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Ana Globočnik Žunac [1]
Vlatka Kordoš
Sanja Zlatić

RISK MANAGEMENT IN THE PROCESS OF USING THE EXTERNAL SERVICE SUPPLIER

Abstract: *The article introduces a key features of risk management and risk reviews at the time when a company decides to begin the process of separating the activities and using the services of an external supplier. Risk is an indispensable part of any process within the organization, so each organization at some point faces the risk. Risk management is monitored through a range covering risks and chances, gains and losses that include positive and negative results, likelihood of occurrence and consequences. Norm 31000: 2009 is fully devoted to risk management. When using an outsourcer service and the relationship between the contracting company and the executing company, the following risks are identified: the risk of human resource, long-term productivity risk, operational and strategic risk and the risk of reputation.*

Keywords: *risks, risk management, outsourcing, use of outsourcing services*

1. Introduction

Risks have always been part of every business step, and with the growing number of different activities the risks become more and more complex. Business without risk would be ideal but it is never so. Risks always exist, affect business, require businesses to deal with them, and by risk management to bring the risks to minimum. Contemporary companies are in a changing environment, the markets in which they operate are constantly being changed, and also they have growing competition on daily basis. Companies need to ensure constant growth and development of every activity they preform. In order to facilitate the performance of certain activities, it is necessary to carefully select an outsourcing supplier company with whom it wishes to establish a good and confidential business relationship and work together to create value for the whole company. Since risks can not be avoided, but only well managed to reduce their negative impact, companies need to dedicate their time and attention to find a way to identify and manage them not allowing them to become a significant threat to the existence of the company itself. Currently the best-developed modern risk management system is the standard ISO 31000: 2009 because it covers all the various issues of risk management. The risk management concept is not risk elimination, but risk control so that the company can achieve the set goals (Leitch, 2010). Therefore it is important to establish an effective risk management and control system. Risk review is one of the ways a company checks the success of a previously defined strategy. Risk isues are a complex and wide area, but this article has focus on

[1] Ana Globočnik Žunac
Email: agzunac@unin.hr

the risks that may arise during the process of using an outsourcing service supplier.The problem with the risk management is the attitude of the company and decision on how to transfer the risk from a potential loss to a not imortant factor of the business success. When it comes to risks, organisations see them as uncertainty to the outcome of expected events in the future. Risk management is being participated through a range of risks and chances, gains and losses that include positive and negative outcomes, probability of occurrence and consequences (Udovičić and Kadlec, 2013).

Since the significance of risk varies in relation to different situations as well as in relation to human perception, it is best to review a few key definitions in chronological order:

1. Risk is the measure of probability and the severity of the unwanted consequences (Lawrence,1976).
2. Risk is a situation or event where something of human value (including humans) is questioned and the outcome is uncertain(Rosa,1998).
3. Risk is a combination of probability and scale of consequences (Risk Management Vocabulary,ISO2002).
4. The risk is equal to the expected damage (Campbell,2005).
5. Risk represents the impact of uncertainty on goals (Leitch, 2010).

All definitions can be categorized into several groups in which risk is expressed through uncertainty and expected values, consequences and uncertainty as well as risk in relation to goals. Risk assessment and identification is carried out in essential situations for the organization, especially when a new risky situation is identified, the degree of known risk changes and when a new understanding of the risky situation arises. Such situations and activities carried out by an organization are to be analyzed because they have a significant impact on the conduction of business and on the quality of all business processes (Regester and Larkin, 1997). Each concept of risk has three elements: perception of whether an adverse event could really happen, the likelihood that it will actually take place and the consequences of this event that might occur. Risk would therefore be a synergy of all three elements together (Drljača and Bešker, 2010). Any identified risk that an organization recognizes as a danger if it is not reduced to the lowerest extent can greatly affect the achievement of the goals envisioned by the organization. Therefore, the risk is a very widespread and frequently mentioned concept and subject of various discussions, considerations and studies, and is an unavoidable part of everyday business life. The concept of risk could be observed in various ways from theoretical discussion itself to practical causal and consequential facts. Causes of the risk are different, from the causes of market competition, natural disasters, recession, to human or financial impacts.

