Chapter 2
Business outcomes of outsourcing: lessons from management research

Luca Giustiniano, Lucia Marchegiani, Enzo Peruffo and Luca Pirolo

1. Introduction[1]

Outsourcing has been broadly recognized as an important strategic choice made by companies and other organizations to achieve a wide variety of goals. Many studies have focused on the economic and financial impacts and on the relationship between outsourcers and outsourcees. This chapter offers a comprehensive overview of actual outsourcing outcomes found in management research, including impacts on human capital.

Analysis of the evidence on outsourcing in the OECD STAN database (OECD 2011: 1970-2009) shows that both the number of transactions (deals) and their scope (activities involved) have increased constantly during the last 20 years. Over time, outsourcing popularity peaks have coincided with certain trends, such as business process reengineering, strategic focusing on core business, outsourcing/offshoring strategies, shared services and corporate downsizing (e.g. Brunetta and Peruffo 2014). Furthermore, as recent research shows, companies are expeditiously outsourcing non-core business processes and functions in order to maximize their profits. Business profits can be increased through reducing costs and/or via acquiring external sources of strategic differentiation (e.g. higher-quality raw materials or distinctive expertise/competences able to improve the overall quality of products and services, enabling companies to sell them at higher prices) (De Fontenay and Gans 2008; Gospel and Sako 2010; Angeli and Grimaldi 2010; Doellgast and Gospel 2012; Giustiniano *et al.* 2014). In such a scenario, multinational

1. The authors are very grateful to Howard Gospel, Jan Drahokoupil and the anonymous reviewers for their careful and meticulous reading of the paper, as well as for their constructive feedback.

companies (MNCs) have a wider range of opportunities for outsourcing and offshoring activities due to their scope and international presence. On the other hand, MNCs are exposed to possible changes in employee relations models in the diverse labour markets in which they operate (Marginson and Meardi 2006; Sippola 2011).

At company level, the decision to outsource activities is linked to expected structural and strategic changes which can be assessed through the adoption of a long-term perspective. While immediate results are related to purely economic assessments, long-term effects are more strategic and made up of opportunities (e.g. focus on core competencies and pursuit of greater higher specialization) and drawbacks (e.g. less strategic flexibility). Nevertheless, in a company's strategic plans, management focus is generally on the short-term results due to the (shorter, expected) timespan of their individual assignments and the contingent pressures of shareholders and financial markets.

The short-term nature of outsourcing assessments is also a traditional argument used by trade unions and emphasized by the widening geographic scope of outsourcing and offshoring. While unions have been traditionally considered as opposing outsourcing and offshoring (e.g. Lommerud, Meland and Straume 2009), more recent studies have detected a significant shift from resistance to proactive strategies (Ramioul and De Bruyn 2006). Similarly, MNCs embracing outsourcing are better able to interpret the differences existing in national cultures, business practices, workplace representation systems and collective bargaining structures (Anner *et al.* 2006; Doellgast and Gospel 2012; Pulignano and Doerflinger 2013), contributing to a better local strategic responsiveness in their local subsidiaries (Almond *et al.* 2005; Arrowsmith and Marginson 2006; Bartlett and Ghoshal 1992).

The aim of this chapter is to illustrate the main findings on the expected outcomes as reported in management and financial literature. To achieve this, the chapter explains a number of management paradoxes related to outsourcing, as well as how companies relate to their stakeholders. Management paradoxes referred to include: a) the paradox of financial and economic vs. strategic and organizational outcomes; and b) the time paradox. The chapter draws on previous research conducted on outsourcing antecedents, processes and outcomes, both in general (Marchegiani *et al.*, 2012) and applied to specific activities within the value chain (Gospel and Sako 2010; Doellgast and Gospel 2012; Giustiniano *et al.* 2014; Brunetta, Giustiniano and Marchegiani 2014; Sorrentino *et al.* 2015). The focus is on analyzing the 'lessons learned' reported in management and financial literature to nurture implementation strategies, for use by workers representatives (e.g. Benassi 2011). Among these lessons, it seems useful to affirm that in order to maximize the positive outcomes of outsourcing strategies, organizations have to take into account all the human implications of outsourcing, such as the effects on workers and their representatives. To illustrate this, the investigation on the outsourcing outcomes will be complemented by an analysis of certain aspects related to organizational design (i.e. company boundaries, coordination mechanisms) and labour issues (i.e. human reactions: resistance to change, hidden costs and the loss of competences and competitive advantage).

