East, west, would home really be best? On dissatisfaction with offshore-outsourcing and firms' inclination to backsource

Ilan Oshri⁎a, Jatinder S. Sidhub, Julia Kotlarskyc

a Loughborough School of Business and Economics, Loughborough University, United Kingdom
b Rotterdam School of Management, Erasmus University, The Netherlands
c Aston Business School, Aston University, United Kingdom

ARTICLE INFO

Keywords:
Backsourcing
Behavioral theory
Managerial expectations
Organizational politics
Sourcing decisions

ABSTRACT

With so many firms seemingly disenchanted with their experiences of offshore outsourcing one may well wonder why relatively few of these firms choose to ‘backsource’—i.e., bring their offshored operations back in-house. Of all sourcing decisions that firms take, back sourcing seems to be perhaps the least understood and least researched. In this article we draw on the behavioral theory of the firm (BTF) to propose a new model in which differences in firms’ inclination to backsource are ascribed to the level of dissatisfaction at not having achieved offshoring aspirations. Building on BTF concepts of bounded rationality, problemistic search and satisficing decisions, the model suggests that how this dissatisfaction with offshoring affects a firm’s inclination to backsource is dependent on managerial expectations regarding the technical challenges of reintegrating activities and the possible financial losses and decline in quality following back sourcing, as well as on internal political support and financial slack for back sourcing. SEM analysis of data from U.S. and U.K. firms shows support for the model. The study highlights the importance of recognizing the role of managerial perceptions and biases and subgroup political relations in shaping firms’ back sourcing behaviors. We also discuss the study’s contributions to research and practice.

1. Introduction

There is tremendous interest in academic and professional circles in understanding more about the drivers and outcomes of firms’ sourcing decisions. To advance understanding, key questions that need attention are why, what, where, how, and when firms outsource (Dibbern, Chin, & Heinzl, 2012; DiRomualdo & Gurbaxani, 1998; Mudambi & Tallman, 2010; Mudambi & Venzin, 2010; Tanriverdi, Konana, & Ge, 2007) and offshore (Aron & Singh, 2005; Doh, Bunyaratavej, & Hahn, 2009; Farrell, 2006; Musteen, 2016). When addressing such questions, scholars have often tended to use transaction-cost economics (TCE) and the resource-based view (RBV) as lenses to model firms’ sourcing decisions as rational choices that capitalize on either the cost or resource advantages that offshoring provides (Aubert, Rivard, & Patry, 1996; Karimi-Alaghehband, Rivard, Wu, & Goyette, 2011; Lewin, Massini, & Peeters, 2009; Mudambi & Venzin, 2010; Vivek, Banwat, & Shankar, 2008). Notably, despite an increasing trend to bring offshored operations back in-house (Bhagwatwar, Hackney, & Desouza, 2011; Ejodame & Oshri, 2017), there has so far been little scrutiny of firms’ decisions to backsource. The handful of studies that have looked at the phenomenon indicate that back sourcing seems to follow disenchantment with offshoring because of a failure to realize anticipated improvements in performance (Veltri, Saunders, & Kavan, 2008; Whitten & Leidner, 2006).

Importantly, however, disenchantment with offshoring does not always lead to back sourcing, raising the intriguing question of why these disappointed firms differ in their inclination to back source. In this article, we address the question by using the behavioral theory of the firm (see Argote & Greve, 2007; Desai, 2016; Gavetti, Greve, Levinthal, & Ocasio, 2012; Tyler & Caner, 2016) as lenses. Rooted in the work of scholars from the Carnegie School (Cyert & March, 1963), the behavioral theory of the firm (BTF) offers an account of the decision making process in firms that is based on realistic assumptions about human cognition and relations. This account suggests that decision making in firms is shaped by decision makers’ bounded rationality and organizational politics. As discussed in more detail later on in the article, we draw on the core ideas of BTF to articulate a model in which variation in firms’ inclination to backsource is ascribed to differences in decision
makers’ dissatisfaction with offshoring, and the problematic search for a solution that dissatisfaction prompts. Furthermore, the model suggests that whether dissatisfaction with offshoring ultimately leads to backsourcing is likely to depend on decision makers’ expectations regarding the technical difficulty of reintegrating offshored work, financial losses, and decline in product quality. Moreover, whether dissatisfaction leads to backsourcing is also likely to depend on what political support for back sourcing there is within the firm, and whether there is financial slack to facilitate the re-aggregation of the firm’s value chain.

Structural equation modeling of data from a cross-industry survey of firms located in the U.S. and the U.K. provides support for the theoretical model. Empirical results show that, while greater dissatisfaction with offshoring is indeed associated with a greater inclination to backsource, the relationship is conditional on managerial perceptions and the political climate in a firm. In particular, the greater the financial loss and the greater the decline in product quality that managers expect to result from discontinuing offshoring, the weaker the relationship between dissatisfaction with offshoring and the inclination to backsource. Surprisingly, though, managerial expectations about the technical difficulty of reintegration do not seem to moderate the effect of dissatisfaction with offshoring. As regards political climate, dissatisfaction with offshoring has a stronger effect on inclination to backsource when there is more political support in the firm for back sourcing. Quite interestingly, contrary to our theoretical model, we find that financial slack weakens the effect of dissatisfaction with offshoring on inclination to backsource. This result seems to suggest that, because greater financial slack provides more buffer, it discourages firms from switching from offshoring to back sourcing – rather than undertaking such a radical shift, firms seem to prefer the status quo, pinning their hopes on an offshoring strategy, despite their dissatisfaction with it.

