Chapter 18

Strategic Implications of Information Technology for Resource and Capability Outsourcing Decisions

Paul Drnevich
University of Alabama, USA

Thomas H. Brush
Purdue University, USA

Mark T. Shanley
University of Illinois at Chicago, USA

ABSTRACT

Outsourcing generally involves non-strategic resources and/or non-asset specific capabilities. However, in this paper, the authors examine the non-traditional, but increasingly more common, use of IT to facilitate theoretically inconsistent outsourcing decisions involving core resources and capabilities. The authors reconcile theory with practice by developing propositions to explain how IT can enable such outsourcing decisions and how performance advantages may ensue. The authors develop a finer-grained perspective of the constructs of knowledge-based resources and capabilities. The paper concludes with a discussion arguing that such IT-enabled outsourcing decisions, if implemented correctly, can provide an organization with both capability advantages and cost benefits, resulting in higher performance.

INTRODUCTION

The practices of outsourcing and offshoring are popular trends (Hunter & Cooksey, 2004; Clegg, Burdon, & Nikolova, 2005; Cornelissen, Floyd, & Wright, 2005; Doh, 2005; Lacity, Willecocks, & Rottman, 2008), with outsourcing decisions generally based on cost and efficiency arguments stemming from the resource-based view (RBV) (Barney, 1991; Mahoney & Pandian, 1992) and/or transaction cost economics (TCE) (Williamson, 1975, 1991). These decisions rely on the notions of not outsourcing ‘core’ or ‘strategic’ firm resources (from an RBV perspective) or ‘firm-specific’ assets (from a TCE perspective). Yet, even when following such theory guidelines,
outsourcing does not always lead to competitive advantages and/or improved performance (Lacity & Hirschheim, 1995; Loh & Venkatraman, 1992; Mahoney & Pandian, 1992; Watjatrakul, 2005), and ineffective outsourcing decisions can result in a loss of organizational capabilities and even affect firm survival (Loh & Venkatraman, 1992; Ngwenyama & Bryson, 1999).

However, many firms are successfully buying some things they should make (i.e., strategic resources and unique firm-specific capabilities), and/or making some things they should buy (i.e., non-strategic resources and non-firm-specific capabilities) - the performance implications of which should be disadvantageous. Are these firms merely lucky, and enjoying temporary short-term cost advantages at the expense of long-term competitive advantage and firm survival? Perhaps firms are lucky in some cases, but in other cases, is it possible that we are observing some unique phenomena that provide some cause to reconsider the predictive logics of RBV and TCE? If so, what conclusions could we draw from such ‘counter-theoretical’ outsourcing decisions that lead to improved performance and/or competitive advantages? Would such observations indicate that the types of resources and capabilities firms outsource, and the ways firms outsource them, have changed from our accepted theoretical logics for the sourcing decisions from RBV and TCE? If so, they may hold new implications for the firm, providing cause to re-examine our theoretical perspectives for outsourcing decisions, and their implications for research and practice.

Prior research has examined the general cost and efficiency arguments for outsourcing and provides strong evidence to support the cost efficiency argument (Clegg et al., 2005). Other concurrent work has examined the specific roles of firm ‘asset specificity’ and ‘uncertainty’ from TCE and ‘core’ or ‘strategic’ resources from RBV as drivers of IT related sourcing decisions, and identified contexts where the theories differ (Watjatrakul, 2005). However, we still do not have a strong understanding of the implications of outsourcing decisions that appear to successfully conflict with theories’ predictive logics. Therefore, in this study, we review and extend these theoretical perspectives for outsourcing decisions. We do this to attempt to address some of the major understudied research questions in this area: (1) What is the process for making effective outsourcing decisions; and (2) How do firms realize performance benefits from these types of sourcing arrangements?

We organize this paper as follows: In the next section, we review related literature to examine and extend existing theory on outsourcing. Then we leverage our extended theory to develop propositions for the types of resources and capabilities to outsource under these conditions. We conclude with a discussion of the contributions and implications of our paper for future research and management practice.

**THEORY DEVELOPMENT**

Outsourcing refers to a management decision to “abandon or forgo attempts to perform certain value chain activities internally and instead farm them out to outside specialists and strategic allies” (Thompson, Strickland, & Gamble, 2006, p. 175). The outsourcing process usually involves firms consolidating around their primary activities and core competencies, while outsourcing some or all of their support activities and non-core capabilities. Outsourcing decisions are made with the expectation of significant efficiency gains for the firm through focusing “time, effort and capital on value-creating activities that yield a competitive advantage, an improved overall performance, and security for the organizations’ long-term survival” (Hunter & Cooksey, 2004, p. 27). However, debate about the merits and processes of sourcing decisions has been considerable and the implications of outsourcing are far from clear (Porter & Millar, 1985; Vitale, 1986; McFarlan, 1990; Clemons &