THE EFFECT OF OUTSOURCING ON THE FINANCIAL PERFORMANCE OF SUPERMARKETS IN NAIROBI

BY

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DECLARATION

This research project is my original work and has not been submitted for an award of a degree in any other University.

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This project has been submitted with my approval as the University supervisor.

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DEDICATION

This project is dedicated to my parents Mr. Gerald Kiama and Mrs. Salome Kiama for their love and parental care. For the support they have given me during my study and strong believe in power of education. Thank you and May the Almighty God bless you.

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I am grateful to the Almighty God for his provision of strength and good health during the entire stages of my study.

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ABSTRACT

Outsourcing is receiving a lot of attention from supermarkets chains all over the world. This is attributed to perceived benefits expected to accrue to a firm from outsourcing by way of cutting costs and hence enable supermarkets to improve their performance and add firm value. In current years the competition has been extremely intense with each supermarket fighting for its survival against competitors who do not only want to remain cost effective and drive profit but also attract and retain customers.

The objectives of this study were to determine the effect of outsourcing on financial performance of supermarkets in Nairobi Kenya and establish the services that are outsourced. The study adopted a descriptive research design. Primary data was collected using a questionnaire that was dropped and picked from a population of 50 supermarkets in Nairobi. The number of supermarkets that responded in time for the study was 28 which represent 56% of the total population studied.

The study established that all the supermarkets that responded embrace the outsourcing strategy. The supermarkets outsourced various activities the most prevalent being information technology and security services. The findings indicated that there is a significant relationship between outsourcing and the level of financial performance for each of the respondents. Results indicated positive performance and hence outsourcing is viewed to have enhanced banks performance. However, as a suggestion to future research, a more sophisticated performance measurement system ought to be used.

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LIST OF ABBREVIATIONS

ANOVA	-	Analysis of Variance
EBIT	-	Earning Before Interest and Tax
FDI	-	Foreign Direct Investment
GDP	-	Gross Domestic Product
IMF	-	International Monetary Fund
ROA	-	Return on Assets
ROE	-	Return on Equity
ROI	-	Return on Investments
SG&A	-	Sales, General and Administrative Expenses
SPPS	-	Statistical Package for Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Markets today are fast changing, characterized by globalization, fast information spreading, intensive technological development and innovation. To response and succeed in those market conditions companies use different strategies and tools. By outsourcing particular activities, business functions or processes, companies of all sizes want to achieve different goals. To gain a competitive edge, supermarkets have become more flexible and innovative in their modes of operations by outsourcing. Outsourcing can be defined as the situation where an external vendor provides on a regular basis a service that would normally be performed within the organization. Lyson and Farrington (2006) and Jacobs (2009) perceives it as a management strategy by which non-core functions are transferred to specialist, efficient, external providers. In outsourcing organizations concentrate on aspects of their business which give them a competitive advantage and contract out the more peripheral or non-core aspects of their firms.

Successful implementation of an outsourcing strategy has been credited with helping to cut costs, increase productivity, improve quality, improve on capacity, increase profitability and financial performance, lower innovation costs and risks and improves organizational competitiveness efficiency and effectiveness (Jiang et al., 2006). Intense competition and market saturation are forcing supermarkets to access new revenue streams worldwide. Outsourcing trends have been embraced by supermarkets worldwide to find solutions to increase revenue, reduce expenses and enhance profitability .While

cost savings is the primary driver of outsourcing initiatives; firms are saving less than projected and in some cases, it is costing more (Li Wang et al 2008).

1.1.1 Outsourcing

Outsourcing concept is based on the premise that a specialist company that focuses on a specific functional area can do a better job at less cost than employing all functional areas needed internally (Jacobs, 2009). The main outsourcing cost factors firms need to assess to make an informed decision on whether to outsource or to do the services internally are direct costs, labour costs and indirect costs. One main advantage that drives outsourcing is that it allows a company to move fixed cost to variable costs and limits capital expenditure to drive up economic value of the company. Instead of using scarce capital to employ underutilized resources, you can employ a variable cost for the functional service when you need it.

Outsourcing makes sense for firms that lack the necessary economies of scale, skills or technology to perform certain functions quickly and efficiently (Jacobs, 2009). However, there are risks and costs associated with outsourcing. This includes, vendor selection cost, legal contract costs, layoff costs, workers fears over loss of jobs and it reduces a company's control over how certain services are delivered which may in turn raise the company's liability exposure.

Lyson and Farrington (2006) observes that the services most easily outsourced are those that are resource-intensive, relatively discrete, require specialist competencies, characterized by fluctuating work patterns in loading and throughput, subject to quickly

changing markets (for which it is costly to recruit and retain staff), and subject to rapidly changing technology requiring expensive investment. Services commonly outsourced in most supermarkets in Kenya include; security, payroll, transport, training, information t echnology, administration, marketing, human resource among many others.

1.1.2 Financial Performance

Performance measurement system plays a key role in developing strategic plans, evaluating the achievement of organizational objectives and compensating managers. Scholars as well as practitioners have paid considerable interest in performance measurement (Ittner and Larcker 1998).

There are different ways to measure a supermarket's financial performance. This may be reflected in the firm's return on assets, operating Income, and cash flows among others. However, in this paper we use operating income as a profitability indicator to evaluate financial performance on supermarkets in Nairobi. Apparently the effects of outsourcing on a firm's financial performance are not yet fully understood and perhaps the variables and their relationships to be measured are more complex than expected (Ittner and Larcker 1998).

Operating income is one of the most common measures of profitability. Operating income measures a company's earning power from ongoing operations also called operating income or EBIT (Earnings before interest and tax). Operating income provides managers with useful information for evaluating a company's financial performance without regard to interest expenses or taxes, two variables that may be unique from

company to company. Using operating income as a comparative measure was best to compare it against a firm's previous operating income or the operating income of a similar company across a single industry where those companies may have varying capital structures (Ittner and Larcker 2000). This indicated how effective outsourcing practices lead to profitability on supermarkets in Nairobi.

In this study we focused on the profitability and cost efficiency of the outsourcing supermarkets, as these two instruments are commonly used to define financial targets in supermarkets. From an accounting point of view, an increase in profitability, for example, can either stem from a reduction in costs, an increase in revenue, or both. Sharing the costs and risks of commercialization with outsourcing partners can help maximize operating Income.

1.1.4 Effects of Outsourcing on Financial Performance

Outsourcing gives a positive effect on firm performance by saving resources in terms of labour and capital. If firms are profit maximiser and act rationally, outsourcing should increase profitability of the firm through cost reduction (Welch and Nayak, 1992).

First, it offers firms an opportunity to save costs, because a specialized vendor may benefit from economies of scale and offer lower prices than the firms could achieve in-house. Second, firms do not have to replenish their investments in infrastructure and technology and thus can reduce committed costs. Third, firms do not have to invest in

employee training. Finally, the risk of demand and cost fluctuations can be at least partially transferred to the vendor, who pools contracts from a number of firms to reduce risk, (Vining and Globerman, 1999).

However, outsourcing gives a negative effect on firm performance as there are no guarantees that expected savings will be realized. There is increasing evidence that cost savings have been overestimated and costs are sometimes higher after outsourcing, (Domberger and Fernandez, 1999).

