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Breaking the outsourcing path: Backsourcing process and outsourcing lock-in

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ABSTRACT

The objective of this paper is to develop research on backsourcing, which consists in recalling outsourced activities back in-house. We focus on the processes that firms follow to backsource these activities, particularly when they are locked into outsourcing. We refer to path dependence and path creation concepts to conduct this research. Using a case study methodology, we analyze the process related to the backsourcing of information technology activities in a telecommunications company. This paper highlights the negative effects of the need to control outsourced activities as it maintains outsourcing lock-in. Organizational crises and the perception of backsourcing as a success are two elements that enable significant mindful deviations from outsourcing practices and the development of a backsourcing path. The decision to backsource and its implementation can be facilitated by past successful integration experiences, internal productive capabilities, and capabilities to control activities. Changes in power relations within the firm can sustain the development of a backsourcing path. Our research contributes to research on organizational path breaking by studying the backsourcing process as an outsourcing path breaker. This paper complements studies on organizational practices such as outsourcing and backsourcing and their interplay.

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1. Introduction

After extensive outsourcing, some large firms, such as JP Morgan in 2004, Deutsche Post in 2008 (Bengtsson & Berggren, 2008; Qu, Oh, & Pinsonneault, 2010), and General Motors in 2012,¹ decided to backsource some of their activities, that is, recall outsourced activities back in-house. Research has been developed to understand these backsourcing decisions (Cabral, Quélin, & Maia, 2014; Chanson, 2008; Drauz, 2014; Freytag, Clarke, & Evald, 2012; Fréry & Law-Kheng, 2007; Veltri, Saunders, & Kavan, 2008; Whitten, Chakrabarty, & Wakefield, 2010). The main reasons cited for backsourcing are that firms experience outsourcing failure or ultimately consider outsourcing an outdated business model for their activities (Immelt, 2012; Veltri et al., 2008).

However, apart from these successful publicized backsourcing cases, only a few firms elect to backsource activities. According to Deloitte's 2014 survey,² only a quarter of the surveyed firms decided to backsource an outsourced activity after terminating the outsourcing contract. One reason behind the lack of a general backsourcing trend may be the difficulties companies encounter to backsource activities, resulting from the fact that they are locked into an outsourcing path. According to the concept of path dependence (Arthur, 1989; David, 1985), the scope of actions taken by organizations can narrow over time to only one action because of past events, decisions, or self-reinforcing mechanisms. Moreover, from a path creation perspective (Garud & Karnøe, 2001; Garud, Kumaraswamy, & Karnøe, 2010), actors in organizations, by their continuous actions, can deliberately influence the emergence of organizational paths without the ability to control those paths. Finally, organizations may find themselves voluntarily or involuntarily locked into outsourcing.

To our knowledge, no research on backsourcing has been undertaken using both the path dependence and path creation perspectives. Therefore, to complement research on backsourcing, this paper focuses on how firms backsource activities despite being

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¹ Reuters. GM reverses gears on outsourcing, plans big IT overhaul. (2012). <http://www.reuters.com/article/us-gm-outsourcing-idUSBRE86B1BT20120712/> 10.08.16.

² Deloitte. Deloitte's 2014 Global Outsourcing and Insourcing Survey. (2014). <http://www2.deloitte.com/content/dam/Deloitte/us/Documents/strategy/us-2014-global-outsourcing-insourcing-survey-report-123114.pdf> 10.08.16.

locked into outsourcing because of path-dependent mechanisms.

We study this question by using a longitudinal and embedded case relating to the process of back-sourcing information technology (IT) activities at a large firm in the telecommunications industry. The study shows that the firm followed a back-sourcing process encompassing the following four phases: outsourcing lock-in, organizational crisis, emergency back-sourcing, and proactive back-sourcing. Our study highlights the negative effects of the need to control outsourced activities as it maintains outsourcing lock-in. Organizational crises and the perception of back-sourcing as a success are two elements that enable significant mindful deviations from outsourcing practices and the development of a back-sourcing path. The decision to back-source and its implementation can be facilitated by past successful integration experiences, internal productive capabilities, and capabilities to control activities. Changes in power relations within the firm can sustain the development of a back-sourcing path.

Our paper's contribution is two-fold. First, this paper complements organization research that focuses on path breaking by studying back-sourcing process as an outsourcing path breaker. This paper confirms that actors in organizations are not passive when facing organizational lock-in because they try to deviate mindfully from lock-in. Moreover, organizational crises help enlarge mindful deviations. Second, our paper contributes to the research on back-sourcing and analyzes the interplay among back-sourcing decisions, a firm's situation, managers' interests, and past decisions (Mackay & Chia, 2013).

