What is the right outsourcing strategy for your process?

In particular, the ramekin provides a mechanism for understanding, which processes should be kept internal and which should be outsourced based on both organizational capability and opportunism considerations. The logic of the framework and the sourcing strategies is illustrated through providing real case examples from organizations that participated in the research. Introduction The trend towards outsourcing both locally and offshore has been increasing dramatically throughout the developed economies of the world.

The drive for greater efficiencies and cost reductions has forced many organizations to increasingly piecewise in a limited number of key areas. Outsourcing is increasingly being employed to achieve performance improvements across the entire business. Leading firms have been adopting more sophisticated outsourcing strategies and have been outsourcing core processes such as design, engineering, manufacturing, and marketing. These organizations have been benefiting greatly from accessing the specialist capabilities of suppliers in a range of business processes (Aaron and Sings, 2005).

Many specialist suppliers can develop a greater depth of knowledge, * Tell. : +44 28 71375275; fax: +44 28 71375323. E-mail address: r. Microcomputer. AC. UK invest more in systems and processes, and achieve efficiencies through economies of scale and experience. Leveraging the capabilities of more capable suppliers allows organizations to outsource more critical business processes and enhance their own internal core capabilities that drive competitive advantage. However, many organizations are Tattling to acceptable on ten opportunities trotter Day outsourcing.

Many organizations continue to make outsourcing decisions on a piecemeal basis and fail to develop outsourcing strategies for their processes that allow them to moment in the global economy (Cottonseeds et al. , 2005). In many cases, the choice of which parts of the business to outsource is based on ascertaining what will save most on overhead costs, rather than how the decision impacts upon the long-term capabilities of the organization. In some instances, organizations are outsourcing processes that are critical to competitive advantage and over time are relinquishing important knowledge sets and capabilities. 263-2373/$ – see front matter ? 2007 Elsevier Ltd. All rights reserved. DOI: 10. 1016/ j. Meg. 2007. 08. 008 What is the right outsourcing strategy for your process? Two influential theories in the study of outsourcing have been transaction cost economics (ETC) and the resource's view (ORB) of the firm. Transaction cost economics specifies the conditions under which an organization should manage an economic exchange internally within its boundaries I. E. Hierarchies and the conditions suitable for managing an economic exchange externally I. . Markets (Williamson, 1975, 1985). Hierarchies involve performing processes inside the firm, using management authority to make and execute decisions. Markets involve relatively short-term, arraigning relationships between independent buyers and suppliers. The needs of the buyer are non-specific, which enables the supply market to achieve economies of scale. According to transaction cost economics, a company will make the outsourcing decision on the basis of reducing production and transaction costs.

Production costs refer to the direct costs involved in creating the product or service and include labor and infrastructure costs. Transaction costs include the costs of selecting suppliers, negotiating prices, writing contracts, monitoring performance, as well as the potential for opportunism from suppliers. The potential for opportunism increases if investments have to be made which are specific to a particular relationship. ETC argues that organizations should employ hierarchical governance or employ a governance structure that uses less specialized investments in order to reduce the potential for opportunism.

Another prominent theory employed in the outsourcing decision is the resource-based view which views the firm as a bundle of assets and resources that if employed in distinctive ways can create competitive advantage (Peter, 1993; Barney, 1991). A major concern of the resource-based view s how an organization’s capabilities develop and affect its competitive position and performance. Proponents of the resource-based view argue that heterogeneity in an organization’s knowledge-based resources and capabilities explain differences in performance and the sustainability of a competitive advantage (Tech et al. 1997). Therefore, the outsourcing decision is influenced by the ability of an organization to invest in developing a capability and sustaining a superior performance position in the capability relative to competitors. Processes in which the organization lacks the accessory resources or capabilities internally can be outsourced. Organizations can access complementary capabilities from external providers where they can gain no advantage Trot performing sun processes Internally.

BE Ana I CT are focusing on two different issues (1) the search for competitive advantage and (2) the most efficient governance structure, organizations have to deal with these two important issues when making outsourcing decisions. Practitioners have to assess their capabilities across a range of business areas as they are increasingly being confronted with constraints on resources. This meaner that they have to priorities source allocation in certain key business areas where they possess strengths and outsource less critical areas.

