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Outsourcing Decision in Capabilities Perspective

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KEYWORDS

Outsourcing Strategy, Strategic Outsourcing, Strategic Capabilities, Strategic Liabilities, Parity Effect, Value Chain, Strategic Competitive Advantage, Organization Resources, Resources' Rarity & Value, Competitive Intensity, Competitive Heterogeneity, Robust Advantage, Core Competencies, Integrated Decision Making Model Make or Buy, Business Cost

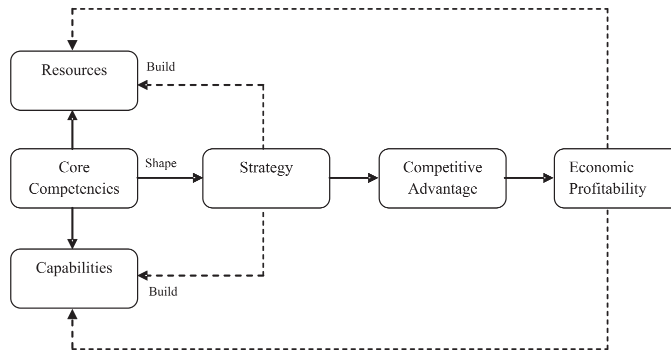
ABSTRACT

There are many theories and framework which suggest performance link to strategy and / or resources. In order to succeed in the market, the organization must transform its core strengths into competitive advantages so that it becomes harder for its rivals to snatch its customers and market share. This paper has attempted to integrate the issue of weakness emanating out of the capability frame in terms of strategic decision in outsourcing. With the help of our proposed "Integrated Decision Making Model" for strategic outsourcing,, significant advantage can be achieved by directing investments and efforts in areas where firms perform better as compared to others. Over time, a continued effort to develop core competencies by building strategic capabilities (strengths) and minimizing strategic liabilities (weaknesses), bar the present or future competitors to expand into the company's areas of interest, thus helps to defend the strategic competitive advantages lying in the firm's value chain.

Introduction

In strategic management, decisions are made on purpose in order to have the performance outcome in the form of competitive advantage. By the same logic, it follows that performance would only increase in a firm that has competitive advantage. Managers use many tools when it comes to strategic decision making; the stakes are high and managers want to

use reliable techniques to uncap the mystery of uncertainty and test the dependability of the decisions that they make. Many authors (Miles & Snow 1978, Porter 1980, Miller 1986) have suggested that there is a link between performance and strategy. Recently, authors (Wernerfelt 1984, Barney 1991, Sirmon 2010) have emphasized linking performance to resources through which decision makers can analyze their core strengths and bolster their competitiveness against industry rivals. Rothaermel (2008) theoretical model investigates further the factors that contribute towards competitive advantage.



Source: Technological Innovation: Generating Economic Results Advances in the Study of Entrepreneurship, Innovation and Economic Growth, Volume 18, 201–225 (Page 209-Chapter 7)

Frank-2008 model suggests that organizational resources and capabilities make an impact through various integrated or complex frameworks on competitive advantage and performance.

However, this model is not comprehensive in capturing the decision in its totality or in complexity. Therefore, this research paper presents a comprehensive model that will incorporate the original with elaborated framework as well as target the strategic outsourcing decision which has been ignored because outsourcing is normally based on the weakness of capabilities. In theory, there is definitely a relationship between resources, capabilities and a whole frame. These resources do not interact directly with the market. The interaction comes into play through strategies. Organizational resources and capabilities are actually converted into strategies to achieve competitive advantage. Strategic management is targeted into decision making which improves competitive advantage and makes an impact on performance as defined by literature (Covin & Miles, 1999).

Competitive advantage can be achieved through two logical frames; one is resource based while the other is the strategic frame. However, in an integrative frame, strategies are devel-

oped on the basis of the strengths and weaknesses of capabilities. Theory also suggests (Sirmon, Hitt, Campbell-2010) that a firm's performance is largely influenced by external environmental factors. These factors impact its performance, strengths, and weaknesses in a positive or negative way. In a dynamic competitive environment, strong parity effect occurs when organizational strength shifts towards weakness. The test lies in figuring out a way to build a sustainable competitive advantage, and deal with capability weaknesses in a dynamic marketplace that is continually evolving.

