OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

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DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

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DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

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My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company's competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.

ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.

iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent “friction in the market” or “cost of using the price mechanism”. Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms' performance. These capabilities constitute the core competencies' of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn't have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization's competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company’s control over how certain services are delivered which in turn may raise the company’s liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management's lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users' requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

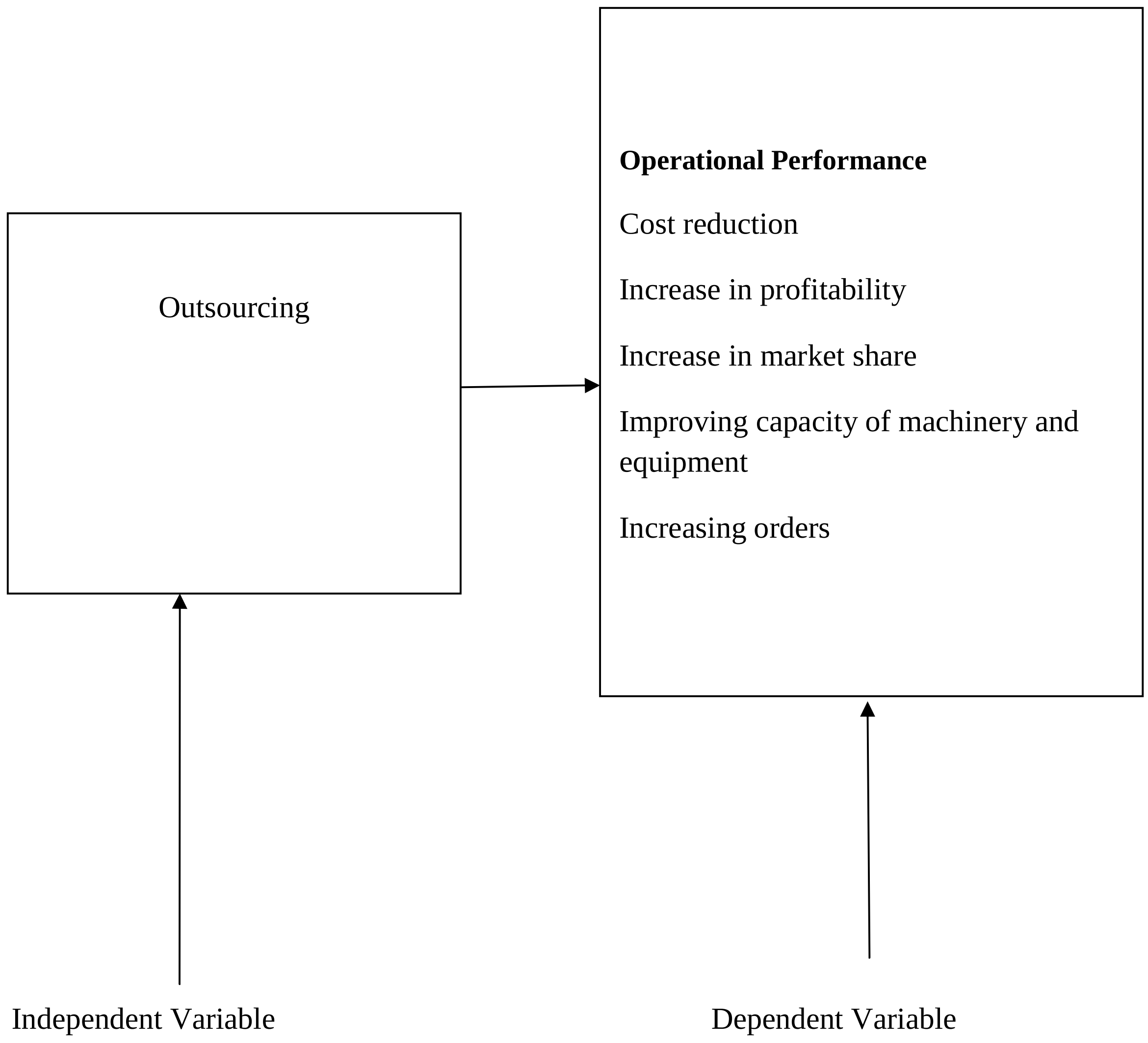
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes " decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms' in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms' operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through 'drop and pick' method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \alpha$

Where Y = Operational performance

β_o = Constant

x_1 = Access to modern technology

x_2 = Cost savings

x_3 = Focus and core competence

α = Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	Percent	Cumulative Percent
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was 'Strongly agree (5)' to 'strongly disagree' (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; ($3.5 \leq$ S.A <5.0). The scores of 'moderately extent' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: $2.5 \leq$M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	Std. Deviation
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	Std. Deviation
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$

The coefficient of the independent variables ($X_1 – X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ……………………………………………..………
2. Name of your organization……………………………..………………………….
3. What is the ownership of the organization?

   a) Local ( )

   b) Foreign ( )

   c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

   a) Under 20 years [ ] b) 21 – 30 years [ ]

   c) 31 – 40 years [ ] d) 41- 50 years [ ]

   d) Over 50 years [ ]

5. Length of continuous service with the company?

   a) Less than two years [ ] b) 2-5 years [ ]

   c) 6- 10 years [ ] d) Over 10 years [ ]

6. For how long has your company been in existence in Kenya?

   a) Under 5 years [ ] b) 6-10 years [ ]

   c) 11-15 years [ ] d) Over 16 years [ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

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DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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May the Almighty God bless and reward each one of you abundantly.

ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms’ performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm’s competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms’ transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company’s competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.

ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.

iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent "friction in the market" or "cost of using the price mechanism". Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms' performance. These capabilities constitute the core competencies' of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn’t have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization’s competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management's lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users' requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

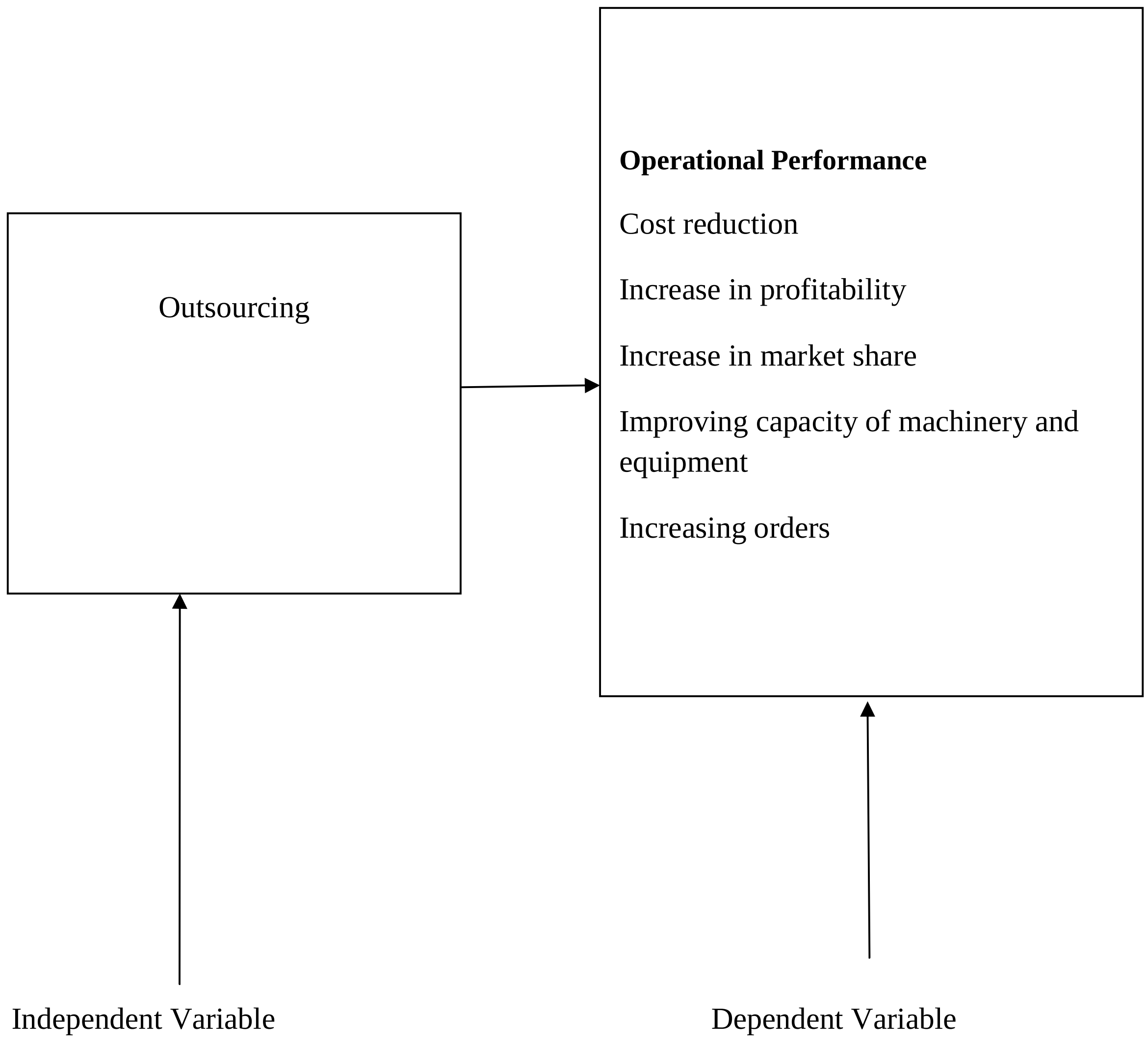
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes " decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms' in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms' operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through 'drop and pick' method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1\ x_1 + \beta_2\ x_2 + \beta_3\ x_3 + \alpha$

Where Y = Operational performance

β_o = Constant

x_1 = Access to modern technology

x_2 = Cost savings

x_3 = Focus and core competence

α = Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	Percent	Cumulative Percent
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was 'Strongly agree (5)' to 'strongly disagree' (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; (3.5≤ S.A <5.0). The scores of 'moderately extent' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: 2.5≤M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	**Std. Deviation**
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	Std. Deviation
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$

The coefficient of the independent variables ($X_1 – X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) …………………………………………….………
2. Name of your organization……………………………..………………………….
3. What is the ownership of the organization?

    a) Local ( )

    b) Foreign ( )

    c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

a) Under 20 years	[ ]	b) 21 – 30 years	[ ]
c) 31 – 40 years	[ ]	d) 41- 50 years	[ ]
d) Over 50 years	[ ]		

5. Length of continuous service with the company?

a) Less than two years	[ ]	b) 2-5 years	[ ]
c) 6- 10 years	[ ]	d) Over 10 years	[ ]

6. For how long has your company been in existence in Kenya?

a) Under 5 years	[ ]	b) 6-10 years	[ ]
c) 11-15 years	[ ]	d) Over 16 years	[ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms’ to exploit their more advanced technologies					
It results in Petroleum marketing firms’ improved service qualities					
It helps the Petroleum marketing firms’ from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms’ to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms’ to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms’ to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

Lecturer, Department of Management Science, University of Nairobi

DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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May the Almighty God bless and reward each one of you abundantly.

ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company’s competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.
ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.
iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent "friction in the market" or "cost of using the price mechanism". Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms’ performance. These capabilities constitute the core competencies’ of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn't have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization's competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company’s control over how certain services are delivered which in turn may raise the company’s liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management's lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users' requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

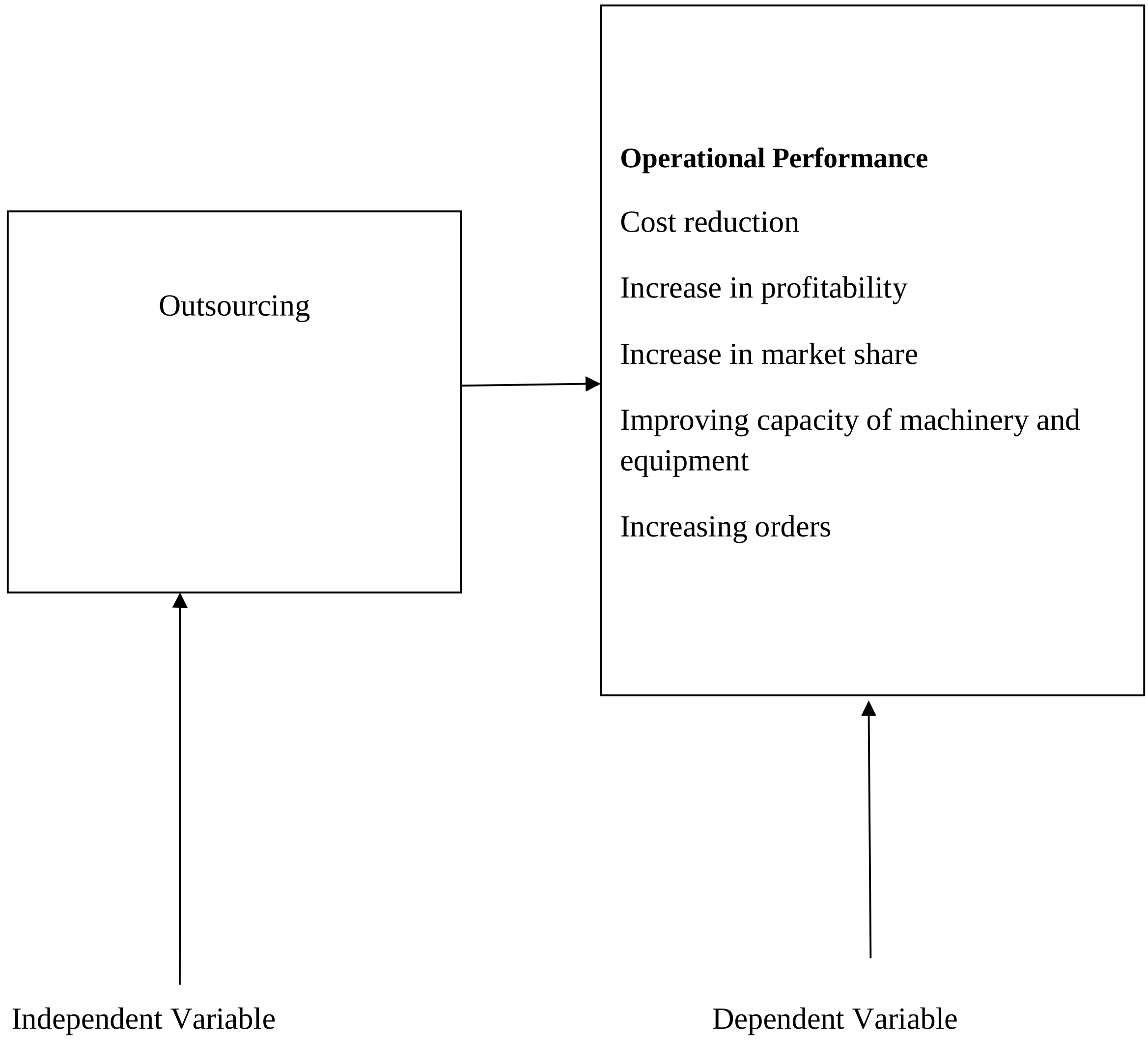
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes " decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company’s control over how certain services are delivered which in turn may raise the company’s liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm’s performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms’ in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms’ operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through 'drop and pick' method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1\ x_1 + \beta_2\ x_2 + \beta_3\ x_3 + \alpha$

Where Y = Operational performance

β_o = Constant

x_1 = Access to modern technology

x_2 = Cost savings

x_3 = Focus and core competence

α = Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	**Percent**	**Cumulative Percent**
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was 'Strongly agree (5)' to 'strongly disagree' (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; (3.5≤ S.A <5.0). The scores of 'moderately extent' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: 2.5≤M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	**Std. Deviation**
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	**Std. Deviation**
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$$

The coefficient of the independent variables ($X_1 - X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads
to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ……………………………………………..………
2. Name of your organization……………………………..………………………….
3. What is the ownership of the organization?

   a) Local ( )

   b) Foreign ( )

   c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

   a) Under 20 years [ ] b) 21 – 30 years [ ]

   c) 31 – 40 years [ ] d) 41- 50 years [ ]

   d) Over 50 years [ ]

5. Length of continuous service with the company?

   a) Less than two years [ ] b) 2-5 years [ ]

   c) 6- 10 years [ ] d) Over 10 years [ ]

6. For how long has your company been in existence in Kenya?

   a) Under 5 years [ ] b) 6-10 years [ ]

   c) 11-15 years [ ] d) Over 16 years [ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

Lecturer, Department of Management Science, University of Nairobi

DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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May the Almighty God bless and reward each one of you abundantly.

ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company’s competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.
ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.
iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent “friction in the market” or “cost of using the price mechanism”. Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms' performance. These capabilities constitute the core competencies' of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn't have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization's competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management's lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users' requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

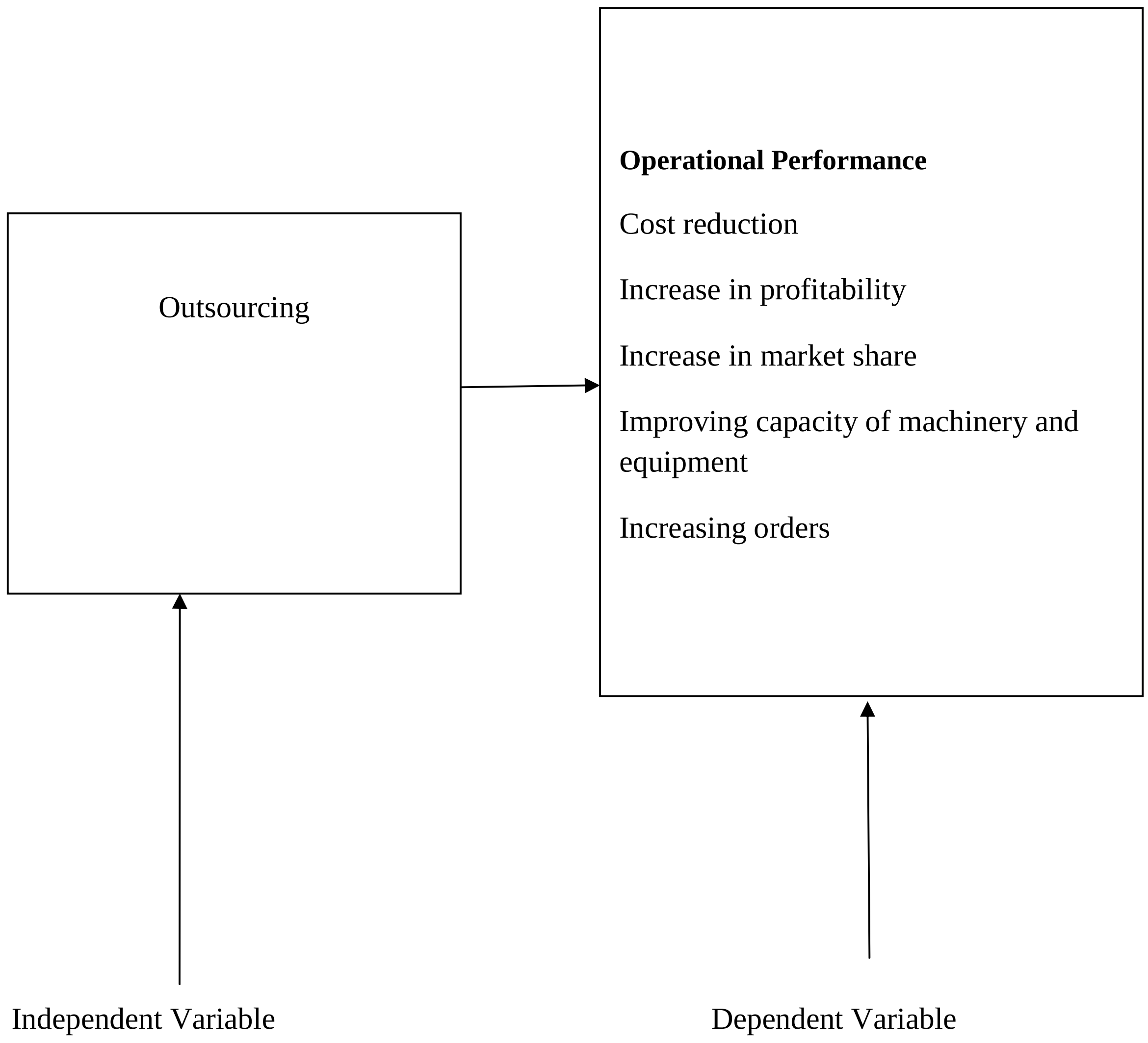
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes " decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms' in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms' operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through ‘drop and pick’ method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = $f\ (x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1\ x_1 + \beta_2\ x_2 + \beta_3\ x_3 + \alpha$

Where Y	=	Operational performance
β_o	=	Constant
x_1	=	Access to modern technology
x_2	=	Cost savings
x_3	=	Focus and core competence
α	=	Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	Percent	Cumulative Percent
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was ‘Strongly agree (5)’ to ‘strongly disagree’ (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; (3.5≤ S.A <5.0). The scores of ‘moderately extent’ have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: 2.5≤M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	Std. Deviation
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	Std. Deviation
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$$

The coefficient of the independent variables (X_1 – X_4) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ……………………………………….………
2. Name of your organization…………………………….………………………….
3. What is the ownership of the organization?

    a) Local ( )

    b) Foreign ( )

    c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

    a) Under 20 years [ ] b) 21 – 30 years [ ]

    c) 31 – 40 years [ ] d) 41- 50 years [ ]

    d) Over 50 years [ ]

5. Length of continuous service with the company?

    a) Less than two years [ ] b) 2-5 years [ ]

    c) 6- 10 years [ ] d) Over 10 years [ ]

6. For how long has your company been in existence in Kenya?

    a) Under 5 years [ ] b) 6-10 years [ ]

    c) 11-15 years [ ] d) Over 16 years [ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

Lecturer, Department of Management Science, University of Nairobi

DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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May the Almighty God bless and reward each one of you abundantly.

ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company's competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.
ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.
iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent "friction in the market" or "cost of using the price mechanism". Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms’ performance. These capabilities constitute the core competencies’ of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one’s own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn’t have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization’s competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company’s control over how certain services are delivered which in turn may raise the company’s liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management's lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users' requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

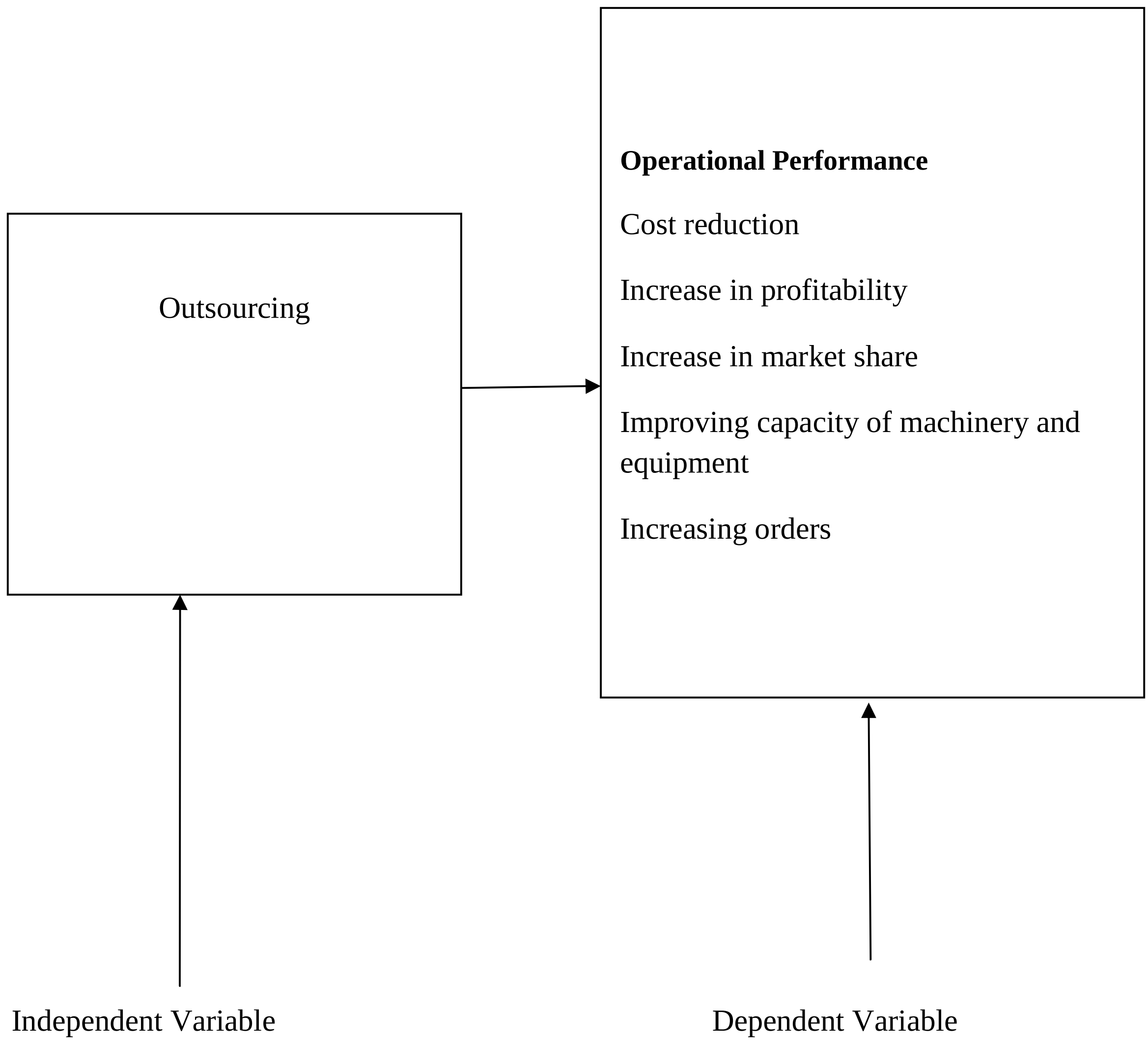
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes " decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms' in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms' operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through ‘drop and pick’ method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \alpha$

Where Y	=	Operational performance
β_o	=	Constant
x_1	=	Access to modern technology
x_2	=	Cost savings
x_3	=	Focus and core competence
α	=	Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	Percent	Cumulative Percent
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was ‘Strongly agree (5)’ to ‘strongly disagree’ (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; (3.5≤ S.A <5.0). The scores of ‘moderately extent’ have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: 2.5≤M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	Std. Deviation
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	Std. Deviation
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$

The coefficient of the independent variables ($X_1 - X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ………………………………………….………
2. Name of your organization……………………………..……………………….
3. What is the ownership of the organization?

    a) Local ( )

    b) Foreign ( )

    c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

a) Under 20 years	[ ]	b) 21 – 30 years	[ ]
c) 31 – 40 years	[ ]	d) 41- 50 years	[ ]
d) Over 50 years	[ ]		

5. Length of continuous service with the company?

a) Less than two years	[ ]	b) 2-5 years	[ ]
c) 6- 10 years	[ ]	d) Over 10 years	[ ]

6. For how long has your company been in existence in Kenya?

a) Under 5 years	[ ]	b) 6-10 years	[ ]
c) 11-15 years	[ ]	d) Over 16 years	[ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

Lecturer, Department of Management Science, University of Nairobi

DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company's competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.
ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.
iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent “friction in the market” or “cost of using the price mechanism”. Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms' performance. These capabilities constitute the core competencies' of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn't have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization's competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management’s lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users’ requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

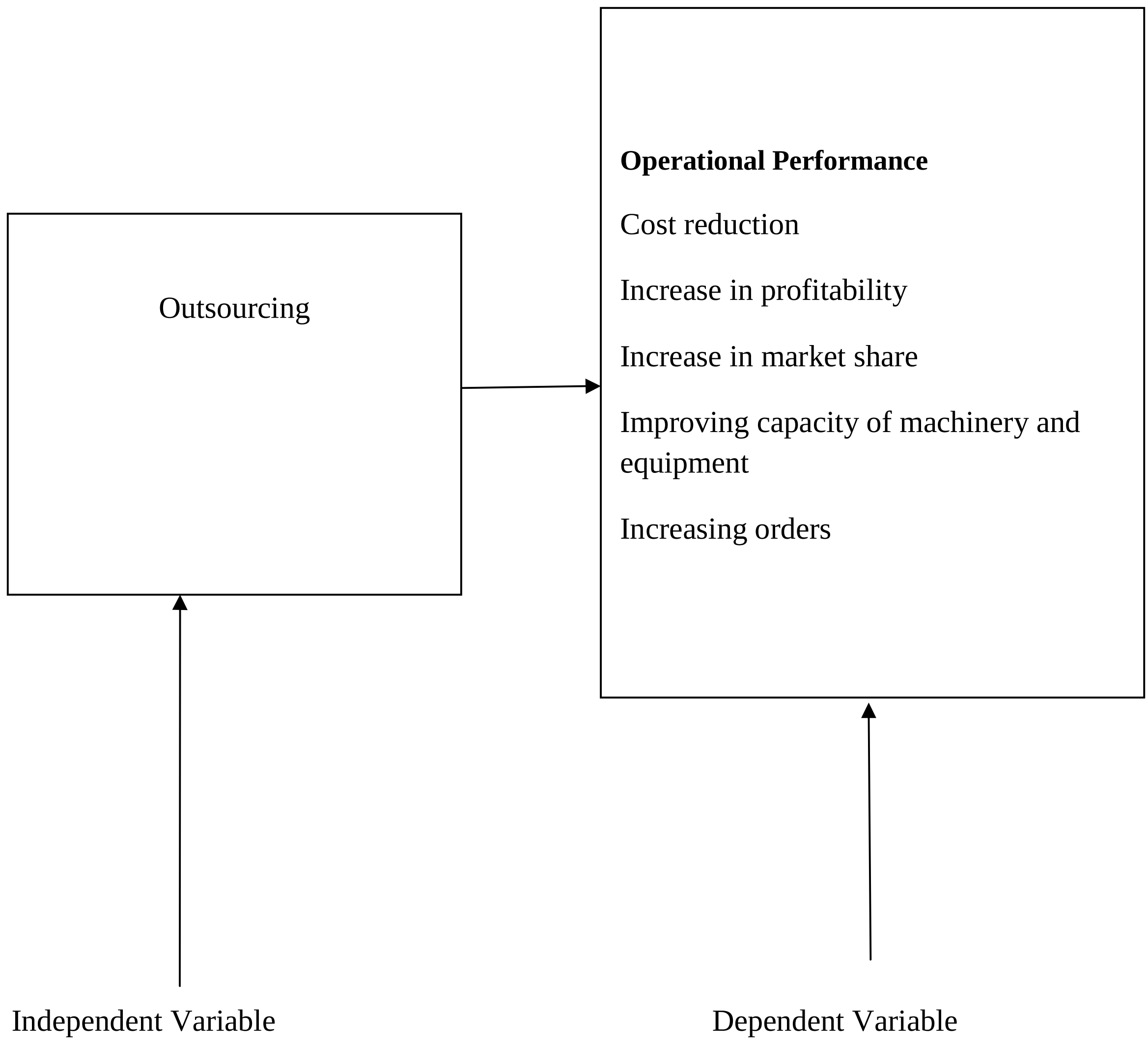
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes “ decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms' in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms' operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through ‘drop and pick’ method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \alpha$

Where Y	=	Operational performance
β_o	=	Constant
x_1	=	Access to modern technology
x_2	=	Cost savings
x_3	=	Focus and core competence
α	=	Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	Valid Percent	Cumulative Percent
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	**Percent**	**Cumulative Percent**
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was ‘Strongly agree (5)’ to ‘strongly disagree’ (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; ($3.5 \leq$ S.A <5.0). The scores of ‘moderately extent’ have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: $2.5 \leq$M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	**Std. Deviation**
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	**Std. Deviation**
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	**Std. Deviation**
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$

The coefficient of the independent variables ($X_1 – X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ……………………………………….………
2. Name of your organization…………………………….………………………….
3. What is the ownership of the organization?

   a) Local ( )

   b) Foreign ( )

   c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

   a) Under 20 years [ ] b) 21 – 30 years [ ]

   c) 31 – 40 years [ ] d) 41- 50 years [ ]

   d) Over 50 years [ ]

5. Length of continuous service with the company?

   a) Less than two years [ ] b) 2-5 years [ ]

   c) 6- 10 years [ ] d) Over 10 years [ ]

6. For how long has your company been in existence in Kenya?

   a) Under 5 years [ ] b) 6-10 years [ ]

   c) 11-15 years [ ] d) Over 16 years [ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					

OUTSOURCING AND OPERATIONAL PERFORMANCE OF MAJOR PETROLEUM MARKETING FIRMS IN KENYA

MACHANA MAGOKO DANNIS

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2014

DECLARATION

This project is my original work and has not been presented for an award of degree in any other university.

