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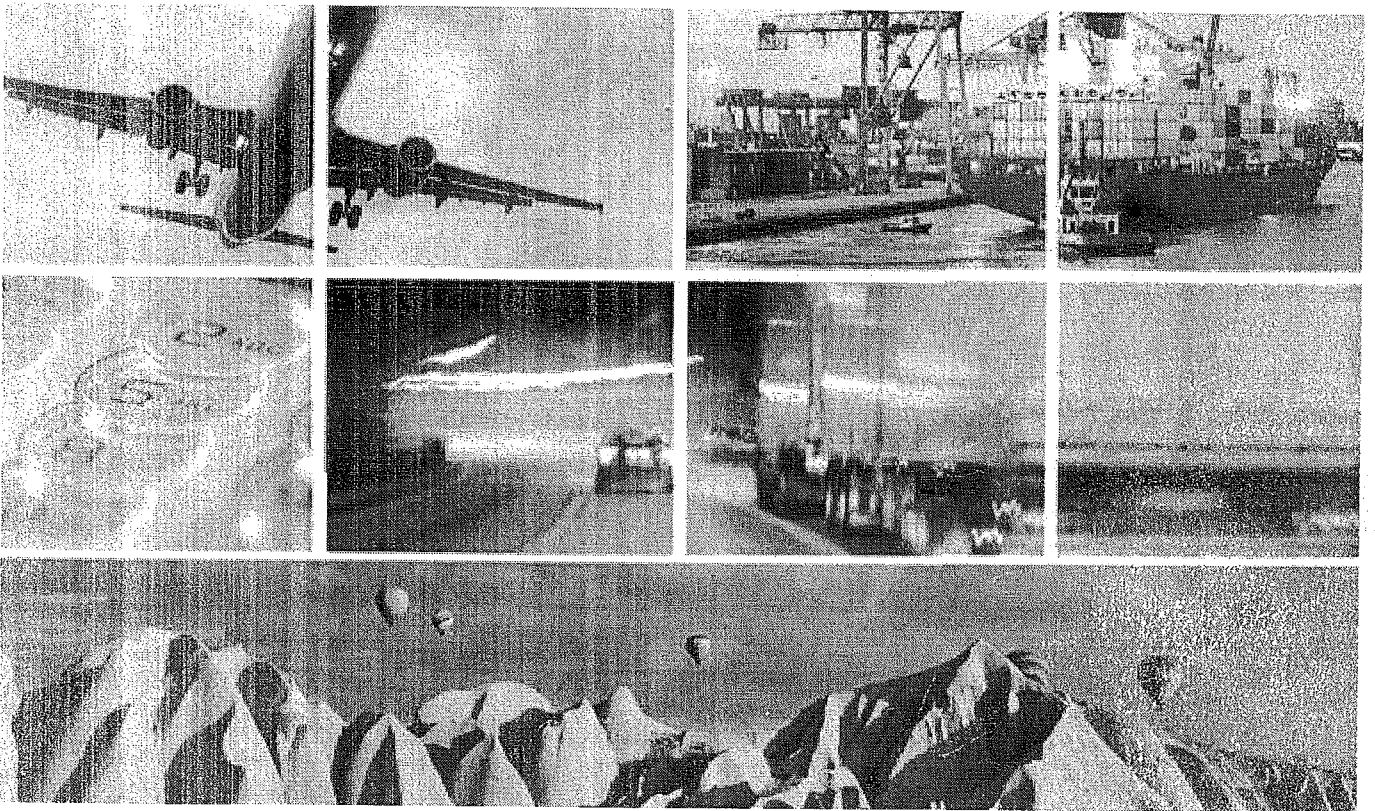
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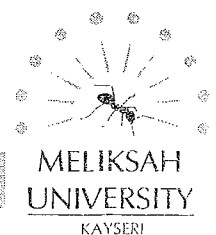