In resources strategy, outsourcing has attracted significant attention in the contemporary business world. For example, Apple Inc. focuses its internal resources on its own Apple IOS operating system and products only. The architecture section of the company developed software that exactly met the consumers' needs and expectations. Apple not only benefited from its internal capabilities but also from the Research & Development efforts by its value chain members and raw material vendors. It continuously adapts to changing market trends and brings innovation in its products in order to stay competitive in the industry. With the help of these strategies, Apple Inc. remained the top market leader on the basis of market share and capital turnover in the 1980's (Moritz 1984).

This type of outsourcing is like "make or buy" examples in HR. There are many functions that may be outsourced, even in marketing. For example, distribution, advertisement or in the entire value chain where except core competence area, rest can be outsourced. According to survey (Outsourcing Institute-1998), there are ten top reasons which require companies to outsource their operations. These reasons include: (1) minimizing the business costs, (2) improving organizational focus (3) reaching world-class capabilities and opportunities (4) capitalizing on internal resources and capabilities (5) getting access to the resources which are not readily available in the local markets (6) improving the research, manufacturing, and engineering capabilities, (7) managing complex organizational procedures (8) strengthen financial position (9) controlling environmental threats, risks, and complexities, and (10) avoid cash crisis or financial difficulties. Thus the goal of the article is "To suggest outsourcing as a significant strategy which has not been given as much significance as other type of strategies which are generic strategies. We will approach this by reviewing literature which will cover these three points: (1) Competitive Advantage (2) Capabilities and (3) Strategies which are actually applied and then come through outsourcing strategies. To do all this, the basic model we are using is as proposed by Frank T. Rothaermel 2008. And to further dig that model, we will demonstrate how outsourcing strategies will apply on capabilities outcome or strategy outcome on performance.

Literature Review

Achieving and sustaining competitive advantage is the outlining question of a strategy. Similarly, managers are motivated by attempting to answer basic questions like, "'How the firm's overall performance is determined and why some organization succeed in the start-up and others fail". As an entrepreneur or manager, what can you do about it?

Another reason why researchers make efforts to figure out the effectiveness of the strategies formulated and implemented by different companies is to identify and explain the internal performance parameters which these companies use while designing their strategies. Research suggests that a firm's strategy entails each and every element which a manager considers during the course of achieving a competitive advantage for his firm (Drucker, 1994). An organization cannot achieve a competitive advantage if it does not capitalize on its strengths and core competencies on continuous basis (Dierickx and Cool, 1989). In strategizing resources, among many strategies, one strategy is to either build and transform the weak capability into strength in-house or outsource to achieve or maintain competitive advantage. Grant (1991) believes that an organization chooses outsourcing strategy in order to gain a competitive advantage which is not possible to be gained through its internal capabilities, competencies, or resources.

Firms, as a whole have to survive in dynamic atmospheres and many factors affect decisions. The work of Wernerfelt (1984) and Barney (1991) discusses an important theory which explains the importance of an organization's internal resources and competencies for gaining competitive advantage in the industry. This theory is called RBV – The Resource Based Theory that describes the characteristics of an organization's resources which can help it in gaining competitive advantage. This theory focuses on rarity and value of such resources. A typical organization has both tangible and intangible resources. The most common resources which an organization can possess comprise of workforce, brand identity, technology, plant and machinery, building, patents, and of course – the money which is invested by the shareholders of that company (Wernerfelt, 1984).

RBV theory also suggests that outsourcing strategy may be considered successful when the company observes a positive improvement in all or any of its business operations. For example, the improvement can be observed in sales performance, technology, inventory management, quality of the products, customer satisfaction, market share, etc. Teng (1995) believes that strategic outsourcing decisions are successful when the performance of an organization is according to its set expectation or when the efficiency of its value chain

members increases. The resource based view also suggests the impact of competitive heterogeneity on a firm's performance. It describes that firms within the same industry may possess different resources, capabilities, and distinctive competencies. These differences create heterogeneity when these firms have to design their competitive strategies (Peteraf, 1993; Hoopes, Madsen, and Walker, 2003). Quoting an example from Arend which states that "the RBV only tells half of the story; the RBV considers only factors that positively contribute to sustained performance" (Arend RJ. 2004).