2. Risk management process

Risk management is a continuous process on reducing and managing the risks that has the main goal of preserving the effectiveness of the action. Risk management is one of the main components of effective management of the organization itself. Effective management is always based on the strategy and goals of the company. Depending on the desired goal, potential risks that may be an obstacle are identified. Although the identification process itself is important for the organization's awareness of the dangers that may arise or have already arisen, determining the risks in relation to the goals is necessary to prevent unexpected expense for the organization (https://www.poslovnaucinkovitost.eu/kolumne/poslovanje/1468-kako-biti-ucinkovit-kod-upravlja-rizicima).

Risk management is a complex process, has multiple impacts, sometimes with a chain reaction of events that can lead to new risks, but the procedure of risk management is the same for any form of organization or business. The risk management process requires the discipline of all involved as it is the only possible way to recognize risks and have them under control. Throughout the process, special attention should be paid to avoiding the repetition of the same mistakes (Perhot, 2011). Failure to make the same mistakes can be achieved when the process is clearly defined, carefully monitored, checklists are regularly filled in, periodically meetings where experiences and opinions are exchanged are organised.

Each decision and action that is being carried out within the organization also contains a certain risk, so this mode of management is the central part of strategic decision-making. When it comes to qualitative and quantitative dana, the process involves the evaluation of probabilities of events and possible consequences.

ISO 31000: 2009 standard is fully devoted to risk management. It can be used by any organization, regardless of the size and type of business they are doing. Using the ISO 31000 standard organisations increase the likelihood of achieving goals and improve the ability to recognize business risks in time. The standard covers several units. As a starting point it explaines the norms and gives the framework under which the standard is carried out as well as it gives the very process of risk management. Communication between all units is necessary because they are interrelated (Čupić, 2018).

Each step in the risk management process brings a series of business decisions related to (Buntak et al 2014):

1) Communication and consultation are developed immediately at the very beginning and at an early stage of risk management implementation. Effective internal and external communication in which responsible persons for the introduction of any decision-making and risk management policy maintain ongoing communication with the top management of the organisation, is important. Communication represents the most important step and serves as the best basis for a further risk management process. Communication involves transferring all relevant information fundamental for numerous business decisions that are important for business operations and for further course of risk management and is required at every stage of the process. The context of the organisation takes place both in communication at the internal and external levels. By defining the external context, it is necessary to determine the social and cultural environment, the political situation and the economic situation, on the other hand, by analyzing the internal context the organisation determines the way of leadership and organizational structure, policy and goals of the organisation, the business strategy, and the existing standards under which the organization operates. Taking all factors into account, the organization provides an adequate approach to risk management.

2) Risk assessment includes identification, analysis and risk assessment. At risk assessment and before the identification quantitative or qualitative methods can be used. Some of the tools that organizations can use for risks assessmnet are: Brainstorming, Delphi Method, Checklist, or Primary Hazard Analysis (Sekulić, 2016). Identification of the risk means that the organization must know how to find the causes that have led to the risks. The causes may be discovered inside or outside of the organization, and following the cause, possible consequences can be determined. In this step the organization is doing a comprehensive list of risks that can create positive or negative impact on the entire organization. Identification requires applying of fresh dana because any old or inaccurate one may not contribute to the improvement

but may only offer a greater negative effect. The risk analysis involves measuring the potential size of the loss and its likelihood of occurrence. Certain risks will require greater involvement and effort in accordance to the measurment of the negative effect. Critical risks are those that may result with the bankruptcy and disintegration of the entire organization. Risk assessment consists of a comparison of the analyzed risk with certain criteria. Criteria are determined before risk identification, and if it is concluded that the risk is higher than the acceptable level, it is necessary to take steps to minimize it (Sekulić, 2016).

3) Risk treatment includes a step related to how and what to do with a particular risk, or in other words to detect effective strategies and plans that are needed (Sekulić, 2016). Risk treatment refers to the organization's response to the existing risk, and the options the organization has are: accepting risks to gain greater profit, risk transfer, risk avoidance in a way that a risky activity is stopped and minimizing the risks by bringing thoughtful and correct decision.

4) Monitoring and review includes continuous monitoring of effectiveness across the entire risk management process. Due to the need for constant improvement, it is important to monitor every decision. This last step is also important because of the change between internal and external factors as well as the speed of identifying new potential risks. All activities that have been carried out in risk management process must be documented. These documents provide the main tool for further development of the process itself and the detection of possible mistakes within it.