Indeed, the trend towards specialization in many product and service markets has opened up opportunities for further outsourcing as specialist suppliers chase demand through offering a wider range of capabilities in more critical business areas. Furthermore, organizations perceive outsourcing as a meaner of achieving performance improvements in many areas of the business. Specialist suppliers are expected to deliver costs efficiencies whilst at the 25 same offer a higher level of value. However, the potential for performance improvement has to be balanced against the potential for opportunism in the supply market.

Organizations have to consider factors that influence the potential for opportunism such as the level of specific investments with the supplier, performance measurement difficulties, and the inclusion of contractual safeguards to allow for uncertainty and changes in requirements. Possessing an understanding of these factors also allows an organization to adopt a relationship strategy, which reduces the risks of outsourcing whilst at the same time leverage the specialist capabilities of appliers.

Outsourcing frameworks in the literature There are a number of frameworks in the literature offering guidelines and prescriptions on the outsourcing decision. Early approaches in this area tended to focus on outsourcing in a manufacturing context – the classic make-or-buy decision (Scullion, 1956; Higgins, 1955). These approaches were principally concerned with applying quantitative models to evaluate the decision. Transaction cost economics has been extremely influential on outsourcing frameworks proposed in the literature (Pining and Clobbering, 1999; Magenta and Bryon, 1999).

Proponents of approaches influenced by the transaction cost perspective argue that the optimal sourcing option will be chosen on the basis of transaction cost minimization. Pining and Salesman's (1999) framework focuses on how an organization assesses ex ante the potential transaction costs that arise in outsourcing and how and in what circumstances transaction costs can be reduced. Pining and Salesman's (1999) framework focuses on how an organization assesses ex ante the potential transaction costs that arise in outsourcing and how and in what circumstances transaction costs an be reduced.

Some have challenged the predominance of cost considerations in the outsourcing decision with scant attention being given to how the decision impacts the overall business strategy of the organization (Baden-Fuller et al. , 2000). Consequently, a number of frameworks proposed in the literature have focused on the strategic implications of the outsourcing decision (Roy and Auber, 2002; Innings and Were, 2000; Quinn, 1999; Eventuates, 1992). Many of these outsourcing approaches nave Eden Innocence Day ten principles escalated Walt n ten resource- based view.

For example, Eventuates (1992) describes the approach adopted at the US engine manufacturer – Cummins Engine, which introduces the ideas of integrating product differentiation, an analysis of component families and manufacturing capabilities into deciding whether processes should be outsourced. The core competence approach – which has evolved from the ORB – has been extremely influential in distinguishing between processes that should be kept in-house and outsourced.

Quinn (1999) has argued that effective outsourcing for an organization involves concentrating on a set of core competencies where it can achieve pre- eminence and outsourcing other processes which are neither critical nor the company has a distinctive capability. Although many of the frameworks discussed have made a valuable contribution to the study of outsourcing, they tend to be derived from a single theoretical standpoint, which 26 limits their predictive power.

One approach in the literature that considers ETC and the ORB in outsourcing decision making is Cox's relational competence framework (Cox, 1996). However, this approach is largely conceptual and fails to sufficiently integrate each theoretical standpoint into explaining the complexities of outsourcing. Although the approach links capabilities and asset specificity into outsourcing, explicit recommendations are not provided on how the principles associated with the ORB can be integrated into the analysis.

The main gap in the frameworks discussed is the lack of a structured approach to outsourcing, which is clearly underpinned by antecedents of both ETC and the ORB of the firm. This is an important limitation in the existing literature, as evidence suggests that outsourcing in practice is increasingly considering both capabilities and transaction costs (Holcomb and Hit, 2007; Micro, 2005). Indeed, some authors have found both ability considerations and factors such as asset specificity and the threat of opportunism are present in outsourcing practice (McNally and Griffin, 2004; Micro, 2007).

R. Micro directors, senior managers, and managers from a range of business functions. As well as illustrating the practical implications of the outsourcing framework, these case studies illustrate the presence of ETC and the ORB considerations in practice. These findings also emphasis the need to consider both theoretical perspectives in order to understand the outsourcing decision. In the final section, management implications are presented.

