

# The Effects of Outsourcing on Enterprises' Cost Structure in Supply Chain Management

\*<sup>1</sup> Seher Kanat and <sup>2</sup> Turan Atılğan

\*<sup>1</sup> Dr., Department of Textile Engineering, Ege University, İzmir, Turkey

<sup>2</sup> Prof. Dr., Department of Textile Engineering, Ege University, İzmir, Turkey

## Abstract

Supply chain management plays an active role in enterprise performance and competitiveness. Rivalry level is increased with increasing globalization and most of the enterprises are stuck in difficult situations in this new global economic order. Enterprises make serious alterations and arrangements in their supply chain management systems in order to survive and achieve their aims under these new rivalry conditions. One of these alterations is dimensional change and usage increment of outsourcing. Therefore, enterprises can focus to their core businesses and allocate more resource and energy to innovative implementations. On the other hand, they can eliminate or reduce their costs in order to be able to decrease price pressure which is constituted by intense rivalry conditions.

This study aims to analyze the effects of outsourcing, which is rapidly increased during the recent years, on enterprises' competitiveness in terms of cost advantage. For this purpose, the dimensions and types of outsourcing, which are used by Turkish clothing enterprises, are investigated. Besides, the influence levels of enterprise costs and the contributions of this situation to enterprise performance are analyzed.

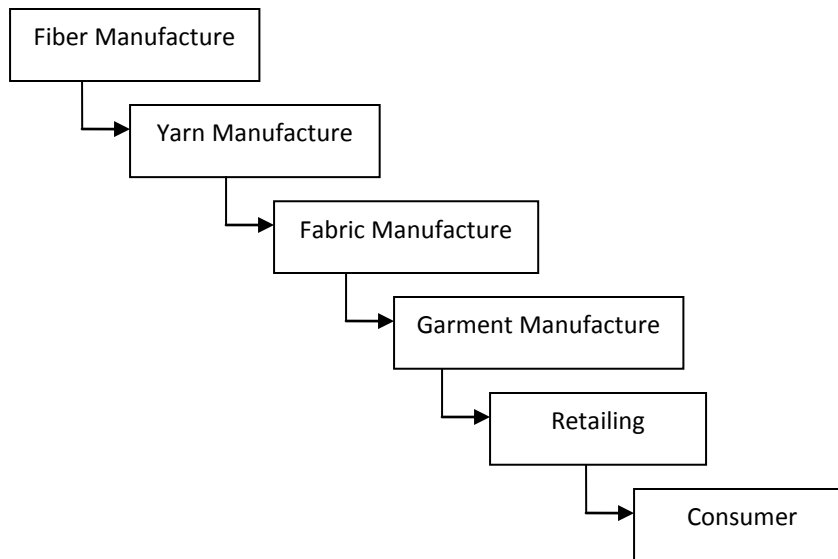
**Key words:** Supply chain management, outsourcing, cost structure, Turkish clothing sector

## 1. Introduction

The clothing sector is characterized by short product life cycles, high volatility, volatile and unpredictable demand, high number of stock-keeping units, low predictability, high impulse purchasing, tremendous product variety, long and inflexible supply processes and a complex supply chain management [1,2,3]. Therefore, the sector can be defined with the term lean retailing, responding with agility to the demand of the retailers [3]. Lean retailers in clothing industry require rapid replenishment of products and shipments need to meet strict requirements in terms of the delivery times, order completeness and accuracy [2]. In such an environment, efficient supply chain management practices can spell the difference between success and failure [1].

The supply chain of clothing industry is complex [2,4]. The supply chain of clothing industry is characterized by volatile markets, short product life cycles and high product variety. The clothing supply chain is full of uncertainty and unpredictability [4]. Often the clothing supply chain is

relatively long with a number of parties involved (Figure 1). Consequently, careful management of supply chain is required in order to reduce lead times and achieve quick response [2].



**Figure 1.** Clothing supply chain [5]

Using agile supply chain management model could achieve quick response and reduce lead times [2,4]. Clothing supply chain is a typical example of buyer-driven commodity chain. The main job of the core company in a buyer-driven commodity chain is to coordinate scattered global production and trade networks and to make sure all the pieces of the business come together as an integrated whole. However, considering the characteristics of clothing products and current lean retailing practice, communication effectiveness and agility is an even more integral part of clothing supply chain management than any other supply chains [3].

Globalization of the clothing supply chain is currently intensifying, with many companies either sourcing components from overseas or moving manufacturing to countries with lower labor costs [2]. In the clothing supply chain, as in the other sectors, current competition does not just concern the individual enterprise but rather, involves the entire supply chain [3].

## **2. Outsourcing in Clothing Supply Chain Management**

Outsourcing is a key supply chain practice that is on the agenda of many organizations. Outsourcing can be defined as the allocation of business activities that were previously done internally by an organization, which are now sources from outside of the organization [6]. In other words, outsourcing is the strategic use of resources outside the enterprise to perform tasks that are usually handled internally by the enterprise itself [7].

The decision to “make or buy” or “in-source or outsource” is typically a question of whether the enterprise could increase its performance by leveraging on the specialized capabilities of the supplier [8]. The decision to outsource is based on the growth in supply chain surplus provided by the third party and the increase in risk incurred by using a third party. An enterprise should consider outsourcing if the growth in surplus is large with a small increase in risk. Performing the function in-house is preferable if the growth in surplus is small or the increase in risk is large. Third parties can increase the supply chain surplus effectively if they are able to aggregate supply chain assets or flows to a higher level than an enterprise itself [9].

The stages involved in taking the outsourcing decision can be summarized as below [10]:

1. Defining the core activities of the business: The stage is involved with identifying the core and non-core activities of the organization. A core activity is central to the enterprise successfully serving the needs of potential customers in each market. The activity is perceived by the customers as adding value and therefore being a major determinant of competitive advantage.
2. Evaluating the relevant value chain activities: Once all the core and non-core activities have been identified, the next section is concerned with analyzing the competencies of the enterprise in these core activities in relation to potential external sources.
3. Total cost analysis of core activities: This stage involves attempting to measure all the actual and potential costs involved in sourcing the activity internally or externally. It encompasses all costs associated with the acquisition of the activity throughout the entire supply chain and not just the purchase price.
4. Relationship analysis: A number of issues have to be addressed before outsourcing a core activity. The enterprise may wish to maintain the knowledge (design skills, management skills, manufacturing etc.) that enable the technology of the activity to be exploited, even when it is being provided by another partner.

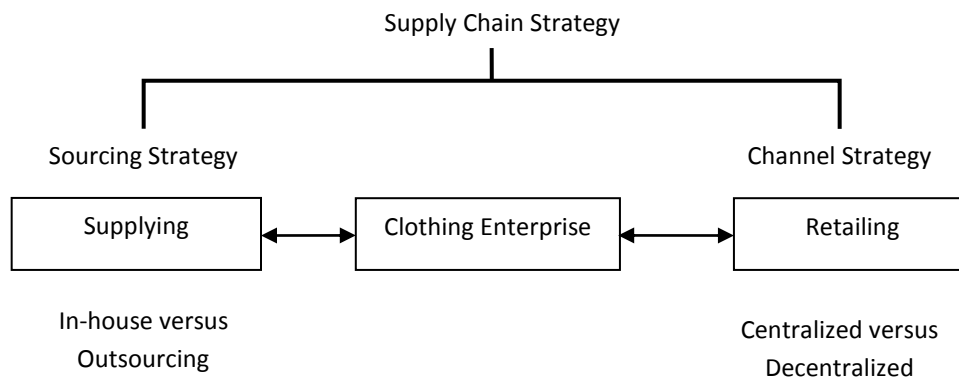
In today’s competitive world, successful outsourcing is a powerful tool for companies to generate value and gain competitive edge over rivals [7]. In many instances outsourcing was initially implemented in non-core activities and then diffused into almost every function, even the core of a business [6]. However, some risks can be occurred during outsourcing implementations.

Risks of using outsourcing can be summarized as below [9]:

1. The process is broken: The biggest problems arise when an enterprise outsources supply chain functions simply because it has lost control of the process.
2. Underestimation of the cost of coordination: A common mistake when outsourcing is to underestimate the effort required to coordinate activities across multiple entities performing supply chain tasks.
3. Reduced customer/supplier contact: An enterprise may lose customer/supplier contact by introducing an intermediary.
4. Loss of internal capability and growth in third-party power: An enterprise may choose to keep a supply chain function in-house if outsourcing will significantly increase the third party’s power.
5. Leakage of sensitive data and information: Using a third party requires an enterprise to share demand information and in some cases intellectual property. If the third party also serves competitors, there is always the danger of leakage.

6. Ineffective contracts: Contracts with performance metrics that distort the third party's incentives often significantly reduce any gains from outsourcing.