2. Outsourcing and management paradoxes

The literature analyzed in this chapter shows that the birthplaces of the so-called 'trendy phenomena' in which outsourcing decisions are taken are somehow related to certain management paradoxes companies might face (e.g. Andriopoulos and Lewis 2009). A management paradox is a situation involving the simultaneous presence of contradictory, even mutually exclusive elements (Cameron and Quinn 1988; Clegg, Cunha and Cunha 2002). Such elements may be related to the different nature of outcomes (which we call an outcomes paradox) or the short- vs. long-term orientation in choices (which we call the time paradox). With respect to the first, financial and economic outcomes can be offset by strategic and organizational effects. For example, cost savings may be cancelled out by strategic and organizational rigidity, such as a less effective span of control over the activities and the formal and informal practice of power.

The 'time paradox' related to outsourcing refers to the fact that massive reorganizations of value chain activities call for organizational change which often overtakes the timespans considered when assessing outcomes. In short, while companies expect the organizational settings to adapt to the changes in the medium term, outcomes are generally assessed for the short term. While the short-term perspective focuses on comparing the cost of in-house activities vs. the price of purchasing services and goods from the market, the long-term perspective highlights the effects from a strategic and organizational viewpoint. An organization needs to adopt the latter approach to genuinely estimate the risks linked to the outsourcing strategy, such as i) losing strategic flexibility; ii) sacrificing knowledge; and iii) the 'ex-post cost control' needed to monitor the quality level of the outsourced activities. The situation is even more serious when top managers believe the organizational design will automatically adapt to the new post-outsourcing setting, without inertial constraints or negative reactions. As a result, where companies once sought order, clarity and consistency (as seen in old organization charts and procedures), outsourcing might create paradoxes by generating chaotic contradictions and inconsistencies regarding organizational goals, structures, processes, cultures and even professional identities (Smith and Lewis 2011).

Nevertheless, the achievement of long-term goals depends on both the short-term coordination and control of activities (as they affect company results) and the long-term maintenance of relationships, both with the outsourcees and other stakeholders (e.g. Gittel 2004). As reported by other studies on the subject, a deep understanding of outsourcing requires us to move beyond the oversimplified 'either/or' discourse (typical of the 'make or buy' perspective), complementing the analysis of the resulting trade-offs with the identification of 'both/and' opportunities (Lewis 2000), including the option to create partnerships with external organizations (Geyskens, Steenkamp and Kumar, 2006). Accordingly, this chapter aims to contribute to 're-booting' the managerial mindset through a re-examination of outsourcing phenomena doing justice to their inner complexity. This is even more relevant in MNCs engaged in outsourcing and offshoring practices due to their presence in numerous countries with different institutional settings (e.g. Jarzabkowski and Sillince 2007; Marchegiani *et al.* 2010; Jay 2013; Perri and Peruffo 2014).

3. Companies and their stakeholders

The idea that companies are subject to multiple pressures is not new. In fact any corporation is subject to different groups of 'who or what really counts' (Freeman 1984; Mitchell, Agle and Wood 1997) or 'constituencies' (Zammuto 1984). Such an assumption is opposed to the simplistic economic view by which only a company's owners, or shareholders, count as the company, which is seen as a means to fulfil their aspirations (for example, create and increase value for them). By contrast, the stakeholder approach argues that there are other parties involved, including employees, customers, suppliers (also outsourcees), business partners (for example, allied companies), financiers, communities, governmental bodies, political groups, trade associations and trade unions.

The inclusion of the unions in the framework in which companies might take the decision to outsource requires the illustration of certain conceptual elements related to the way companies relate with their stakeholders, whereby we refer in particular to their *identification* and their *role*.

Donaldson and Preston (1995) introduce three distinct, though mutually supportive, approaches to identifying company stakeholders: descriptive, instrumental and normative. The descriptive approach explains company behaviour and characteristics, while the normative approach focuses on the function of the corporation, identifying the 'moral or philosophical guidelines for the operation and management of the corporation' (Donaldson and Preston 1995, p. 71). Looked at from this angle, when it comes to outsourcing, the literature mostly describes companies as *instrumentally* oriented to financial and strategic goals (see later Par. 2.3, 2.3.1), with minimal consideration of other relevant stakeholders. A normative approach, instead, would suggest a more inclusive consideration of all stakeholders (including trade unions and workers' representatives).

