Chapter I

Development of Outsourcing Theory and Practice: A Taxonomy of Outsourcing Generations

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Abstract

This chapter tracks the evolution of outsourcing theory and practice in order to develop a taxonomy of outsourcing generations. Our taxonomy identifies three generations, distinguished according to several definitional criteria: key drivers, outsourcing activities, relational features, critical success factors and performance measurement. Case study evidence consistent with the taxonomy proposed provides support to its efficacy as a valuable analytical platform for the study of outsourcing as a dynamic construct.

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Introduction

Although outsourcing today is bigger than ever before, and is receiving increasing attention in the management literature, it would be erroneous to think of it as a new phenomenon since sub-contacting practices have been part of the corporate landscape since the industrial revolution. It is equally important to emphasise that the theoretical underpinnings of the make-or-buy decision, framed as it is within the “bigger-is-better” versus “small-is-beautiful” debate (Harrison, 1994; Tucci & Sweo, 1996; Lonsdale & Cox, 2000; Lewin & Johnston, 2000), also have a very long history.

The purpose of this chapter is to trace the evolution of outsourcing theory and practice in order to formulate a taxonomy of outsourcing generations. The chapter begins by exploring the roots of outsourcing theory and by framing its development in the context of the “bigger-is-better” versus “small-is-beautiful” debate. This historical review is then used to identify drivers for, and basic features and outcomes of outsourcing. After a critical evaluation of models aimed at guiding the decision of what should be contracted out, we develop a framework of outsourcing generations articulated across five dimensions (key drivers, outsourced activities, relational features, critical success factors, and performance measurement) and offer case study evidence consistent with the taxonomy proposed.

Bigger-is-Better vs. Small-is-Beautiful

As early as 1885, in his Principles of Political Economy, John Stuart Mill was theorising about the benefits of production on a large vis-à-vis small scale. Drawing from the earlier writings of Adam Smith on the advantages to be accrued from specialisation and the division of labour, Mill argued that “the larger the enterprise, the farther the division of labour may be carried. This is one of the principal causes of large manufactories” (Mill, 1885, p. 81). He further contended that “as a general rule, the expenses of a business do not increase by any means proportionally to the quantity of business” (p. 82) and concluded that “the large system of production is inevitable” (p. 83).

It is upon these theoretical antecedents to the theory of economies of scale that the rationale for the “bigger-is-better” corporate paradigm of the post-war period can be positioned. As theory developed, the arguments in support of the high volume strategy of large, hierarchical organisations mounted. In addition to taking advantage of economies of scale, vertical integration offered opportunities to secure suppliers and distribution channels, horizontal integration allowed access to a wider market, and conglomerate/portfolio diversification provided the potential to benefit from risk spreading and economies of scope.

As organisations of the 1960s and 1970s kept growing by expanding their boundaries, the 1980s witnessed a radical u-turn in the consciousness of academics, management gurus and captains of industry alike, with the key to competitiveness suddenly being looked for in “small size and high value” rather than “large size and high volume”.

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