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Exploring and managing the "innovation through outsourcing" paradox ☆

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ABSTRACT

This paper identifies the conditions that create a paradox when firms try to obtain innovation using outsourcing contracts. While outsourcing can be a way to obtain new ideas from business partners, most of the guidelines related to good contract management seem to deter innovative behavior. Managers trying to innovate using outsourcing are therefore facing two opposing sets of constraints, and have to manage both at the same time. In this paper, the nature of the "innovation through outsourcing" paradox is discussed in terms of the tensions between a contractual view of outsourcing and an innovation view of outsourcing, along with their associated reinforcing cycles. The paper outlines four mechanisms that are essentially self-correcting cycles. They include: 1) dual formal reviews; 2) matching governance with level of innovation focus; 3) dynamic decision-making/ "extreme contracting"; and 4) ambidextrous organization. These can enable managers to deal with this paradox and obtain innovation from outsourcing arrangements in a successful manner. Complexities involved in implementing these mechanisms are discussed and some avenues for future research are offered.

Introduction

In the current economy, innovation is a key driver for growth, for firm productivity, and for firm profitability. It is important for companies of all sizes, from start up to multinational firms (Rosenbusch et al., 2011; Tushman and Nadler, 1986). Innovation includes the generation, development, and implementation of new ideas in organizations (Damanpour, 1991). It enables companies to survive in the long term and to remain competitive. While traditionally innovation was done by a single organization, more and more, it requires firms to exchange ideas with other organizations (Chesbrough, 2003). The speed of innovation, and the variety of information required to innovate, increasingly force companies to collaborate with external partners. Not surprisingly, some firms have looked at their outsourcing partners or suppliers for sources of innovation (Oshri et al., 2015). Other research also shows that a firm does not innovate alone, it uses its network of suppliers

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to access their knowledge (Amin and Roberts, 2008). For example, IBM uses a large set of alliances and outsourcing arrangements to create new products or services (Ghemawat, 2007). Further, the benefit of the heterogeneity of contributors on innovation has also been suggested for software innovations (Boudreau, 2012).

However, much research on information technology outsourcing (ITO) has focused on the determinants of ITO, the properties and management of the outsourcing arrangements, and on the specific outcomes associated with the outsourcing contract (Dibbern et al., 2004; Lacity et al., 2010), and there is hardly any research focused on innovating through outsourcing. Researchers have looked at outsourcing as a dependent variable (explaining what to outsource) or looked at its immediate consequences (explaining how to outsource successfully) (Lacity et al., 2010). Research on business process outsourcing mirrored this choice of dependent variables (Lacity et al., 2011). Outsourcing has been mostly analyzed under a contracting or relationship lens, even when investigating the motivations of managers (Seddon et al., 2007). The key results obtained reflect this focus on contract and traditional contractual outcomes.

Moreover, when considering the outsourcing literature, it seems that some elements associated with successful outsourcing contracts might be at odds with innovation, which is known to require flexibility, slack resources, and adaptability (Crossan and Apaydin, 2010; Damanpour, 1991). For instance, successful outsourcing contracts are generally associated with low uncertainty, measurability, and detailed contracts (Lacity et al., 2010). It appears that innovation through outsourcing is a paradox: a set of contradictory elements that both exist and persist over time (Smith and Lewis, 2011). While several elements support the idea that innovation can be obtained through outsourcing, the guidelines for successful outsourcing appear to deter innovation.

This paper uses paradox as the theoretical lens to explore the phenomenon of developing innovations through IT outsourcing, and to develop propositions for successfully managing the paradox and innovate through outsourcing. First, the notion of paradox is reviewed, and its applicability to IT outsourcing and innovation is assessed. Results show that outsourcing and innovation really form a paradox. Following this description, four mechanisms are offered to understand how to resolve the "innovation through outsourcing" paradox; how to obtain innovation from outsourcing, while still ensuring that the outsourcing contract remains manageable. These mechanisms suggest different ways to manage outsourcing relationships when innovation is expected from the outsourcing arrangement. The avenues developed are not solely interesting for practitioners, they open new paths for research on IT outsourcing and innovation.

What is a paradox?

Organizations are complex systems. In order to manage this complexity and to adapt organizations to their environment, managers set up different structures and rules to facilitate their work (Galbraith, 1974). While these rules and *modi operandi* are established, conflicting elements sometimes emerge. These create tensions. These tensions are numerous: tension between exploitation of current business lines and exploration of new lines (Chesbrough, 2010), tensions between employee discretion for problem solving and formal monitoring in Just-in-Time management, or between the need for companies to be global and to adapt locally at the same time (reported in Lewis, 2000). These tensions are often qualified as paradox.

A paradox can be defined as "contradictory yet interrelated elements that exist simultaneously and persist over time. This definition highlights two components of paradox: (1) underlying tensions—that is, elements that seem logical individually but inconsistent and even absurd when juxtaposed and (2) responses that embrace tensions simultaneously" (Smith and Lewis, 2011, p. 382).

In organizations, a paradox reflects the joint existences of two elements that seem logical when considered in isolation, but appear incompatible when considered together, like collaboration and competition, or innovation and efficiency (Eisenhardt, 2000).

On a theoretical level, exploring paradoxes helps discover creative solutions. Different paths were offered to deal with paradoxes when conducting theory building. Researchers could simply accept the existence of a paradox, or try to resolve it by clarifying the level of analysis, by separating conflicting elements into different times, or by introducing new elements offering a new perspective (Poole and Van de Ven, 1989). These avenues are not mutually exclusive.

Paradoxes are important to identify correctly. If they are not recognized, there is a risk that they will be managed by focusing only on the most pressing problem. This can lead to a downward spiral in which actions only address one of the conflicting components. Ignoring paradox to select only one path can lead to a tunnel vision and be detrimental to the organization. In these situations the managers enter vicious circles in which each response to a difficulty intensifies the problem instead of solving it (Miller, 1992). Paradoxes can also create paralysis in organizations. Managers can be torn between conflicting demands and become incapable of deciding a course of action (Lewis, 2000).

Adequately managing paradoxes and meeting conflicting demands enable long-term success for organizations (Smith et al., 2010; Smith and Lewis, 2011). Paradoxes have been used to understand many complex organizational situations: control and autonomy in team innovation (Gebert et al., 2010), or in corporate governance (Sundaramurthy and Lewis, 2003), exploration and exploration in innovation (O'Reilly and Tushman, 2004), or in business strategy (Smith et al., 2010).

Investigating the paradox in innovation through outsourcing

In order to resolve a paradox, Sundaramurthy and Lewis (2003) proceed with three steps: