International Journal for Innovative Engineering and Management Research
PEER REVIEWED OPEN ACCESS INTERNATIONAL JOURNAL
www.ijiemr.org

IMPACT OF OUTSOURCING ON INDIAN EMPLOYEES AND COMPANIES – A SURVEY PAPER

V. SUJITHA
Assistant Professor, Department of M.B.A,Siddhartha Institute of Technology and Sciences, Narapally, Hyderabad, Telangana, India

Outsourcing

The concept of outsourcing came from the American terminology "outside resourcing", meaning to get resources from the outside. The term was used later in economics to signal the use of external sources to develop the business, which were typically using their internal resources[1]. Today, outsourcing is a common practice in both public and private enterprises. Earlier outsourcing was usually carried out for organization's non-core activities to save money but now outsourcing is omnipresent. Firms are outsourcing a wide range of activities ranging from research and development to marketing, from production to assembly, distribution to after sales service. Today, even activities like security and public relations are outsourced. Organizations may expect to achieve many different benefits through successful outsourcing, although there are risks that may be realized if outsourcing is not successful.

Predominantly, there are two kind of outsourcing:

1) ***With manpower*** – where the service provider's employees work inside the premises of the organization. For example, company X has outsourced its security department to company ABC, and then ABC's employees operate at the location of company X.

2) ***Without manpower*** – the service provider's employees do not work inside the organization premises. For example, if company X is an electronics company and has outsourced the after sales services of its products then the service provider's employee's work not at the parent organization's location but provides services at the customer's location.

Why Outsourcing?

- **Save Costs:** Reducing cost remains the top reason that organizations decide to outsource. As per various surveys, most of the companies cite costs as the top reason for outsourcing. Cost aspect of outsourcing involves various kinds of costs like fixed and variable. The lower costs are mainly due to specialization and economies of scale. At outsourcing, the fixed costs are translated to variable costs, which are totally dependent on the quantity of provided activities but

there is an increase in transaction costs with the loss of control and the increased

information asymmetry.If we specifically look at outsourcing in terms of Labour, hiring contract Labour can result in cost savings over hiring full time employees. Because the workers are not full-time, companies save on costs associated with well-defined benefits and as governed by Labour Laws and Labour – union contracts like health insurance or pension plans.

- **Better Quality**: Due to specialization being offered by the outsourced companies, there is a better quality and hence higher customer retention. The combination of creative programmes, informed and talented agents and timely execution can lead to dramatic increases in customer retention rates.
- **Increased Effectiveness**: Companies by outsourcing non-core activities can focus their resources on the management of the core activities leading to enhanced organization effectiveness. The second most cited reason for outsourcing is to allow the organization to better focus on its core competencies. Because of intense competition, organizations are forced to reassess and redirect their scarce resources to the core competencies.
- **Access to world class experts**: Outsourcing to specialized companies gives organization access to world class experts and the latest technologies for specialized projects and it may enable an organization to be a world-class performer for a whole suite of products and services where it could only be an average performer by itself.
- **Increased flexibility**: Organizations operate in a dynamic and competitive environment and hence need to react quicker

to customer requirements and outsourcing is seen as a vehicle to accomplish this. By outsourcing business functions to external service providers, the organizations don't need to maintain fixed assets and invest on infrastructure. This gives the organization flexibility to meet changing business needs and respond to the dynamic environment. Also, there is a risk sharing with the suppliers and at the same time the organizations get access to suppliers' expertise. A kind of virtual organization is formed where the principal employer outsource its activities to multiple contractors that have a wide base of agents across the world enables a company to quickly scale up or down based on customer demand.

Laws related to outsourcing

Outsourcing, as already discussed, is of two types: Outsourcing with manpower, and outsourcing without manpower.

Outsourcing without manpower

When outsourcing is done without manpower, it is essentially a contract between two parties and only the Indian Contract Act, 1872 (hereinafter referred to as the ICA) becomes applicable. Both the parties are bound by the ICA and the terms of the contract are regulated by ICA only.

