Journal of Business Research 62 (2009) 1165–1172

Contents lists available at ScienceDirect

Journal of Business Research

Outsourcing: Think more expansively

Rajan Varadarajan

Department of Marketing, Texas A&M University, 4112 TAMU, College Station, TX 77843, United States

ARTICLE INFO

Article history:
Received 8 May 2008
Accepted 16 September 2008

Keywords:
Outsourcing
Offshore outsourcing
Off-shoring
Micro-outsourcing

ABSTRACT

Outsourcing refers to the practice of a firm entrusting to an external entity the performance of an activity that was performed erstwhile in-house. Although off-shoring and offshore outsourcing to suppliers have dominated much of the recent discussion and debate on outsourcing in scholarly journals and the business press, the nature and scope of outsourcing that does not transcend national boundaries, and outsourcing to entities other than to suppliers is quite substantial. Against this backdrop, a five sources outsourcing framework delineating a broad array of outsourcing avenues available to firms is proposed. For the most part, lowering costs as a motive underlying off-shoring and offshore outsourcing have dominated recent discussion. Furthermore, in the aftermath of the rapid growth in offshore outsourcing in the services sector, the technological forces underlying these developments have been extensively written about. Against this backdrop, the relevance of considerations other than cost in the outsourcing decisions of firms, and the role of technology in automating and thereby either making redundant an erstwhile outsourced activity or performing the activity in-house are discussed.

1. Introduction

Outsourcing refers to the practice of a firm entrusting to an external entity the performance of an activity that was erstwhile performed in-house. The outsourced activity could either be the manufacturing of a *good* or the performance of a *service*. Outsourcing to third party firms based in other countries is commonly referred to as *offshore outsourcing*, and sourcing from a firm's subsidiaries located in other countries as *off-shoring*. Regardless, both offshore outsourcing and off-shoring essentially constitute international trade in goods and services. Notwithstanding the current high level of interest in offshore outsourcing and off-shoring, it should be noted that they are only a slice of a much larger pie that also encompasses outsourcing that does not transcend national boundaries, and outsourcing to entities other than to a firm's suppliers. Against this backdrop, this article presents a five sources outsourcing framework delineating the vast and expansive scope of outsourcing.

The decision by firms to outsource is often driven by as well as drives (i.e., is influenced by and facilitates) the emergence of specialist organizations in various fields and the associated scale driven cost efficiencies. While much of the discussion relating to outsourcing is focused on the cost of performing an activity within the boundaries of the firm versus entrusting to a third party, situations in which cost may not be the principal consideration in a firm's outsourcing decisions also merit careful consideration. This constitutes the second building block of the "think more expansively" position advanced in the paper.

On the one hand, technological developments in the macro environment can be a driver of a firm's decision to outsource an activity that was erstwhile performed in-house. On the other hand, technology can also be a driver of a firm's decision to perform in-house an activity that was erstwhile outsourced. In still other instances, by leveraging technology to automate, it might be possible to make redundant an outsourced activity. Against this backdrop, the role of technology in automating and thereby either making redundant an erstwhile outsourced activity or performing the activity in-house constitutes the third building block of the "think more expansively" position advanced in the paper.

2. Outsourcing is more pervasive than you might think

Issues relating to outsourcing have been the focus of numerous books (Friedman, 2005), journal articles (Weidenbaum, 2005), scholarly working papers (Mankiw and Swagel, 2005) and white papers by management consulting firms (McKinsey Global Institute, 2003). Outsourcing is a pervasive business practice in a number of organizational functions such as accounting (e.g., bookkeeping and payroll processing), computers and information systems management, human resources management, facilities maintenance, logistics and supply chain management, manufacturing and marketing. Besides the actions of firms that are explicitly referred to as outsourcing, a broad array of actions that are referred to using terms such as *make versus buy*, *vertical integration versus vertical disintegration (contraction)*, *disintermediation versus intermediation*, and *using an in-house sales force versus sales force affiliated with a third party firm* also focus on the same underlying phenomenon; namely, the choice

E-mail address: Varadarajan@tamu.edu.

0148-2963/$ – see front matter
doi:10.1016/j.jbusres.2008.09.006

between performing an activity within versus outside the boundaries of a firm. Similarly, to varying degrees, the actions of firms described using phrases such as *externalization of low value added value chain activities in firms*, the *hollowing of corporations*, the *transformation of firms into virtual enterprises,* and terms such as *contracting* and *sub-contracting*, also imply outsourcing.

In certain industries, outsourcing may often by the only viable business model, either for all firms or for a subgroup of firms. Case in point is the practice of newspapers outsourcing some of their news gathering activity (particularly, news gathering in other countries) to external entities such as Reuters and the Associated Press. In the absence of such an arrangement, it would not be possible for most newspapers to publish in their pages news happenings in various parts of the world.