When it comes to the *role* that stakeholders can play, Mitchell, Agle and Wood (1997) propose a model combining the attributes of power (the extent to which one party has the means to impose its will in a relationship), legitimacy (socially accepted and expected structures or behaviour) and urgency (time sensitivity or criticality of stakeholder claims) (p. 865-867). When a stakeholder bases his influence on the company solely on his power, he is classified as dormant. When facing a dormant stakeholder, managers are entitled to stay 'cognizant' (ready to react) but not fully responsive. On the other hand, a stakeholder is dominant when he has power and legitimacy, and definitive when he is also able to address urgent (temporal) claims. Viewing labour unions as claimants of compatible interests with stable links to companies could help them gain a louder voice in outsourcing decisions (e.g. Jones and Wicks 1999). In such a scenario, the role unions could play is particularly relevant in view of the evidence on outsourcing and offshoring affecting employment dynamics and skills/competences over time (e.g. Timmermans and Østergaard 2014). Indeed, the outsourcing of activities does not prevent companies from developing the related knowledge and competences. For example, outsourcing IT still requires companies to maintain and update the related competences if they do not want to gradually lose control over their providers.

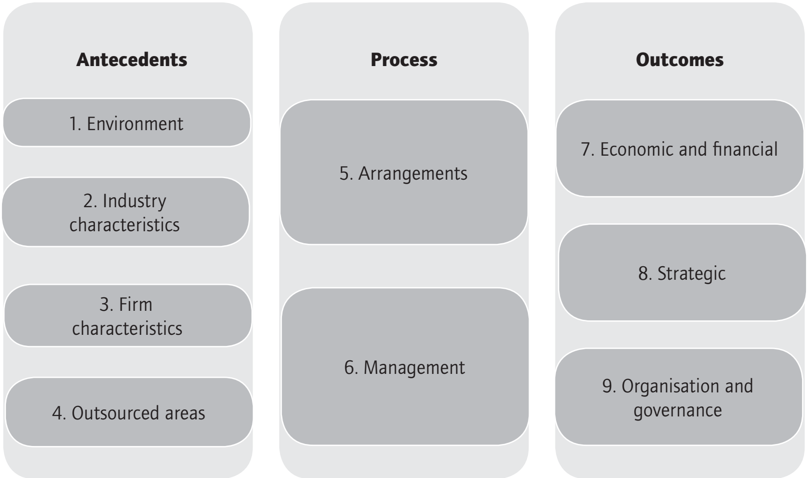
Within the described framework, unions can achieve a progressive centrality (relevance) in company outsourcing decisions by adopting proactive strategies. These would be based on the assumption that a deeper understanding of the 'offshore outsourcing processes should have a long-term positive impact on the economic effectiveness of the company as well as the working conditions and quality of work of the employees in source and destination countries' (Ramioul and De Bruyn 2006, p. 621).

4. Understanding the outcomes of outsourcing

Outsourcing decisions involve complex iterative processes covering the whole company as well as external stakeholders. Such processes can however be broken down into three simple stages: 1) the decision to outsource: why and how firms decide to outsource certain activities; 2) implementation of the outsourcing decisions: how the process of outsourcing should be managed; and 3) assessment of outsourcing outcomes: what are the effects of the outsourcing decisions. Trying to assess the outcomes without considering the previous points would lead to only a partial understanding of the phenomenon. Hence, in dealing with outsourcing outcomes we refer to a general framework – that proposed by Marchegiani *et al.* (2012) – extensively used in the literature: antecedents – processes – outcomes. The framework uses 10 boxes to classify the existing studies on outsourcing into three columns: i) antecedents, ii) processes, and iii) outcomes.

Within this framework, two groups of outsourcing studies can be identified. The first contains studies that fit into a specific box; in general, these describe the relevant phenomena or variables. Within this group, outcomes can be viewed in different ways, ranging from an economic or financial view to a broader management vision. The outcomes can be classified into three categories: economic and financial, strategic and organizational (see Par. 2.3.1, 2.3.2, 2.3.3). The description of such categories also includes the relations between outcomes and such 'antecedents' as a company's characteristics, its sources of competitive advantage and its corporate and business strategies.