1.1.5 Supermarkets in Nairobi

The growth of the supermarket sector in Kenya has been driven by factors such as rapid urbanization; a growing middle class and its changing lifestyle; market liberalization that has led to increased competition in the sector; market stabilization which had several important effects for supermarkets among them being import licensing removal and increased consumers buying power (Neven and Reardon, 2005).

The supermarket is not a new concept in Kenya, having had the first store of its kind in the 1960s (Neven and Reardon, 2005). Some of the old players in the retail industry are Uchumi supermarkets, founded in the mid 70s and Nakumatt supermarkets, founded in 1987. However, much growth was not seen within the retail chains until the mid 90s when supermarkets grew from 5 to the current over 300 stores in Kenya (Kamau, 2008; Neven and Reardon, 2005). These range from well established retail chains to independent one store supermarkets.

1.2 Research Problem

Outsourcing is one of the strategies that has become popular the world over as a strategy to attain competitive advantage. Much of the literature on the outsourcing deals with the reasons that affect the decision, both for and against it. The message in the literature is that the desire for cost savings may drive many outsourcing initiatives showing that significant savings can result (Gilley and Rasheed, 2000).

Supermarkets are facing an increasing pressure of customers' requirements in product customization, quality improvement, and demand responsiveness. In order to sustain the business under these pressures, supermarkets are striving to develop strategic partnerships with suppliers and collaborate with them in non-core process outsourcing. This strategy saves resources in terms of labour and capital, thus improving business value (Gilley and Rasheed, 2000). However, the fundamental question whether outsourcing affects positively supermarkets financial performance has not been solved. Performance implications of this outsourcing decision are not yet fully understood. Moreover, the scant research that has studied the performance outcomes of outsourcing is inconclusive.

To date there are only limited number of studies that have examined the financial performance and the economic implications of outsourcing (Elmuti 2003; Li Wang et al 2008).The attitudinal results presented in the studies provide support for the claims of outsourcing proponents that outsourcing allows companies to enhance expertise, improve service quality, reduce staff, streamline the process, lower costs and reduce the administrative burden and saving time. Outsourcing in this sense, is beneficial to

organizational performance and its effect need to be ascertained. Gilley and Rasheed (2000) researched on influence of the outsourcing of core functions on firm performance. The results of this study show no direct effect of outsourcing on firm performance. However, outsourcing is positively related to the performance of firms which pursue cost leadership and innovation differentiation strategies.

Jiang, Frazier and Prater (2006) empirical work on the effects of outsourcing on the firm performance find improved cost efficiency but no change in the productivity and profitability of the outsourcing firms. The authors conclude that the firms invest freed resources to improve core competencies. Additionally firms utilize the cost savings to lower prices at the cost of higher profits to gain competitiveness in the market. Li Wang et al. (2008) research on information technology outsourcing indicated that it has very few positive effects on firm performance; however, the effect can vary significantly across industries.

In the Kenyan context, a number of studies have been done on outsourcing in the service industry similar to this study. Rono (2011) concluded that outsourcing contributed to banks performance through cost saving, specialization of core competencies and improved service levels. Kinyua (2000) concluded that companies need to conduct careful analysis before engaging in outsourcing to minimize risks and other unforeseen costs. It was also found that cost saving and profitability are not significant predictors of outsourcing practices in the service industry in Kenya. In addition, Chanzu (2002)

concluded that outsourcing is most prevalent in departments like human resource, finance, and information technology mostly in the service industry.

Although a number of studies have been done on outsourcing and its effect on financial performance, none has focused on the effect of outsourcing on financial performance in the Kenyan supermarket industry. There is need to fill this research gap. Hence this study seeks to answer the question “what is the effect of outsourcing on financial performance in supermarkets in Kenya?”

1.3 Objectives of the Study

i. To determine the effect of outsourcing on financial performance of supermarkets in Nairobi.

ii. To establish the services that are outsourced by supermarkets in Nairobi.

1.4 Value of the Study

The benefits of successfully implementing an outsourcing strategy helps organizations maximize returns on internal resources by concentrating investments and energies on what they do best. In a rapidly changing market place and technological situations, this strategy decreases risks, shortens cycle times, lower investments, lowers cost and creates better responsiveness to customer needs Quinn and Hilmer (1994).

The study will benefit the following stakeholders;

The Supermarket which will find the results from this study valuable in making decisions on whether or not to outsource services as they endeavor to reduce costs to optimize on their financial performance.

Investors will benefit from the research since they will be enlightened about outsourcing and its effect on financial performance. Investors can then be knowledgeable enough to contribute in the annual general meetings especially if they have invested in the supermarket chain business. Their contributions during such meetings will be valuable to the firms. This may also increase the firm's profitability.

The findings from this study will add-up the literature on outsourcing to the academicians and expose the gaps for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews previous studies conducted by other scholars who have carried out their research in the same field. Specific emphasis has been put on outsourcing, outsourcing costs and their effects in determining financial performance in an organization.

2.2 Theoretical Review

2.2.1 Agency Theory

The focus of the agency theory originally was on the relationship between managers and stakeholders (Jensen and Meckling, 1976), but had spread over the time on explaining the relationship between two inter-firm subjects. In that context we associate the agency theory to understanding the relationship between outsourcer (principal) and vendor (agent). Both parties are utility maximizers and each party in the relationship has their own profit motive and interest, their goals are not congruent according to agency theory.

The agent will not always act in the best interest of the principle. There can be a number of reasons including for example, the agency misusing his power for pecuniary or other advantage and the agent not taking appropriate risks in pursuance of the principals interest because he(the agent) views those risks as not being appropriate and the principal may have different attitudes to risks. The principal tries to control the agent in order to maximize his own profits in the process incurring costs. The agent on the other hand is driven by self-interest as well. Here a conflict can be clearly observed. The costs

resulting from agents misusing their positions, as well as the costs of monitoring and disciplining them to prevent abuse have been called ‘agency cost’. Agency problem and moral hazards should be resolved by monitoring and bonding (Barney and Hesterly, 1996).

2.2.2 Transaction Cost Economics

Transaction cost economics has been the most utilized theory of outsourcing. Transaction cost economics is perceived to provide the best decision making tools to help organizations to decide to outsource and to prepare themselves for forthcoming outsourcing arrangements.

The theory was developed by Coase (1937). He developed the idea that economizing on transaction costs would determine the organization of economic activity and the division of activity between firms and markets. Coase (1937) suggests that a firm will replace the market when the costs of transacting within the firm are less than the costs of transacting through the market. He states ’’the operation of a market costs something and by forming an organization and allowing some authority (an entrepreneur) to direct the resources, certain marketing costs are saved’’. Pearce and Robinson (1997) modified this notion slightly by proposing that economic activity will be conducted through whatever organizational form minimizes the sum of production and transaction costs. From these perspectives, it is apparent that the notion of cost minimization or efficiency is a fundamental aspect of transaction cost economics.

Pearce and Robinson (1997) sees transaction costs as including all search and information costs as well as the costs of setting up contracts and monitoring and enforcing contractual performance. He defines transaction costs as those costs associated with an economic exchange that vary independent of the competitive market price of the goods or services exchanged. Hart (1998) states that there are a number of costs to writing a contact between principal and agent which include the cost of thinking about and providing for all the different eventualities that may occur during the course of the contact, the cost of negotiating with others and the cost of writing the contract.