This article speaks directly to the timely question in this Special Issue’s call for papers, namely, “[w]hat are the factors that influence a firm’s decision to re-shore and back-source?” As the decision to back source is a poorly understood aspect of firms’ outsourcing and offshoring decision making, the article makes several contributions to the literature. It presents one of the first theoretical and empirical inquiries into differences in firms’ inclination to backsource, providing insights into why so many firms are hesitant to backsource, in spite of the widespread dissatisfaction with offshoring reported in the news and business press. It adds to the literature by showing that the expectations of boundedly rational decision makers and organizational politics, both of which are variables that have not received sufficient attention in prior work, play a critical role in guiding backsourcing decisions. More generally, by employing the BTF lens the article augments the literature, complementing earlier research that used TCE and RBV frameworks to suggest that sourcing decisions are shaped by rational cost and resource considerations (cf. Lewin et al., 2009; Mudambi & Venzin, 2010). Since back sourcing and outsourcing are essentially two sides of the sourcing coin, the article indicates that there may be value in also examining outsourcing using a BTF lens – outsourcing choices may very well reflect managerial biases and company politics. In this regard, the article provides a valuable addition to a growing stream of offshoring research that has started to draw on BTF to advance our understanding of sourcing decisions (Massini, Perm-Ajchariyawong, & Lewin, 2010; Musteen, 2016). Overall, the article offers a behavioral explanation of why some firms are more inclined than others to ‘remake’ rather than to ‘continue to buy’.

2. Research background

2.1. Sourcing decisions, and the incidence and challenges of backsourcing

Outsourcing, offshoring, and backsourcing form a spectrum of sourcing options (Aron & Singh, 2005; Dedrick, Carmel, & Kraemer, 2011; Kotlarsky, Scarbrugh, & Oshri, 2014; Metters, 2008; Mudambi & Venzin, 2010). Whereas outsourcing refers to the contracting of external service providers to carry out some of a client firm’s value-chain functions, processes, and activities for a specified length of time and at an agreed cost and service level, offshoring (i.e., offshore outsourcing) refers specifically to the contracting of external service providers operating from an offshore location, usually a developing country separated from the client firm’s country by an ocean (Oshri, Kotlarsky, & Willcocks, 2015). Backsourcing, in contrast, is the practice of bringing offshored operations back in-house (Hirschheim & Lacity, 1998; Whitten & Leidner, 2006). The backsourcing process starts with a decision by a client firm to terminate its existing offshore contracts, and it culminates in the reintegration of the previously offshored operations into the firm’s value chain.²

The last decade has witnessed a growth in the phenomenon of backsourcing across industries. For example, in the retail sector, in 2006 Sainsbury’s backsourced its IT systems from Accenture in a deal worth over $2 billion. In the banking sector, in 2011 the Spanish bank Santander brought back its contact centers from India to the UK, and in 2013 Maybank Singapore brought back its IT function in-house after ten years of a multi-million dollar contract with CSC Computer Services. In terms of sheer scale, the termination of a contract between JP Morgan and IB – centering on the outsourcing of data-centers, helpdesks, and data and voice networks – stands out for the $5 billion sum of money involved (Bhagwatwar et al., 2011; Overby, 2005). These and other backsourcing cases (see, for example, Kotlarsky & Bognar, 2012) seem to signal that firms may backsource even more frequently in the future as part of their overall sourcing strategy (Dibbern, Goles, Hirschheim, & Jayatilaka, 2004). The most common explanation for this growing use of backsourcing is firms’ disenchantment with offshoring as offshoring goals are not realized (e.g., Bhagwatwar et al., 2011; Veltri et al., 2008).

It is important to note that successful backsourcing of offshored operations is not an easy or straightforward process. It represents a major change in sourcing strategy, and can be anticipated to produce substantial technical and financial challenges of the kind that usually accompany large system re-integration projects (Volkoff, Strong, & Elmes, 2005). It may also entail legal difficulties linked to the termination of contracts with service providers (Bhagwatwar et al., 2011). In relation to technical challenges, one significant potential difficulty is that a firm’s capabilities to carry out offshored operations in-house may have atrophied; these thus may need re-building by committing sufficient time and monetary resources to allow the offshored operations to be reincorporated effectively into the firm’s value chain (Bhagwatwar et al., 2011; Ejdame & Oshri, 2017). Below, we draw on the insights of the BTF to submit that, alongside other factors, decision makers’ expectations regarding the technical difficulty of reintegrating offshored operations and the financial losses and decline in product quality if offshore contracts are terminated, will form a crucial element in determining how dissatisfaction with offshoring affects firms’ inclination to backsource.

2.2. The behavioral theory of the firm (BTF) and firms’ inclination to backsource

Two salient premises of the BTF are that decision makers in firms have bounded rationality and that firms are political entities made up of coalitions who may have shared as well as conflicting interests and goals (Cyert & March, 1963; Eisenhardt & Zbaracki, 1992; Gaba & Joseph, 2013; Gavetti et al., 2012). Based on these premises, BTF
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