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Overcoming Inertia: Drivers of the Outsourcing Process

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Almost all managers have directly or indirectly been involved in the practice of outsourcing in recent years. But, as they know, outsourcing is not straightforward. Outsourcing inertia, when companies are slow to adapt to changing circumstances that accommodate higher outsourcing levels, may undermine a firm's performance. This article investigates the presence of outsourcing inertia and the factors that help managers overcome it. Using statistical evidence, we show that positive performance effects related to outsourcing can accumulate when circumstances change. This is then followed by rapid increases in outsourcing levels (i.e. outsourcing processes). We investigate what gives rise to these outsourcing processes through follow-up interviews with sourcing executives, which suggest five drivers behind outsourcing processes: managerial initiative (using outside experience); hierarchy (foreign headquarters); imitation (of competitors and of similar firms); outsider advice (from external institutions); knowledge sources (using external information). These five drivers all offer scope for managerial action. We tie them to academic literatures and suggest ways of investigating their presence and impact on the outsourcing process. Overall, we conclude that while economising factors play a key role in explaining how much firms outsource, it is socialising factors that tend to drive outsourcing processes.

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Introduction

The process of outsourcing, the organisational relocation of activities or entire functions outside a firm's boundaries, has been a key driver of business transformation over the past decades. Firms attempt to use outsourcing to remain competitive or even to improve their competitiveness. While in the past they mostly outsourced simple, peripheral activities, now they increasingly outsource manufacturing and service activities that sit near the centre of their business models and involve proprietary processes (Brusoni et al., 2001). Among academic approaches transaction cost

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economics (TCE) (Walker and Weber, 1984; Williamson, 1985), related contracting approaches (Holmström and Roberts, 1998), and the resource-based view of the firm (RBV) (Barney, 1999), have been particularly instrumental in explaining outsourcing levels.

A relatively straightforward explanation of the costs of wrongful managerial decision-making has emerged (Leiblein et al., 2002; Masten, 1993; Williamson, 1991) in that a failure to align governance modes with transaction characteristics and firm resources induces efficiency losses, which eventually lead to firm failure. The argument suggests that managers will shift between the governance modes of make or buy whenever appropriate. Given alignment, the level of outsourcing itself is believed not to directly influence organisational performance or competitive advantage because once an optimum set of decisions has been reached, no further performance gains will be obtained by outsourcing more or less and organisations in principal have no incentive to deviate from that optimum.

Yet practical puzzles remain that cannot be explained through this view of outsourcing, which Oliver Williamson (1991), calls economising. For instance, some firms remain vertically integrated for a long time in the face of substantial change in their technological and institutional environments that shifts the balance between transaction and production costs to allow for more outsourcing (Afuah, 2001). The US automotive industry long remained too vertically integrated until it recognised that the success of its Japanese competitors was aided by their reliance on keiretsu alliances with external suppliers (Womack et al., 1990).

The process of outsourcing often appears to take place in rapid (industry-wide) waves, during which every manager wants to be seen engaged in outsourcing (Bettis et al., 1992; Kotabe, 1998). Once the Detroit Big Three realised that Japanese firms were playing the game differently, they quickly and collectively copied Japanese practices of substantial outsourcing of key manufacturing activities and more co-operation with suppliers, albeit with mixed success (Dyer, 1996; Kotabe, 1998). Understanding whether such resistance to change affects performance negatively, and what drivers eventually help firms overcome that resistance could help both practitioners and researchers.

The focus of this paper is on better understanding changes in outsourcing levels over time. We provide an argument for why outsourcing processes take place slowly, and perhaps belatedly, and then study what organisational factors drive these processes. We first construct a coherent set of propositions. We introduce the notion of outsourcing inertia as a useful way to characterise slow occurrence of outsourcing processes in the face of environmental change. We argue that such inertia will lead to a positive association between outsourcing levels and firm performance. When such a positive performance effect occurs, this will be eventually followed by rapid increases in outsourcing, which are triggered by various drivers inside and around the organisation. To empirically investigate our propositions, we use a combination of large-scale quantitative data and qualitative interview findings on businesses in the Netherlands. Finally, we link the drivers of the outsourcing process to existing literature and suggest implications for practice and theory. The drivers we find are suggestive of a socialising view of outsourcing processes, although we also find that economising factors help explain outsourcing levels.

Outsourcing and the outsourcing process

In academia and practice alike, there is disagreement between two broad definitions of outsourcing. One suggests that outsourcing refers to *any goods and services that are procured from outside suppliers*. Lei and Hitt (Lei and Hitt, 1995) think of outsourcing as "the reliance on external sources for the manufacturing of components and other value-adding activities". The other definition of outsourcing looks at it as *a transfer process of activities possibly including related human, physical and other assets*, i.e., "the transfer of an internal service function to an outside vendor" (Friedberg and Yarberry, 1991). We are not in a position to conclusively argue for one definition or the other. Instead, we refer to the first definition as *outsourcing level* or simply *outsourcing*, and the second definition as *outsourcing process*. These are analytically distinct entities. An outsourcing level is established at a single point in time while an outsourcing process takes place between two

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