2.3 The Concept of Outsourcing

Different definitions on outsourcing have been coined by different authors. Pearce and Robinson (1997) define outsourcing as the use of a source other than internal capacity to accomplish some tasks or processes. It is the strategic use of outside resources to perform activities that are traditionally handled by internal staff and resources. Corbett (1999) describes outsourcing as the wholesale restructuring of the corporation around core competencies and outside relationships. Sharpe (1997) defined outsourcing as turning over to a supplier those activities outside the organization's chosen core competencies. Lei and Hitt (1995) defined outsourcing as reliance on external sources for manufacturing components and other value adding activities. Kaathawala and Elmuti (2000) define outsourcing as a management strategy by which an organizations delegate's major non-core functions to specialized and efficient service providers.

Emphasis is shifting from outsourcing parts, facilities and components, towards outsourcing the intellectual based systems. Traditional outsourcing emphasis on tactical

benefits like cost reduction have more recently been replaced by productivity, flexibility, speed and innovation in developing business applications, and access to new technologies and skills, Wild et al (1999). A study conducted by PricewaterhouseCoopers (1999) established that outsourcing has moved markedly from attending to a single function more efficiently, to reconfiguring a whole process in order to attain greater shareholder value across the enterprise. Casale (2001) and Macrea (2002) forecasted global outsourcing growth of 20 percent per annum.

2.4 The Financial Effect of Outsourcing

Much of the literature identifies the desire to save costs as an explanation for why outsourcing occurs (Laarhoven et al., 2000; Vining and Globerman, 1999; Willcocks et al., 1995). In theory, outsourcing for cost reasons can occur when suppliers' costs are low enough that even with added overhead, profit, and transaction costs suppliers can still deliver a service for a lower price (Bers, 1992; Harler, 2000).Organization can achieve enough savings to cover an additional layer of overhead and still meet profit requirements through specialization and economies of scale (Kakabadse and Kakabadse 2000; Quinn et al., 1990). Cost savings due to outsourcing can be quite significant. In a survey of 7500 public organizations in Australia, the outsourcing of cleaning services saved an average of 46 percent over in-house performance of the service (Domberger and Fernandez, 1999). Some organizations outsource to achieve better cost control (Alexander and Young, 1996), while others try to shift fixed costs into variable costs (Anderson, 1997).

Although organizations may outsource for cost related reasons, there are no guarantees that expected savings will be realized. There is increasing evidence that cost savings have

been overestimated and costs are sometimes higher after outsourcing (Vining and Globerman, 1999; Welch and Nayak, 1992). Example is when the outsourcing of IT resulted in an average 9 percent increase in costs (Domberger and Fernandez 1999).

In addition to the costs that originally drove the outsourcing initiative like employment and overheads, there are also some additional costs. First is indirect costs which may include contract monitoring and oversight, contract generation and procurement, intangibles, and transition costs. Capital expenses incurred by the relationship should also be calculated (Kakabadse and Kakabadse, 2000; Vining and Globerman, 1999).

Second is social costs of outsourcing which may be difficult to quantify but they can be significant. Outsourcing may result in low morale, high absenteeism, and lower productivity (Kakabadse and Kakabadse, 2000; Walsh, 1996). Further, Lafferty's and Roan's (2000) study suggests that the education and skill level of a whole class of workers may be declining due to outsourcing of public services. Contractors are less willing to pay for employee education and development. The message in the literature is that the desire for cost savings may drive many outsourcing initiatives and that significant savings can result.

2.5 Outsourcing and Financial Performance

The design of incentive contracts and the use of performance measures in these contracts is the basic problem addressed by agency theory. In general, agency models analyze the situation in which a principal designs an incentive contract to motivate a risk and work averse agent to provide effort. These incentive contracts are traditionally based on one or

more noisy measures of performance. The assumption underlying these agency models is that the incentive contract and, more specifically, the performance measures used affect the agent's behavior. That is, the agent directs his attention to those aspects of the job that are being measured (Holmström and Milgrom 1991; Feltham and Xie 1994). Furthermore, increasing the incentive payment will lead the agent to exert more effort.

Agency theory predicts that the performance measure used for incentive purposes determines the direction of effort by the agent and that the incentive weight determines the amount of effort provided by the agent. This means that the use of incentive contracts will lead to higher effort levels and increased performance on those dimensions that are being measured, Holmström and Milgrom, (1991).

The findings in the empirical accounting literature on the effects of incentive systems are consistent with the agency predictions. For example, Banker et al. (1996), Wallace (1997), and Banker et al. (2000) all find that (measured) performance increases after the implementation of an incentive plan and that the decisions made by management are consistent with the incentives provided.

Agency theory prediction that agent's effort is determined by the incentives provided making rewards contingent on performance not only provides agents with incentives but it also increases the risk they have to bear, Wallace (1997). Agency theory states that the use of performance measures for incentive purposes depends on the trade-off between incentives and risk sharing and is affected by the risk aversion of the agent.

As outsourcing vendors typically provide services to many clients they can achieve cost advantages over single firms' productions costs as they benefit from economies of scale and centralization of expertise, Jiang, Frazier et al. (2006). Additional cost savings can stem from lower wage levels of the service provider, Abraham and Taylor (1996). If vendors pass on their production advantages via lower costs to their clients, the outsourcing firms will benefit from this transaction in terms of higher cost efficiency by producing the same output at lower costs.

2.6 The Benefits and Problems of Outsourcing

Outsourcing may face the organization with a range of performance benefits and problems.

2.6.1 Cost Reduction

Cost reduction has been the predominant motive for outsourcing (Ford et al., 1993). While outsourcing contracts commonly target a minimum of 15 percent cost saving and sometimes 20-25 percent (Lankford and Parsa, 1999), failure to achieve anticipated cost improvement is a frequently occurring aspect of outsourcing (Cross, 1995; Darling, 1999). The level of achieved saving may average 9 percent, although a large proportion of outsourcing clients may only break even or even find their costs increase (Embleton and Wright, 1998). Ketler and Walstrom (1993), provide further evidence for the underachievement of cost reduction targets, finding that initial vendor bills were usually 20 percent higher than anticipated due to a low vendor estimate and/or honest misunderstanding of the contact.

On occasion, in- house supply can provide lower costs (D'Aveni and Ravenscraft, 1994). Large organizations may find prospective suppliers unable to match their own internal economies of scale and many specialists' suppliers may have an effective scale that is no greater than that of their customers (Alexander and Young, 1996). Even if outside suppliers possess greater efficiency, cost savings may not be obtainable when a few vendors dominate a specialized market (Greer et al., 1999). While outside supply can reduce cost, there are examples of organizations, such as Harley Davidson, that have reduced cost by reinstating in-house supply (The Economists, 1991).To achieve reduced cost while maintaining standards requires that the supplier has access to superior cost drivers, such as economies of scale, learning and low cost locations. However, account also has to be taken of transaction costs, the costs of search, negotiation and contract enforcement which may be greater for highly differentiated services and components. In addition, there is the need to ensure that, following outsourcing, the outsourced activities' associated overhead is reduced (Bettis et al., 1992).

2.6.2 Focus on Core Activity

Various authors (including Quinn et al., 1990) emphasized the benefits of outsourcing in providing increased focus upon a set of core activities and reduction in the functional scope of the organization, enabling the development of a more focused organization capable of increased responsiveness to market change. The complementary use of outside resources can also provide opportunities for enhanced leverage of the organization's core resources. In the garment industry, Benetton (1982-1997) has sustained an average annual sales growth of 14 per cent developing a network of 7,000 franchised sales outlets in 110 countries. While Benetton directly employs 6,000 people, the company provides

work (through outsourced manufacture and franchised sales outlets for an additional 70,000 (Frery, 1999).

The use of outsourcing may also facilitate the development of economies of scope through product diversification (Reve, 1990). This may be achieved indirectly, through reduced functional complexity and greater focus upon core activities facilitating the development of product/market complexity. Organizations in the course of diversification may choose to buy-in activities expertise and components that they lack or would find inappropriate to develop.

2.6.3 Access to Superior Quality

Outsourcing can provide access to ‘’best in the world’’ quality for particular activities or components (Quinn et al., 1990). However in the absence of fully developed service level monitoring the development of quality may fail. Jennings (1996) cites the case of building society security services being repeatedly returned to in-house supply following disappointment with the standard of successive external providers. The use of external supply can also imply a reduction in the opportunities with which to achieve differentiation through the use of more widely available activities and components (Alexander and Young, 1996).

2.6.4 Flexibility

Outsourcing presents organizations with the opportunity to avoid the constraints of their own productive capacity in meeting changes in the volume of sales. The potential for improved flexibility may apply not only to the volume of output but also the ability of the organization to change the product range in response to market conditions. The adoption

of lean supply by Boeing has at times resulted in the company being unable to meet cyclical increase in the demand for aircraft. Lacking sufficient in-house production capacity, the company has found that attempts to increase capacity have resulted in their drawing resources away from the company's suppliers (The Economist, 1997).

Within the fashion apparel retailing, Richardson (1996) describes how rapid information exchange, rather than ownership of the various stages of production, enable companies to respond to the industry's short life cycles and abrupt changes in fashion.

2.6.5 Loss of Skills and Knowledge

While an organization's managers may share a concern to avoid outsourcing core or near core activities (Jennings, 1997), the frequent absence of formal policy guidelines (Jennings, 1996) can allow the incremental loss of key competencies to take place and hence undermine capability leading to a loss of critical skills, cross function working and creation of the ''hollow corporation'' (Betis et al., 1992). As a consequence cross-functional processes, such as innovation, may become more difficult. This is illustrated by situations where manufacturing and retailing are undertaken by separate organizations; retailers have a greater opportunity to develop knowledge of customer demand and may come to see manufacturers as out of touch with market developments (Howe, 1998).

The use of outside supply may also provide a situation in which there is a leakage of critical knowledge concerning processes and customers leading to the creation of potential competitors. Within the automobile industry the extensive use of components suppliers has enabled a number of component producers to develop to a stage where they

are capable of themselves becoming producers of entire vehicles (The Economist, 1998). Such outsourcing enables car companies to concentrate upon their core products, such as high-volume vehicles, but also furthers the ability of component producers to enter the car market with their own vehicles.

2.7 Supermarket Industry in Kenya

The growth of the supermarket sector in Kenya has been driven by various factors: First, there has been rapid urbanization and high population growth. Between 1989 and 2002, Kenya's population grew from 21 million to 33 million (Mungai et al. 2000). In addition, the average urban population growth rate is double that of the overall population growth rate (United Nations, 2002). The populations of main cities like Nakuru and Eldoret doubled between 1989 and 2002 (World Gazetteer 2002). Nairobi is on a high growth curve, with a recent study predicting that (mainly through rural-to-urban migration) population will grow from the current 2.5 million to 7.5 million over the next 20 years, i.e. an increase of almost 700 additional inhabitants every single day (African Population and Health Research Centre 2003).

Second, beginning in 1993, in collaboration with the World Bank and IMF, the Government of Kenya started to stabilize and reform its economy (Tradeport, 1996). Import licensing and foreign exchange control were eliminated, the agricultural sector was liberalized, a process of privatization of parastatals was initiated and trade barriers were reduced. Import licensing removal lead to increased product variety and shifted the retail market from a seller's to buyer's market in which retailers had to fight for the

consumer's shilling vote. Both trade liberalization (more imports) and market liberalization (more competitors) increased product variety in the market place, thus favoring bigger stores who can stock a wider assortment of products (economies of scope).

Third, price liberalization also played into the hands of the supermarkets because it facilitated the low margin-high turnover strategy that has been the core of most of the supermarket growth around the world. And finally there was a mild and short-lived recovery of the economy in 1995/6 (with annual real GDP growth in the 4% range) which gave consumers the buying power to try all these new products that supermarkets were marketing to them (Tradeport, 1996).

Fourth, Inward Foreign Direct Investment (FDI), a key supply-side explanatory factor behind the rapid growth of supermarket in other parts of the world, has not really played an important role in Kenya. Kenya's supermarket sector growth has been almost completely indigenous and endogenous. Before 1993, the main chains stuck to their headquarter cities. However, Uchumi broke this pattern in 1993 by building its first store outside Nairobi, in Nakuru, starting a national level competition that has built-in crescendo (Weatherspoon and Reardon, 2003).

Fifth, competition, most notably between leading chains Uchumi and Nakumatt, has been an important growth driver in the industry. World Gazetter (2004) observes that a new strategy by one competitor forces imitation and/or a counter strategy by its competitor(s). Competition leads to low margin – high turnover strategies which imply

economies of both scale and scope and thus fuel a never ending need for supermarkets to grow the size of their operations while at the same time reduce costs.

2.8 Empirical Review

Majority of academic studies have focused on understanding outsourcing decision determinants and outsourcing process control while the results of outsourcing have not yet been well confirmed by existing research (Jiang, Qureshi 2006). Two assessing methodologies have been applied to measure the outcomes of outsourcing. One focuses on the assessment of how well the perceived objectives are satisfied after outsourcing. Survey, case study and interviews are the main methods used to gather data (Lacity, Hirschheim 1994, Weeks, Feeny 2008). The Other methodology conducts performance based analysis using public available financial data such as stock price (Hayes, Hunton & Reck 2000, Oh, Gallivan & Kim 2006) and financial accounting data (Wang et al. 2008, Jiang, Qureshi 2006). However, most available studies concerning the results of outsourcing rely upon perceived metrics rather than direct measures which are likely to be influenced by subjective perceptions (Jiang, Qureshi 2006). The Interviewees usually only think about their own fields or departments instead of taking the whole picture of the firm into consideration.

Studies based on objective financial data are very limited. Using public available data, Jiang et al. (2006) found no significant difference in assets turnover (sales/assets), ROA and net profit margin. They conclude that outsourcing can improve a firm’s cost efficiency but not its productivity and profitability. This research is regarded as the first

one that empirically tests the relation between the outsourcing decision and the firm's financial performance (Jiang, Frazier & Prater 2006).