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THE INFLUENCE OF OUTSOURCING INTENSITY ON FIRM PERFORMANCE: THE MEDIATING ROLE OF ENVIRONMENTAL DYNAMISM.....	273-282
<i>Özgür DEMİRTAŞ, Korhan KARACAOĞLU</i>	
GAME THEORETICAL APPROACH IN RETAILERS' STRATEGIC BEHAVIOURS IN VENDOR MANAGED INVENTORY ENVIRONMENT.....	283-291
<i>Saliha Karadayı, Murat Başkak</i>	
SYSTEMATIC RISK ANALYSES OF TURKISH TRANSPORTATION SECTOR.....	293-311
<i>Sinem Derindere Köseoğlu, Meltem Akca</i>	
CASE STUDY ON DIFFERENT DISTRIBUTION METHODS FOR AN URBAN WHOLESALE MARKET.....	313-319
<i>Thomas Dubois, Muhammed Bamyacı, Hamit Vanlı, Levent Aksoy, Mehmet Tanyaş, Georges Allaert, Frank Witlox</i>	
EXPLORING THE PARAMETERS IN THE SOCIAL MEDIA USAGE OF AIRLINE INDUSTRY.....	321-336
<i>Ömür Yaşar SAATÇIOĞLU, Alperen AKKAYA, Tekin ERDOĞAN</i>	
INVENTORY MANAGEMENT IN HUMANITARIAN RELIEF LOGISTICS: A CONCEPTUAL FRAMEWORK.....	337-345
<i>Alev Taskin Gumus, Erkan Celik, Nima Gheshlaghi</i>	
IMPACT OF SUPPLY CHAIN MANAGEMENT (SCM) PRACTICES ON ORGANIZATIONAL PERFORMANCE.....	347-357
<i>Müjdeli İpek Yener, Ahmet Doğanay</i>	
RECYCLING NETWORK DESIGN FOR MUNICIPAL WASTE MANAGEMENT IN ANKARA.....	359-368
<i>N. Demirel, H. Gökçen</i>	
SIMULATION MODELING OF A CLOSED-LOOP SUPPLY CHAIN NETWORK.....	369-378
<i>Eren Özceylan, Saadettin Erhan Kesen, Turan Paksoy</i>	
THE IMPACT OF INTERCULTURAL COMMUNICATION ON THE MARKETING EFFECTIVENESS OF GLOBAL LOGISTICS COMPANIES ..	379-391
<i>Emine Tuğba Kocabıyık, Funda Yercan</i>	
FRAMEWORKS OF SUPPLY CHAIN PERFORMANCE MEASUREMENT: A LITERATURE REVIEW.....	393-404
<i>Ourania Areta</i>	
A SYSTEMATIC REVIEW OF THE SUPPLY CHAIN RISK MANAGEMENT LITERATURE.....	405-418
<i>Saliha Karadayı, Şeyda Serdar Asan</i>	

THE INFLUENCE OF OUTSOURCING INTENSITY ON FIRM PERFORMANCE: THE MEDIATING ROLE OF ENVIRONMENTAL DYNAMISM

Özgür DEMİRTAŞ¹, Korhan KARACAOĞLU²

Abstract - There are a lot of studies in the literature that mentioned the relationship between outsourcing and its influence on firm performance. But, little is known about how the environmental dynamism has to be considered in the outsourcing and firm performance relationship. Therefore, this study examines a mediated model of environmental dynamism. The aim of this study is to investigate the influence of outsourcing intensity on firm performance. It is also hypothesized that environmental dynamism would mediate the outsourcing intensity and firm performance relationship. Data of this study were collected from a sample of 318 participants, who are working full time within an organization. The results indicate that outsourcing intensity has a direct influence on firm performance and the environmental dynamism has a partial mediator role in the proposed model.

Keywords: Firm Performance, Environmental Dynamism, Mediating, Outsourcing Intensity

INTRODUCTION

In today's highly competitive environmental dynamism, sustainable growth becomes more important attitude for organizations. To comply with these improvements, organizations have to head towards their core capabilities in order to have effective working conditions. Corporate growth has some components which signify the internal context, the external context, the business concept, resources and capabilities, and strategic investment decisions [1-2]. Decisions for sustainable growth are affected by external context such as market structure, economic environment, rivals, customers and their belonging industry. The dynamic supply environment, the increasing level of competition in the worldwide market, the uncertainty of global business environment, and the corresponding changes in firm's purchasing function suggest that sourcing should play an important role in a company's strategic decision-making process [3-4]. Nowadays the firms confront a more compelling bussiness

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environment. It is more competitive, universal, integrated and irregular. For this reason, the decision taken by senior management for outsourcing is naturally more strategic, and companies depends on this strategy in order to change their businesses.

However, explaining outsourcing simply in terms of procurement activities does not reflect the true strategic nature of the issue. Outsourcing is not merely a purchasing decision, so it is proposed in this study that outsourcing represents the fundamental decision to decline to do an activity in-house and look for external sources. In this way, outsourcing is a fairly strategic decision that has the capability to cause performance effects through the organization.

Regarding outsourcing as strategic and suggesting that it has an influence on the firm performance, is something that has been done with a few empirical research in management literature. This research was one of the first empirical study to examine the outsourcing intensity impact on firm's performance. Moreover the mediating role of environmental dynamism in the relation between outsourcing intensity and firm performance was considered.