Signature …………………………….. Date ……………..

MACHANA DANNIS MOGOKO

D61/79642/2012

This project has been submitted for examination with my approval at the university.

Signature …………………………….. Date ……………..

ZIPPORAH KIRUTHU

Lecturer, Department of Management Science, University of Nairobi

DEDICATION

This research project is dedicated to my children Stephanie and Randy may you have the same urge to further your education to greater heights

ACKNOWLEDGEMENT

My foremost gratitude is to Almighty God that through His amazing grace I was able to undertake and complete this study. To Him I give honour and glory.

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ABSTRACT

An organizational competitiveness based on capabilities and production strategies, results in a better quality, efficiency and flexibility in the firms operation. With the increasingly competitive environments along with changing customers' demands, companies are required to continuously evaluate, improve and reengineer their operations with the aim of identifying those strategies that enhance the firms' performance. Outsourcing is one such strategy that can be pursued. The research objective was to establish the effect of outsourcing on operational performance of major petroleum firms in Kenya. The research adopted a descriptive research design. Data was collected using a self-administered questionnaire that was distributed to 20 senior and middle level managers at the firm that were selected randomly. It was found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives. The limitation of the study was that the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Changes in technological resources, business modes, and strategy management continually raise new challenges to businesses in the present day operating environment. The current business environment is characterized by several issues that include augmentation of competitive pressures, business difficulties, limitation of sources, technologic complexities and specialization of tasks, acceleration of environmental changes, uncertainty about future, price increase, excessive enlargement of some organizations and legal considerations, which leads organizations to reconsider their managerial models to reach competitive advantages. One of these strategies is to focus on the core competencies and to entrust most of the activities to out-side suppliers or to outsource them. So in order to obtain the possibilities to do the tasks and simultaneously to give desirable services to the customers and to enable firms to react to various demands, outsourcing strategy is a necessary tool used by many progressive firms (Masaaki *et al.*, 2012).

Many organizations today operate in a competitive business environment where they have to stake out their market position by attracting and satisfying their customers to achieve organizational objectives (Romney & Steinbart, 2003). Organizations have to come up with strategies on how to accomplish their business objectives else they be edged out of the market by the competitors. Firms have always sought ways to gain a competitive advantage over their competitors; however, with the increased movement

towards a single globalized economy, this desire is even more prevalent for businesses today. One avenue that firms have pursued to improve their competitive position in this new business environment has been to increase the role of outsourcing in their operations, which has been found to provide a competitive advantage to these firms. Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Bustinza *et al.*, 2010). Determining the most suitable service provider is an important problem to deal with when managing outsourcing of a company. It is vital in enhancing the competitiveness of the company and has a positive impact on expanding the life span of the company.

The energy sector like any other environment continues to transform with changes such as new taxation laws, sector regulation, political shifts, stabilities and instabilities among others. The need to retain the largest market share in the midst of much competition has driven much of the strategic thinking adopted by these companies. Outsourcing is pursued by the companies in order to enable them to concentrate on their core activities while at the same time improving their performance. Rapid changes in the business environment of major petroleum firms require senior management to adopt strategies that focus on both current success and to invest in those activities that will promote a competitive advantage for future success. One widely recommended technique for improving the company's competitive position is outsourcing, however, outsourcing has

its drawbacks which if not considered carefully by the company's would have severe effect on the intended objective of outsourcing.

1.1.1 Outsourcing

Outsourcing means finding new suppliers and new ways to secure the delivery of raw materials, goods, components and services. It means using the knowledge, experience and creativity of new suppliers, which you did not use previously (Rothery and Robertson, 2012). Sharpe (1997) defines outsourcing as turning over to a supplier, those activities outside the organizations chosen core competencies. In general outsourcing can be described as the transfer of activities that were previously conducted in house to a third party. In many cases, outsourcing involves a transfer of management responsibility for delivery of service and internal staffing patterns to an outside organization. Subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting, and contract services are all terms which refer to outsourcing (Sarpin and Weideman, 2009). Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance (Sarpin and Weideman, 2009).

Outsourcing is growing at a rapid rate throughout the world because organizations view it as a way to achieve strategic goals, improve customer satisfaction and provide other

efficiency and effectiveness improvements (Ellram, 1997). Outsourcing assists management focus all their intellectual resources, expertise and time on the distinctive competencies that give the firm an edge in the market. Outsourcing is seen as a means through which a business condition or problem can be alleviated in a manner that is more efficient or effective than in-house performance of logistics functions. Cognitive motivation involves careful analysis of alternatives or a well-thought-out corporate policy indicating that outsourcing is the best path for the company (Gottfredson *et al.,* 2005). Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in-house operations report significant savings on operational and capital costs. In the Kenyan petroleum industry, the oil firms outsource majorly the transportation of the bulk oil from Mombasa and the distribution of the same to different fuel station in the country and regional markets. In addition, the petroleum firms in Kenya outsource such services as cleaning, security, provision of medical cover to staff as well as management of the fuel stations.

1.1.2 Operational performance

Operational performance is described as the extent to which the organization is able to meet the needs of its stakeholders and its own needs for survival (Griffin, 2003). According to Swanson (2000), operational performance is the valued productive output of a system in the form of goods or services. Private sector organizations strive for good financial results whereas public organizations are aimed at non-financial results like delivering good public services to citizens. To achieve operational performance through employees, the organization must consider them as assets and they must be treated with great attention so that the employees become productive. In order to improve the

performance of the entire value chain, it is necessary to cross the boundaries of individual companies and consolidate the entire chain, in other words, a cohesive and integrated system to increase the chain's knowledge flow.

The companies that can supply their products to customers faster and more efficiently will probably be in better conditions to create a sustainable competitive advantage gained from knowledge and innovation in order to create new products as the main source of economic income (Johannessen, and Olsen, 2010). Thus, innovative companies began to focus more on their own abilities to adapt to the economic value generated from their knowledge and innovations. Most corporations believe that in order to compete globally they have to look at efficiency and costs containment rather than relying strictly on revenue increases. With outsourcing a firm is likely to increase profitability, increase in market share, improvement in capacity of machinery and equipment, increase in orders, improved product functionality, improved product reliability, improving product quality and organizational competitiveness.

1.1.3 Petroleum Firms in Kenya

Kenya is the largest economy in East and Central Africa and the 8th largest economy in Africa (ATC Consortium, 2011) and the only one in the top eight without a significant extractive industry. While the country has just recently discovered hydrocarbons including oil, natural gas and coal, further drilling is ongoing to establish commerciality of the reserves. Thus the country is a net petroleum importer consuming just less than 80,000bpd or 4.2M MT p.a. (Mukherjee, 2012). Kenya currently has over fifty licensed oil marketing companies, but the top six controls over 60% of the market share. The top five oil companies by market share are Total (K) Ltd – 21%, KenolKobil – 17.5%, Vivo

Energy (Shell) – 14.5%, Libya Oil (K) Ltd – 8.1% and National Oil Corporation of Kenya (NOC) – 5% (Petroleum Insight, April – June 2013).

Consumer clamour fuelled by a belief that oil marketers were exhibiting cartel-like behaviour in pricing, forced the Government to reintroduce price caps nearly 16 years after liberalizing the economy. Today the Oil industry in Kenya is facing challenges that include reduced profit margins, inadequate infrastructure, increased competition with entrance of small independent dealers, lowering quality standards and official price caps which are forcing big oil marketing firms out of Africa as they shift focus to the more lucrative exploration and production activities. Still, Kenya's petroleum market remains dominated by foreign capital because local firms are unable to raise resources for acquisition. Departures have often only strengthened the position of international oil firms already in the market, even as the state-owned National Oil Corporation of Kenya stakes a claim to a larger market share (Angela, 2011).

1.2 Statement of the Problem

In the 21st century, businesses globally are being affected by external environment. Due to increasing global competition and declining profit margins most corporations are pursuing different operations strategies to keep market share and maximize the share holders' value. The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by

outside suppliers. Outsourcing has been adopted by many organizations with much success. These organizations have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to an organization like loss of control of the activities outsourced and dependency on suppliers.

With intense competition from both domestic and international players, rapid innovation and introduction of new financial instruments, changing consumer demands, sector regulation and explosive growth in information technology, the way in which Oil firms in Kenya conducts business and reach out to its customers has significantly changed. Therefore in order to survive and adapt to the changing environment, Oil firms are is putting more effort in understanding the drivers of success, like better utilization of its resources (like technology, infrastructure and employees), process of delivering quality service to its customers and how to increase its market share through employment of practices such as outsourcing. This has necessitated them to search for ways of offloading some of these activities for efficiency and competitiveness. These petroleum firms have reaped many benefits of outsourcing such as access to best in class technologies and reduced costs of operations. However outsourcing may also pose major challenges to the companies like loss of control of the activities outsourced and dependency on suppliers.

International studies that have been undertaken on the effect of outsourcing on organizational performance include Khaki and Rashidi (2011) research on Outsourcing and its impact on operational objectives and performance of Iranian telecommunication industries. The study found out that outsourcing could lead to reduce cost, improve

quality, increase flexibility, better financial and non-financial performance and services. Dabhilkar et al., (2009) researched factors of performance improvement when outsourcing manufacturing and established that characteristics and supplier operating capabilities are more important than supplier relationship strategies when outsourcing manufacturing, meaning that supplier selection trumps supplier collaboration in the make-or-buy decision. Jiang et al. (2006) empirically investigated the effect of outsourcing on firms' operational performance in the United States of America. Results of this study reveal that outsourcing can improve a firm's cost efficiency but does not improve both productivity and profitability of the firms. Arvanitis and Loukis (2012) examine outsourcing and firm performance in both Swiss and Greek countries. The study concludes in terms of impact of outsourcing on performance that outsourcing tends to enhance process innovation but has weak relationship with productivity.