The study of Wang et al. (2008) develops a conceptual framework to examine the effect of outsourcing on firm performance. They study a sample of 120 companies with IT outsourcing announcement from 1993 to 2003. Their research suggests that IT outsourcing firms have significantly higher SG&A (sales, general and adminstrative expenses/net sales) and significant lower ROA compared with the non-outsourcing counterparts in year t=1(one year after outsourcing) but there is no significant difference in ROA,ROE, ROI and other measures in the rest of the years Wang et al. (2008).

The study by Elmuti (2004) focused on the perceived effect of outsourcing on organizational performance. The results presented provide support for the claims of outsourcing proponents that outsourcing allows companies to enhance expertise, improve service quality, reduce staff, streamline the process, lower costs and reduce the administrative burden and saving time. Outsourcing in this sense is beneficial to organizational performance (Casale 1996; Crane 1999: Quinn 2000). In addition, this study identified current outsourcing strategy trends and practices for randomly selected firms in the United States. The important contribution of this study is the revelation that organizations generally considered themselves successful at outsourcing. However, while they achieved significant improvement in organizational performance they have not reached the magnitude of improvements ascribed to outsourcing strategies. Organizational strategies which were identified as key contributors to outsourcing

success include strategies with clear objectives, right outsourcing partners, adequate skills, adequate planning, effective communication, and cooperation and collaboration throughout the organization.

Kinyua(2000) asserts that outsourcing engagements like other contractual engagements are characterized with risks and rewards. To be successful, a company should have a portfolio of competencies rather than a portfolio of business. Companies need to conduct careful analysis before engaging in outsourcing. This will ensure that it is not transferring benefits that could have been realized had it in-sourced the activity.

2.9 Conclusion

Outsourcing can be an efficient and effective alternative to using in-house resources, but a full determination of costs involved is required to make that decision. To understand the effect of outsourcing costs on financial performance of supermarkets, this study looked at the main outsourcing cost factors companies need to assess to make an informed decision on whether to outsource or to do the services internally. Successful decisions are dependent on having a clear understanding of all the costs options which is a mixture of overhead costs, direct cost, and labour costs.

Most academic studies have focused on understanding outsourcing decision determinants and outsourcing process control while the results of outsourcing have not yet been well confirmed by existing research (Jiang, Qureshi 2006). Methodologies used to measure performance are assessment of how well the perceived objectives are satisfied after

outsourcing. Majority of these studies were done in foreign countries and involving different organizations. There is therefore a need to conduct a study in a developing country like Kenya.

The study aimed to determine the effect of outsourcing on financial performance of supermarkets in Nairobi considering that cost reduction is one of the major objectives of outsourcing. It will also establish the activities that are outsourced by the supermarkets in Nairobi.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research design and methodology that was used in the study. It describes the research design, the target population, sample size and sampling procedure, data collection and data analysis techniques.

3.2 Research Design

Research design refers to the approach used to collect data. The design for this study was descriptive research design. Dane (1990) defines a descriptive study, as a study where no attempt is made to change behavior or conditions of the subjects. Things are measured as they are. Description involves elements of comparison and of relationship of one kind or the other; it establishes only associations between variables. The method was useful since the study aimed at discovering the association between outsourcing practices and financial performance of supermarkets in Nairobi.

3.3 Population

The population in the study was composed of all supermarkets operating in Nairobi as listed in the Nairobi Business Directory (2012). There were 77 supermarkets operating in Nairobi as indicated in the Appendix III. The study was on supermarkets in Nairobi since it’s on a high growth curve due to urbanization and most supermarkets have their headquarters in the capital.

3.3 Sample

The sample of the study consisted of fifty (50) supermarkets within Nairobi. The fifty (50) supermarkets were selected from a sampling frame of seventy seven (77) sampling units using random sampling. This represented 65% of the population. Mwanyota (2004) used a sample of fifty (50) supermarkets; Mageto (2009) used a sample of fifty (50) supermarkets. Both studies consisted of a population of all supermarkets in Nairobi similar to this study. Therefore a sample size of fifty (50) supermarkets was deemed fit and adopted as sufficient for purpose of this study. Supermarkets with one branch and those with more than one branch were considered as the only two categories that existed. For supermarkets with more than one branch information was collected from the head office thus the supermarket was treated as one organization.

3.4 Data Collection

The study used primary data which was collected by use of a self- administered questionnaire. The questionnaire targeted finance managers at the head offices of the supermarkets. The questionnaire was semi structured in the sense that it contained both closed ended questions intending to elicit quantitative data for statistical analysis and open ended questions intending to elicit qualitative responses. The questionnaires were administered using drop and pick method. Primary data was collected for the financial periods 2007 to 2011.

3.4.1 Data Validity and Reliability

Questionnaires were pilot tested on 5 random respondents to ensure that data collected was reliable and valid. It was edited for any mistakes in the questions then the final questionnaire was prepared and used to collect data for analysis.

3.5 Data Analysis

The data analysis was based on the research questions. The data was first edited for accuracy and completeness then responses was coded to facilitate statistical analysis. The resulting data was analyzed using SPPS (Statistical Package for Social Sciences) Version 17. Various tables, charts and bar graphs diagrams were used to present the data for ease of understanding and interpretations. Regression analysis was applied to show the relationship between the variables.

3.5.1 The Analytical Model

Supermarkets profitability is affected by outsourcing costs that are incurred in generating income. The Model seeks to explain the relationship between profitability and the outsourcing cost factors that affect profitability of supermarkets.

The model gives the determining function of supermarkets profitability. All the costs listed here may not include all costs which will affect supermarkets profitability but this function will help us understand the profitability at mechanism level. Outsourcing costs determine the profit behavior of supermarkets in some extent. A change in outsourcing costs will result in the change of supermarkets profitability. Its practical significance can

be understood like this: supermarkets should take outsourcing decisions based on these outsourcing costs. This is also the general theoretical significance of this model.

The regression model used in the study was of the form;

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$

Y = financial performance as measured by operating Income

α = constant term

β = beta coefficients of the independent variables

X_1 = direct outsourcing costs

X_2 = labour costs in outsourcing

X_3 = overhead outsourcing costs

e = standard error

The model treats financial performance as the dependent variable while the independent variables will be the outsourcing cost which includes overhead costs, labour costs and direct costs. To test the relationship, coefficient of correlation (R) was calculated to give an indication of the strength and the direction of the relationship between the independent variables and the dependant variable. Coefficient of determination (R square) was calculated to give an indication of the extent or significance to which changes in the dependant variable will be attributed to a change in the independent variables. ANOVA and t statistics will be used to further analyze the data.

CHAPTER FOUR

DATA ANALYSIS FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents the interpretation of the data that was collected and analyzed by the researcher. The main objective of the study was to determine the effect of outsourcing on financial performance of supermarkets in Nairobi. The study adopted a regression equation of the form $Y = \alpha + \beta 1X1 + \beta 2\ X2 + \beta 3\ X3 + e$. This equation was applied in all the years from 2007 to 2011 and on average figures for all the years. The findings are presented below in tables.