The remainder of the paper is structured as follows. In the following section, we review studies on the formation of the outsourcing path and lock-in to outsourcing as well as ways to break from this path. The subsequent section presents our research design based on face-to-face interviews. The last three sections present our case analysis and main findings, a discussion of our findings and research propositions, and, finally, our conclusions.

2. Theoretical background

Our research objective is to understand how firms take outsourced activities back in-house despite their being locked into outsourcing by path-dependent mechanisms. In this section, we review the reasons for back-sourcing and the processes that lead to organizational lock-in and to path breaking according to path dependence and path creation concepts.

2.1. Reasons for back-sourcing

There are two main reasons for back-sourcing decisions (Veltri et al., 2008), which consist in deciding “to reincorporate a given activity within a company that had formerly been transferred to an external supplier” (Cabral et al., 2014, p. 366): (1) outsourcing has resulted in failure and back-sourcing is viewed as a solution to correct outsourcing problems, and (2) external or internal changes may motivate firms to back-source activities to respond to new opportunities created by these changes.

Several factors can explain outsourcing failure. First, outsourcing may be costlier than expected. While outsourcing, firms may not have considered all costs, transaction costs in particular (Barthélemy, 2003). Second, vendors can behave opportunistically either ex ante or ex post, like in the “winner's curse” (Kern, Willcocks, & Van Heck, 2002), all the more so as the outsourced transactions involve highly specific assets. Third, the incomplete nature of outsourcing contracts can be a source of outsourcing failure and necessitates strong capabilities to design and monitor contracts (Cabral et al., 2014), which may increase

costs and reduce outsourcing advantages. Therefore, firms may decide to vacillate between opposite modes of organization, such as integration, to conciliate efficiency and flexibility (Nickerson & Zenger, 2002).

External or internal changes assume other reasons for back-sourcing. Concerning external changes, Drauz (2014) noted that during economic crises, a decrease in demand may motivate firms to back-source production activities because of underutilized internal productive capabilities. Pressures for back-sourcing may also come from the institutional environment and bandwagon behavior (Cabral et al., 2014). For internal changes, the arrival of new executives and the recognition of the importance of outsourced activities for the firm may set reintegration (Veltri et al., 2008). Cacciatori and Jacobides (2005) showed that for manufacturing or service industries, pressures to reintegrate activities may come both from external changes regarding the demand environment and from internal changes such as firms trying to protect or expand their position. Thus, Glimstedt, Bratt, and Karlsson (2010) demonstrated that back-sourcing can be a way to control innovation. Although research gives clear ideas for the different reasons for back-sourcing, questions remain as to how firms decide to back-source activities in cases of organizational lock-in to outsourcing.

2.2. Path dependence, path creation, and lock-in

The path dependence concept was originally used to explain the diffusion and persistence of technological innovations, although these innovations are suboptimal (Arthur, 1989; David, 1985). This concept has recently been extended to organizations to explain organizational rigidity, inertia, or lock-in (Garud et al., 2010; Koch, 2011; Schreyögg & Sydow, 2011; Sydow, Schreyögg, & Koch, 2009; Vergne & Durand, 2010).

Organizations are said to follow a path-dependent pattern whenever they are constrained to an increasingly narrow scope of actions and have no other alternative. This lock-in is the result of self-reinforcing mechanisms that foster the adoption of initially and potentially inefficient paths. These mechanisms include positive feedback processes such as coordination, complementarity, and learning or adaptive expectation effects (Sydow et al., 2009). They can result from increasing returns such as higher productivity (Arthur, 1989; Pierson, 2000) and constant or even decreasing returns (Dobusch & Schüßler, 2013). Self-reinforcing mechanisms may also involve negative feedback processes (Page, 2006; Vergne & Durand, 2010). These processes rely on negative externalities such as constraints in terms of budget, space, or time that will prevent organizations from selecting other choices and directly impose a path on organizations.

Recently, Garud and Karnøe (2001) introduced the concept of path creation that complements the concept of path dependence. Although the authors both view path formation as historically embedded, they differ in their opinion of the mechanisms that lead to path stabilization and lock-in (Meyer & Schubert, 2007). In contrast to path dependence, path formations are influenced by human agency. Actors in organizations deliberately and mindfully deviate from existing procedures or rules and therefore initiate the formation of a path (Garud et al., 2010). Although a path can be induced by the continuous actions of multiple actors, actors may not be sure of the effects of their actions on the path. Therefore, there is no guarantee that actors can control path development.

The path constitution concept has been recently developed to integrate the path dependence and path creation concepts (Meyer & Schubert, 2007; Sydow, Windeler, Müller-Seitz, & Lange, 2012). Instead of strictly opposing path dependence and path creation, the path constitution concept considers these two former concepts as

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