Local studies that have been undertaken on the effect of outsourcing on operational performance includes Smith (2012) who researched on outsourcing and supply chain performance among mobile telephone service providers in Kenya. The findings of the study were that supplier network responsiveness has the greatest impact on outsourcing while operating system responsiveness has the greatest negative effect on outsourcing. Further results show that supply chain effectively expedites emergency customer orders, rapidly reconfigures equipment to address demand changes, rapidly changes manufacturing processes to address demand changes and rapidly adjusts capacity to address demand changes. Njoroge (2013) undertook a study on the challenges of import logistics outsourcing by manufacturing firms in Nairobi and established that manufacturing firms should put more focus on core business functions and ensure

reduction of overhead costs. They should take advantage of external expertise and experience and put measures to improve internal capabilities and expertise. From the studies that have been undertaken, so far according to my knowledge there is no study that has been done on energy sector and the since the sector is crucial to the economy of the country, the study will therefore seek to answer the question; what is the effect of outsourcing on operational performance of major petroleum firm's performance?

1.3 Research Objectives

The general objective of the study was to determine the effect of outsourcing on operational performance of major Petroleum firms in Kenya.

1.3.1 Specific Objectives

i. To establish the extent of outsourcing of services by the petroleum marketing firms in Kenya.
ii. To determine the effect of outsourcing on petroleum marketing firms operational performance.
iii. To determine the challenges facing outsourcing by major petroleum marketing firms.

1.4 Value of the Study

The study will be of value to the management of the companies as it will be able to know the effect of outsourcing as it would affect the overall performance of the company. This study will be an instant source of information to the management of the companies as it will be able to evaluate the benefits vis a vis the challenges of business process outsourcing and whether it is still beneficial for the companies to continue business

process outsourcing its non-core operations or it should just do it on its own. Other petroleum firms will also benefit from this study as it will act as a source of information regarding the effects and challenges of outsourcing.

The policy makers can obtain knowledge of the energy sector dynamics and the challenges of outsourcing and therefore they can obtain guidance from this study in designing appropriate policies that will regulate the industry. The findings of the study will enable the policy makers know the factors that affect performance of outsourcing practice thus formulate policies that will spur outsourcing in the companies in order to grow. The study provides the background information to other researchers and scholars who may want to carry out further research in this area. The study facilitates individual researchers to identify gaps in the current research and carry out research in those areas, the work will also be used by students who will want to study similar area and to come up with comprehensive conclusion and reasoning in regard to outsourcing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review related to the study. It includes a review of the various studies conducted by researchers on theoretical foundation, effect of outsourcing on organizational performance and the challenges of outsourcing.

2.2 Theoretical Foundations of Outsourcing

A number of theories have also been put forward in the literature that attempt to justify the unprecedented rate of outsourced contracts (Gottschalk and Solli-Saether, 2005). These theories include the transaction cost theory and resource based theory.

2.2.1 Transaction-Cost View

According to transaction-cost theory, the relative transaction and production costs associated with the process or service determines whether to outsource or internalize the process (Mahnke et al, 2005). The three dimensions of transactions include: frequency of transactions, uncertainty, and degree of asset specificity. If all the dimensions of the transaction are found to be low, then the firm will decide to outsource its business processes. This approach highlights the need for a detailed and specific contract between the client and vendor in order to avoid opportunism and performance measuring problems (Poppo and Zenger, 2002). But such formal and highly specific contracts may lead to distrust and opportunism. This view fosters rigidity and distrust among vendors due to its emphasis on over-specification.

Transaction-cost theory indicates that firms outsource production in order to reduce costs and to achieve cost efficiency. Production cost is the cost incurred to make the product or to provide the service e.g. labor, material, and capital. Coordination costs include monitoring, controlling and managing the work internally. If the job is handed over to an external vendor, the coordination costs are called transaction costs. Kulmala (2003) argues that externally outsourcing of services or production results in lower production costs than doing it internally due to economies of scale. But in such a case the transaction cost is high because vendors need to be managed and monitored.

Transaction costs represent “friction in the market” or “cost of using the price mechanism”. Aubert *et al.* (2004) basic rule states that when the marginal costs of using markets (transaction costs) are higher than the costs of running a firm (management costs), the transaction should be organized within the firm and vice versa. The reasons behind transaction costs are transaction difficulties. These are bounded rationality, opportunism, uncertainty and complexity, small numbers, information impactedness and asset specificity. Based on transaction cost theory, when a firm has already integrated its operational functions, the decision to outsource such functions to the market should be made if it is necessary to create or protect firm value. Complex supply chains and networks may hide the problem of analyzing the actual unit cost accumulation. For example, the lowest price supplier in a certain phase of a supply chain may cause a significant cost increase in other phases due to non-optimal activity structure. Therefore, the activity-based costing method should not be limited to single phases of a supply chain, as is too often the case in outsourcing; the total unit cost accumulation in a supply chain should be covered (Kulmala, 2003).

2.2.2 Resource-Based View

This perspective is based on the firm‘s internal competence i.e., the resources and capabilities. According to Barney (1991), a firm‘s competitive advantage is derived from those capabilities that are unique and non-substitutable and are the main drivers of the firms' performance. These capabilities constitute the core competencies' of the firm (Prahalad and Hamel, 1990). According to resource-based theory, organizations wish to maintain a distinctive product (competitive advantage) and will plug gaps in resources and capabilities in the most cost-effective manner (Krim, 2003). This theory emphasizes that resources internal to the firm are the principal driver of a firm's profitability and strategic advantage (Barney, 1991). It rejects traditional economic assumptions that resources are homogeneous and perfectly mobile. Instead, it argues that resources are heterogeneously distributed across firms and are imperfectly transferred between firms (Barney, 1991). Barney (1991) categorized resources into three groups: physical resources such as plant, human resources and organizational resources. Resources enable a firm to conceive of and implement strategies to improve its efficiency and effectiveness. Organizations can obtain above-normal returns if they can use their existing resources to sustain competitive advantage by exploiting opportunities in the market or neutralizing threats from competitors' strategic resources. Resources might be imperfectly imitable if they involve unique history, causal ambiguity, or social complexity Barney (1991). Similarly, resources are non-substitutable if another organization is not able to implement the same strategies by using alternative resources.

The inadequacies of the transaction-cost and resource-based views have brought about the relational view that draws from both the transaction cost and resource-based

approaches. This view focuses on creating value through different forms of partnerships for both the parties. As discussed by Dyer and Singh (1998), relational rents are created wherein partners share, combine, or invest their assets, knowledge, or capabilities, or employ effective governance to lower their transaction costs or improve synergies. Thus, a firm will enter into an outsourcing relationship only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets. Outsourcing plays a big role on organizational performance through;

2.3 Outsourcing and its Effects in an Organization

There are various benefits which can be associated with outsourcing on a firm. Some of them include: access to modern technology and expertise, cost savings and focus on core competences.

2.3.1 Access to modern technology and expertise

Technology of the business exerts major influences on the internal environment and how it is organized, managed and carried out (Armstrong, 2002). The introduction of new technology may result in considerable changes to systems and processes he notes. The availability or the lack of technology in a firm may be the cause to outsource some human resource functions. Gilley et al., (2004) noted that outsourcing is useful for firms competing with increasing levels of environmental dynamism. For example, when new technologies emerge and mature technologies become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. On the contrary, this technology-related flexibility is not so necessary in stable

environments because production and service technologies do not change so rapidly. Similarly, demand uncertainty makes outsourcing attractive because it allows firms to shift much of the risk associated with declining demand to supplier firms.

Lamming (2003) posit that as suppliers may be significantly more advanced, outsourcing to them allows organizations to exploit their more advanced technologies. Successful implementation of outsourcing has been accredited with helping to improve quality, increase capacity and productivity, lower innovation costs and risks. Outsourcing enables an organization to benefit from complimentary assets by partnering with organizations whose resource bases compliment one's own. Greaver (2009) highlighted that companies of all sizes outsource part of their service to effect improvement in efficiency. Outsourcing gives an organization exposure to outsourced specialized systems. Specialization provides more efficiency that allows for quicker turnaround time and higher levels of quality. Outsourcees are bound to certain service levels and quality. Since the people hired to deliver the same have more time to concentrate on it, it means they put more caution in the provision of the service heading to improved qualities. Outsourcing also helps the organization from being locked up into specific assets and technologies.

Outsourcing enables an organization to have means of accessing expertise not otherwise available. Particularly in the information technology era, companies may not have personnel available in house to take on certain projects. According to Bakas (2006) some services requires experts who are scarce. By outsourcing organizations seek technological

knowhow can be achieved by using vendors with more expensive and more specialized processors. An outsider service would have the required resources for hiring proper training facilities and inspection ability that many not be available if the function were kept in house. In addition if a company is growing rapidly the organization may not have time to recruit the workers needed and may outsource the necessary labour.

2.3.2 Cost Savings

Outsourcing reduces costs. According to Lange's et al. (2005) reduced costs would come from economies of scale and scope. Scale economies would come from using focused large scale specialists for activities where the outsourcers lack the necessary volume of requirements for current technology. Scope economies would be gained through access to a wide range of service provided by niche specialists. Outsourcing one's business functions can improve one's competitive advantage. Scope economies might also arise through the outsourcer providing complimentary assets. Successful implementation of outsourcing strategy has been accredited to cutting cost (Bowersox, 2010). Outsourcing can improve organizations effectiveness when applied as an organizational strategy. usually companies may choose to outsource with certain business objectives in mind. The first objective amongst this, is the need to improve financial performance usually, such companies are aware that outsourcing companies may offer them an opportunity to work cheaply through efficient technology and economies of scale.

Outsourcing can free up assets and reduce costs in the immediate financial period. Organizations outsourcing parts of their in house operations report significant savings on operational costs. Laugen et al., (2005) found a co relation between outsourcing best

practice and high performing companies. Many companies decide to outsource because it cut costs such as labour costs, regulatory and training costs. Outsourcing by reducing costs helps the organization to generate more profit. More profit comes in when vendors are able to purchase products at a less expensive rate and continue to sell them at a reasonable price for consumers. Another way outsourcing saves business money is due to the fact that the business doesn't have to pay payroll tax deductions and other benefits to outsourced workers. If some work can be outsourced it can cut down on this expense, which means that the business can operate more profitably. There is also less need for infrastructure.

Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost are emphasized by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced singled to the creation of new firms and the destruction of old ones (Antras et al. 2004). To compete in increasingly competitive economic environments, decisions to outsource company activities are driven by factors related to the costs of production, distribution, and productivity. More and more firms are outsourcing increasingly higher levels of their activities in order to reap the profit from the low-cost-high-value-innovation and skills from emerging countries. The firm determines its outsourcing strategy based on the shortcomings in its resources or capabilities, which, in turn, are affected by the state of the resources that support the services. Antras et al. (2004) pointed out that the organization's competence depends on its capability to combine resources and organizational processes to meet the desired objectives and also stated that the

conventional approach to the creation of resources has focused on a company's lack of resources and capabilities.