4.2 Organizational Profile

The researcher sought to establish a few facts concerning the profile of the supermarkets that were involved in the study. On the number of years they had been in operation, it was clear that 92.8% of the supermarkets had operated for a duration of less than 10 years. This is an indication that they were relatively new entrants into the market. 78.5% of the supermarkets had less than 10 branches in total compared to only 7% who have more than 20 branches.

It was also significant for the researcher to establish the types of services that are commonly outsourced by supermarkets in Kenya. It was also established that supermarkets outsource a number of activities but the most prominent were information technology, security and cash in transit. The rating for each of them is shown in the table below.

Table 4.1: Outsourced Services

Service	Frequency	Percent
Security	14	50%
Information Technology	26	92.85%
Cash in Transit	11	39.10%
Marketing	9	32.10%
Finance	8	28.60%
Others	6	21.40%

Source: Research Findings

It can be observed that the services most easily outsourced are those that are resource-intensive, relatively discrete, require specialist competencies, characterized by fluctuating work patterns for which it is costly to recruit and retain staff.

4.3 Regression 2007

Table 4.2: Model Summary 2007

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.737[a]	.553	.527	.491

a. Predictors: Overhead costs 2007, Direct costs 2007, Labour costs 2007
Source: Research Findings

The researcher conducted a regression analysis for the year 2007. Operating income the dependent variable whereas overhead costs 2007, direct costs 2007 and labour costs 2007 were the dependent variables. It can be observed from the model summary in Table 4.1 above that the R square value is .0553. This translates to 53.3%. This indicates that the

three costs accounted for 53.3% of the operating Income. The remaining 46.7 variance was for some other costs other than these three.

Table 4.3: ANOVA 2007

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	7.816	1	0.816	1.914	.000[b]
Residual	5.160	23	6.044		
Total	12.974	24			

a. Dependent Variable: Operating income 2007
b. Predictors: Overhead costs 2007, Direct costs 2007, Labour costs 2007
Source: Research Findings

Table 4.4: Coefficients 2007

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1482.59	48.114		1.174	.251
Overhead costs 2007	240.963	40.780	.757	5.909	.000
Direct costs 2007	120.242	20.511	.531		.123
Labour costs 2007	111.324	18.544	.462		.023

a. Dependent Variable: Operating Income 2007
Source: Research Findings

Based on the table of coefficients above, it is therefore possible to develop a regression equation that can explain the relationship between operating Income and overhead costs 2007, direct costs 2007 and labour costs for the year 2007. The constant 1482.59 represents the operating Income when all the costs are held constant. Overhead costs had a positive value of 240.963, direct costs a positive value of 120.242 and labour costs a value of 111.324. From these values therefore this equation can be derived: Y= 1482.59 +

240.963X1+ 120.242 X2+ 111.324 X3+ 48.114. This is therefore the equation that can explain the relationship between the three costs and operating Income for supermarkets in Nairobi for the year 2007.

4.4 Regression 2008

Table 4.5: Model Summary 2008

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.828[a]	.696	.674	0.28

a. Predictors: Overhead costs 2008, Direct costs 2008, Labour costs 2008

Source: Research Findings

The regression results for 2008 indicate that there was an upward trend in terms of the variance of operating Income explained by the three independent variables of overhead costs, direct costs and labour costs. The model summary in Table 4.4 above illustrates that the R square value was 69.6%. This is an increase of 11.4% from the year 2007. It clearly indicates that in the year 2008, the three costs accounted for 69.6% of the total operating Income among supermarkets in Nairobi.

Table 4.6: ANOVA 2008

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.104	1	8.096	6.862	.000[b]
	Residual	4.128	26	1.774		
	Total	12.234	27			

a. Dependent Variable: Operating Income 2008

b. Predictors: Overhead costs 2008, Direct costs 2008, Labour costs 2008

Source: Research Findings

Table 4.7: Coefficients 2008

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	109.451	10.678	1.057	.300	1.057
Overhead costs 2008	70.830	9.393	.828	5.543	.000
Direct costs 2008	64.422	7.856	.932		.000
Labour costs 2008	82.631	9.834	.785		.000

a. Dependent Variable: Operating Income 2008

Source: Research Findings

The constant for the year 2008 was 109.451. This means that even without these costs, there would still be a operating Income equal to the value of the constant in 2008. overhead costs had a value of 70.830 which depicts a positive relationship to operating income, direct costs had a positive value of 64.422 whereas labour costs had a positive value of 82.631. These put together produce a regression equation that can explain the relationship between the independent and dependent variables in 2008: Y= 109.451 + 70.830X1+ 64.422X2+ 82.631X3+ 10.678

4.5: Regression 2009

Table 4.8: Model Summary 2009

Mode l	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.878[a]	.773	.744	3.196

a. Predictors: Overhead costs 2009, Direct costs 2009, Labour costs 2009

Source: Research Findings

In 2009, the same upward trend observed in 2008 is repeated itself. Table 4.7 above confirms this position since the R square value is 0.773 which translates to 77.3%. This is an indication that in the year 2009, the three costs: overhead costs, direct costs and labour costs accounted for 77.3% of the operating income of supermarkets in Nairobi. This was an increase of 6.7% up from the year 2008. The Anova table below illustrates a significance of .000 which is a clear indication that there is a very significant relationship between the variables under consideration.

Table 4.9: ANOVA 2009

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.640	1	9.640.000	79.294	.000[b]
	Residual	3.020	26	1.693.000		
	Total	12.660	27			

a. Dependent Variable: Operating Income 2009

b. Predictors: Overhead costs 2009, Direct costs 2009, Labour costs 2009

Source: Research Findings

Table 4.10: Coefficients 2009

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	89.222	9.38		.993	.330
Overhead costs 2009	43.951	4.936	.868	8.905	.000
Direct costs 2009	4.562	.856	.538		.984
Labour costs 2009	2.356	.534	.387		.884

a. Dependent Variable: Operating Income 2009

Source: Research Findings

From the table of coefficients above, it is evident that the constant for the year 2009 was 89.222. This constant illustrates that even when the three costs assumed a zero value in 2009, the operating Income would still be 89.222. In 2009, the overhead costs had a positive value of 43.951, direct costs a positive value of 4.562 and labour costs a positive value of 2.356. All the three independent variables exhibited a strong positive relationship towards operating Income in the year 2009 among supermarkets in Nairobi. Using the values of the variables, the following equation was derived to explain the relationship between the variables in the year 2009: $Y= 89.222+ 43.951X1+ 4.562\ X2+ 2.356X3+ 9.38$

4.6: Regression 2010

Table 4.11: Model Summary 2010

Mode l	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.896[a]	.803	.795	3.920

a. Predictors: Overhead costs 2010, Direct costs 2010, labour costs 2010

Source: Research Findings

It is evident from the model summary for 2010 in Table 4.10 above that the R square value was 0.803. This represents a percentage of 80.3% of the variance that can be explained by the three independent variables. This is an indication that outsourcing costs accounted for 80.3% of the operating Income. The remaining 19.7% is accounted for by other factors outside this study. It can also be observed that there is an upward increase of 5.3% from the year 2009.

