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Outsourcing relationships: Changes in power and dependency

Zaza Nadja Lee Hansen [a,*], Lauge Baungaard Rasmussen [b]

[a] Deloitte Consulting, Deloitte Touche Tohmatsu Limited, Weidekampsgade 6, København 2300, Denmark
[b] The Technical University of Denmark, DTU Management Engineering, Building 425, 115, DK-2800 Kgs. Lyngby, Denmark

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Summary Recent research has shown that it is important for companies to correctly reflect the power and (inter)dependency to vendors so that an appropriate and aligned relationship can be created. Power and dependency, however, can change over time, which means that the vendor strategy necessary for the relationship to remain aligned and appropriate must also change. Through an empirical dyadic investigation of a large multinational corporation and three of its vendors the key-determinants related to changes in outsourcing relationships are investigated. This dyadic study shows that companies need to consider three aspects additional to those mentioned in previous research when selecting a vendor strategy: (1) Vendor expectations, (2) Vendor potential, and (3) Long-term relationship goal.

Introduction

In recent decades, changes in the political environment (e.g. the fall of the Soviet Union, the expansion of the European Union) and technological advance in telecommunication (e.g. the Internet, e-mail and teleconferences) have enabled a global spread of development and production activities. This is often done through global outsourcing or offshoring of activities and services. *Outsourcing* refers to the specific practice when a firm entrusts the performance of an erstwhile in-house activity to an external entity, whereas *offshoring* is when a company moves a task or service to its own facilities abroad (Belcourt, 2006).

The option to use outsourcing strategy globally is a choice which all companies, be it large or small, increasingly have to consider. The motivation for outsourcing is often cost, market access, or to gain access to specific resources (Ferdows, 1997). When the decision to outsource has been taken, the buyer company needs to decide which relationship to create with the vendor organization (e.g. the level of collaboration and trust between the companies). This decision, however, will influence the assignments given and the level of knowledge shared. Furthermore, over time the relationship can change and evolve. This change is suggested by the literature to depend on alterations in power and dependency (Cox, Sanderson, & Watson, 2000, Cox, 2004; Caniels & Gelderman, 2005; Caniels & Roeleveld, 2009; Maskell, Pedersen, Petersen, & Dick-Nielsen, 2007; Vivek, Glenn Richey, & Dalela, 2009). Power can be defined in many ways. Pfeffer defines power as "... *the potential ability to influence behavior, to change the course of*

* Corresponding author. Tel.: +45 2874 2864; fax: +45 4593 4467.
E-mail addresses: znlhansen@gmail.com, znlh@man.dtu.dk (Z.N.L. Hansen).

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events, to overcome resistance, and to get people to do things that they would not otherwise do.'' (Pfeffer, 1994, p. 30). The latter definition of power is used in this paper, because it fits very well with the main purpose of the article. Very few empirical studies on outsourcing, have been carried out at the dyadic level including both buyers and vendors perspectives (Caniels & Roeleveld, 2009; Jane, Lago, & Arin õ, 2005; Zhao, 2007).

This paper is an empirical dyadic study. By investigating the relationship from both the buyer and the vendor perspective this paper adds three additional key-determinants related to changes in outsourcing relationships, key-determinants that have not previously been suggested in the existing literature about the topic.

Literature review

Outsourcing decisions are strategic decisions where a company has decided to implement a service from a third party instead of producing it in-house (Gilley & Rasheed, 2000).

Outsourcing decisions can be explained using four different theoretical perspectives (Grant, 1991; Javalgi, Dixit, & Scherer, 2009; Tsang, 2000); (1) Transaction cost economics, (2) Relational exchange theory, (3) Resource-based view and (4) Resource dependency theory. Transaction cost economics (TCE) assume that the most powerful partner will dominate the exchange in an asymmetric relationship. This perspective favors keeping activities in-house to avoid a situation where the partner holding much power might exploit the relationship (Frazier & Rody, 1991; Ireland & Webb, 2007). Relational exchange theory (RET) suggests that knowledge is embedded in organizational practices and relationships (Blackman & Sadler-Smith, 2009; Hawk, Zheng, & Zmud, 2009; Lam, 2000; Lave & Wenger, 1991). Trust and interaction is therefore encouraged. It is the opposing theory to TCE, and when using this perspective a company should engage in strategic partnerships which would be mutually beneficial. In the view of resource dependence theory (RDT) it is in the best interest of a company to retain control over their supply chain and not engage in outsourcing relationships to ensure control over external resources. The resource-based view (RBV) says that competitive advantage comes from resources and capabilities (Colota, 2003). A company should outsource none-core activities in order to focus on its core competences (Grant, 2002; Peteraf, 1993; Prahalad & Hamel, 1990; Ricardo, 1817; Wernerfelt, 1984).