2.3.3 Improved focus on core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies. Outsourcing will enable firms to transfer resources from non-value added staff functions to value-added core functions (Hayes et al. 2009). Outsourcing firms can also utilize the superior knowhow of the service provider to enhance their own production capabilities, which enables them to offer higher value and thus higher margin bearing products to their customers. According to Greaver (2009) core competencies are innovative combinations of knowledge special skills, proprietary technologies, information, and unique operating methods Organizations use to produce products or services which customers value and want to buy. By focusing on fewer, manageable core activities organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and processes to meet changing customer demands. Outsourcing is a viable option to any company because it takes away attention from dealing with other aspects of the business that have nothing to do with the functions of a company. Companies can therefore concentrate on aspects of business that encircle their business objectives and eventually improve their business function (Kakabadse & Kakabadse, 2003).

Many companies see outsourcing as a way to hire the best in class companies to perform routine business functions and the focus corporate resources on key activities on their value chain where the impact will be felt the most by the customer. Mullin (2006) argue

that the strategy of focusing corporate resources mainly on those activities where clear differentiation can be developed and outsourcing much of the rest has also served many other companies well. The key often lies in knowing which of the main value drivers to concentrate on-customer intimacy, product leadership or operational excellence. Outsourcing can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. By outsourcing to specialist organizational performances services not generated by core competences, companies can see an improvement in their organizational performance (Lei and Hitt, 2005). The outsourcing of non-strategic services allows the organization to center on what it really can do well, that is, on the services whose resources have a high strategic value. Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Bester (2000) found out that increasing the outsourcing of non-strategic services can improve both the quality and the service. This is because specialist organizations concentrate their efforts on a reduced set of functions, thus obtaining a better result than if the company carried them out internally.

2.3 Challenges of Outsourcing

Despite the many cost and effort advantage, the potential problems associated with outsourcing have led many companies to decline to make use of external service providers. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to

outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information. According to Lysons and Farrington (2006) Problems related to outsourcing include; overdependence on suppliers, costs escalation, lack of supplier flexibility, lack of managerial skills to control suppliers and unrealistic expectations of outsourcing providers due to over promising at negotiations stage. Relly and Tamken (2006) mention that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers which may be able to seize the initiative for their advantage.

Unique quality requirements and design secrecy frequently represent a condition requiring control of the production process (Hill and Jones, 2001). Outsourcing introduces a new relationship, new culture and a different approach to handling client confidentiality and these experiences may portend serious problems that firms are expected to overcome. One main dilemma is that the incoming provider does not know all the company-specific intricacies that reside in the minds of the people who have been doing the work for many years. The issue then becomes how the companies could ensure knowledge transfer without disruption of company operations.

As a business development move, outsourcing comes with certain disadvantages which can be external or internal in nature. An external disadvantage is, for instance, the knowledge spillover flows from supplier to outsourcer can also be reversed, leading to a decrease in competitive advantage over competitors (Hoecht & Trott, 2006). In some

cases this can even augment to a certain point where the supplier has gained that much knowledge, that it can produce the entire product itself, leapfrogging the original outsourcer (i.e. through vertical integration). When a service is outsourced, clients gradually lose their understanding of the service over time. Even if the provider delivers innovative services to the client, a large proportion of the new knowledge required remains in the hands of the provider and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs. Furthermore, the innovation capability of the firm itself can be reduced, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favored by outsourcing. Another risk is the provider's inability to adapt to the new technologies. If providers do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer. What is more, if the contract does not include a clause specifically devoted to technological evolution, the latter will most probably not be completed (Glass, 2006).

Outsourcing initiative reduce investment in assets, free-up resources for other purposes, and generate cash by transferring assets to the service provider. These business processes when outsourced reduce the investment required by the host organization to modernize them. Outsourcing can also improve certain financial measurements by eliminating the need to show return on equity from capital investments in non-core areas. One important risk is the possible loss of differentiation in the service, which, when outsourced to a supplier from whom another customer also acquires it, becomes easily imitable, and the possibility of gaining any competitive advantage from it is lost. Therefore, the

organization must develop specific, idiosyncratic relationships that enable it to generate relational capabilities and rents. Along these lines, Reve, (2010) consider that companies outsourcing key functions or functions central to their business must preserve the means to establish policy and direction as well as monitor delivery of the service and control the supplier. Depending on the extent to which these services can be controlled, companies can opt to outsource more strategic services as long as there are more capable suppliers.

Haizer & Render (2008) posit that outsourcing results in loss of control, increase in transportation costs if the distance from the outsourcing provider to a client firm and creating future competition. They also said that a company that outsources can get into problems if the service provider is unable to provide the services due to bankruptcy, lack of funds or labor. Organizations are at risk of becoming dependent on the outside suppliers of services, failing to realize the purported hidden cost savings to outsourcing, losing control over critical functions and having to face prospects of managing relationships that go wrong and lowering the morale of permanent employees. Lysons and Farrington (2006) noted that difficulty in obtaining organizational support was also an obstacle to outsourcing. Management’s lack of confidence in an outside company to deliver service at as high a level as the company employees is a major issue: the third party may be inadequate in its capabilities to meet users’ requirements. Difficulty of assessing the savings to be gained through outsourcing creates additional problems.

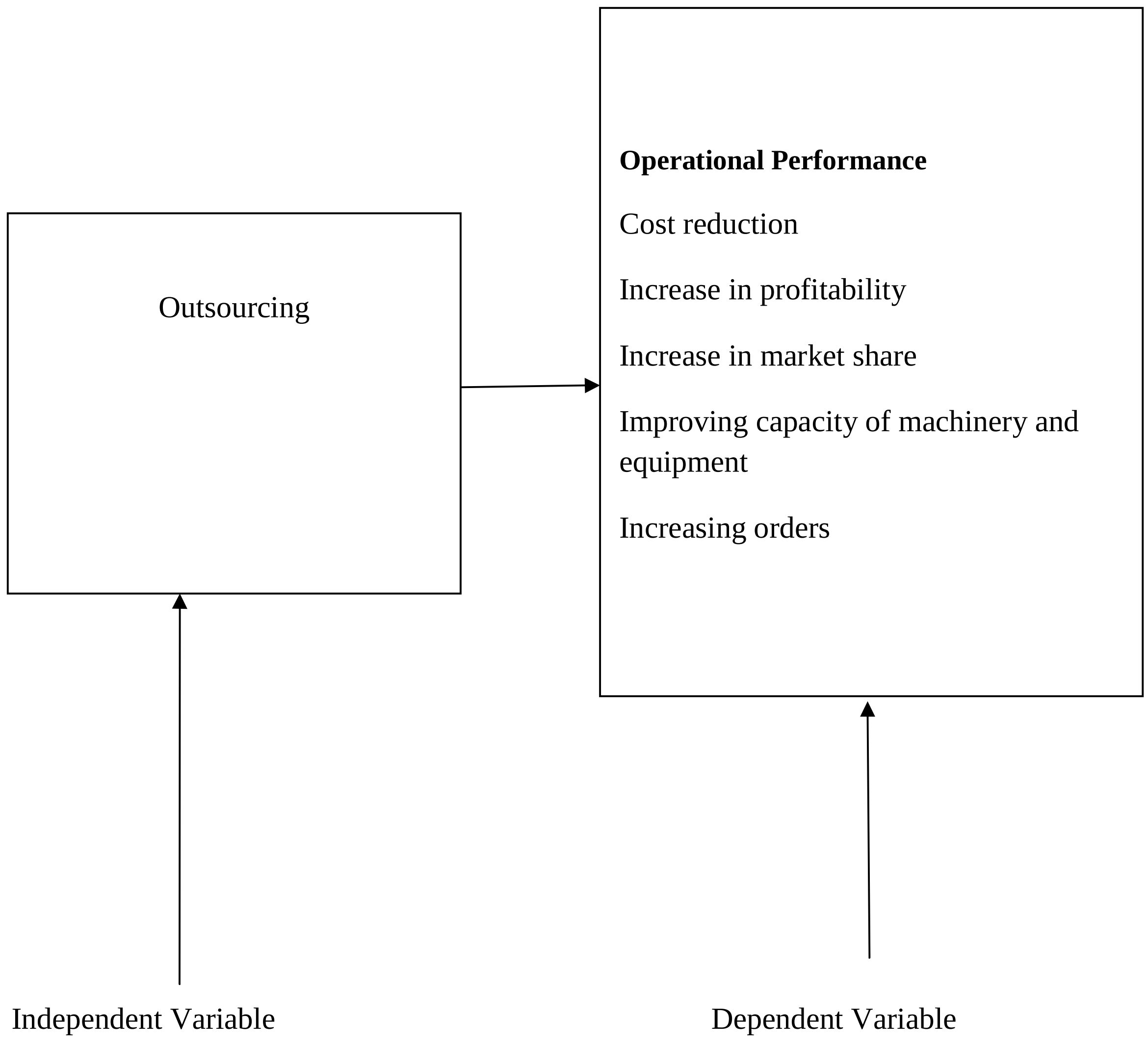
Successful outsourcing requires a strong understanding of the organizations capabilities and future growth. As William (2004) observes “ decisions regarding outsourcing significant functions are among the most strategic that can be made by an organization

because they address the basic organizational choice of the functions for which internal expertise is developed and nurtured and those for which such expertise is purchased. These are basic decisions regarding organizational design. Outsourcing is also fraught with various problems. Outsourcing reduces a company's control over how certain services are delivered which in turn may raise the company's liability. Pearce and Robinson (2009) avers that by definition outsourcing places control and coordination of that function to outsiders, this is loss of control can result in many future problems such as delays in delivery, quality, customers complaints and loss competitive sensitive information.

2.4 Conceptual Framework

A conceptual framework is a diagrammatical research tool intended to assist the researcher to develop awareness and understanding of the situation under scrutiny and to communicate this. A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. It can be defined as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The interconnection of these blocks completes the framework for certain expected outcomes. In the study the petroleum firm's performance will be the dependent variable that is to be measured by both financial and non financial measures.

Figure 2. 1: Conceptual Framework



Source: Researcher 2014

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The research design was a descriptive research design. According to Cooper and Schindler (2000), a descriptive research design is concerned with finding out the; who, what, where, when and how much. Furthermore, a research design is structured, has investigative questions and part of formal studies. The design was appropriate because the main interest was to explore the viable relationship and describe how the factors support matters under investigation.

Descriptive design method provides quantitative data from the chosen population. This design provided further insight into research problem by describing the variables of interest. Best and Kahn (2002) asserts that descriptive design involves describing, recording, analyzing and interpreting condition that exists. The advantage of this method is that it is quite easy to plan and execute and it enables the gathering of data on a variety of issues related to the concept.