An overview of the outsourcing methodology The principal proposition of this paper is that implementing a successful outsourcing strategy for a process must involve an analysis of a number of dimensions including relative capability in the process, contribution of the process to competitive advantage and the potential for opportunism from outsourcing the process. Analyzing each of these dimensions will provide an organization with a number of sourcing strategies. The relationship between each of these dimensions and these sourcing strategies is shown on the matrix in Figure 1 .

The importance of considering nose Loneness In outsourcing echelons Is now alehouses Research approach This paper presents a framework developed from integrating ETC and the ORB and through in-depth case study analysis of outsourcing strategies in real industry situations. The development of this framework evolved from a research project concerned with analyzing both theoretical and practical influences on outsourcing in a range of organizations that have been involved in extensive outsourcing. The objective of this work has been to develop a practical methodology for application in a range of service and manufacturing settings.

This work is based on a case study approach. The initial phase of the research involved analyzing the literature on ETC and the ORB in the area of outsourcing decision-making. Exploratory research was then carried out, using interviews with practitioners and analyses of documentary evidence, in order to understand how organizations approached outsourcing. Furthermore, this phase of the research examined the presence of ETC and ORB variables in outsourcing decision making. This facilitated the development of an initial outsourcing methodology, which was based on both theory and practice.

The initial methodology was then applied through conducting workshops with a number of organizations, which allowed further refinements to be made to the initial methodology. Finally, in-depth case study analysis was carried out with a number of organizations in order to further refine the outsourcing methodology. In adopting this approach the recommendations of Eisenhower (1989) for in-depth case study research were followed. The following section provides an overview of the outsourcing methodology. The next section then outlines the implications of each of the sourcing strategies.

Throughout this section the implications of the sourcing strategies are illustrated by providing real case study experiences of companies that participated in the research. The case studies are illustrations of successful outsourcing strategies from the case companies and validate the outsourcing strategies proposed in the framework. These case studies were developed from interviews with personnel involved at each stage of the outsourcing process within the companies including Relative capability position in the process A key issue in competitive strategy involves understanding why one firm differs in reference from another.

Some firms gain advantage over others because they can conduct certain organizational processes in a superior manner relative to their competitors. Furthermore, the superior performance in the process is considered sustainable where it is extremely difficult for competitors to replicate within a realistic timeshare or cost (Barney, 1991). In evaluating the suitability of processes for outsourcing, determining whether the organization performs certain processes relative to competitors, and indeed suppliers, is a key issue.

Therefore, this analysis is unconcerned with identifying the disparity between the sourcing organization and potential external providers of the processes under scrutiny. It allows an organization to focus on whether it will be detrimental to its competitive position to outsource certain organizational processes. It is also important to determine whether the organization can conclave a sustainable competitive advantage Day performing a critical process internally on an ongoing basis.

Clearly, if the organization can perform such a process uniquely well, then this process should continue to be carried out internally. Part of this analysis involves understanding the sustainability of a superior performance position. In the case of critical processes, such an understanding will have a fundamental influence on the sourcing option chosen due to the implications for the competitive position of the organization. Understanding the source of the advantage will provide a sound indication of the difficulties with attempting to replicate or surpass superior performance levels in the process.

Contribution of the process to competitive advantage This stage is concerned with assessing the contribution of the process to competitive advantage. Determining the QUADRANT ONE Most appropriate when: Relative capability – possible to replicate and advance upon the superior performance position of competitors/suppliers in the process; Contribution to competitive advantage – superior performance in the process has a major impact upon competitive advantage; and Opportunism potential – high potential for opportunism associated with outsourcing. 7 QUADRANT TWO Most appropriate when: Relative capability – sourcing organization possesses a significant performance advantage over competitors/suppliers which is difficult to replicate; Contribution to competitive advantage – superior performance in the recess has a major impact upon competitive advantage; and Opportunism potential – high potential for opportunism associated with outsourcing the process.