2.1. Outsourcing refers to a transitional phase: the steady state is sourcing

Outsourcing refers to a transitional phase—a firm transitioning from performing an activity in-house to contracting with an external entity to perform the activity. Past the transitional phase, the steady state is *sourcing* from an external entity. For instance, in the area of marketing, firms routinely entrust the performance of specific services to specialist organizations such as advertising agencies, sales promotion agencies (e.g., firms that specialize in in-store product sampling, fulfillment of sales promotion offers and processing of cents-off coupons), market research agencies, public relations (PR) management firms, and firms that specialize in selling, distribution and warehousing, supply chain management, and bad debt collection. The term outsourcing is generally not used in reference to performance of activities that have been *traditionally* sourced by firms to external entities, such as to advertising agencies and public relations firms. In contrast, in recent years, a growing number of firms have resorted to offshore outsourcing of processes and activities relating to presales and/or after sales customer relationship management (CRM). Even here, while offshore outsourcing of CRM related processes and activities is a relatively recent development, outsourcing of CRM activities related to customer acquisition, retention and reactivation has been in vogue to varying degrees and in various industries, for some period of time. Case in point is the widespread practice of quasi-outsourcing of the solicitation of new subscribers, renewal of current subscribers, and reactivation of dormant subscribers by publishers of newspapers and magazines.

3. Think more expansively: a five sources outsourcing framework

In today's intensely competitive environment, there is a need for firms to move away from a narrow view of outsourcing (as primarily a business-to-business phenomenon entailing outsourcing by firms to vendors/suppliers) to a more expansive view that systematically identifies and delineates potential opportunities for outsourcing to a broader array of external entities. Fig. 1 presents a five sources outsourcing framework that distinguishes between (1) *off-shoring* to a firm's overseas subsidiaries, (2) *upstream vertical outsourcing* to a firm's current and new suppliers, (3) *downstream vertical outsourcing* to a firm's intermediate and end use customers, (4) *horizontal outsourcing* to a firm's direct competitors, peripheral competitors and potential competitors, and (5) *horizontal outsourcing* to a firm's strategic alliance partners. Unlike in business-to-business (B2B) markets, when a firm outsources to end use customers in business-to-consumer (B2C) markets, the customer may more often be an *individual* rather than a *firm*, in the traditional sense. In such instances, the focal firm does not enter into a *formal contractual relationship* with the individual customer. Consider for instance, the *customer referral marketing* programs that some credit card companies and mobile telephone service companies, among others, have employed in recent years with considerable success. Typically, these firms offer rewards (in the form of credit toward future purchases) in the range of \$20 to \$25 for customer referrals by present customers that result in new customers for the firm. In effect, the task of acquiring new customers that was erstwhile performed exclusively by the employees of the firm is partially outsourced to the firm's present customers. Against the backdrop of such marketplace realities, it is more meaningful to broadly define outsourcing as the practice of a firm *entrusting* to an *external entity* the task of performing an activity that was performed erstwhile in-house, rather than narrowly as a *firm contracting* with another *firm*. In other words, the external entity in question can either be a firm in the traditional sense or an individual customer who has ongoing relationship with the firm. The terms under which performance of an activity is outsourced to the external entity can either be *formal* and *contractual* or *informal* and *non-contractual*. A discussion of the sources delineated in Fig. 1 follows.

3.1. Off-shoring: outsourcing to a firm's overseas subsidiaries

In the previous section, outsourcing was defined as the practice of a firm entrusting to an *external* entity the task of performing an activity that was performed erstwhile in-house. On the one hand, when a firm outsources the manufacturing of goods and/or performance of services to an overseas subsidiary (i.e., engages in off-shoring), the subsidiary in not an external entity, but part of the firm. On the other hand, issues relating to off-shoring have been extensively examined in extant literature under the broader rubric of outsourcing. Often, a new overseas subsidiary is specifically formed for the purpose of entrusting to it the performance of certain activities that were previously performed in another facility of the firm. Furthermore, it is not uncommon for firms to *spin off* their offshore subsidiaries as separate companies (to facilitate their achieving greater scale efficiencies and increased revenues by providing the service to the focal firm, its competitors, and to firms in other industries), or *sell off* to specialist firms (which in turn, by leveraging scale efficiencies are able to provide the service to the focal firm at a lower cost as well as other value added services). Craig and Willmott (2005) highlight the link between *divestitures* and outsourcing by pointing out that many of today's formalized outsourcing arrangements are essentially divestitures that entail the transfer of assets such as people, systems, intellectual property, buildings and management control to a vendor. These considerations justify delineation of off-shoring as one of the five potential sources in the proposed framework.

3.2. Vertical outsourcing upstream: outsourcing to current and new suppliers

Vertical outsourcing upstream can either take the form a firm outsourcing to a third party firm with which it currently does not have a relationship (i.e., establishment of a new buyer–seller relationship) or outsourcing to one of its *current suppliers* additional activities that are currently being performed in-house (i.e., broadening of the scope of an existing buyer–seller relationship). While outsourcing to new suppliers, particularly in the context of offshore outsourcing has been extensively written about, developments in the arena of broadening of the scope of outsourcing to current suppliers also provides valuable insights into potential opportunities that might be available to firms. Case in point is the practice of defective products that are under warrantee being shipped by customers to the after sales service centers of manufacturers. A significant portion of the shipping of defective products by customers to manufacturers and back to customers is normally handled by specialist transportation and logistics firms under long-term contracts. Sensing a business opportunity, some firms in this sector have recently invested in developing in-house after sales servicing capabilities at their transportation hubs to repair an array of high-end consumer products such as laptop computers, DVD players and cell phones manufactured by different firms (products that are normally shipped through an