The motivation to outsource a task has been shown to change within one relationship over time from cost reductions to knowledge gains, as trust in the supplier grows and the relationship develops (Maskell et al., 2007). Outsourcing relationships can, in other words, experience a theoretical shift over time from transaction cost (focus on lowering costs), resource-based (focus on developing competences), to relational governance (focus on continuous learning and commitment and relationship governance with an emphasis on trust) (Vivek et al., 2009).

This change in motivation of an outsourcing relationship can be viewed from a dyadic perspective. Over time, the buyer and supplier company interact and influence each other. This can prompt changes in power and dependency in the relationship between the companies, which in turn can influence the motivation for keeping the relationship. Low levels of dependence often reflect a buyer—supplier relationship which is concerned with routine services and products which have a low value for the company. Switching costs for the buyer company are therefore low. Suppliers will often be aware of this and will have many short-term contracts, meaning that switching costs for suppliers are also often low. Relationships with a high level of interdependence indicate a strategic and collaborative relationship in which both parties have invested substantially, and switching costs for both are high (Casciaro & Piskorski, 2005; Gulati & Sytch, 2007). In such a relationship, mutual trust and commitment is therefore also high (Geyskens, Steenkamp, Scheer, & Kumar, 1996).

Caniels and Roeleveld (2009) expanded the research by Cox et al. (2000), Cox (2004) and Caniels and Gelderman (2005) to create a power map for supplier relationships which detail supplier relationships according to buyer's dependence and supplier's dependence (see Fig. 1) .

While Caniels and Roeleveld (2009) take a dyadic approach and interview both the supplier and buyer, most research has been from one perspective: the buyer's. There seems to be an underlying assumption that the power and dependency in buyer—supplier relationships are defined by the buyer only, and that they remain static for a prolonged period of time. To understand the actual and potential changes of the buyer—supplier relationship it is important to investigate both the buyer and the supplier, as they both have the ability to influence the power structure.

By taking a dyadic approach it is possible to include not just current, explicit and actual approaches and understandings of the buyer—supplier relationship, but also expectations from both parties by having a focus on the possibility of moving a buyer—supplier relationship in a given direction (for example, towards a more strategic relationship). In this paper we build on and expand the research

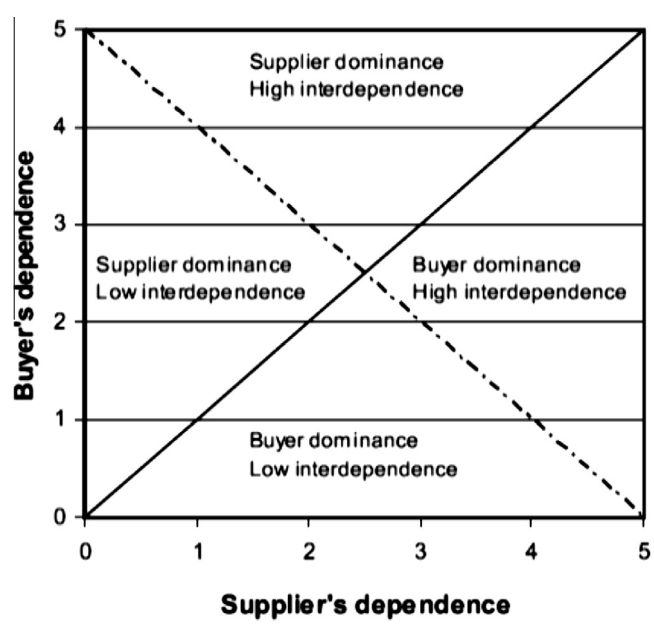

Figure 1 Power map for supplier relationships (Caniels & Roeleveld, 2009).