3.2 Target Population

Population refers to an entire group of individuals, events or objects having common characteristics that can be observed and measured (Yin, 2003). It is the group of people the researcher wants to draw a conclusion from. The population of the study comprised of all the petroleum firms’ in Kenya. According to Energy Petroleum Corporation (2013), there are five petroleum marketing firms’ operating in Kenya and all of them participated hence the study was a census.

3.3 Data Collection

The study used primary data that is collected through self-administered questionnaires containing both open ended and closed questions. The primary data collection also ensured relevance of the data collected. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization.

The questionnaires were distributed through ‘drop and pick’ method and in some cases by email. The target respondents in the petroleum marketing firms were the purchasing and the finance managers. These are deemed to be versed with the outsourcing practices in the firm and their effect on operational performance in the firms. There was follow-up to ensure that questionnaires are collected on time and assistance to the respondents having difficulty in completing the questionnaires will be offered. Follow-up calls were made to ensure that the questionnaires are dully filled within a reasonable period of time. This ensured that the information gathered was valid, reliable and suitable for this study.

3.4 Data Analysis

The data collected was analyzed using descriptive statistics (measures of central tendency and measures of variations). Once the data is collected, the questionnaires were edited for accuracy, consistency and completeness. However, before final analysis is performed, data was cleaned to eliminate discrepancies and thereafter, classified on the basis of

similarity and then tabulated. The responses were coded into numerical form to facilitate statistical analysis. Data was analyzed using statistical package for social sciences based on the questionnaires. In particular mean scores, standard deviations, percentages and frequency distribution was used to summarize the responses and to show the magnitude of similarities and differences. Results were presented in tables and charts.

The dependent variable in the study was operational performance. The independent variables for the study were access to modern technology; cost savings, focus and core competence. The regression equation assumed the following form:

Operational performance = f $(x_{1,}\ x_{2,}\ x_{3,})$;

More specifically, the regression was of the form;

$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \alpha$

Where Y	=	Operational performance
β_o	=	Constant
x_1	=	Access to modern technology
x_2	=	Cost savings
x_3	=	Focus and core competence
α	=	Error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the Effect of Outsourcing on Operational Performance of Major Petroleum Firms in Kenya. This chapter presents the analysis, findings and the discussion with regard to the objective. The analysis is presented in mean and standard deviations while the findings are presented in frequency distributions and tables.

4.2 Background Information

The demographic information considered in this study included the name of the organization, the ownership structure of the firm, length of continuous service, and the length of time that the organization had operated in Kenya. This information is necessary because the respondents' competence of answering the questions ably will be dependent on their level of education and also the period in which they will have worked in the organization. A total of 20 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of all the questionnaires distributed 15 were fully filled and collected back. The returned questionnaires' represented 75% response rate which was deemed to be adequate in the realization of the research objectives.

4.2.1 Ownership Structure of the Organization

This section of the questionnaire sought to establish whether the petroleum company was locally owned, foreign or both. The results are presented in table 4.1 below. The findings on the ownership of the petroleum companies indicate that, 53.3% of the firms are foreign owned while 13.3 of the respondents are locally owned. This shows that majority of the firms operating in the country are foreign owned and consist of the multinational petroleum companies that have diversified their operation in the country. The ownership of the companies varied due to the fact that some companies have been transformed from parastatals to mobile companies.

Table 4. 1: Ownership Structure

	Percent	**Cumulative Percent**
Local	13.3	13.3
Foreign	53.3	66.7
Both Local And Foreign	33.3	100.0
Total	**100.0**	

4.2.2 Length of Continuous Service

This is the duration of continuous service that the respondents had worked with the petroleum firms. The result is represented in table 4.2 below.

Table 4. 2: Length of Continuous Service

	Frequency	**Valid Percent**	**Cumulative Percent**
Less than 2 years	2	13.3	13.3
2-5 years	5	33.3	46.7
6-10 years	2	13.3	60.0
over 10 years	6	40.0	100.0
Total	**15**	**100.0**	

The findings indicates that majority of the respondents (40%) have been working in the organization for a period more than 10 years while 33.3% said they have been working for a period between 2-5 years. Majority of the respondents have worked in their organization for over 5 years, thus there is high level of understanding of organization operation including their outsourcing strategies.

4.2.3 Company Existence in Kenya

This section sought to establish the total number of years that the petroleum companies had operated in Kenya. The results are presented in table 4.3 below.

Table 4. 3: Period of company Existence

Number of years	Percent	Cumulative Percent
6-10	6.7	6.7
11-15	6.7	13.3
over 16	86.7	100.0
Total	**100.0**	

The results indicates that majority of the firm (86.7%) had operated in Kenya for more than 16 years and consequently would have understood the local market dynamics that will enhance their operations. Generally over 90% of the respondents have been in existence for more than 10 years.

4.3 Effect of Outsourcing on Operational performance

The respondents were to indicate the extent to which the outsourcing practice had affected the operation of the firms in terms of modern technology, cost savings and focus on core competence of the firm. The range was 'Strongly agree (5)' to 'strongly disagree' (1). The scores of strongly agree/agree have been taken to present a variable which had a mean score of 3.5 to 5 on the continuous Likert scale; ($3.5 \leq$ S.A <5.0). The scores of 'moderately extent' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous Likert scale: $2.5 \leq$M.E. <3.4) and the score of disagree/strongly disagree have been taken to represent a variable which had a mean score of 0 to 3.4 on a

continuous Likert scale; 0≤ L.E. <3.5). A standard deviation of >0.8 implies a significant difference on the impact of the variable among respondents.

4.3.1 Access to modern technology and expertise

The ability of the petroleum companies to outsource some of the services might lead them to access the use of some modern technologies which on their on might not be easily accessible or make them to move outside their core duties. The results on this question are presented below.

Table 4. 4: Effect of modern Technology and Expertise

	Mean	Std. Deviation
It enables the firms to effect improvement in efficiency	4.2667	1.03280
It allows firms' to exploit their more advanced technologies	3.5333	.83381
It results in firms' improved service qualities	4.1333	.83381
It helps the firms' from being locked up into specific assets and technologies	2.9333	.88372
It enables the firms' to increase their competitive edge	3.6667	1.04654
Overall Mean	**3.707**	

From the above findings it is found that by outsourcing, the firms are able to effect improvement in efficiency (mean=4.2667) and result in the improvement in service quality (mean = 4.1333). When new technologies emerge and mature technologies

become obsolete, outsourcing enables firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality. This finding will be consistent with that of Gilley et al., (2004) who further observed that such outsourcing benefits will be more useful for firms competing with increasing levels of environmental dynamism, for example the petroleum firms in Kenya.

4.3.2 Cost Savings

Table 4. 5: Effect of Outsourcing on costs

	Mean	Std. Deviation
It enables the firms' to reduce costs from economies of scale and scope	3.9667	1.30201
It free up assets and reduce costs in the immediate financial period	3.2000	.94112
Outsourcing by reducing costs helps the organization to generate more profit	4.0667	.99043
It enables the firms' to reduce product costs like labour costs, capital expenditure cost	3.8667	.97590
Overall Mean	**3.775**	

The above findings shows that outsourcing reduces costs reduce cost by the generation of the economies of scale and scope (mean = 3.9667) and also will lead to the generation of more profit. This supports the views of Lange's et al. (2005) who noted that the reduced

costs would come from the outsourced firms being able to employ more staff for example and the resulting service offering will be lower in cost per unit and the same is transferred to the petroleum firms for example. The cost benefit was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost (mean= 3.8667). The petroleum business involves huge capital outlay in setting up such infrastructure as the petrol station and purchasing of the tankers that supply the fuel to various stations. If the petroleum firm could purchase all these assets, it will need a huge capital outlay. However by outsourcing, the petroleum firms would be able to save on such capital expenditure. Contracting out production of goods and services to a firm with competitive advantages in terms of reliability, quality and cost is also supported by (Perry, 2007). Outsourcing could also have productivity-enhancing effects at a more aggregate level if outsourced would led to the creation of new firms and the destruction of old ones.

4.3.4 Focus and core competence

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. The findings on the effect of outsourcing on the ability of outsourcing enabling the firm to focus on core competence are presented in table 4.6 below.

Table 4. 6: Capacity of a firm to focus on Core Competence

	Mean	Std. Deviation
It enables the petroleum companies to lessen the costs and complexity of their own operations thus better customer focus flexing	3.8667	1.12546
It enables petroleum companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function	4.1667	.74322
It enables the companies to grow without a corresponding expansion in organizational size or bureaucracy	3.9667	.99043
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource	4.0667	.72375
It heightens consumer satisfaction	3.8000	.86189
Overall Mean	**3.993**	

From the above findings, it is found that through outsourcing, petroleum companies are able to concentrate on aspects of business that encircle their business objectives and eventually improve their business function (mean= 4.1667) and also helps the firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource (mean=4.0667). It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage (Porter, 1985) over the other competitors in the

market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations. This provides better customer focus flexing and changing offerings and also adapts processes to meet changing customer demand. As Kakabadse & Kakabadse, (2003) noted, these companies can concentrate on aspects of business that encircle their business objectives and eventually improve their business function.

4.4 Effect of Outsourcing on Firm Performance

The effect of outsourcing on firm performance was measured by a regression analysis. The firms performance measures was determined using different qualitative measures such as increased product quality, reliability, market share and cost reduction, improved organizational competitiveness as well as improved capacity of the companies machinery and equipment. To determine the same, the relationship between the overall mean of each of the outsourcing benefits covered under section 4.3 was regressed with the resultant mean from the performance measure in table 4.7 below.

Table 4. 7: Effect of outsourcing on Performance

	Mean	Std. Deviation
Cost reduction	3.6667	1.33452
Increase in profitability	3.6000	1.05560
Increase in market share	4.0667	.79881
Improving capacity of machinery and equipment	3.6667	.89974
Increasing orders	3.3333	.91548
Improved product functionality	4.0000	.92582
Improved product reliability	4.2000	.67612
Improving product quality	3.8667	1.06010
Improved organizational competitiveness	3.5333	1.06010
Overall Mean	**3.770**	

4.4.1 Regression Analysis

The effect of outsourcing on the performance of the petroleum firms was determined for the 20 petroleum firms surveyed. From Table 4.7 below, the established multiple linear regression equation becomes:

$Y = -52.345 + 3.438X_1 + 7.925X_2 + 3.112X_3$

The coefficient of the independent variables ($X_1 – X_4$) is significant at 5% because the test statistics (t-values) are less that the critical *P*-value of 1.697 at the 5% significance level.

The coefficient of cost savings resulting from the outsourcing of services is the highest of the independent variables and this means that a unit increase in the risk evaluation will increase the performance of the supply chain by 7.925 units.