Outsourcing with manpower

Outsourcing with manpower is also essentially a contract between two parties and hence ICA becomes applicable. Once the contract is made the agency sends its employees to the premises of Company and

agreed activities are carried on. Therefore the Contract Labour (Regulation and Abolition) Act, 1970 (hereinafter referred to as CLRA) also becomes applicable, provided that twenty or more workmen (in case of PSUs) are employed as Contract Labour in the establishment.

Categories of Employees

In the present scenario, employees can be broadly categorized into two categories, namely, *On-roll employee* and *Off-role employee*.

On-Roll Employee

On-roll employees are the direct employees of an organization and are on the company's payroll. They usually avail most of the benefits and awards from the company. The On-roll employees can be further classified into the following:

a) Regular/Permanent
b) FTE (fixed Term Employees)
c) PBE (Project Based Employees)

Off-roll Employee

Off-roll employees are the employees who are not in the direct payroll of the employer. They are the employees of a third party with whom the company gets into a contract for service. We mostly find off-role employees in outsourced services like housekeeping, security, maintenance, logistics, canteen,

Outsourcing: The Players involved

In cases of outsourcing with manpower, there are three players, vis-à-vis, Principal Employer, Contractor and Contract Labour. The outsourcing organization is the Principal Employer, the organization providing the service is the Contractor, while the employees of the Contractor working on the premises of the Principal Employer are the Contract Labour.

Even though the Contract Labour works in the premises of the Principal Employer, there is no employer-employee relationship between the two. The Principal Employer does not hire, fire, or control the Contract Labour. Neither is he directly responsible for their health, welfare and wages. Also, there is no employer-employee relationship between the Principal Employer and the Contractor. The relationship between them is only contractual relationship.The only employer-employee relationship that exists is between the contractor and the Contract Labour. However, the Contract Labour does not work in the premises of the contractor. Rather, he works far away from his actual employer and is mostly in the premises of the principle employer who does not owe any direct responsibility to the Contract Labour. Given the situation, among the three players, it is the Contract Labour who may be exploited the most, both by the principal employer as well as the contractor. Therefore the CLRA Act, 1970 is enacted only to regulate the service conditions of Contract Labour. In case of outsourcing without manpower, there are only two players and they are Principal Employer and Contractor and their relationship is only contractual. The Contractor is responsible for the health, welfare and payment of wages of the Contract Labour. It is only when the contractor fails to meet those responsibilities; the Principal Employer comes to the picture and becomes liable.

However, the Principal Employer, as per section 20 and 21 of CLRA, can recover the costs incurred for meeting such liability from the Contractor.

CLRA Act in a Nutshell

The object of the Act is to prevent exploitation of Contract Labour and also to introduce better conditions of work. Contract Labour is one of the several terms which are widely used to describe work arrangements which do not fall within the traditional understanding or definition of employment. Contract Labour is indirect employees and differs from direct Labour in terms of employment relationship with the establishment and method of wage payment. Different companies give different name to Contract Labour as off-roll employees, third party employee, agency employee, service providers' employees and many more. These terms are being used throughout the world but because of the variations in national law and practice, there is no internationally agreed definition of these terms.The CLRA Act contains 35 provisions and is divided into seven chapters. The Central Act, as its preamble of the Act reads as follows:

An Act to regulate the employment of Contract Labour in certain establishments and to provide for its abolition in certain circumstances and for matters connected therewith.

Chapter I deal with Preliminary which runs only two sections. This Chapter provides its application and define different concept like Principal Employer, Contractor, Contract Labour, Establishment etc.

Chapter II deals with the Advisory Boards empowering the Appropriate Government to constitute the advisory boards to advise it with regard to matters arising out of the administration of the Act. The Chapter deals with the Central and State Advisory Boards and their composition.

Chapter III deals with registration of establishments employing Contract Labour.

