The dynamics of outsourcing relationships in global value chains: Perspectives from MNEs and their suppliers

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A B S T R A C T

We investigate the dynamics of outsourcing relationships within global value chains, through six case studies of lead firm-supplier dyads, considering these relationships from the perspectives not only of the lead firms but also of their suppliers. We track the evolution of the relationships by identifying the roles played by heterogeneous resources and capabilities, isolating mechanisms, and relationship-specific investments in creating potential resource dependence/power asymmetries in the dyads. In our cross-case analysis, we identify different lead firm-supplier dynamics, key underlying mechanisms, and related degrees of dependence/power asymmetries. We also found evidence of the development of trust and of partnerships in situations of power asymmetry and of power balance. In doing so we contribute to an under-researched area in International Business about the evolution over time of outsourcing relationships within global value chains. We advance a set of propositions to be tested in future research.

1. Introduction

Much scholarly attention (e.g. Ellram, Tate, & Petersen, 2013; Gereffi, 2014; Gereffi & Lee, 2012; Lox, Timmer, & Vries, 2015; Ponte, 2014; Yeung & Coe, 2012) is currently being devoted to the nature of global value chains (GVCs) and, in particular, to how they are organized and governed (Gereffi, Humphrey, & Sturgeon, 2005; Gereffi & Lee, 2016; Ponte & Sturgeon, 2014; Soder, Liesch, Inomata, Mihailova, & Meng, 2015; Turkina, Van Assche, & Kali, 2016; UNCTAD, 2013).

The aim of this study is to contribute to the International Business (IB) literature on the evolution of outsourcing relationships within GVCs. This is an under-researched area (Denicolai, Strange, & Zucchella, 2015), in which we aim to understand which factors drive the changes in outsourcing relationships over time. We consider these relationships from the perspectives not only of the lead firms but also of their suppliers. In this paper, we contend that lead firm-supplier relationships involve power asymmetries, and that the ability of firms to capture the rents within GVCs depends upon their exploitation of these power asymmetries (Cox, 2001; Denicolai et al., 2015; Hingley, 2005; Strange, 2011). We focus on outsourcing relationships - as a special case of buyer–seller relationships (Dwyer, Schurr, & Oh, 1987; Heide & John, 1990) - trying to uncover their dynamics over time, adopting the lens of power asymmetries. We are aware that alternative perspectives on outsourcing relationships are possible, including focusing on the development of trust between lead firms and their suppliers. However, we believe that power asymmetries are a distinctive characteristic of outsourcing relationships (Blois, 1997), and these asymmetries are particularly evident in the international outsourcing of manufacturing activities, which represents the specific object of this study. In addition, since we aim at uncovering the dynamics of outsourcing relationships, the power viewpoint can better explain change in relationships, while the trust perspective is better at explaining stability. Hingley (2005: 849) asserts that, there “appears to be a gap in business relationships literature concerning the role of power and the ability of organizations to manage power imbalance.” In a similar vein, Cuevas, Jukunen, & Gabrielson (2015: 149) suggest that power “is a central issue in business to business relationships”, but that it is not necessarily an alternative to trust, as the two can be complementary (Chicksand, 2015; Cuevas et al., 2015). The development of trust is typically thought to be constrained in asymmetric relationships (Lusch & Brown, 1996), such as frequently are outsourcing relationships, but Cuevas et al. (2015) found that this was not necessarily the case.

Power asymmetries are pivotal in the international buyer–supplier relationships literature (Caniels & Gelderman, 2007). In this literature, relationship stability can be threatened by the excessive exploitation of power by the stronger party over the weaker (Anderson & Weitz, 1989; Frazier & Rody, 1991; Geyskens, Steenkamp, Scheer, & Kumar, 1996; McDonald, 1999; Provan & Gassenheimer, 1994). Within the buyer-
supplier relationship literature, power is defined as the ability of the buying firm to influence or control the decisions and behavior of the supplier (Narasimhan, Nair, Griffith, Arljbjerg, & Bendoly, 2009). It is seen as a mechanism to control the dynamics of business relationships (Bachmann, 2001) and to “induce desired actions of another firm by either punishment or threatened sanctions, or by providing or withholding rewards.” (Pulles, Veldman, & Schiele, 2014: 18). However, this literature mainly discusses the effects of power on the absolute performance of the buyer, without taking into consideration the impact on the supplier (Pulles et al., 2014). Cox, Lonsdale, and Watson (2003) consider that power should be at the center of any study of buyer–seller relationship, while Hingley (2005) suggests that the role of power in business-to-business relationships has been either overlooked or its importance has been denied (Cox, 1999; Williamson, 1995). We further argue that power asymmetries evolve over time – either widening or narrowing - and thus buyer-seller relationships are inherently dynamic in nature. Dapiran and Hogarth-Scott (2003) note that firms are always looking for a more favourable power balance: when one party is seen to gain power, the other will act to counterbalance it.

In this paper, we first discuss the underpinnings of organizational interdependence and power asymmetries in lead firm-supplier relationships. We draw upon insights provided by resource dependency theory, transaction cost economics, and the resource-based view of the firm, and propose a conceptual model which captures the determinants of power asymmetries and in turn the dynamics in international supply relationships, which represent an underexplored topic. A second contribution is the adoption of dyads of relationships as unit of analysis: we consider the relationships from the perspectives of both lead firms and suppliers. Third, we discuss how the dynamics of these relationships are driven by the possession of heterogeneous resources and capabilities, isolating mechanisms (IMs), alternative suppliers and/or buyers, and investments in relationship-specific assets.

