

Chapter 11

Impact of Strategic Outsourcing on Operational Control

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ABSTRACT

Many studies using the theories of Transaction Cost Economics and the Resource-Based View together with the core competencies approach have confirmed that strategic outsourcing might be an effective means for efficient exploitation of available resources. Additionally, for companies, outsourcing provides access to resources beyond the reach of the intrinsic capabilities of an organisation. In theory, such strategies should fuel competitiveness and operational efficiency. Five cases – all characterised by Make-to-Order or Engineering-to-Order for processing orders – have been reviewed, to explore the operational issues that result from strategic decision-making on outsourcing. From this evaluation, it appears that these companies perform weakly on the control of the outsourced activities. Furthermore, it seems that the (manufacturing) strategy is disconnected from outsourcing practices and that outsourcing is not perceived as contributing to competitive advantage. Finally, traditional criteria and behaviour for decision-making, i.e. a cost-driven perspective, prevail, which does not address the operational challenges for the cases. This chapter indicates that, based on these three theories, strategic decision-making on outsourcing insufficiently accounts for operational issues that emerge later during manufacturing.

INTRODUCTION

Over the past decades, it has been recognised that outsourcing has become a cornerstone for manufacturing strategy. The reasons for outsourcing have been extensively elaborated in academic

literature (Kremic *et al.*, 2006, p. 467). Not only has management science embraced the concept of outsourcing, industrial companies have also done so, sometimes combined with different initiatives, such as downsizing or restructuring (Micklethwait & Wooldridge, 1996), or have presented outsourcing under different labels: out-tasking, offshoring, *etc.* (Beaumont & Kahn, 2005, p. 4). Many have

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positively related outsourcing to performance; for example, Görzig & Stephan (2002, p. 12) confidently associate outsourcing with profits and Görg & Hanley (2004, p. 283) relate it to profitability and plant size. However, it appears that most researchers focus on cost-reduction more than integral performance improvement, as demonstrated by Mazzawi's call (2002, p. 43). Gilley & Rasheed (2000, p. 788) conclude that the benefits of outsourcing may be more fully realised by those firms that pursue cost leadership and innovative differentiation strategies.

In the past decade, increasingly signs appear that outsourcing is not all rosy. Leiblein *et al.* (2002, p. 829) present evidence that the degree of outsourcing does not make a difference for technological performance, using a refined model based on Transaction Cost Economics theory. This is supported by Rothaermel *et al.* (2006, p. 1052) who stipulate that vertical integration and outsourcing should be carefully balanced for technological performance, that way raising doubts about the increasing trend towards outsourcing. Maggi *et al.* (2008) draw similar conclusions for logistics activities related to manufacturing. Furthermore, Broedner *et al.*'s study (2009) points out that outsourcing had a detrimental effect on labour productivity in German firms. In that perspective, Barthélemy (2003) refers to seven deadly sins for outsourcing, one of them being hidden costs, which indicate potential detrimental effects of the decision to outsource. Finally, there is a trend towards insourcing (Caputo & Palumbo, 2005), to meet the criteria of flexibility and responsiveness. Kinkel *et al.* (2008, p. 255) note a similar shift for German SMEs, with flexibility, capacity bottlenecks, quality and coordination costs motivating back sourcing¹ decisions. When Berggren & Bengtsson (2004, p. 221) compare two telecom firms, they conclude that there is no one best way to organise manufacturing and outsourcing; hence, they hint at a relationship between contingencies for strategic decision-making on outsourcing and organisational structures. These

investigations about technological performance, labour productivity and in-/back sourcing contrast with the earlier mentioned studies of Görzig & Stephan (2002), Görg & Hanley (2004) and others about the beneficial effects of outsourcing; this inference is bolstered by Olsen's remark (2006, p. 28) that outsourcing might be more beneficial for services than for manufacturing processes in industrial firms. This points to a conclusion that, although we generally perceive outsourcing as a positive move for companies, factually, we know little about the impact of decision-making about outsourcing manufacturing activities on operations.

Research Objectives

This position is notably strengthened by the wave of literature that followed the introduction of the core competencies approach, which has mainly focused on the decision-making process itself. Beaumont & Khan (2005) propose a taxonomy of literature on outsourcing based on 289 journal articles published between 1986–2003; this overview reveals that many aspects (of decision-making) have been covered by past academic research. For the manufacturing domain, decision-making on outsourcing is often viewed as a one-time process (Cáñez *et al.*, 2000; Hafeez *et al.*, 2002; Humphreys *et al.*, 2002; Probert, 1997), therewith ignoring the dynamics of the business environment and the continuous development of organisations (*e.g.* Dekkers, 2005, pp. 369–370). Others have concentrated on criteria for decision-making, both qualitative and quantitative (for example, Akarte *et al.*, 2001; Choi & Hartley *et al.*, 1996; Dowlatsahi, 2000; Ghodsypour & O'Brien, 1998; Stamm & Gohar, 1993). All these studies indicate that the locus of past research has been mostly on the decision-making process itself and its criteria. At the same time, the implementation – particularly, operational control and performance management for manufacturing – appears to be under-researched (Busi & McIvor [2008, p. 191]

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