Table 4.12: ANOVA 2010

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	10.416	1	10.416.	5.697	.000[b]
Residual	25.000	26	9.784.		
Total	35.416	27			

a. Dependent Variable: Operating Income 2010

b. Predictors: Overhead costs 2010, Direct costs 2010, Labour costs 2010

Source: Research Findings

Table 4.13: Coefficients 2010

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	79.154	8.240		.960	.346
Overhead costs 2010	33.081	3.218	.896	10.281	.000
Direct costs 2010	5.325	.956	.655		.895
Labour costs 2010	3.462	.978	.468		.956

a. Dependent Variable: Operating Income 2010

Source: Research Findings

The table of coefficients above also gives the values associated with each of the variables. The constant for the year 2010 is 79.154 which mean that this is the operating Income that could be achieved even when the three outsourcing costs were held constant. The overhead costs 2010 had a positive value of 33.081, direct outsourcing costs 2010 had a positive value of 5.325 whereas the labour outsourcing costs for 2010 had a positive value of 3.462. Based on these values therefore the regression equation for the year 2010 would appear as follows: $Y=79.154 + 33.081X1+ 5.325X2+ 3.462X3+ 8.240$. This equation therefore explains the relationship between outsourcing costs and operating Income.

4.7: Regression 2011

Table 4.14: Model Summary 2011

	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.904[a]	.818	.811	3.330

Predictors: Overhead costs 2011, Direct costs 2011, Labour costs 2011

Source: Research Findings

In 2011, the regression results confirm that the three outsourcing costs accounted for 81.8% of the operating Income. This was an increase of 1.5% from the year 2010. This is an indication that the costs accounted for 81.8% of the operating Income in 2011 among supermarkets in Nairobi.

Table 4.15: ANOVA 2011

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	11.928	1	11.028	16.903	.000[b]
1	Residual	2.028	26	9.231		
	Total	13.946	27			

a. Dependent Variable: Operating Income 2011
a. Predictors: Overhead costs 2011, Direct costs 2011, Labour costs 2011
Source: Research Findings

Table 4.16: Coefficients 2011

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	79.977	8.415		.984	.334
Overhead costs 2011	27.394	2.534	.904	1.812	.000
Direct costs 2009	7.235	.844	.524		.746
Labour costs 2009	4.352	.924	.342		.925

a. Dependent Variable: Operating Income 2011
Source: Research Findings

The operating Income for 2011 even when there were no outsourcing costs was 79.977. Overhead outsourcing costs had a positive value of 27.394, direct outsourcing costs had a value of 7.235 and labour outsourcing costs a value of 4.352. The relationship between

outsourcing costs and operating Income among supermarkets in Nairobi could therefore be explained using this regression equation: Y= 79.977+ 27.394X1+ 5.325X2+ 4.352X3+8.415.

4.8 Regression Average for 5 years

Table 4.17: Model Summary average for five years

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.720[a]	.518	.418	.243

a. Predictors: Average overheads, Average Direct costs, Average labour costs

Source: Research Findings

A regression was also conducted on the average costs of outsourcing and the average operating Income for the period 2007 to 2011. The results indicate that the outsourcing costs account for 51% of the operating Income. This is lower than the percentage observed in 2011 of 81.8%.

Table 4.18: ANOVA average for five years

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.344	2	4.067	37.536	.000[b]
	Residual	3.480	25	1.259		
	Total	12.824	27			

a. Dependent Variable: Average Operating Income

b. Predictors: (Constant), Average overheads, Average Direct costs, Average labour costs

Source: Research Findings

Table 4.19: Coefficients average for five years

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	671.282	9.112		.654	.519
Average Direct costs	-16.691	16.466	-4.334	-1.014	.320
Average overheads	271.497	223.536	5.193	1.215	.236
Average labour costs	14.622	.762	.342		.925

a. Dependent Variable: Average on Operating Income

Source: Research Findings

The table of coefficients indicates that the operating Income for the entire 5 year duration is expected to be 671.28 when there are no outsourcing costs. The trend so far observed from the year 2007 to 2011 indicates that the operating Income figures have been reducing every year even when the three outsourcing costs were held constant. This is an indication that the outsourcing costs did not have such a large impact on Operating Income even though they accounted for a larger percentage of the same. Average direct outsourcing costs for the 5 year duration had a negative value of -16.691, average overhead outsourcing costs had a positive value of 271.497 and average labour costs a positive value of 14.622. The average regression equation for the entire duration will therefore be: $Y = 671.28 - 16.691X1 + 271.497X2 + 14.622X3 + 9.112$

4.9 Interpretation of Findings

It is clear from the findings based on the regression results conducted for the years 2007 to 2011 that the three outsourcing costs accounted for a greater percentage of operating Income among supermarkets in Nairobi. The trend observed from the findings is that of increasing costs of outsourcing. The costs kept on increasing from 2007 to 2011 hence accounting for even a greater percentage of the operating Income. This scenario had been observed by Embleton and Wright (1998) who indicated that most of the outsourcing clients experienced increasing costs or a saving of around 9%.

But it is worth noting that the increase was at a decreasing rate. This implies that at some point the three outsourcing costs will reach a time when they will not increase anymore and fail to have any effect on operating Income. These findings agree with Banker et al. (2000) who also noted that performance increases after the implementation of an incentive plan and that the decisions made by management are consistent with the incentives provided.

Even though the outsourcing costs accounted for more than three quarters of operating Income for the five years since 2007 to 2011, what is clear is that the costs do not seem to have any significant effect on the profitability of the supermarkets. These findings agree with Lankford and Parsa (1999) who established that companies may not achieve significant changes or improvement on their profitability since the expected cost savings from outsourcing do not in most cases yield the desired results or savings in terms of costs.

These findings also agree with Lyson and Farrington (2006) who observed that the services most easily outsourced are those that are resource-intensive, relatively discrete, require specialist competencies, characterized by fluctuating work patterns in loading and throughput, subject to quickly changing markets (for which it is costly to recruit and retain staff), and subject to rapidly changing technology requiring expensive investment.

CHAPER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of findings on the effect of outsourcing on financial performance of supermarkets in Nairobi. The chapter also gives the conclusions, recommendations based on the findings, suggestions for further research and limitations of the study.

5.2 Summary

The study established that in the year 2007, the three outsourcing costs of labour outsourcing costs, direct outsourcing costs and overhead outsourcing costs could be equated to 53.3% of the operating Income. However when the three costs were assumed to be constant, the value of operating Income was 1482.59. This indicated that even if the three outsourcing costs were not in existence, there would still be a operating Income of 1482.59 that year.

In the year 2008, the regression analysis conducted against the three outsourcing costs the same year and operating Income for the same duration confirmed that there was an upward trend in the level of outsourcing costs. The study established that in 2008, the three outsourcing costs accounted for 69.6% of the operating Income. The operating

Income value when the costs were held constant for that year was 109.451. This was a large decrease from the value observed in 2007.

It was further established that in the year 2009 there was a continuing upward trend in the variance explained by the outsourcing costs. They accounted for 77.3% of the operating Income. The study also found out that if the three outsourcing costs were held constant in 2009, the value of outsourcing would be 89.222. This is an indication that there was a operating Income of 89.222 even when there were no outsourcing costs.

