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Determinants of IS sourcing decisions: A comparative study of transaction cost theory versus the resource-based view

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Abstract

Many organizations have employed the concepts of ‘asset specificity’ and ‘uncertainty’ from transaction cost theory (TCT), and ‘strategic resources’ from the resource-based view (RBV) as drivers of their information systems (ISs) sourcing decisions. They, however, face a dilemma when TCT and the RBV suggest different sourcing alternatives. The study identifies contexts where sourcing decisions made based on these two theories differ, and examines which theory accounts better for an organization’s sourcing decisions. Results show that a high-specificity asset is a major driver of sourcing decisions. It overpowers the effects of uncertainty on sourcing decisions; while a non-strategic resource has no impact on sourcing decisions. In particular, where the two theories make conflicting predictions, organizations should not always outsource non-strategic resources. Non-strategic resources that involve high specificity should be retained internally. The paper concludes with implications for academics and practitioners, and a discussion of future research directions.

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1. Introduction

During the last decade, the e-commerce revolution has forced the transformation of traditional IS outsourcing structures into new IS outsourcing service configurations,

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e.g. Internet service outsourcing, application service outsourcing, and business process outsourcing. The IS outsourcing market worldwide is expected to increase to more than US\$110 billion by 2006 (IDC, 2002). Outsourcing, however, does not always lead to competitive advantages and cost savings (Gerwig, 1999; Lacity and Hirschheim, 1993; Loh and Venkatraman, 1992; Mahoney and Pandian, 1992), and the chances of success in outsourcing are at best 50/50 (Gartner Group, 2002). A wrong sourcing decision results in lost capabilities and exposure to risks that can result in business failure (Loh and Venkatraman, 1992; Ngwenyama and Bryson, 1999). The ultimate drivers of sourcing decisions are not identical in all circumstances (Lacity and Hirschheim, 1993; Nam et al., 1996) further complicating the sourcing decision. Organizations select the drivers of sourcing decisions based on the particular set of circumstances they face.

Two theories that have been used to understand and explain ITS sourcing decisions are transaction cost theory (TCT) (e.g. Ang and Straub, 1998; Aubert et al., 1996; Lacity and Hirschheim, 1995; Lacity et al., 1995) and the resource-based view (RBV) (e.g. Insinga and Werle, 2000; Prahalad and Hamel, 1990; Roy and Aubert, 2001; Teng et al., 1995). TCT posits that organizations insource when the costs of using the market are higher than internal governance costs (Ngwenyama and Bryson, 1999; Williamson, 1979). It builds upon three principal attributes of transactions: asset specificity, frequency, and uncertainty (Williamson, 1985b). The RBV, on the other hand, posits that organizations insource when a resource is strategic so as to enable them to sustain competitive advantage (Barney, 1991; Mahoney and Pandian, 1992). It builds upon four properties of a strategic resource: value, rareness, imperfect imitability, and non-substitutability (Barney, 1991). A question that follows, which has yet to be empirically investigated, is 'Are there contingencies that suggest when organizations should use either TCT or the RBV for their sourcing decisions?'

This study addresses the fundamental question: Which of TCT or the RBV better accounts for an organization's sourcing decision, where the organization deems that it has made an effective decision? The study develops a framework to identify circumstances where TCT and the RBV make different predictions about an organization's sourcing decision. A case-study approach is used to test these competing predictions in the context of an email-marketing system, which is an example of a contemporary business process outsourcing (BPO) decision. As a prediction from the two theories about an organization's sourcing decision may result in a mistaken decision, this study focuses on organizations that made an effective sourcing decision.

The study results offer guidance to practice, suggesting circumstances in which either TCT or the RBV should be employed for organizations' sourcing decisions. This study also fills a gap in the literature because no previous work has used empirical research to compare how well TCT and the RBV predict sourcing decisions.

2. Theoretical background

2.1. Transaction cost theory

Transaction cost theory (TCT) seeks to explain why firms exist and how firm boundaries are determined (Coase, 1937; Pitelis, 1998; Pitelis and Pseiridis, 1999;

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