



## 30+ years of research and practice of outsourcing – Exploring the past and anticipating the future

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### ABSTRACT

Outsourcing is a phenomenon that as a practice originated in the 1950s, but it was not until the 1980s when the strategy became widely adopted in organizations. Since then, the strategy has evolved from a strictly cost focused approach towards more cooperative nature, in which cost is only one, often secondary, decision-making criterion. In the development of the strategy, three broad and somewhat overlapping, yet distinct phases can be identified: the era of the Big Bang, the era of the Bandwagon, and the era of Barrierless Organizations. This paper illustrates that the evolution of the practice has caused several contradictions among researchers, as well as led to the situation where the theoretical background of the phenomenon has recently become much richer. Through examining existing research, this paper intends to identify the development of outsourcing strategy from a practical as well as a theoretical perspective from its birth up to today. In addition, through providing insights from managers in the information technology industry, this paper aims at providing a glimpse from the future – that is – what may be the future directions and research issues in this complex phenomenon?

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### 1. Introduction

In 1776 Adam Smith (taken from 1933) argued that a company operates more efficiently if production tasks are distributed among individuals, who specialize in manufacturing certain parts of the production process. Two centuries later Williamson (1975) questioned Adam Smith's pin-making logic by stating that the technically distinct operations (wire straightening, cutting, pointing, grinding, and so forth) of pin manufacturing could, in principle, not only be performed by distinct employees, but independent specialist organizations. Williamson followed the ideas of Coase (1937), who suggested that transactions should be organized within a firm when the cost of doing this is lower than the cost of using the market. The ideas of Coase and Williamson on the transaction cost theory are often referred to as the prominent ideas behind outsourcing. Since then, the research on outsourcing has been gathering increased attention among researchers of several different disciplines.

There is no question that outsourcing, commonly defined as *the transfer of activities and processes previously conducted internally to an external party* (Ellram and Billington, 2001), is one of the most sustained trends of concurrent business (Fill and Visser, 2000). What we have been witnessing is an outsourcing revolution, which has changed the way firms compete in as diverse industries as automobiles, aerospace, telecommunications, computers, pharmaceuticals, chemicals, healthcare, financial services, energy systems and software (Carson, 2007; Dahan and Hauser, 2002; Quinn, 2000), just to name a few.

Outsourcings are nowadays done both domestically and internationally. International outsourcing can also be referred to as offshore outsourcing, and it involves the transfer of both the ownership and the location of the operations. The term offshoring,

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even though often used synonymously with offshore outsourcing, actually refers to the strategy of transferring activities across national borders. This may be done through outsourcing (using external resources) or through foreign direct investment (using internal resources). (Hagel and Brown, 2005).

The current highly competitive environment can also be referred to as an outsourcing economy, which is characterized by an increased focus on core organizational activities and simultaneous leveraging of external resources, skill, knowledge, capabilities and competences. The increased competition in the outsourcing markets has caused a shift towards buyers' markets, enabling companies of all sizes in nearly all industries to capitalize on external sources of knowledge and capabilities.

Such developments have coerced practitioners and researchers alike to rethink the factors behind the success of modern organizations and thereby their position and role in the marketplace. Today, the most significant management challenges lie in recognizing the firm's key competence areas, finding suppliers to provide the value to the rest of the operations, and in managing the resulting global network of suppliers and partners (cf. Quinn, 2000): the management of the relationships with key suppliers is likely to become increasingly important (Kakabadse and Kakabadse, 2002). In parallel to the new challenges, the current industrial fragmentation also creates several possibilities for firms throughout industries. The large-scale decomposition of production activities has dramatically altered new product development in many industries (Carson, 2007), creating new market possibilities for several firms.

As these developments are constantly evolving, current academic research is destined to lag behind the most recent developments of this complex phenomenon. This is largely caused by the fact that the intensified competition and the consequent development of the outsourcing market has created entirely new arenas of possibilities as well as models according to which firms are able to divest and decompose their operations. The task of researchers is to follow in the wake of these developments. Thus, the revolution of outsourcing and the consequent development towards an outsourcing economy has raised new aspects for academic research, and thereby provides "steam" to different research disciplines by introducing new "big questions" to be examined (cf. Buckley, 2002; Peng, 2004).

This paper examines the past and the future of the practice of and research on the outsourcing phenomenon. Accordingly this paper firstly seeks to answer the question of *how has outsourcing practice evolved in the past 30 to 50 years* (RQ1), and consequently, *how has this changed the way researchers have addressed this phenomenon* (RQ2). Finally, this paper aims at elaborating the possible future directions of this practice and research, that is, seeking to investigate *what may be the possible future areas of interest concerning outsourcing research* (RQ3).

Whereas the historical overview on the outsourcing practices and research (RQ1 and RQ2) relies on investigation of existing literature, the aim to unveil some future insights (RQ3) is achieved by reporting results from interviews of managers from the information and communications industry. These insights were gathered through a Global Network Management research project, which was carried out between June 2005 and December 2007. During this time over 170 representatives in over 70 firms from several countries (for example Finland, Sweden, UK, China, and the US) were interviewed related to partner management and outsourcing. The interviewees represented the top management of the companies.

To address the three research questions, this paper is structured as follows. First, the evolution of the outsourcing strategy is viewed from a practice-oriented perspective. Second, the paper examines how the research tradition has evolved along with the changes in the practice, and thereby hopefully addresses a few contradictions that exist in the outsourcing literature. Third, this paper gives some insights on where the practice and the research may evolve in the future. The paper closes with a summary including managerial, theoretical as well as some methodological suggestions.

## 2. The (r)evolution of the outsourcing practice

Companies in all industries used to be highly vertically integrated units, or so-called conventional industrial organizations (Stigler, 1951), in which activities in every link of the value chain were conducted internally. For instance, 7-Eleven used to deliver its own gasoline and make its own candy and ice, and it even owned the cows that produced the milk it sold (Gottfredson et al., 2005). Today, it no longer delivers gasoline or makes candy or ice, nor does it own any cows. IBM, on the other hand, used to build their computers with their own central processing units, and sell them with their own operating system. Today, people buy IBM computers with Intel chips and Microsoft operating systems, all of which were originally produced by IBM. IBM's core business, actually, no longer lies in selling computers: it sells services, and the computers sold under the IBM logo are most likely manufactured by other companies, distributed by yet others, and so on. These changes did not occur overnight, however. Thereby the key question is – how have we come to this point?

In his book "The Outsourcing Revolution" Corbett (2004) describes outsourcing as a phenomenon that is far from new, but which has skyrocketed in recent years, gathering momentum in terms of volumes as well as the importance of the strategy to the overall success of firms. Looking back to the developments that have occurred in this strategy we could identify three broad and overlapping, yet distinct phases: the era of the Big Bang, the era of the Bandwagon, and the era of Barrierless Organizations.<sup>3</sup>

The first wave of outsourcing can be referred to as *the era of the Big Bang*. The name originates from the way and intensity the strategy gained popularity. Although the concept of outsourcing was used by manufacturing executives in the late 1970s (Corbett, 2004), it was only a decade later that the term was officially introduced. Yet, another decade later it was already referred to by

<sup>3</sup> Similarly from the perspective of managing outsourcing relations Kedia and Lahiri (2007) distinguish the development into three generations.

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