Table 4. 8: Results of General Least Square

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	-52.345	45.654		1.373	0.174		
	X_1	3.438	2..108	0.007	0.167	0.947	0.912	.793
	X_2	7.925	2.283	0.071	0.682	0.492	0.935	0.971
	X_3	3.112	1.694	0.086	0.719	0.433	0.830	1.972

Notes: X_1– Access to modern technology and expertise; X_2 –Cost savings; X_3 – Focus and core competence

The variance inflation factor of the model variables is small which means that there is a small collinearity between the independent variables and the SD of around 1.0 for the independent variables indicates that the standard error of the variables will decrease by a unit if one of the variables is excluded.

4.5 Outsourcing Challenges

Despite the many benefits associated with outsourcing, there are several challenges that firms face as a result of outsourcing the same services. This section sought to establish from the respondents how the firms operations have been impacted as a result of outsourcing decision. The effect of outsourcing on control, customer satisfaction, technological breakthrough, service delivery and supplier flexibility is represented in table 4.9 below.

Table 4. 9: Challenges of outsourcing

	Mean	**Std. Deviation**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability	2.5333	.91548
Delays in delivery	2.2000	.94112
Costs escalation	2.1333	.83381
Customer complaints	4.5333	7.89092
Loss of competitive sensitive information	2.6667	1.04654
Lack of supplier flexibility	2.8667	.83381
Lack of managerial skills to control suppliers	2.5333	.51640
Loss of up to date technological breakthroughs	2.6000	.73679
Overall Mean	**2.451**	

The finding shows that the petroleum firms did not consider the challenges identified to be major issues to affect the firm performance. The common challenge that faced the petroleum firms was delays in delivery of the products to the stations (mean=2.2), cost escalation (2.133) and a lack of managerial skill to control the suppliers (mean=2.533). In addition, the expected performance from the outsourcing was not achieved due to a lack of trust which resulted in none sharing of information for fear of sharing with competitors and lack of synergy. Success of outsourcing depends on a user-provider relationship based on mutual trust and faith. This does not imply that control measures are redundant, firms should mandate periodic reporting by the service providers. This finding is consistent to Relly and Tamken (2006)position who note that a principle objection to outsourcing is the possible loss of competitive advantage particularly the loss of skills and expertise of staff ,insufficient internal investments and the passing of knowledge and expertise to the suppliers was a major challenge to outsourcing of services.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research.

5.2 Summary of the Findings

The study findings were that all the petroleum companies had outsourced one form of service or another in their business transactions. The common types of services outsourced include transportation of the petroleum products, maintenance of the fuel stations, security services and the infrastructure required in the station itself. The research found that outsourcing increased the firm's competitiveness through access to modern technology and expertise, cost savings and enable the firm to focus on core competence. When new technologies emerge and mature technologies become obsolete, outsourcing enables the petroleum firms to switch suppliers to exploit any cost or quality improvements that may then be available. This will lead to improved efficiency level and also improve service quality.

The cost benefit accruing to the firms was also found in the capacity of the firms to reduce product costs like labour costs and capital expenditure cost. The petroleum business involves huge capital outlay in setting up such infrastructure but through outsourcing, the petroleum firms would be able to save on such capital expenditure.

Firms can maximize returns on internal resources by concentrating investments and energies on core competencies which can be achieved through firms' transfer of resources from non-value added staff functions to value-added core functions. It is imperative that firms recognize their shortfall as far as having all necessary resources. A firm needs to identify areas of operation which will be a source of competitive advantage over the other competitors in the market and consider outsourcing all the other services which it does not have the necessary competence. By a firm focusing on fewer, manageable core activities, organizations could lessen the costs and complexity of their own operations.

The success criteria needed to establish sustainable partnerships in the area of outsourcing are the various relationships between the people involved. Open and honest environment, key management, coherent and effective internal measurement systems, mutual respect and empathy, commitment to investment, and financial and commercial arrangements are of particular importance in this aspect. It is evident from the findings of the study that commitment from top management and proper selection of third party is essential for successful implementation of outsourcing decision. Management must examine critically each of these success factors to determine how they can be put into practice. Only then firms can truly harness the benefits of outsourcing and to develop long-term partnerships that manifest the many advantages.

5.3 Conclusion

Outsourcing has tremendous positive impacts in many areas of a company's operation. Firstly, this study proved that companies that outsource services improve production and

increase productivity. Secondly, it frees up management time so that a company's management can concentrate on more important areas of its core business. Thirdly, companies are able to use technologies and know how that is not internally available. In addition outsourcing training leads

to knowledge transfer to the sourcing organization. On the basis of findings emanating from this study it can be concluded that outsourcing practice contributes to concentration of core objectives by the companies. Outsourcing however results in loss of control of activity, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. Outsourcing service provider selection process becomes increasingly important in today's complex environment. The selection process involves the determination of quantitative and qualitative factors to select the best possible provider.

Since outsourcing is important in improving and delivering better services, it is quite necessary that these petroleum companies ensure that they cultivate and develop trusting relationships with reputable firms that over time have been outsourced and shown to be good performers. It should be noted that buyer-supplier trust takes time to emerge from fair transactions and cannot be forced. Outsourcing practice though good has its challenges which need to be dealt with before the mobile phone companies decide to outsource its services

5.4 Limitation of the Study

The study is subject to some methodological limitations. First, it is suggested that the size and nature of the sample must be enhanced to ensure variability and control for possible extraneous variation. While the sample is restricted to only a single industry, it would be recommended that data should be gathered from various sectors and industries in Kenya. In addition, since, the data in this research was collected from top managers of the organizations on the basis of their subjective evaluations, objective performance indicators should also be employed in the analysis. Further, the study did not account for certain behavioral factors – related to employees' and managers' characteristics, attitudes, and experience levels – as well as organizational factors – such as structure, size, and business nature – that play a moderating role in the relationships highlighted in this study.

5.5 Recommendation

This study makes several recommendations for policy implementation and also suggest for further research.

5.5.1 Recommendation for Policy and Practice

Firstly, the study established that trust among the companies affected the performance of outsourcing practice and it is recommended that when developing mutually trusting relationship between buyers and suppliers, buyers should ensure that they engage in fair conduct as it relates to agreements that may be in force. In the same spirit of open and fair conduct, petroleum firms should also ensure that they clearly specify and outline

product or service specifications as required and once delivered as needed that they make payments to suppliers in a timely fashion as outlined by the terms of the contract.

The study also found out that outsourcing of processes by the firms has influenced its performance and it is recommended that the petroleum firm should continue outsourcing other services which they do not have competitive advantage over its competitors so that they can continue improving its performance. Consequently, it is recommended that the firms should adopt those practices that would guarantee them competitive advantage in their business environment and at the same time they outsource the processes to the organizations that will provide high quality services which will enable the firms achieve the desired objectives.

5.5.2 Suggestions for Further Research

In light of these limitations, future research is recommended to use mixed methods research in order to validate the results of this research, and apply a longitudinal study to better capture the relationships between outsourcing and its effect on performance. Conducting a replication study with random sample selection can enhance the methodological rigor of the study and increase the possibility of having a better and a supported external validity. Also, another possible source of data could be the customers whose opinions, along with those of executives, can give a better insight of the outsourcing- performance relationship. Furthermore, taking into consideration certain factors that may have a moderating role in these relationships, such as the country culture, could enrich the research results.

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APPENDIX I: RESEARCH QUESTIONNAIRE

PART A: Demographic and Respondents Profile

1. Name of the respondent (optional) ……………………………………….………
2. Name of your organization……………………………..……………………….
3. What is the ownership of the organization?

   a) Local ( )

   b) Foreign ( )

   c) Both local and foreign ( )

4. What is your age bracket? (Tick as applicable).

   a) Under 20 years [ ] b) 21 – 30 years [ ]

   c) 31 – 40 years [ ] d) 41- 50 years [ ]

   d) Over 50 years [ ]

5. Length of continuous service with the company?

   a) Less than two years [ ] b) 2-5 years [ ]

   c) 6- 10 years [ ] d) Over 10 years [ ]

6. For how long has your company been in existence in Kenya?

   a) Under 5 years [ ] b) 6-10 years [ ]

   c) 11-15 years [ ] d) Over 16 years [ ]

Part B: Effect of Outsourcing on Operational performance

7. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum company access to modern technology and expertise? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Access to modern technology and expertise	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms to effect improvement in efficiency					
It allows Petroleum marketing firms' to exploit their more advanced technologies					
It results in Petroleum marketing firms' improved service qualities					
It helps the Petroleum marketing firms' from being locked up into specific assets and technologies					
It enables the Petroleum marketing firms' to increase their competitive edge					

8. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum firm cost saving? Use 1-Strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5-Strongly agree.

Cost Savings	**1**	**2**	**3**	**4**	**5**
It enables the Petroleum marketing firms' to reduce costs from economies of scale and scope					
It free up assets and reduce costs in the immediate financial period					
Outsourcing by reducing costs helps the organization to generate more profit					
It enables the Petroleum marketing firms' to reduce product costs like labour costs, capital expenditure cost					

9. To what extent do you agree with the following regarding the effect of outsourcing on the petroleum companies focus and core competence? Use 1-Not at all, 2-Small extent, 3-Moderate extent, 4-Great extent and 5-Very great extent.

Focus and core competence	**1**	**2**	**3**	**4**	**5**
It enables the petroleum marketing companies to lessen the costs and complexity of their own operations thus better customer focus flexing					
It enables petroleum marketing companies to concentrate on aspects of business that encircle their business objectives and eventually improve their business function					
It enables the Petroleum marketing companies to grow without a corresponding expansion in organizational size or bureaucracy					
It helps firms to perform well in their core competencies and mitigate shortage of skill in the areas where they want to outsource					
It heightens consumer satisfaction					

Part C: Outsourcing and Operational Performance

10. To what extent has the adoption of total quality management practices by your company resulted in the following? **5) Greater extent; 4) Great extent; 3) Moderate extent; 2) Low extent; 1) Very low extent**

Operational Performance	**1**	**2**	**3**	**4**	**5**
Cost reduction					
Increase in profitability					
Increase in market share					
Improving capacity of machinery and equipment					
Increasing orders					
Improved product functionality					

Improved product reliability					
Improving product quality					
Improved organizational competitiveness					

Section E: Outsourcing Challenges

12. To what extent has your company encountered the following challenges as a result of outsourcing? Use 1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Great extent and 5-Very great extent.

Outsourcing Challenges	**5**	**4**	**3**	**2**	**1**
Reduced a company control over how certain services are delivered which in turn may raise the company's liability					
Delays in delivery					
Costs escalation					
Customer complaints					
Loss of competitive sensitive information					
Lack of supplier flexibility					
Lack of managerial skills to control suppliers					
Loss of up to date technological breakthroughs					