Figure 1 **Classificatory framework**



Source: Marchegiani *et al.* 2012

4.1 Economic and financial outcomes

Although outsourcing is generally pursued by companies seeking efficiency gains, assessing the economic impact of outsourcing is not straightforward. From a transaction cost perspective, outsourcing decisions are taken when a comparison of make-costs and buy-costs is in favour of the latter. Thus, in principle the economic outcome of outsourcing should refer to the difference between make and buy. In practice, organizational implications make such a comparison rather complex. Despite the emphasis on performance improvement in most of the literature (e.g. Leiblein and Miller 2003), many studies evaluate this variable through perceptions of advantages, cost-cutting and efficiency, market share and overall exports (Bertrand and Mol 2013).

We present here the main indicators that can be used to measure economic and financial outcomes, together with their relationship to outsourcing antecedents.

The relevant literature shows that economic and financial performance mainly refers to the reactions of financial markets to the announcement of an outsourcing strategy and its effects on a company's value. Oh, Gallivan and Kim (2006) analyzed market perceptions in reaction to IT-related outsourcing announcements and found that investors tend to react favourably to outsourcing when the level of transactional risk is low, while reacting negatively when the arrangements imply high transactional risk. Transactional risks may be related to opportunistic behaviours of providers, high switching cost for replacing them, the monitoring and control of the execution of the deals, increased resource dependency or suboptimal provider performance. Similarly, the study by Hayes, Hunton, and Reck (2000) found positive and significant market value gains for smaller companies compared to larger ones, and for service companies compared to non-service ones. In fact, such companies can overcome competitive gaps (for example, lack of expertise/competence) via the services acquired from the outsourcees.

4.2 Strategic outcomes

The strategic outcomes of outsourcing have been analyzed from both an empirical and a theoretical standpoint. The conclusion drawn by Insinga and Werle (2000) seems still valid: outsourcing is motivated by growing pressure on management to remain competitive through 'accomplishing more with less'. The attempt to achieve more with less is pursued by companies through organizational solutions such as restructuring, downsizing and the reengineering of activities (see for example Peruffo, 2013; Peruffo *et al.* 2014; Peruffo *et al.* 2014). Long-term innovation advantages can be related to outsourcing when companies seek specialized sources to complement and strengthen internal R&D (Bertrand and Mol 2013). Despite the number of studies on the effect of outsourcing on companies' sustainable competitive advantage, actual findings on productivity and efficiency gains are still very fragmented and with a significance limited to specific industries/sectors (Giustiniano and Clarioni, 2013). However, a number of interesting findings have been found at different strategic levels: a) corporate, b) business, and c) functional.

The effect of outsourcing on corporate strategies has been analyzed with respect to vertical integration. This corporate strategy involves a company integrating (value chain) activities which represent either inputs (for example, raw materials) or outputs (for example, distribution channels) for its core business. For example, a producer of musical instruments could acquire a producer of wood (input) or a chain of music stores (output). Rothaermel, Hitt and Jobe (2006) investigated the relationship between strategic outsourcing and vertical integration and found that, by balancing vertical integration and strategic outsourcing, companies could enrich their product portfolio and boost product success, while in turn achieving a major competitive advantage. The latter is related to the degree and success of 'selectiveness', i.e. integrating those inputs/ outputs generating the best synergies with existing activities, and the 'smart' outsourcing of those services that can be delivered at better conditions by other companies (oursourcees). For example, in knowledge-intensive industries (for example, pharmaceutics, biochemistry and healthcare), selective outsourcing could occur in favour of specialized and focused suppliers and in business-related activities (Quinn, 2000). Following this path of study, the contribution of Parmigiani and Mitchell (2009) argues that the concurrent sourcing of complementary components becomes more common when companies have relevant knowledge of the components in conjunction with suppliers (inter-company expertise) and within the company (inner-company shared expertise).

Other studies have investigated the role of outsourcing strategies in pursuing or enhancing competitive advantage at the business strategy level. For example, Gilley and Rasheed (2000) showed that company strategy mediates the relationship between outsourcing and performance. Specifically, on the one hand, 'cost leadership' strategies foster a positive relation between peripheral outsourcing and financial performance and between core outsourcing and innovation performance. On the other hand, strategies of 'strategic differentiation' of products and services (for example, higher-quality products sold at higher prices than the competitors' ones) have a negative relationship. The latter can be explained by the fact that while outsourcing can contribute to 'cost leadership' strategies via the acquisition of services at a lower cost, companies competing on 'quality/differentiation' face more difficulties in nurturing their sources of competitive advantage from external partners. In fact, if the strategy is based on the final quality they should be able to acquire higher-quality services compared to the internal provision thereof.