A clothing enterprise has to make decisions on sourcing and channel strategy (Figure 2). A sourcing decision involves how much of the process needed to make its products the enterprise should internalize. In-house sourcing implies that the enterprise makes its products the enterprise should internalize. If the enterprise adopts an outsourcing strategy, it utilizes external suppliers and/or partner enterprises for making products or procuring parts and materials. For a channel strategy in the downstream, the adoption is the categorization of centralized versus decentralized. Under the centralized channel strategy, the focal enterprise centralizes or tightly controls most of key decision making factors involving price, product mix and inventory. An extreme example of centralized channel strategy is to own all of the retail stores. Under the decentralized channel strategy, the enterprise manages its distribution function more flexibly in order to respond to the local market changes promptly. Using the two strategies, sourcing and channel, a typology of supply chain strategy is developed. The concentrated supply chain strategy is defined as the one consisting of in-house sourcing and centralized channel strategy whereas the dispersed supply chain strategy is the one consisting of outsourcing and decentralized channel strategy [11].



**Figure 2.** Clothing Supply Chain Strategy [11]

### 3. Outsourcing in Turkish Clothing Sector's Supply Chain Management

Turkish clothing enterprises have to manage their supply chains effectively and accurately in order to be successful in today's intense competitive environment. Outsourcing, which becomes a significant element of supply chain management within the recent years, is used intensively by Turkish clothing enterprises.

In this study, the dimensions and types of outsourcing in Turkish clothing enterprises' supply chains and their effects on enterprises' cost structures are analyzed. The analyzed enterprises possess their own brands and they are successful both in national and international markets. For this purpose, interviews are made with supply chain managers and/or purchasing managers.

### **3.1 LC Waikiki**

LC Waikiki is established in 1985 as a French brand. Since 1997 it proceeds on its way as a Turkish brand. It produces women, men, children, teenagers and baby clothes. The brand possesses 515 physical stores in 23 countries. The enterprise aims to become one of the best European clothing retailers, which possess their own brands, since 2023.

The enterprise supplies all of its production processes (cutting, sewing, dying & printing, embroidery, packaging etc.) with outsourcing. It approximately works with 250-300 suppliers in terms of production. The enterprise is pleased with its suppliers. The enterprise defines its core activities as brand management, marketing and retailing. The enterprise performs all of its core activities within the enterprise and doesn't benefit from outsourcing. The enterprise outsources approximately 80% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 20%.

### **3.2 Koton**

Koton, which is established in 1988, produces women, men, children and teenager clothes. The enterprise possesses 392 stores in 25 countries. The enterprise aims to become a fast fashion brand, which owns the favorite and richest collections, throughout the five continents since 2023.

The enterprise supplies all of its production processes (cutting, sewing, dying & printing, embroidery, packaging etc.) with outsourcing. It approximately works with 200-250 suppliers in terms of production. The enterprise is pleased with its suppliers. The enterprise defines its core activities as design, brand management, marketing and retailing. The enterprise performs all of its core activities within the enterprise and doesn't benefit from outsourcing. The enterprise outsources approximately 85% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 15%.

### **3.3 Defacto**

Defacto, which is established in 2003, produces women, men, children and teenager clothes. The brand possesses 264 stores in 5 countries. The enterprise aims to become a world brand in 10 countries within 10 years.

The enterprise supplies all of its production processes (cutting, sewing, pattern & sample preparing, dying & printing, embroidery, packaging etc.) with outsourcing. It approximately works with 80 suppliers in terms of production. The enterprise is pleased with its suppliers. It supplies 64% of its production processes from Turkey whereas it supplies 36% from 6 foreign countries. The enterprise defines its core activities as design, logistics, marketing and retailing. The enterprise performs all of its core activities within the enterprise and doesn't benefit from outsourcing. The enterprise outsources approximately 80% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 10-12%.

### **3.4 Mavi**

Mavi, which is established in 1991, produces denim wear and non-denim sportswear for women and men. Mavi has been the leading jeans brand in Turkey since the last 18 years with 11 % market share. The brand possesses 352 stores in 50 countries. The enterprise aims to create a Mediterranean brand around blue jean culture and perfect fitting jeans.

The enterprise supplies 50% of its production processes (cutting, sewing, dying & printing, embroidery etc.) with outsourcing. The enterprise possesses its own production facilities. In these facilities sewing preparing (embroidery, cutting etc.), finishing, washing and quality control processes are performed. Predominantly denim fabrics are used. The enterprise especially supplies its knitted apparel products with outsourcing. It approximately works with 50-60 suppliers in terms of production. The enterprise is pleased with its suppliers. The enterprise defines its core activities as production, marketing, brand management, design and retailing. The enterprise performs 50% of its core activities within the enterprise and outsources the other 50%. The enterprise outsources approximately 90% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 10-20%.

