (2007) also acknowledges that small hotel have more tendency to outsource their activities. This study shows that there is a consistence relationship between size of organization and outsourcing decision. Organizations in hospitality industry also tend to contracting out their activity because of the frequency or volume. Based on this research, organizations that outsource their activity have high frequency for instance hospitals and hotels. As supported by Williamson (2005), he mentions that larger organization may lead to a greater volume of activity.

## Implications

Malaysian hotels are more likely to outsource the laundry, housekeeping and cleaning functions. With outsourcing, the hotels are able to switch their non-centre chores to external suppliers. As supported by Espino-Rodriguez and Padron-Robaina (2005), to be able to deal with the globalization and the competitive environment in today's businesses operations, hotels may implement outsourcing in their service undertakings. This consists through reallocating the hotel's duties to experts and professionals who then will execute those services for the hotels. Moreover, hotels could want to stress on their main jobs while surviving up with the ever inconsistent atmosphere such as cultural ups and downs, advanced technologies and fierce rivalry.

Other than that, hotels must protect towards outsourcing activities that hollow out the assets and skills that it wishes to be a grasp of its own. According to Hamzah, Aman, Maelah, Auzair and Amiruddin (2010), outsourcing choices be influenced by when an organization must outsource its tasks, which organization to be selected and how much control should be set to the suppliers. The choices on passing over the functions to the external suppliers will drive to jeopardies comprising of harm of managerial control, because it is more challenging to manage outside service providers than managing one's own workforces working probably in the same area. Consequently, outsourcing the laundry and housekeeping functions could guarantee that the hotels would still be in control of their core activities.

Entering to outsourcing will also improve the ability to develop new merchandises and service, to expand its limit in coping with the better capability of business and to control demand efficiently through outsider's process maturity and the newest technology.

## Limitations and Recommendations

This research backings up the argument that cost, activities and size of the hotel are important predictors of outsourcing decision in the Malaysian hotel industry. Conversely, more researches are required in order to cross-validate the findings from diverse directions. For this reason, our results should be understood with carefulness due to the constraints of the study, some of which may be diminished by future study. The time constraint becomes a limitation to further the number of the respondents to be analyzed. Next is a lack of cooperation from respondent itself. Some of them refuse to answer the questionnaire as they are busy with their schedule. However, based on the pilot study that we have done, it shows that the sampling process worked very well and resulted in a high response rate, so, we are confident that the sample was strong. As there are 300 questionnaires survey circulated and collected for this research, therefore, to raise the correctness of the effects of factors impelling outsource decision in Malaysian hotel, researcher would increase the sample size. In addition, the questionnaires were only circulated to the hotels in Klang Valley area. Accordingly, it is sensible to include all hotels within Malaysia (including Sabah and Sarawak) for future research where this permit future researcher to get greater answers as well as wider angles. Lastly, in this research a quantitative research method was used. Extra work should be done by executing qualitative research methods to stress on subjects that are not emphasized here that are essential to the understanding of outsourcing choice.



## Conclusion

This study has been conducted to have a better understanding on factors influencing outsource decision in Malaysian hotels by clarifying the factors of cost, types of activities and size of organization. This study has achieved its goals to recognize the relationship of the three variables towards outsourcing decision making. Moreover, if a hotel task is to be outsourced to a supplier, they might be able to use the famous brand name of the outsourcing suppliers which delivers good comments from the previous services completed. Outsourcing decision is done to ensure that they are being served by an expert to perform the task successfully and the well-known brand name of the suppliers. As a conclusion, the result of the study shows that cost is the utmost vital aspect that prompting outsource decision making in Malaysian hotels and the least vital aspect is size of organization. Furthermore, this study has provided some limitations that have been met and recommendations for future researchers. Therefore, this study offers evidence for individuals who may want to explore more on the factors prompting outsource decision in Malaysian hotels.

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