From this point of view, the main objective of this study is to investigate the impact of outsourcing intensity on firm performance. It is also hypothesized that environmental dynamism would moderate the outsourcing intensity and firm performance.

For this aim, the article is organized in four main sections. First, a review of the literature on outsourcing, firm performance and environmental dynamism are presented, followed by the development of hypotheses. Second, the research method- participants, procedures, and measures- is discussed in detail. Third, an analysis of the field study data is presented along with the discussion of the results in relation to the literature. Finally, strengths and weakness, research implications and future research recommendations are given.

THEORETICAL FOUNDATION

The growth of a firm is an important issue that relies on many variables. There are lots of components that affect organizational outcomes which in turn influence the sustainable growth. One of the important factors in this process is the effectiveness of the organization. Therefore, organizational capabilities and environmental factors have to be considered in order to provide efficiency in working environment. Thus, in the following sections, outsourcing, firm performance and environmental dynamism are explained.

Outsourcing

Outsourcing can be described as; the act of transferring some of an organization's repeated internal activities and decision rights to outside suppliers [5]; buying from someone else a good or service that had been previously supplied internally [6] or the dependence on external sources for manufacturing components and other value-adding activities [7]. In general, the definition of outsourcing used in previous studies is so comprehensive that it involves substantially any product or service that an organization obtains from outside companies.

Outsourcing comes to mean procuring ongoing services from an external firm that a firm presently supplies, or most organizations usually provide for themselves

[8]. Outsourcing is to buy a value creating activity from an outside provider [9]. Jiang [10] adopted this idea as well and made a distinction between substitution and abstention in the description of outsourcing in his study while analyzing the effect of outsourcing on the whole company's value and performance.

Outsourcing is one of the greatest organizational and industry structure shifts of the century [11]. The outsourcing enables a company's resources and capabilities to be improved by attaining better quality services and better performance [12]. There are a great number of researches about outsourcing in management literature. Because any organisation can not stay competitive in today's quickly changing global economy by depending entirely on its own resources, outsourcing is a significant response to today's hyper-competitive business environment. Like any strategic decision, outsourcing is strategically important, and it must be evaluated for its impacts on competitive advantage and its compliance with decisions that mean changes in the organization's environment [13].

Outsourcing Intensity

Outsourcing intensity is a measure constructed to find out a firm's overall dependence on outsourcing (the larger a firm's value of outsourcing intensity, the greater is the role that outsourcing plays in its strategy making and calculated separately for core and non-core activities) [14]. Insinga and Werke [15] supports that a firm's reliance on outsourcing can not be measured simply by the number of activities that the firm outsources. According to them, analysing a firm's level of outsourcing simply in terms of breadth (the number of activities outsourced as a percentage of the total number of activities in which the firm could be engaged) misses an important aspect of the phenomenon.

Giley and Rasheed [14] proposed two types of outsourcing intensity are proposed in their model. The first type occurs when firms acquire less strategically relevant, peripheral activities from external suppliers. The second category occurs when firms acquire activities that are considered highly important to long-run success in their industry from outside suppliers.

Giley [16] supported that a company's dependence on outsourcing can not be evaluated merely by the number of activities that the company outsources. This combined construct is called by Giley as outsourcing intensity, and in his model he proposed two types of outsourcing intensity such as peripheral and core. The first category takes place when companies obtain less strategically related, peripheral activities from outside providers. On the other hand, the second type happens when companies acquire activities that are thought highly important to long term success in their business from external suppliers.

Firm Performance

Firm performance is another important term in this study. It is the level to which an organization achieves its goals. In fact, performance as concept is so comprehensive that it is difficult to measure in organizations. Performance indicators indirectly consists of a series of variables to find out a company's financial and non-financial performance. Most of the previously held companies are not able to supply objective financial data, and their managers are supposed to be reluctant to supply detailed accounting data.

Firm performance has long been the primary dependent variable in management researches. However, prior firm performance can not be looked upon only as an outcome of organization-environment interactions. Rather, it must be viewed as an important input to managerial decision making. A firm's performance is an important independent variable that influences a number of managerial decisions, including outsourcing strategies. Child [17] provides a discussion of the importance of firm performance as an independent variable and states that the performance levels achieved by an organization constitute a vital input of information to its managers that is likely to stimulate them to make adjustments in policies and modes of operation.

