

## Chapter 41

# Outsourcing in Knowledge-Based Service Firms

**Ingi Runar Edvardsson**  
*University of Akureyri, Iceland*

**Gudmundur Kristjan Oskarsson**  
*University of Akureyri, Iceland*

### ABSTRACT

*This paper reports on empirical work recently conducted on outsourcing among knowledge-based and other service firms in Iceland. The results show that knowledge-based firms outsource on a larger scale and more human resource functions than other service firms. However, they do not have a more strategic vision towards outsourcing, nor do they outsource more low knowledge-based activities than other firms. The study gives support to the resource-based view of the firm, and is in line with former studies of knowledge-based firms. The firms in the survey tend to keep their core competencies and employees in-house, and at the same time they outsource other functions that they consider non-core, such as peripheral and administrative tasks, or IT that requires technical specialization. The more innovative firms rely on outsourcing from best in class suppliers regarding training and counselling. The contribution of this study to the theory of outsourcing is that the non-routine tacit knowledge base related to firms' core competencies is not limited to knowledge-based firms, but to a large portion of service firms as well.*

### INTRODUCTION

The economies of developed countries are becoming more service-based and knowledge-based (Parkhe, 2007; Targowski, 2009). With the growing number of knowledge-based firms, their rising

share of total value added from services (Betten-court, Ostrom, Brown, & Roundtree, 2002), and their fast growth within the European economy (Miles, 2005) makes them into an important subject of analysis and empirical investigation.

Along with the rising share of services and knowledge in the economy, some organizational restructuring has been taking place, such as

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networking and supply chain change manifested in outsourcing and offshoring. Outsourcing has grown rapidly among public and private organizations in recent years (Bryson, 2007; Di Gregorio, Musteen, & Thomas, 2009; Kadabade & Kadabade, 2002). In all cases, outsourcing always requires third party involvement (Jagersma & van Gorp, 2007). Outsourcing is defined here as allocating or reallocating a firm's internal activities and services to outside providers.

Very few empirical studies have been conducted on outsourcing in knowledge-based firms (KBFs). In order to fill the gap, this paper reports on recently conducted empirical work on outsourcing among service knowledge-based firms, as well as other service firms, in Iceland. More precisely, the paper analyses the strategies for outsourcing, the human resource impact, and outsourcing of core and periphery functions.

KBFs provide services to customers or other firms, and in most cases they produce an intangible output. By and large, the involvement of the customer is vital, and tacit knowledge is central to the activities of many knowledge-based firms. Currie, Michell, and Abanish (2008, p. 96) state for instance: "Most knowledge of the type that gives competitive advantage to firms is not explicit, but tacit, since it resides in the minds of individuals, and is gained through the acquisition of skill and experience. It is this type of knowledge that is usually associated with the core capabilities of organisations". Given these characteristics of KBFs, how does outsourcing affect such firms? Can it contribute to their competitive advantage or does outsourcing weaken their core competencies? In the paper we set out to answer the following research questions: Does a theoretically oriented classification of KBFs reveal more differences in outsourcing than an empirical classification according to knowledge intensity? Do KBFs differ from other firms in the: 1) amount, 2) reasons, 3) kind of activities, and 4) benefit from outsourcing.

With reference to the theoretical perspective of the resource-based view of the firm, we assume

that KBFs outsource more than other firms in order to enhance their competitive advantage; that they outsource more low knowledge-based activities, such as peripheral and administrative tasks than other firms; that they outsource fewer human resource functions than other firms, as tacit knowledge is central to many such firms. The consequence of this would be that KBFs realize more benefits out of outsourcing.

It is hoped that this study will assist managers in making a sound strategy for outsourcing, as well as setting the initial steps in building a theory of outsourcing in KBFs.

As very few firms in the survey (3%) offshored their service activities, the focus of the paper will concentrate on outsourcing.

The next section of the paper deals with theoretical debates on outsourcing. Then the research method and some information on the characteristics of KBFs and other firms in the survey are presented. We present the results on strategies and motives for outsourcing, as well as the actual benefits realized due to outsourcing. The paper ends by discussion and conclusions.

## **THEORETICAL FRAMEWORK**

There is no consensus on the definition of KBFs. Moreover, the concepts of knowledge-based firms, knowledge intensive firms, and knowledge intensive business services (KIBS) are used more or less interchangeably. In many instances the term is either undefined or is defined indirectly, often by providing a brief list of examples (von Nordenflycht, 2010). KBFs are often defined as those firms that are staffed by a large proportion of highly qualified staff (Lee, 1999; Werr & Stjernberg, 2003). Others define KBFs as firms that "create and define problems, develop and apply new knowledge to solve the problems, and then further develop new knowledge through the action of problem solving" (Nonaka, Toyama, & Konno, 2002, p. 41). Still other researchers define KBFs

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