The study also established that the years 2010 and 2011 illustrated the same trend as observed from 2007 to 2009. There was an upward trend in the variance explained by the three outsourcing costs. In 2010 the outsourcing costs accounted for 80.3% while in 2011 they accounted for 81.8% of operating Income. It is important to note that the operating Income constant value kept on decreasing each year as the outsourcing costs increased. The regression conducted for the five years using average figures indicates that the three outsourcing costs accounted for 51% of operating Income among supermarkets in Nairobi. This is an indication that the three outsourcing costs largely affect the operating Income of the supermarkets in Nairobi. A regression equation of the form: $Y= 671.28 - 16.691X1+ 271.497X2+ 14.622X3+ 9.112$ was therefore derived to explain this significant relationship.

5.3 Conclusions

There is a significant relationship between operating Income on one hand and direct outsourcing costs, labour outsourcing costs and overhead outsourcing costs on the other hand. These three outsourcing costs account for a great percentage of operating Income of the supermarkets in Nairobi hence cannot be ignored. The operating Income for the five years under observation registered a downward trend even when the outsourcing costs were held constant. As the outsourcing costs increased, the operating Income seemed to nosedive.

5.4 Recommendations for Policy

It is imperative that cost – benefit analysis is done before undertaking any outsourcing exercise to maximize on the financial performance and minimize on the costs. This will aid managers in decision making regarding prioritization of services to be outsourced.

It is apparent that outsourcing of services brings with it advantages over internally providing these services. It is the opinion of the researcher that supermarkets should strive to outsource those services that are not core and do not provide a competitive advantage

Supermarkets in Nairobi need to find ways of checking their outsourcing costs since they affect the level of performance. If they are able to control the outsourcing costs, then they are likely to enjoy better financial performance figures.

5.5 Limitations of the Study

The study did not take into considerations other factors that may have affected the performance of the supermarkets during the years of the study.

The sample size used for the study was also small due to the reluctance of most firms to participate in the study citing data sensitivity and confidentiality. A larger sample size would have probably yielded more generalized results.

Lastly the study is limited to the extent that it focus is on a specific country and industry, Kenya and supermarket sector respectively. There was not really any benchmark from within the country in terms of previous study of similar nature.

5.6 Suggestions for Further Research

This study may need to be replicated after duration of 5 years or more to establish whether the situation has changed or will still be the same. The nature of this research in terms of measurability requires a relatively longer period of time to conclusively determine the effects of outsourcing on financial performance of supermarkets in Nairobi due to the ever changing environmental factors.

Further research can also be carried out to include other sectors in the economy not included in this study so as to determine any significance differences on the effect of outsourcing on firm's financial performance.

A study should be carried out to establish the effects of outsourcing on the revenue and general profitability of supermarkets in Nairobi. This will help shed more light on the effects of outsourcing on the financial performance of supermarkets in Nairobi.

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APPENDIX II

QUESTIONNAIRE

This questionnaire is prepared for the purpose of collecting data for research proposal in partial fulfillment of the requirement for an award of master of business administration and therefore all information will be handled confidentially and used for academic purpose only.

SECTION A: GENERAL INFORMATION

Respondent Profile

1. Company Name
2. Respondent's title
3. Respondent's department
4. Email Address (Optional)

Organization Profile

5. For how long has your organization been in existence?
   a) Below 10 years ( )
   b) Between 11 years and 20 years ( )
   c) Over 20 years ( )

6. How many branches do you have?
   a) 0-10 ( )
   b) 10-20 ( )
   c) Over 20 ( )

7. Under which department is Outsourcing Management?
   a) Operations department
   b) Finance department
   c) Department on its own
   Other Department (Please specify)………………………

8. List the services/activities that your organization is outsourcing.

   ………………………………………………………………………

   ………………………………………………………………………

   …………………………………………………………………………

   ………………………………………………………………………

SECTION B: COSTS OF OUTSOURCING AND PERFORMANCE

Note: Please give best estimates if you do not have exact data.

1. Financial Amounts

	2007	2008	2009	2010	2011
Total Operating Income					
Total Sales					
Total Cost					

2. Direct Costs in Outsourcing

	2007	2008	2009	2010	2011
Vendor selection costs					
Monthly contractual costs					
Materials/supplies/utilities cost					
New equipment/software costs					

3. Labour Costs in Outsourcing

	2007	2008	2009	2010	2011
Pension and retirement benefits					
Staff training costs					
Overtime costs					

4. Overhead Costs in Outsourcing

	2007	2008	2009	2010	2011
Administrative costs					
Contract maintenance/licenses cost					
Legal fees					

Thank you for taking the time to complete this questionnaire.

APPENDIX III

LIST OF SUPERMARKETS

1. Acacia Supermarkets Ltd
2. AFCO
3. African Grocers Ltd
4. Alliance Supermarket Ltd
5. Amal Supermarkets td
6. Betcam Savers Supermarkets Ltd
7. Cash and Cary Ltd
8. Centaline Supermarkets Ltd
9. Chandarana Supermarkets
10. City Mattresses Ltd
11. Clean way Ltd
12. Continental Supermarkets Ltd
13. Country Mattresses ltd
14. Eagles Supermarket
15. Eastleigh Mattresses
16. Ebrahims and Co Ltd
17. Esajo Supermarket
18. Fairlane Supermarkets Ltd
19. Gigiri Supermarket
20. Happy Valley Supermarket Ltd
21. Home Choice Supermarkets
22. Jack & Jill Supermarkets
23. Janamu Supermarkets Ltd
24. Jeska Supermarkets
25. Joster Mini Market
26. Juja Road Fancy Store ltd
27. K & A Self Selection store
28. Kaaga Mini Market
29. Kaka Self Services Ltd
30. Kalumos Trading Co Ltd
31. Kanyaki Supermarket
32. Kenton Supermarket
33. Kikomba Mattresses Ltd
34. Mega Market Ltd
35. Mesora Supermarkets
36. Mulika Mini market
37. Mustard Supermarket
38. Nakumatt Holdings
39. New Westlands Stores Ltd\
40. Ngara Road Self Service Stores
41. Nine to Nine Supermarket
42. Njewa Supermarket
43. Nova Supermarket
44. Nuru Supermarkets
45. Park and Shop Supermarket Ltd
46. Parklands Pricerite Ltd
47. Portway Stores
48. Raken Supermarket
49. Ridhika Supermarket
50. Rikana Supermarket
51. Rosjam Supermarket
52. Safeway Hypermarkets
53. Select and Pay Supermarket
54. Shoppers Paradise
55. Skymatt Supermarket
56. Soko Ndogo Ltd

57. Star Supermarket
58. South C Supermarket
59. Spring Valley Supermarket
60. Stagen Enterprises
61. Starehe Supermarket
62. Stellar Supermarket
63. Sterling Supermarket
64. Sunshine Supermarket
65. Supervalue Supermarket
66. Supra Self Selection
67. Three Ways Supermarket
68. Tuskys Supermarket
69. Uchumi Supermarket
70. Ukwala Supermarket
71. Umoja selections
72. Uncle Jims Supermarkets
73. Urban Supermarkets
74. Uthiru Wayside Supermarkets
75. Venture Supermarkets
76. Vishile Kenya ltd
77. Wambu General Stores

Source - Nairobi Business Directory 2012