Similar to corporate and competitive strategies, researchers have also analyzed functional strategies in exploring the link between outsourcing decisions and expected outcomes. With respect to corporate strategy, Quélin and Duhamel (2003) studied the motives of corporate management in large European manufacturing companies engaged in outsourcing and the risks they perceive to be associated with strategic outsourcing of ‘operations’. The study highlighted that the main issues companies might face are related to access to external expertise and the possible quality improvements, as well as the fact that operational cost savings must be in balance with the cost of monitoring suppliers. In a study of functional strategies with a focus on production and innovation activities, Murray, Kotabe and Wildt (1995) hypothesized a moderating effect of product-related factors (product innovations, process innovations and asset specificity) on the relationship between global sourcing strategy and the financial dimension of product market performance. The study summarized that achieving the financial targets set for a product subject to outsourcing depends on the levels of the specificity of the underlying assets, as well on the company’s product and process innovation.

In the research on company characteristics, various authors have focused on the outsourced areas to identify the functions that might produce more positive outsourcing outcomes. The majority of the literature in this area concentrates on IT, seen as the area where outsourcing strategy can be easily implemented with high potential benefits. However, work has also been done in other sectors. For example, Quinn (2000) assumed that innovation and R&D activities play an important role in outsourcing strategies, suggesting that a company can derive higher innovation returns through outsourcing the entire business process or process design activities that are not core competencies. Leiblein and Miller (2003) also investigated the link between innovation, viewed as a possible functional area for outsourcing, and the outcomes of an outsourcing decision. They found that companies with more experience in a particular technological process are more likely to internalize manufacturing activities than are companies lacking such experience. Similarly, companies with high levels of sourcing experience are more likely to outsource their production than those without such experience.

Finally, research on the characteristics able to explain or predict the success of outsourcing has not been limited to ‘internal’ features but has also included some ‘external’ factors, such as the quality of the relationship between a company and its partners. Linking this factor to outsourcing outcomes, Lee and Kim (1999) conducted an in-depth study to investigate whether partnership is an effective way of improving economies of scale and scope in traditional modes of organization. Their study emphasizes that partnership is no guarantee for a desirable outcome. To achieve such, companies must pay particular attention to the quality of partnerships resulting from outsourcing and ensure they are positively influenced by factors such as participation, communication, information-sharing and top management support.

4.3 Organizational outcomes: the effect of outsourcing on human capital

In general terms, all outsourcing strategies affect the boundaries of a company, while the (global) distribution of value chain activities requires new coordination mechanisms (Srikanth and Puranam 2011). In particular, Ceci and Prencipe (2013) posit that physical distance puts pressure on traditional coordination approaches, i.e. focusing on the 'decomposability' of activities into sub-activities and communication. Physical distance, in fact, influences the knowledge boundaries created by the decomposition scheme. Conversely, the 'decomposition' of the value chain and the outsourcing of certain activities affect the division of labour within and outside company boundaries, even internationally. Such new configurations increase the inherent complexity of coordinating labour and knowledge, calling for new organizational practices. Furthermore, Gospel and Sako (2010) found that the 'trajectory' (outsourcing vs. insourcing – transformation vs. preservation of business processes) also affects the distribution of capabilities between users and suppliers.

The underestimation of the core importance of human capital in outsourcing decisions can be also analyzed via other approaches. The individual and collective resistance to outsourcing could generate *hidden* (or less recognizable) *costs*, at least in the short run. Such costs are related to the sub-optimal use of human resources compensating for lacking coordination mechanisms, the sub-optimal allocation of human capabilities, poor preparatory training and inertia. The *hidden* nature of such costs is linked to evidence that actual costs (i.e. wages, bonuses, etc.) are generated by resources unable to develop their full potential. More specifically, such hidden costs are linked to some of the 'dangerous myths about pay' identified by Pfeffer (1998). In fact, managers tend to (wrongly) believe that the cost of labour and labour rates are the same thing, and that therefore companies can reduce overall costs by cutting labour rates (i.e. by offshoring activities). The 'managerial illusion' related to this 'myth' is based on the under-consideration of real productivity (which on the cost side is the ultimate source of profits) in favour of a partial and myopic focus on pay (which is just the compensation/'price' paid for available working hours). The effect of such myths might contribute to the *blindness* of MNCs (*giants*) when international strategies are driven by the tentative exploitation of low-cost localized advantages in labour markets. *Blind giants* are generally defined as any social entity (for example, governmental agencies, regulatory bodies, leading organizations, leading coalitions within companies, unions, other stakeholders) having the power to influence the future trajectories (David 1986) of ‘actors whose vision we would wish to improve before their power dissipates’ (Hanseth 2000, p. 68). All company stakeholders, including top management, can be trapped in this role when they try to promote or compare any international outsourcing initiative without critically assessing the effect of staff defending the ‘in-house’ activity on the whole business.

