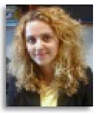

Outsourcing: Making More by Doing Less?

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One of the fundamental research questions in the field of strategy revolves around whether to organize activities internally (within the firm) or externally (using the market). That's the key concept of Outsourcing which refers to the 'External acquisition of activities, including those traditionally considered an integral part of the firm, provided that they do not form part of the firm's core capabilities.' (Quinn & Hilmer 1994) According to the above definition, firms must focus on the competencies they perform best towards their competitors and outsource non-core capabilities, which means those activities that the firm has not competitive advantage and that are not closely related to the core business. (Prahalad and Hamel, 1990)

In addition to this definition of outsourcing many authors also describe a various outsourcing arrangements or options. For instance, Lacity and Hirschheim (1993) offer a taxonomy of sourcing decision options:

- Total Outsourcing which means the decision to transfer a whole business process to a single third party vendor,
- Total Insourcing - the decision to retain internally the activities after evaluating the outsourcing options, and
- Selective Outsourcing which refers to the decision to source selected functions from a business process (e.g. IT department) from external provider(s).

Furthermore, to make the right outsourcing decision companies should acquire detailed information on a number of factors related to the vendor selected. Firms have the option to source an activity from a vendor which is located near the firm (near source) or offshore. In the case of off sourcing the firm should evaluate not only the vendor's internal characteristics but also the characteristics of the environment they operate, such as costs (labor, infrastructure), availability of skills (skill pool, size of offshore sector), environment (government support, business environment, and accessibility). (Farrell 2006)

The practice of outsourcing is spreading throughout a variety of different functional areas of the organization. Firms tend to outsource an expanding variety of activities in their attempt to improve service, quality, performance and cost savings to costumers and finally enhance their competitiveness. These activities include Information Technology (IT) (Loh and Venkatraman, 1992; Lacity and Willcocks, 1998), Human Resources (HR) (Gilley et al., 2004), Logistics, Engineering (Quinn, 2000), Manufacturing (Dekkers, 2000), Finance (Widener and Selto, 1999), Call centers and R&D.

Outsourcing consists of four major elements (Arnold, 2000): the outsourcing subject which is the economic institution which plans to outsource (or not), the outsourcing objects are the processes which might be outsourced, the outsourcing partners are all possible vendors for the activities considered for outsourcing and the outsourcing design which refers to the different governance structures that the firm can adopt (Figure 1).

Figure 1: Adapted from Arnold (2000): The elements of Outsourcing

The above concepts can be seen as the elements that constitute the process of outsourcing which has to be a strategic decision that forms part of the firm's strategy. For such governance decisions, two main theories distinguish: Transaction Cost Economies (TCE) and the Resource Base View (RBV) of the firm.

Transaction costs refer to the effort, time and costs incurred in searching, creating, negotiating, monitoring and enforcing a service contract between buyers and suppliers. (Mahoney, 1992) The archetypal problem in TCE is the vertical integration or the make-or-buy decision and the focus of transaction cost economizing in this context is on mitigation of 'hold-up' problems associated with investments in specific assets. TCE has come to dominate the literature dealing with outsourcing decisions and it has received great empirical support. (Poppo and Zenger 1998; Ang and Straub, 1998) As Kim and Miranda (2006) proposed transaction costs are constituted by two situational conditions and two conditions of human frailty or beliefs about human behaviour. The situational conditions are asset specificity and uncertainty while human frailty refers to opportunism and bounded rationality.

Although contracting hazards have been shown to play a key role in governance, they are not the only factors that stand to influence such decisions. Firms' capabilities can also play a role. Consequently, according to the Resource Base View (RBV), firm specific capabilities are critical to a firm's success. The RBV provides an approach that regards the firm as set of resources and capabilities that are treated as the strengths that must be supported and should guide the firm's strategy (Grant 1991). Regarding to outsourcing the firm has to decide between developing resources internally or acquiring them externally.

Mayer and Salomon (2006) argue that the Resource base view can complement the TCE approach to governance and in their research paper they combine insights from both approaches to explain the firm's decision to outsource. Furthermore, Dyer and Singh (1998) propose that 'relational rents' are created when 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 outsource only if the vendor-client relationship offers relational rents generated through inter-firm exchange or sharing of knowledge, capabilities, and assets.

Finally, outsourcing stems from the firm's effort to reinforce its position taking advantage from the unique resources that the market can provide. The main advantages from this strategic decision are improved financial performance relatively to vertically integrated firms and heightened focus on core competencies. However, there exist several disadvantages to adopting outsourcing strategies. These include becoming dependent on outside suppliers for products or services which can be unfavorable for the firm if the supplier acts opportunistically and the threat of high transaction costs especially in cases that there's a need for highly specific contracts.

Conclusions

As the pace of outsourcing has continued to accelerate, so too has interest in the topic on the part of researchers and practitioners. Despite this increasing interest, there remains a great deal of uncertainty surrounding the outsourcing phenomenon and much more research needs to be done in order to set up and operationalize a descriptive model of the vendor-client relation.

Concluding is outsourcing a practice which can be described by the phrase 'Making More by Doing Less'? Attempting to answer, we result that it surely is a strategic decision and must be driven by strategic considerations and not by the motivation for short-term cost savings. In such situations it can be a useful tool for firms and it can enhance firms performance. From the other hand organizations should consider carefully before outsourcing their activities and they must have a clear idea of what they are getting into when outsourcing their activities and should decide on monitoring, reporting and measuring processes in order to avoid negative results.

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