There are some researches in the literature that emphasized the relationship between outsourcing intensity and firm performance. For example, Giley and Rasheed [14], empirically analysed the extent to which outsourcing of both peripheral and near core tasks affects company's financial and non-financial performance. Results showed that, while there was no important direct impact of outsourcing on firm performance, both firm strategy and environmental dynamism mediated the relationship between outsourcing and performance. Espino-Rodriguez and Padron-Robania [12] examined hotel sector managers' perceptions of the effect of outsourcing on operations strategy empirically and particularly on the objectives of cost reduction related operations, improved quality, flexibility and better service. They proved that outsourcing significantly affects hotel performance. Greer et al [18] empirically examined the relationship between the outsourcing of human resource (HR) activities, namely training and payroll, and firm performance. Results revealed that both training and payroll outsourcing have implications for firm performance. On the other hand, the number of empirical studies in Turkey about outsourcing intensity and firm performance relationship is limited. Güzel's [19] research indicated that outsourcing intensity has low positive contribution to firm performance at the firm level.

Given the above conceptual framework and literature findings, in this study it is hypothesized as follows;

Hypothesis 1: Outsourcing intensity has a direct influence on firm performance.

Mediation: Environmental Dynamism

Environmental dynamism' is described as 'the rate of change and innovation in an industry as well as the uncertainty or predictability of the actions of competitors and customers' [20]. Environmental dynamism is especially practical as an exploratory variable in organizational researches. The dynamic environment is effective on variety of management activities from strategy formation to performance [21]. Giley [16] emphasized that outsourcing and firm performance relationship was positive in stable environments, but negative in dynamic ones. Also, he asserted that the relative dynamism in a firm's external environment have important impacts on outsourcing intensity.

The strategies are the systems through which organizations try to fit their environment [2]. Environmental impacts on organizational strategies, structures, processes and performance have been the subject of many studies in the literature [22]. But, none of these studies have specifically dealt with the relationship between environmental dynamism and outsourcing strategies except for Giley [16].

Barney [23] underlined that, when industry demand was unpredictable, internalization could lead to higher administrative costs and lower margins as a result of coordination and information processing costs. Also, uncertainty with regards to demand makes outsourcing appealing because it allows firms to shift much of the risk related to declining demand (such as idle equipment and head count reductions) to supplier firms. Finally, the changes in technology that accompany high levels of environmental dynamism can make what was once a very valuable organizational technology to become suddenly out of date. By increasing their dependence on outsourcing during times of high environmental dynamism, it is possible for managers to have the flexibility to change suppliers as technological advancements warrant [16]. Therefore, the environment of an organization is generally considered in the presence of outsourcing strategy. In the line of these arguments, it is suggested that firms operating in dynamic environments would follow more intense outsourcing strategies. So, it is hypothesized as follow;

Hypothesis 2: Environmental dynamism will mediate the relationship between outsourcing intensity and firm performance.

METHODOLOGY

Sample

Data of this study were collected from a sample of 318 participants, who are working full time within an organization. The sample consisted of 203 (63.8%) male and 115 (36.2%) female participants with an average age of 39.12 years. Participants averaged 9.6 years spent in their current job. In addition, 66% of the participants are working in a manufacturing firm and the others 34% in a service sector.

Measures

Outsourcing Intensity

Outsourcing intensity scale, which was developed by Giley [16], is used in this study. To measure the outsourcing intensity of the listed activities, respondents are asked to indicate the level of outsourcing intensity on a 5-point Likert type scale, with 1 indicating "not outsourced" and 5 "totally outsourced". This scale consisted of 36 items. The Cronbach's alpha is 0.87.

Firm Performance

Many of the privately held firms are unlikely to provide objective financial data, and their executives are expected to be unwilling to provide detailed accounting data. Therefore, it is found appropriate to use subjective measures of financial performance. This scale was developed by Dess and Robinson [24]. They provided strong evidence of the validity and reliability of this type of financial performance. Each respondent is asked to rank his or her firm's performance compared to other similar firms in their industry on sales growth, after tax return on total assets and overall financial performance over the last 12 months.

Environmental Dynamism

Environmental dynamism is measured using a 7 item scale developed by Miller and Friesen [20]. Also, a 5-point Likert scale, where 1="strongly disagree" and 5="strongly agree", is used to assess this scale. The Cronbach's alpha is 0.91.

RESULTS

The correlations among and descriptive statistics for the variables in this study can be found in Table 1 and the regression analyses results in Table 2. As can be seen from Table 3 results, the sector of the organizations have a positive and significant correlations with all of the variables in this study.