3. Risk identification when using the external service supplier

A specially vulnerable time when the risk management process if of the great importance is the moment when an organization decides to use an external service supplier for performing some of its activities.

The organization has a task to manage the multiple risks that may arise during the agreed co-operation with an external supplier to prevent serious damage that may arise both to the quality of products and services as well as to the entire organization. When outsourcing services are used, the organization transfers the performance of the activity from the internal format to the external supplier, but does not convey the responsibility. The responsibility of the service is on the provider- the the executor of that service or external associate as well. Therefore, if a failure in this agreed co-operation occures, the organization must be able to accept it as soon as possible and solve the detected problem as soon as possible.

Hall (2003) argues that a large number of outsourcing contracts fail because companies themselves run the risk of failing to carry out appropriate analyzes that could show how insourcing will be more productive than outsourcing or vice versa. Case studies have shown that outsourcing carries a different risk set. Once a company makes a decision about switching internal activities to an external supplier, every step in the process needs to be analyzed and planned in detail. Improper and inadequate relinquishment of part of the business to an external co-worker can lead to a number of different problems in the process itself, so it is necessary to foresee as much the risks but as well solutions for negative impacts that may occur. The process of switching business activities is a long-lasting and complex task and its effects are long-term (Čabarkapa-Nedović and Šibalić, 2010).

When applying outsourcing or using an external service supplier, a company may encounter a variety of risks at each stage or step. What is certainly important is to clearly distinguish those risks that pose a direct threat to the company and should be removed as soon as possible. Here are some

of the risks that companies may encounter in the process of transferring activities to external supplier according to the known theory: the risk of product or service quality reductions, the risk of productivity decrease, employee change and quality of service delivery, outsourcing activities that should not be outsourced, the choice of the wrong service provider, negotiating a bad contract, inadequate management of human resources, loss of control over activities, neglect of hidden costs and the failure to plan exit strategy. Different surveys on risk and outsourcing that consisted of companies' views and internal organizational situations have confirmed theoretical risk-taking, and therefore in the practice itself, the main risks include: supplier inability, loss of control over activities and services, loss of flexibility, government problems as well as loss of negotiating power. (https://www2.deloitte.com/insights/us/en/topics/risk-management/global-risk-management-survey.html) Of course, with all these specific risks mentioned, there are general, equal risks for all companies regardless of the type of activity they perform.

Striktesky and Balcar (2017) outlined the specific risks regarding the process of outsourcing, which are explained in more detail below.

3.1. Risk of human resource - employee morale

The use of outsourcing services directly affects employees in the company. Changing the strategy can have a strong and significant psychological impact on employees, as unfortunately in most cases such an impact is negative in terms of reflection, especially if it is a work that has been done internally. According to Delloitte report, 22% of managers stressed out that internal staffing is one of the frequent risk (Landis, 2005). Affected employees in this process become worried about their future in the company, and often worry about possible dismissal. Equally, there are also thoughts on whether this change would mean the need of new training and education to acquire new, different knowledge for carrying out specific activities. They worry about how to attain the expected level at all. Such kind of thinking that occurs with employees exerts a great deal on reducing motivation and dedication to work. If uncertainties are not solved, they can be united and the functioning of the company may be in great risk (Barthelemy, 2003). Employees should understand that making a decision about using an external service supplier is designed to help companies and people who are employed in it (Belcourt, 2006). Therefore, the company should include its employees in the process and planning of the outsourcing itself and take care that all information is available as well as ensure staff to have the ability to submit comments and suggestions. Regardless of making a final decision, that will retain the confidence of employees, and employees will not have constant disagreements that over time can lead to major problems.

3.2. Long-term productivity risk

Using an external service supplier is often associated with the desire for immediate cost savings or quality improvements. Companies wishing to achieve a competitive advantage must constantly develop and invest in the innovativeness of their processes in order to increase productivity. When a company performs "absolute" outsourcing, the control of the activity is transferred from the company to the supplier or from the company's internal activity to the activity of a company executor. The activity performer acts within the boundaries of the contract and in the manner agreed upon. It is considered that the shift of control that a company had so far, and the transfer of responsibility to the supplier company prevents long-term growth of productivity.