Despite the abundant literature on the strategic and economic impact of outsourcing, few works have yet focused on labour and workers’ perspectives. Brooks (2006) focused on the potential effects of outsourcing on IT workers, finding that IT workers switch organizations, change jobs or exhibit different work-related behaviour (changes in motivation, involvement or commitment) according to the impact of outsourcing on individual perceptions of job alternatives and job-related satisfaction. By contrast, workers can decide to be loyal to their organization depending on how outsourcing impacts their perception of the profession, career-related opportunities and their ability to change careers. The conclusions drawn by Brooks (2006) can be generalized around the individual perception of outsourcing: where negative perceptions of outsourcing take precedence over an individual’s level of satisfaction and commitment, then the potential loss in performance, productivity and innovation can be detrimental to the company

Some other human reactions to outsourcing (of any kind of activity) are very similar to the ones observed by scholars analyzing IT infrastructure dynamics (Monteiro 2000; Hanseth 2000; Giustiniano and Bolici 2012). Following David (1986) in particular, it is possible to identify some typical situations and actors as the *angry orphans*, namely groups of ‘users’ whose ‘routinized’ standards are changed. Any employees working in area which has any interdependence with an outsourced function might react with inertia or inefficiently to the change. Furthermore, additional and less easily recognized costs are hidden in the loss of competencies in activities believed to be non-core with regard to a company’s competitiveness (Giustiniano and Brunetta, 2015). Such hidden costs include the ex-post costs necessary to reacquire competencies and capabilities, or the costs involved in controlling outsourced activities, with companies forced to hire specialist consultants to control and maintain relationships with providers.

The implementation of outsourcing strategies may also generate new organizational requirements, such as *gateway roles*, i.e. links between the internal and external sections of the same business process. Such roles may be taken on either by liaison/interface employees or by ex-employees of A who have been transferred to B in the course of outsourcing certain activities. Two scenarios might be relevant for human capital: 1) employees remaining with the outsourcing company may experience significant job enrichment through switching from operational duties to coordinating and controlling providers; 2) where employees are taken on by the outsourcee, they may suffer a temporary liminality possibly generating frustration and the loss of individual/organizational identity. The concept of *liminality*, taken from anthropology, refers to a state of being 'betwixt and between' different statuses (Garsten, 1999). Similarly to other contexts, when workers are transferred to another company in the wake of outsourced activities, they might temporarily suffer from crises in their professional and organizational identities (e.g. De Bernardis and Giustiniano, 2015).

Furthermore, unions can play an important complementary if not exclusive role in supporting employees in the case of activities being resourced (Jussila, Gylling and Saarinen 2014). In fact resourcing, meant as the reacquisition of activities previously outsourced, requires the redevelopment of the related competences and skills by the company's staff. This is even more relevant when resourcing also involves the rehiring of previously transferred staff.

5. Conclusion

The description of potential outsourcing outcomes emphasizes the role of organizations as social entities. Only proper consideration of the human aspect (including workers and their representatives) of organizations can help create the conditions necessary for achieving satisfactory outsourcing outcomes. With a view to explaining the possible outsourcing outcomes reported in management literature, we have tried here to unveil some of their inner paradoxes within a wider framework in which trade unions are considered as relevant stakeholders in a company's strategic and operational decisions. While most of previous literature focuses on the financial and strategic outcomes of outsourcing, we have tried to shift attention to the less consolidated evidence on its organizational implication.

Insinga and Werle (2000) argue that the business environment pushes companies to perform certain functions in-house and the rest by aggressive outsourcing. Nevertheless, this strategic choice creates a number of dependencies which, in turn, can lead to unforeseen strategic vulnerability. Such vulnerability can be explained by referring to human capital.

On the one hand, outsourcing offers dramatic opportunities for a company to enhance its competiveness, allowing it to reduce costs or to acquire external 'quality' from providers. On the other hand, the potential loss of distinctive competencies, embedded in a company's human capital, poses a major threat. Therefore, it is in the interest of the companies to avoid such pitfalls. Conversely, unions can help them dodge such myopia.

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