Table 1.
Mean, Standard Deviations and Correlations

Variable	Mean	SD	1	2	3	4	5	6	7	8
1. Operational Finance Activities	3.27	0.79	-							
2. Managerial Finance Activities	3.12	0.48	0.478***	-						
3. Financial Performance	3.39	0.98	0.317**	0.296**	-					
4. Innovation Performance	3.73	1.02	0.291**	0.407***	0.479***	-				
5. Employee Performance	3.41	1.27	0.343**	0.436***	0.481***	0.379**	-			
6. Customer and Supplier Relations Performance	3.61	1.19	0.267**	0.384**	0.453***	0.341**	0.322**	-		
7. Environmental Dynamism	3.09	0.91	0.283**	0.361**	0.308**	0.297**	0.247*	0.319**	-	
8. Sector	0.66	0.17	0.186*	0.209**	0.229**	0.326**	0.214**	0.231**	0.339**	-

Sector: 0=manufacturing; 1= service; *p<0.05, **p<0.01, p<0.001

Table 2.
Regression Analyses for Mediation

	DV: Firm Performance		
	Step 1 IV-Med (β)	Step 2 IV - DV (β)	Step 3 IV/Med - DV (β)
Independent variable Outsourcing Intensity	0.387**	0.472**	0.143**
Mediator Environmental Dynamism			0.278**
Adjusted R ²	0.24	0.19	
F Change	141.37**	87.63**	208.27**

Note: Standardized Betas are shown. IV = independent variable; DV = dependent variable; Med = mediator; *p < 0.05, **p < 0.01

For the hypotheses testing; the mediator variable (environmental dynamism) on the independent variable (outsourcing intensity); and dependent variable (firm

performance) were regressed. As shown in Table 2, the beta weights were significant and in the predicted direction. Thus, Hypothesis 1 was supported.

In addition, Baron and Kenny's [25] three-step procedure for assessing the mediating role of the environmental dynamism is used. In this methodology; first, the independent variable should be significantly related to the mediator variable; second, the independent variable should be related to the dependent variable; and third, the mediating variable should be related to the dependent variable with the independent variable included in the equation. If the first three conditions hold, then at least partial mediation is present. If the independent variable has a non-significant beta weight in the third step, then complete mediation is present [26]. The results, shown in Table 4, indicate that environmental dynamism partially mediated the relationship of outsourcing intensity to firm performance (Hypothesis 2) as the beta for outsourcing intensity decreased after adding environmental dynamism, but remained significant

Sobel Test

Finally, to confirm support for mediational hypotheses, Sobel tests were used to assess the significance of the indirect effects [26-27]. Sobel tests involve calculating the magnitude of the unstandardized indirect effect (a and b) and its accompanying standard error (s_a and s_b). The ratio of the indirect effect over its standard error, referred to as the Sobel statistic, is then compared to a z -distribution to determine the statistical significance of the indirect effect. Supporting hypothesis 3, the Sobel test results indicated that the indirect effects of outsourcing intensity on firm performance for environmental dynamism ($z = 5.13$, $p=0.00$) was in the anticipated direction and statistically significant.

CONCLUSION

In the literature review, it has seen that many researchers have made arguments both for and against outsourcing as a means of sustainable competitive advantage [12; 14; 16; 28-32]. However, less attention has been given to those factors that influence a firm's outsourcing intensity and previous works on the subject have examined a relatively narrow set of determinants.

This study investigated the outsourcing intensity's influence to firm performance. Results indicated that outsourcing intensity, directly and indirectly, through shaping environmental dynamism, impacted firm's performance outcomes.

This study contributes to this domain by developing a more comprehensive set of potential determinants and also it contributes by providing a description and analyses of the influence of outsourcing intensity and findings mesh with and extend previous theoretical and empirical research efforts.

Strengths and Weaknesses

This study has several notable strengths. First, in this study a large number of employees from manufacturing and service sectors are involved. Second, the survey is made by face to face to reduce questionnaire mistakes. Third, this study advances the outsourcing intensity literature by which outsourcing intensity influences directly and indirectly to firm performance. Especially, this study is one of the rare researches that

studied the mediating effect of environmental dynamism on the relationship between outsourcing intensity and firm performance.

This study also has several limitations which need to be mentioned in order to fully interpret the results offered. First, firms in the sample were mostly in manufacturing sector. Second, the sample is drawn from two industries and it was not demographically diverse. Data in this study are gathered from Kayseri. Therefore, the result can not be generalized to other cultures.

Future Research

The findings of this study suggested that relationships do exist between outsourcing intensity and firm performance, but further research is needed to more closely examine the complexities of these relationships. Future research can extend this study's results by developing a new outsourcing intensity scale. Because, outsourcing implications evolve from time to time. In addition, other variables that may have an impact on outsourcing intensity and firm performance should be examined. Finally, future researches could use a longitudinal data to theorize and analyze the effects of outsourcing intensity.

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