Most appropriate when: Relative capability – not possible to replicate the superior performance position of competitors/ suppliers in the process; Contribution to competitive advantage – process likely to diminish in importance in the future; and Opportunism potential – possible to manage the potential for opportunism associated with outsourcing by adopting an appropriate relationship strategy. Critical to Competitive Advantage INVEST TO PERFORM INTERN ALLY

Most appropriate when: Relative capability – not possible to sustain superior performance position in the process; Contribution to competitive advantage – process likely to diminish in importance in the future; and Opportunism potential – possible to manage the potential for opportunism by adopting an appropriate relationship strategy. Contribution to Competitive Advantage Not Critical to Competitive Advantage QUADRANT THREE performance position of competitors/suppliers in the process; Contribution to competitive advantage – process not a source of competitive advantage; and

Opportunism potential – possible to manage the potential for opportunism by adopting an appropriate relationship strategy Most appropriate when: Less Capable More Capable Relative Capability Position Relative capability – sourcing organization possesses a performance advantage over competitors/ suppliers in the process; Contribution to competitive advantage – process not a source of competitive advantage; and Opportunism potential – possible strategy with a supplier or spinning it off as a separate business. Significant performance advantage over competitors/ suppliers which is difficult to plicate; Contribution to competitive advantage – process not a source of competitive advantage; and Opportunism potential – outsourcing not possible due to the lack of capable suppliers and spin-off not feasible. Figure 1 The Sourcing Strategies. Contribution AT a process to competitive advantage Is central to ten outsourcing process. Processes that are critical to competitive advantage and in which the organizations possesses a distinctive capability should remain internal and receive a considerable level of strategic attention to maintain such a position.

Processes that re critical to competitive advantage have a major impact upon the ability of an organization to achieve competitive advantage either through the ability to achieve a lower cost position and/or create higher levels of differentiation than competitors. Therefore, superior performance in such a process allows an organization to offer sustained price reductions and/or differentiate the product or service in the eyes of the customer. Processes that are not critical to competitive advantage have a limited impact upon the ability of an organization to achieve competitive advantage.

Although these processes have to be performed well, any performance improvements achieved in such processes are unlikely to be a source of competitive advantage as they are not key differentiators in the eyes of customers when purchasing the product or service. Potential for opportunism This stage involves assessing the potential for opportunism from outsourcing the business process. There are a number of indicators of opportunism potential in outsourcing situ- actions. The presence of investments in physical or human assets dedicated to a particular relationship will create switching costs for the sourcing organization.

This problem is further exacerbated if there are a small number of capable suppliers in he supply market. Such conditions make the sourcing organization prone to opportunism during the contract and at the time of contract renewal. Uncertainty both in the business environment and in the requirements of the sourcing organization may mean that it is not possible to write complete contracts and renegotiation and frequent amendments are required as circumstances change. Complex interdependencies between business processes can also increase the potential for opportunism.

High levels of interdependencies between processes – either internally or with other outsourced processes – increase the need for co- ordination, Joint problem solving and mutual adjustment (Van deer Vega et al. , 1998). The degree to which the process can be codified will also influence the ease of transfer of the process to the supplier. Processes with a high proportion of explicit knowledge are more codified than those with high proportion of tacit knowledge and therefore can be transferred more readily to a supplier (Aaron and Sings, 2005).

Difficulties with measuring the contribution and performance of the supplier can also create problems in the relationship, as the sourcing organization must expend additional resource on monitoring performance. Furthermore, 28 differences in relation to the interpretation of performance can also create difficulties in the relationship. For example, where effective performance measures have not been developed for the outsourced process, it will be difficult to determine whether the supplier has executed the process better than when it was in-house.

I nerve are a under AT strategies Tanat companies can adopt to deal Walt opportunism. Firstly, the high potential for opportunism may lead the sourcing organization to retain the process internally. In certain circumstances, it may not be Seibel to draft a sufficiently robust contract to deal with the potential for opportunism. However, in many circumstances it is possible to deal with the potential for opportunism by adopting an appropriate contracting arrangement.

In an outsourcing situation where there is low level of investment in specific assets and relative certainty in requirements, a short-term contractual arrangement can be adopted. Alternatively, where the requirements of the sourcing organization are highly specific and there is uncertainty surrounding the transaction, a relational contracting arrangement is more appropriate. Relational contracting involves more than a formal contract and includes social mechanisms that promote flexibility, information exchange and Joint problem solving.

