



## The dynamics of business service exchanges: Insights from logistics outsourcing

Kostas Selviaridis\*, Martin Spring<sup>1</sup>

Department of Management Science, Lancaster University Management School, Lancaster, LA1 4YX, UK

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### ABSTRACT

This paper offers insights about the dynamics of business service exchanges. We draw on the interaction approach, contracting theory and the notion of qualification from economic sociology to develop an analysis frame for such dynamics. We then apply this frame to a single, longitudinal case study. Contrary to the extant service supply literature assuming that service definitions remain (or should remain) fixed throughout the purchasing process, our findings suggest that, under high uncertainty conditions, the service exchange object is (re)shaped through iterative cycles of stabilisation and destabilisation. This study also reveals a connection between service definition and relationship governance dynamics—uncertainty and opportunism risks related to service destabilisation can be managed through dynamic deployment of relational, contractual and economic mechanisms. This paper also contributes to our understanding of the contract as basis for interaction and openness and offers an extension of qualification theory to complex business-to-business (B2B) service settings.

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### 1. Introduction and literature review

The continuing trend towards specialisation and outsourcing of goods and services is well documented (e.g. McIvor, 2005; Domberger, 1998) and business services such as accounting, management consulting, information technology/system (IT/IS) and logistics form a large proportion of firms' acquisition of external resources (Axelsson and Wynstra, 2002; Vining and Globerman, 1999). This has become global in scope, with companies shifting service activities to low-cost economies such as India, China and Eastern Europe—hence the terms *off-shoring* and *near-shoring* (Youngdahl and Ramaswamy, 2008; Sako, 2006; Jahns et al., 2006; Axelsson et al., 2005). Facing such a global marketplace, buying companies often need to deal with changing decision-making contexts and increasingly complex offerings. Service providers, with different business backgrounds and capability sets, bundle core offerings with value-adding services in their attempt to differentiate from competition and secure higher profit margins. Despite all this, there is relatively little research in business services from a purchasing and supply management perspective (Ellram et al., 2007; Wynstra et al., 2006; Carter and Ellram, 2003).

Existing service supply research focuses on problems associated with definition and evaluation of offerings, treating definition of service requirements as the starting point of the

purchasing process (e.g. Fitzsimmons and Fitzsimmons, 2006). Little is known, however, about how complex services actually develop and evolve throughout the purchasing process, from setting the initial requirements to adapting the offering after contract award. This paper attempts to fill this gap by offering a dynamic conceptualisation of business service exchanges. The focus is on understanding and explaining how the object of service exchange is shaped and reshaped and the role of underlying relationship governance mechanisms (contractual, economic, relational). This combination of analytical frames has not, thus far, been applied to services purchasing. The approach is deployed and developed in a longitudinal case study of the process of buying third party logistics (3PL) services. Like other industries (e.g. IS outsourcing), the logistics market has grown in complexity, with providers bundling transport and warehousing solutions with value-added services (e.g. contract manufacturing, procurement). However, such bundled offerings are far from well defined (e.g. Bask, 2001) and often customised. Hence these parallels, it is suggested, allow extension of the insights developed here in the 3PL context to other complex business-to-business (B2B) services. In the remainder of this section we critically review the relevant literature and present the research questions.

#### 1.1. Business services outsourcing

Existing research focuses on 'do or buy' decision frameworks (e.g. Barrar et al., 2002; Barragan et al., 2003), the purchasing process (e.g. Day and Barksdale, 1994) and, to a lesser extent, on

\* Corresponding author. Tel.: +44 1524 594673; fax: +44 1524 844885

E-mail addresses: [k.selviaridis@lancaster.ac.uk](mailto:k.selviaridis@lancaster.ac.uk) (K. Selviaridis),

[m.spring@lancaster.ac.uk](mailto:m.spring@lancaster.ac.uk) (M. Spring).

<sup>1</sup> Tel.: +44 1524 592739.

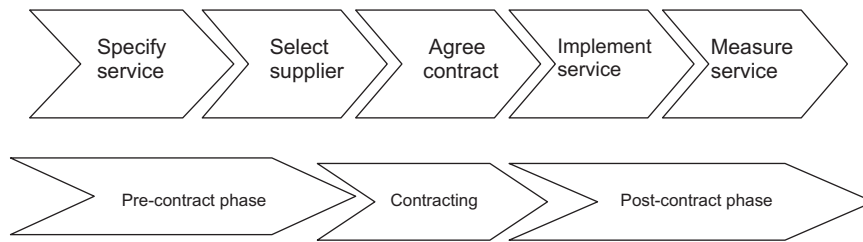


Fig. 1. Business services (out)sourcing process.

performance evaluation and relationship management (Lee, 2001; Klepper, 1995). Overall, the *process* of (out)sourcing appears to be the dominant issue (Mahnke et al., 2005), with studies focusing on the description of stages, procedures and tasks involved in purchasing business services (see Fig. 1). Researchers appear to be more interested in the pre-contract stages of requirements specification and service supplier selection (Feeny et al., 2005; Day and Barksdale, 2003; Stremersch et al., 2001) and pay little attention to post-contract adaptations and interactions between client and service provider (Wynstra et al., 2006; Kern and Willcocks, 2000).