### **3.5 Kiğılı**

Kiğılı, which is established in 1938, produces suits, shirts, trousers, jackets and casual wear for men. The enterprise owns two brands which are named as Kiğılı and Abdullah Kiğılı Exclusive Cut. The enterprise possesses 246 stores in 13 countries. The enterprise aims to become one of the ten leading global male brands.

The enterprise supplies 80% of its production processes with outsourcing. The enterprise possesses its own production facilities. It approximately works with 50-100 suppliers in terms of production. The enterprise is pleased with its suppliers. The enterprise defines its core activities as brand management, design, logistics and retailing. The enterprise performs all of its core activities within the enterprise and doesn't benefit from outsourcing. The enterprise outsources approximately 80% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 25%.

### **3.6 İpekyol**

İpekyol, which is established in 1986, produces skirts, blouses, jackets, trousers and casual wear for women. The enterprise possesses 121 stores in 6 countries.

The enterprise supplies 30% of its production processes with outsourcing. The enterprise possesses its own production facilities. It approximately works with 30-40 suppliers in terms of production. The enterprise is pleased with its suppliers. The enterprise defines its core activity as retailing. The enterprise supplies 70% of its core activities with outsourcing. The enterprise outsources approximately 80% of its noncore activities within the supply chain. The saving amount, which is provided with outsourcing, is around 20-30%.

#### 4. Conclusions and General Evaluation

The clothing sector is a sector in which rivalry is intensive, variability is high and supply chain is relatively long. Nowadays, the rivalry involves the whole supply chains instead of enterprises. Therefore, the clothing enterprises must manage their supply chains effectively and successfully. In this context, outsourcing decision becomes one of the most important issues of enterprises. The supply chain managers have to take many decisions. First of all, they must decide for performing inside or outsourcing. If they are going to outsource, how much of it will be outsourced? Which activities will be defined as core activities? Will they perform core activities only inside? If they are going to outsource, how much of the core activities will be outsourced?

Turkish clothing sector, which possesses high employment and export potential, is a significant sector that provides added value to its country for many years. The sector provides 124 billion dollars added value during the last 10 years. The sector operates in international markets since 1980s. Turkish clothing sector swiftly tends towards value added products and branded products due to the liberalization increments throughout the world depending on the foundation of World Trade Organization (WTO) in 1996 and the consequences of China's membership to WTO. The Turquality project (has started in November 2004) significantly contributes to this situation in terms of inciting branding. The sector passes through an alteration and transformation process during the last 15 years and it discovers that in order to be successful and competitive in international markets, it has to possess successful brands and retail chains. Therefore, Turkish clothing enterprises work for creating their own brands, increasing the brand value and brand awareness, establishing their own national and international retail chains. At this point, they usually give up inside production and outsource their production processes. Therefore, Turkish clothing enterprises swiftly give up the production and define their core activities as marketing, logistics, retailing and brand management. Consequently, they canalize their sources to these areas. Thus, the outsourcing usage of Turkish clothing enterprises reach to high levels during the last 15 years.

As it can be seen from our research results, successful Turkish clothing enterprises which possess their own brands benefit from outsourcing in their supply chains intensively and increasingly. The enterprises define their core activities as brand management, marketing, retailing and design. The enterprises perform all of their core activities within the enterprise and don't benefit from outsourcing. Only one enterprise, which is involved in our research, defines the production as its core activity. However, also this enterprise outsources 50% of its production. They approximately work with 100-200 suppliers in terms of production. The suppliers are both located inside and outside Turkey. The saving amount, which is provided with outsourcing, is around 10-20%.

The Turkish clothing enterprises, which are involved in our study, define the most value added elements of their supply chain as design, brand management, logistics and retailing. Therefore, they create their strategies in this respect. The enterprises mostly perform the designing process inside. However, they evaluate the designs and collections of their qualified suppliers. Turkish clothing enterprises generally don't benefit from outsourcing in terms of core activities. However, they outsource approximately 80-90% of their noncore activities within the supply

chains. This situation can be explained with reasons such as core activity concentration, predomination with regards to core activities, knowledge accumulation and unwillingness for sharing knowledge.

As it can be seen from our study results, Turkish clothing enterprises outsourcing usage rates are swiftly increased during the last years. The enterprises continue to perform their core activities inside. However, they outsource almost all of their noncore supply chain activities such as production and raw material supply. The enterprises can focus to their core activities (brand management, retailing, design, marketing, logistics etc.) by the help of outsourcing. At the same time, the enterprises provide serious cost advantage. In this context, outsourcing in supply chain management becomes indispensable for Turkish clothing enterprises.

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