Chapter IV deals with licensing of contractors. Chapter III and IV brings out a question that if the principal employer does not get certificate of registration under Section 7 and/or the contractor does not obtain a license under Section 12 of the Act, the establishment or the contractor can not engage the Contract Labour as the case may be. The consequence of non compliance of Section 7 or Section 12 would lead to an offence punishable under the Act. The Supreme Court in *Dena Nath v. National Fertilisers Ltd*[2] rightly observed that the only consequence where the principal employer or the contractor violates the provision of the Act is the penal provision and they would be guilty of criminal offence punishable under Section 23 or Section 24 of the Act.

Chapter V deals with the welfare and health of the Contract Labour. Section 20 casts a liability on the principal employer to provide the amenities for the benefit of Contract Labour employed in his establishment if the contractor fails to provide these amenities. Chapter VI provides for penalty for a person who contravenes any of the Act or the

Rules. Chapter VII deals with the miscellaneous matters.

The most powerful section of the Act is Section 10 which prohibits the employment of Contract Labour and reads as follows:

Section 10: Prohibition of employment of contract labour

(1) Notwithstanding anything contained in this Act, the appropriate Government may, after consultation with the Central Board or, as the case may be, a State Board, prohibit, by notification in the Official Gazette, employment of contract labour in any process, operation or other work in any establishment.

(2) Before issuing any notification under sub- section (1) in relation to an establishment, the appropriate Government shall have regard to the conditions of work and benefits provided for the Contract Labour in that establishment and other relevant factors, such as--

(a) Whether the process, operation or other work is incidental to, or necessary for the industry, trade, business, manufacture or occupation that is carried on in the establishment:

(b) whether it is of perennial nature, that is to say, it is of sufficient duration having regard to the nature of industry, trade, business, manufacture or occupation carried on in that establishment;

(c) Whether it is done ordinarily through regular workmen in that establishment or an establishment similar thereto;

(d) Whether it is sufficient to employ considerable number of whole- time workmen.

Explanation-- If a question arises whether any process or operation or other work is of perennial nature, the decision of the appropriate government thereon shall be final.

In view of the provisions in Section 10, it is only the appropriate government which has the authority to abolish the system of Contract Labour in accordance with the provisions of the said section.

Supreme Court in *Air India Statutory Corporation v. United Labour Union*[3] held that on abolition or prohibition of Contract Labour under Section 10, the workers engaged through the contractor will automatically become the employees of the principal employer

Steel Authority of India Ltd v. National Union, Waterfront Workers[4] overruled the Air India case prospectively on the abolition or prohibition of Contract Labour under Section 10. It adopted a literal construction of the statute basing that legislature means what they expressed. The Court observed that neither Section 10 nor any other provision in the Act, whether expressly or by necessary implication, provides for automatic absorption of Contract Labour on issuing notification by the appropriate government, under sub-section (1) of Section 10, prohibiting employment of Contract Labour.

4

In *Steel Authority of India Ltd* v. *Union of India*[5], popularly known as SAIL II case, the Supreme Court held that the abolition of Contract Labour is within the exclusive domain of the appropriate government.

Sham and Camouflage

As already discussed, even if there is an abolition of Contract Labour under Section 10 of CLRA, it does not result in automatic absorption of the Contract Labour as the employees of the principal employer. They are still not the employees of the principal employer.However, there is a scenario where Contract Labour would be declared as the employees of principle employer if the case falls within the ambit of sham & camouflage. The Supreme Court has categorically discussed the different situations when it can be considered as sham & camouflage.We can discuss the issue in detail in the light of some landmark Supreme Court Cases