The company can take various measures to reduce this risk and the first measure is to start controlling the activity. The company should have an insight and follow every step that the supplier performs. Equally, if possible and in collaboration with the supplier, a company needs to be able to redefine any of the steps to reduce all costs, improve output quality, and achieve greater flexibility. If the company does not work in such a way it will increase the margin of the supplier while the company will not get any extra benefit. The contract should, according to the opinions of the various companies, be realized for a shorter period of time, as this will have a better effect on the part of the supplier. With this approach suppliers are forced to offer different improvements and innovations to ensure the extension of the contract as the company can easily realize a new co-operation with another supplier that bring various offerings and service quality in different segments (Striktesky and Balcar, 2017). On the other hand, the company should take into account the importance of certain unique and difficult to substitute activities that in the same time have a significant impact on the transformation and reorganization of the company.

3.3. Operational and strategic risk

Operational risk refers to the risk of losses due to inadequate procedures and unsuccessful internal processes, human factors, systemic or external events (Chernobai et al., 2012). The company using outsourcing expects and requests from suppliers continuous performance of activities while operational risk represents a situation in which the performance is suspended. In order to minimize the possibility of facing operational risks, the company should apply the appropriate monitoring to note warning signs and include sanctions in the contract. The supplier with a reputation, a successful report and a well-positioned on market reduces the likelihood of operational risks. The company should take measures to mitigate the impact of operational risk, and to have the exit strategy plan, as well as to include default in suppliers performance in the crisis management plan. (Stritticky and Balcar,2017)

Successful outsourcing process depends on co-operation between both parties and emphasizes the involvement and sharing of information. Selected supplier should be provided with the sufficient number and amount of information needed to enable the successfull performance of activity. Some internal processes simply need to be available to the supplier but providing excessive information and knowledge is also not recommended. Possible risk may occure dealing within the industry with a great competition. In such environment the supplier can share the new knowledge and experience with the direct competitors of a company. In order to minimize the strategic risk, it is necessary to carefully select the supplier and to identify the information that is really needed to be shared. Again, the key is in a well-defined contract that would not leave possibility of violations. In case it does, it is essential to clarify the sanctions that would follow.

3.4. Reputational risk

When deciding to use an outsourcer service the company may also face a risk of reduction of reputation. The environment can accuse the company as incompetent for outsourcing certain activities. Therefore, both internal and external stakeholders need to have the information that will explain this decision and that it is not a sign of weakness or ignorance but is one of the strategic options and means of improvement and further progress. The company in this situation should clearly point out which benefits come from outsourcing as for example lower prices or shorter delivery times. When it comes to reputational risk, it is also important to mention the reputation of

the external supplier company. In case the company has chosen a poor-quality supplier that has no secured quality of the product or service and has such reputation, it can be a very significant risk. In today's modern companies that face a large number of competitors reputation and good voice mean a lot to the quality of the business itself and it is extremely difficult to achieve. The reputational risk also comes from a supplier in a situation when a reputable damage is caused to the company of the supplier and then is transmitted to the company that is outsourcing the activities. The best way for reputational risk control is defining careful set out the criteria for assessing, choosen by the supplier itself. Along with risk safety this will build mutual trust and communication.

4. Conclusion

Using an external service supplier can be one of the very good strategic options an organisation can apply for part of its activities. This strategy will be successful if the company continually and carefully takes care of all the risks that may arise. Any of the above-described risks may have a significant negative impact on the entire enterprise and its organizational structure. It would be desirable for each company to have a separate risk management department because conscious and conscientious management greatly reduces the ability of facing unexpected problems. Risk management demands forming a team with a leader and a group of specific experts. The team participates in the process of overviewing possible problems, and it deals with anticipating possible negative events for the organisation in the future. The quality of overall results depend on the risk identification and on the decision of the needed counterpoints. Iti s not possible to pick out one risk among of all the risks that are described, to be the greatest threat to the company, or one that would have the most negative impact on the company. Any risk is equally important and as so demands careful, access and management.

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Ana Globočnik Žunac
Sveučilište Sjever,
Koprivnica,
Hrvatska
agzunac@unin.hr

Vlatka Kordoš
Sveučilište Sjever,
Koprivnica,
Hrvatska
vlkordos@unin.hr

Sanja Zlatić
Sveučilište Sjever,
Koprivnica,
Hrvatska
sanja.zlatic@unin.hr