These studies often draw on established theoretical perspectives such as transaction cost economics (TCE), resource-based view (RBV) and agency theory to explain service outsourcing phenomena, in sectors such as IT/IS, telecoms and logistics services (e.g. Mahnke et al., 2005; Watjatrakul, 2005; Marshall et al., 2007; Logan, 2000). They focus mainly on the make or buy decision and present a rather static view of outsourcing. Theories of industrial networks, social exchange and relational contracting are also applied to buyer–service provider relationship management (e.g. Laing and Lian, 2005; Kern and Willcocks, 2000; Skjoett-Larsen, 2000). However, most of these approaches are used on a piecemeal basis without serving any broader research objective and, as a result, they offer little back to theory in terms of its potential extension, refinement or testing. Integration and cross-fertilisation of theoretical perspectives could provide more robust explanations covering the outsourcing process in its entirety, from decision making to design and management of service outsourcing relationships (Selviaridis and Spring, 2007; Mahnke et al., 2005).

The service supply literature has, for some time, emphasised problems regarding the definition and evaluation of service exchanges, given the presumed difficulty in writing specifications and contracts for services as compared with manufactured goods (Alström and Nordin, 2006; van Weele, 2005; Allen and Chandrashekar, 2000; Fitzsimmons et al., 1998). Ahlström and Nordin (2006) identify four problem areas: the development of service specification and contracts, the definition of service processes, service implementation and supplier transition and the control of end-user interfaces. Ellram et al. (2007, 2004) pinpoint difficulties relating to inadequate service definition, problematic service measurement and potential supplier opportunism. Research in the area of professional services (e.g. Mitchell, 1994; Day and Barksdale, 1994) suggests that their purchasing is problematic in the sense that evaluation of offerings is very difficult both *ex ante*, where clients have indeterminate or even unclear expectations, as well as *ex post* due to the existence of credence qualities (Emons, 1997), hence the importance, in such cases, of supplier reputation (Glückler and Armbrüster, 2003). Buying companies should, nonetheless, strive for clear specifications and detailed contracts to control service performance and avoid supplier opportunism (Ellram et al., 2007). The dynamics of service exchange is, however, underplayed, it being assumed that the offering is defined at the outset of the process. Very little is

known about how exchanged services take shape and how/why they are reshaped during both the pre- and post-contract phases (Wynstra et al., 2006; Day and Barksdale, 1994).

There is also very little attention to the role of contractual and economic governance mechanisms with regard to the formation and evolution of business service exchanges. Reference to relational, trust-based mechanisms (e.g. Laing and Lian, 2005) should be complemented by consideration of contractual and economic aspects of the exchange, since such aspects (e.g. asset investment requirements and price/volume changes) often play an important role in explaining the dynamics of business service exchanges (Harrison, 2004; Kern and Willcocks, 2000; Halldórsson and Skjoett-Larsen, 2006). Contractual design is an important research area because it determines the extent to which parties can adapt the exchange while, at the same time, minimise uncertainty and avoid opportunism (Mahnke et al., 2005).

## 1.2. Purchasing logistics services

3PL is defined as the organisational practice of outsourcing logistics activities to reduce costs and/or enhance customer service (Christopher, 2005). The literature on 3PL purchasing mainly focuses on provider selection criteria (e.g. Menon et al., 1998) and on normative procurement process frameworks. Three such frameworks are outlined here. Andersson and Norrman (2002) compare the purchasing process between commoditised (e-freight exchanges) and advanced logistics services. They find that definition of service requirements appears to be more difficult, criteria for 3PL selection extend far beyond price considerations and contracts are much more detailed when buying advanced logistics solutions (Andersson and Norrman, 2002). Sink and Langley (1997) emphasise process issues such as need identification, formation of cross-functional buying team, development of selection criteria and service implementation. Bagchi and Virum (1998) also emphasise process, but their framework is wider in scope than the previous two, dealing with post-contracting issues such as performance measurement.

Such studies are useful insofar as they describe the typical buying process and focus on individual stages and procedures such as provider selection. However, they appear to be weakly theorised and based on some problematic assumptions: (a) the buyer has complete knowledge of its requirements, facing low need and market uncertainty, (b) the buyer can, without problems, convey such requirements and information to suppliers for the purposes of service design and (c) service requirements and design assumptions remain fixed. Such assumptions can be severely challenged in practice, as lack of information often necessitates iterative service specification/design (Lynch, 2000) and relationship renegotiation in the post-contracting period (Halldórsson and Skjoett-Larsen, 2006). Some authors (Sink and Langley, 1997; Andersson and Norrman, 2002) do hint at the non-linear nature of exchange definition, but they stop short of providing empirical evidence and addressing the issue in detail.

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