Finally, a potential sourcing strategy involves reducing the complexity of the process by re-designing it into a number of more nonspecific processes that can be provided by more than one supplier. This in turn will reduce the level of uncertainty in the transaction. In addition, it is possible that these more standard outsourced processes share some of the transaction characteristics of a short-term market contract. Another potential strategy for educing opportunism is transferring the process to a supplier that the sourcing organization already has a relational contracting arrangement with.

In fact, the outsourcing of such a process may be part of a wider strategy of the sourcing organization further strengthening a relational contracting arrangement with one of its key suppliers. R. Micro advance upon a superior performance position held by one or more of its competitors. There are a number of situations when this option may be desirable: In a case where the technologies associated with the processes are in the early stages f development and offer potential for future growth, investing in this area may be the most appropriate option.

Analysis of the process may reveal that the disparity in performance is in an area such as quality or productivity, which can be addressed through an improvement initiative. An effective benchmarking exercise may assist in determining what actions need to be taken in order to improve performance. The potential for opportunism associated with outsourcing such a process to a supplier may also force the sourcing organization to improve the process and keep it internal.

Exhibit 1 illustrates how a retail bank decided to improve rather than outsource a process due primarily to the potential for opportunism in the service provider market. Exhibit 1 . This case focuses on a retail bank. The bank had been experiencing considerable growth in the area of mortgages, whilst internal systems could not cope with the increasing volume of transactions. The bank investigated the feasibility of outsourcing this area, which involved an analysis of both their existing systems in the area of mortgages and the capabilities of external service providers.

The investigation revealed that the bank had under invested in suitable technology and was managing the increased workload through increasing staff numbers along with the introduction of excessive overtime. Analysis of the service provider market revealed a number of service providers that had a lower cost base and could provide enlarger levels AT service tan ten Dank could tall Internally, primarily tongue achieving greater economies of scale and investing more resource in technology.

An in-depth analysis and benchmarking study of one service provider revealed that it could bring new products to market within six weeks, which was considerably more quickly than the bank could achieve internally. Initially, this seemed an ideal service provider to select as an outsourcing provider. However, analysis of the banks internal processes in mortgages had revealed that there were complex interdependencies in the form of unwieldy reporting structures and process duplications that would prevent the bank from transferring the relevant processes to this service provider.

In particular, the current structures made it extremely difficult to establish clear acquirement and linkages with other internal processes, which would have increased the potential for opportunism in an outsourcing relationship. The bank were also concerned that it did not have volume of business relative to other clients of this service provider, which may have impacted service levels. Therefore, senior management embarked upon a business improvement initiative.

This involved radically redesigning the existing mortgage processing structure internally, which involved separating mortgages into two distinct processes – sales/sanctioning and processing. This involved re-defining current work roles and drawing up key reference indicators to include The sourcing strategies Quadrant one This quadrant includes critical processes where competitors or suppliers are more capable than internally within the sourcing organization.

In this case, the sourcing organization has to consider how performance in this process can be improved. There are a number of potential sourcing strategies for improving performance. Invest to perform internally This option involves investing the necessary resources in order to address the performance disparity in this process. The selection of this option will be influenced by the significance of the disparity in performance. Where the disparity is not significant, there is the potential to invest resources in order to perform the process internally.

Furthermore, the sourcing organization may have to consider this option due to the high potential for opportunism as indicated by the lack of capable suppliers. However, the sourcing organization should ensure that it is in a position to replicate and What is the right outsourcing strategy for your process? productivity rates, quality of work, turnaround times and levels of cross sales achieved. Furthermore, re-designing the mortgages area into sales/sanctioning and processing would enable the bank to outsource the processing element in the future.

Outsource Where the capabilities of the organization lag considerably behind the capabilities of competitors, it may be difficult to Justify a substantial investment of resources in order to match or advance upon external capabilities. This option is likely if it is both difficult and costly for the sourcing organization to replicate a superior performance position. For example, consider an automaker that has previously designed and manufactured the engines for all its models internally.