SAIL 2001 (SAIL I) Case

The Constitution Bench of the Supreme Court had made it clear that neither Section 10 nor any other provision in CLRA provides for automatic absorption of Contract Labour on issuing a notification by the appropriate government under Section 10 of the CLRA and consequently the principal employer cannot be required to absorb Contract Labour working in the establishmentThe Court further held that on a prohibition notification being issued under section 10(1) of CLRA, prohibiting employment of Contract Labour in any process, operation or other work, if an industrial dispute is raised by any Contract Labour in regard to conditions of service, the industrial adjudicator will have to consider whether the contractor has been interposed either on the ground of having undertaken to produce any given result for the establishment or for supply of Contract Labour for work of the establishment under a genuine contract or is a mere ruse to evade compliance with various beneficial legislations so as to deprive the workers of statutory benefits. If the contract is found to be sham, then the so called Contract Labour will have to be treated as direct employees of the principal employer and the industrial adjudicator should direct the principal employer to regularize their services in the establishment subject to such conditions as it may specify for that purpose.On the other hand, if the contract is found to be genuine and at the same time there is a prohibition notification in respect of the establishment, the principal employer intending to employ regular workmen for the process, operation or other work of the establishment in regard to which the prohibition notification has been issued, it shall give preference to the erstwhile Contract Labour if otherwise found suitable, if necessary by giving relaxation of age.However, the Supreme Court, in this case, did not deal specifically with the legal position regarding a dispute which is brought before the Industrial adjudicator regarding whether the Contract Labour agreement is sham, when there is no prohibition notification under Section 10 of the CLRA.

International Airport Authority Case: [6]

In this case, the Supreme Court further held that where there is no abolition of Contract Labour under Section 10 of the CLRA, but the Contract Labour contends that the contract between principal employer and the contractor is a sham and nominal, the remedy is purely under the Industrial Disputes Act. The industrial adjudicator can grant the relief sought if it finds that contract between the principal employer and the contractor is sham, nominal and merely a

camouflage to deny employment benefits to the employees and that there is in fact a direct employment.

Gujarat Electricity Board Case:[7]

The principles laid down in this case still governs the issue related to sham and camouflage contract. It reiterates that where there is no abolition of Contract Labour under Section 10 of CLRA, but the Contract Labour contends that the contract between principal employer and the contractor is a sham, the remedy is purely under the Industrial Disputes Act. The remedy of the workmen is to approach the industrial adjudicator for an adjudication of their dispute that they are the direct employees of the principal employer and the agreement is a sham, nominal and merely a camouflage to deny employment benefits to the employees and there is in fact a direct employment. The Supreme Court evolved the following tests which are only illustrative to know whether the contract made between the principal employer and contractor is sham & camouflage and they are as follows:

a) Who pays the salary;

b) Who has the power to remove/dismiss from service or initiate disciplinary action;

c) Who can tell the employee the way in which the work should be done, in short who has direction and control over the employee.

It is submitted therefore that if any time the principal employer creates and intends to create the employer and employee relationship the Contract Labour would be declared as the employees of principal

employer. However, where it cannot be proved that the contract was a sham, and there is no notification under section 10 of the CLRA, then the question of directing the principal employer to absorb or regularize the services of the contract labour does not arise. The tests that are applied to find out whether a person is an employee or an independent contractor may not automatically apply in finding out whether the contract labour agreement is a sham, nominal and is merely a camouflage. For example, if the contract is for supply of labour, necessarily the labour supplied by the contractor will work under the directions, supervision and control of the principal employer but that would not make the contract labour a direct employee of the principal employer, if the salary is paid by the contractor, if the right to regulate the employment is with the contractor, and the ultimate supervision and control lies with the contractor. The principal employer only controls and directs the work to be done by a

contract labour, when such labour is assigned/allotted/sent to him. But it is the contractor as employer, who chooses whether the worker is to be assigned /allotted to the principal employer or used otherwise.

Employer-Employee Relationship— a concluding remark

It is interesting to note that he Contract Labour, who carries out the activities in the premises of the Principal Employer, is not the 'employees' of the Principal Employer. The Principal Employer does not hire, fire, supervise or control the Contract Labour. Neither he is directly responsible for their

health, welfare and wages. As long as the contract between the principal employer and the contractor is not a sham or camouflage, no employer employee relationship exists between the principal employer and the contract labours. Thus, we can say that there is no direct relationship between Principal Employer and Contract Labour. Considering the law of the country in relation to *"outsourcing with manpower"* one can reach to the conclusion that Outsourcing in India – A myth of employer and employee relationship.