Our empirical work investigates and contrasts how the relationships established by the three lead firms with, for each firm, two different suppliers have evolved over time, and why. We elaborate on the extant theory by considering six dyads (three multinational enterprises (MNEs) with two each of their suppliers). We contribute to the IB literature studies on the dynamics of international outsourcing relationships by focusing on suppliers located in Europe, where these relationships develop in more complex ways than in emerging and developing countries where the exploitation of low labour cost advantages may be paramount.

The paper is structured as follows. We first develop our conceptual model, through a concise analysis of the relevant literature. In the following section, we detail our research approach, outline the selection of the firms for study, provide brief profiles of each firm, and explain the processes of data collection and data analysis. We then report the results of the within-case and cross-case analyses, concluding with some propositions and, discussing the limitations of the study as well as the avenues for future research.

2. Theoretical background

The process of “international fragmentation of production” has made MNEs’ boundaries increasingly porous through the practice of outsourcing. Outsourcing and offshoring evolved from transactional work to that of more core activities (Contractor, Kumar, Kundu, & Pedersen, 2010; Dess, Rasheed, McLaughlin, & Priem, 1995), such as manufacturing. Gilley and Rasheed (2000) suggest that outsourcing is often narrowly defined as a discontinuation of internal production by lead firms, and an initiation of procurement from outside suppliers. This substitution-based outsourcing thus involves some vertical disintegration of the lead firms. However, Gilley & Rasheed also point out that outsourcing need not be limited to activities that had previously been undertaken in-house, but suggest that abstention-based outsourcing may arise when a lead firm chooses to purchase goods or services from outside suppliers even though it has the financial and managerial capabilities to internalize the activities. Accordingly, they suggest a broad definition embracing both substitution-based and abstention-based outsourcing. We adopt a similar definition in this paper, and consider outsourcing to be a strategic decision by a lead firm to forego the internalization of an activity (Gilley & Rasheed, 2000: 764) and to buy in intermediate/final products from independent suppliers, even when the lead firm possesses the requisite capabilities to undertake that activity.

Despite the dramatic increase of outsourcing over recent last decades, many issues still need to be better understood and explored. The extant literature has typically focused on the drivers of outsourcing adopting a static viewpoint and without considering how buyer–supplier relationships evolve (e.g. Baraldo, Proença, Proença, & De Castro, 2014; Kaipa & Turkulainen, 2017). Few studies have addressed the issue of outsourcing dynamics (Holcomb & Hitt, 2007; Strange & Magnani, 2017) despite the recent signs of changes in the dynamics of GVCs, with several firms insourcing and/or resharining manufacturing activities (Albertoniti, Elia, Fratocchi, & Piscitello, 2015; Fratocchi, Di Mauro, Barbieri, Nassimbeni, & Zanoni, 2014) as well as the increasing importance of large-first-tier suppliers (Azmeh, Raj-Reichert, & Nadvi, 2015).

Outsourcing dynamics have been studied from two main viewpoints. The first is the industry/product-level perspective on the evolution of GVCs - which builds on global value chain theory (Gereffi, 1999) - and which has been primarily interested in the “upgrading of global value chains” – i.e. moving to higher value activities in GVCs with improved technology, knowledge, and skills (Gereffi et al., 2005). This body of literature looks at strategic upgrading at an aggregate level of analysis, such as industry or clusters (Giuliani, Pietrobelli, & Rabellotti, 2005; Pérez-Luño, Wiklund, & Cabrera, 2011).

The second perspective is found in strategic management studies. This stream of literature (see e.g. Holcomb & Hitt, 2007; Quelin & Duhamel, 2003; Quin, 1999) has typically looked at the drivers of outsourcing, but has generally adopted a static viewpoint and has not considered that buyer-supplier relationships evolve, industry conditions change, and so too may firms’ strategic objectives. From this perspective, outsourcing involves an asymmetric power relationship between the lead firm and its supplier(s) (Mudambi & Venzin, 2010).

Overall, the extant literature lacks an in-depth investigation of the dynamics of outsourcing manufacturing activities. In the following sections of the paper we analyse the dynamics of outsourcing relationships in lead firm-supplier relationships, with a focus on the international outsourcing of core activities like manufacturing, with the aim of achieving a better understanding of its drivers and underlying mechanisms. In order to explain the dynamics of the outsourcing, we address the perspective of power relationships between the lead firm and its supplier(s) (Mudambi & Venzin, 2010). The international outsourcing of production, which contributed substantially to the growth in GVCs, seems to pertain to the case in which relationships between MNEs and their (manufacturing) suppliers are dominated by power asymmetries. Yet these processes have been under-investigated in IB studies, especially when suppliers are based in advanced economies and not in developing countries.

The power asymmetry perspective highlights the relationships between the lead firms and their suppliers, and helps in a deeper understanding of their nature and their evolution over time. Power is certainly an elusive construct, about which much remains to be researched and empirically tested. As Cuevas et al. (2015) argue, power does not necessarily conflict with trust development. Our empirical analysis will permit us to understand whether, and if so how, asymmetric power relationships may also be associated with mutually beneficial behavior.
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