Montgomery (1995) explores the negative impact of resources which cannot give any competitive advantage to the firms. These resources can only be considered normal operational necessities of the firm without giving them any credit towards competitiveness. A number of researchers have discussed the negative impacts of competitive disadvantages which are caused by weak organizational resources (Leonard-Barton, 1992; West and DeCastro, 2001, Powell, 2001). Arend (2004) believes that weak organizational resources are basically the company's strategies liabilities which always hinder its performance against its industry rivals. Therefore, they can be put on the liability side of the balance sheet (Arend, 2004). Sirmon (2010) believes that an organization's strengths and weaknesses have a direct impact on its operational and financial performance. In order to succeed in the market, the organization has to capitalize on its strengths and overcome its weaknesses so that it can compete with its competitors in a more profitable and competitive fashion. However, the organization must transform its core strengths into competitive advantages so that it becomes harder for its rivals to snatch its customers and market share.

		Relative strength set	
		Low	**High**
Relative weakness set	**Low**	**I** Offsetting - undifferentiated Neutral performance effect (0)	**II** Robust advantage Positive performance effect (+)
	High	**III** Undermining Negative performance effect (-)	**IV** Precarious advantage Positive performance effect (+)

Source: The Dynamic Interplay of Capability Strengths & Weaknesses – Strategic Mgt Journal 31: 1386-1409 (2010) Sirmon, D. G., Hitt, M. A., Arregle, J.-L. and Campbell, J. T. (2010).

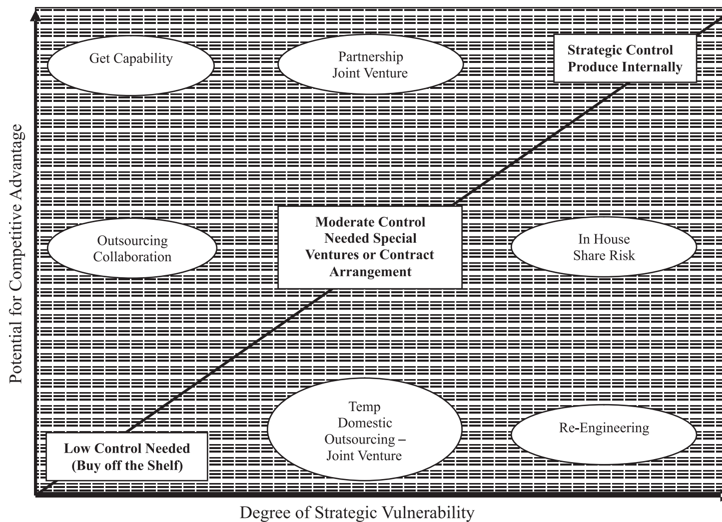
It is very rare for an organization to operate in "Robust Advantage" area or with precarious advantage in a dynamic market place. The "All for One" effect also focuses on the strengths and internal resources rather than weaknesses or limitations in the organizational procedures (Barnett and McKendrick, 2004). In order to beat the competition in the most effective way, an organization must keep in view the environmental complexities and challenges which can hinder or support its performance at any point in time.

Eisenhardt & Martin (2000) believe an organization's dynamic capabilities are those which can easily be identified by the external stakeholders. These capabilities may include manufacturing processes, decision making approaches, strategic business relationships, etc. In contrast to the Resource Based View (RBV) theory, Eisenhardt & Martin (2000) argue that a firm can achieve competitive advantage through its dynamic capabilities; not from its resources which may be strong or weak at any point in time. Therefore, they suggest that organizations should capitalize on their dynamic capabilities like quality management, production efficiency, value chain, inventory management, leadership and personnel management, etc. in order to achieve success in the industry.

	Porters Frame Work	**RBV Frame Work**	**Dynamic Interplay of Capabilities**
Focus on Strategic Attention	Industry/Business (Outside in)	Corporation Extended (Inside out)	Integrative Effects Of Strengths / Weaknesses sets
Type of Competitive Advantage	Low Cost or differentiation Lock In	Resources / Capabilities	Capabilities
Basic Unit of Competitive Advantage	Activities	Core Products, Strategic Architecture	Robust Advantage / Precarious Advantage
Strategy As	Rivalry	Resources / Capabilities Optimization	Shift from Parity to strengths over time

Source: http://www.12manage.com/methods_hax_wilde_delta_model.html
(Adopted and rework by adding Dynamic Interplay of Capability)

Outsourcing is a commonly accepted and growing practice and helps the organization to achieve sustainable competitive advantage. However, outsourcing is not the answer to every capability weakness and is highly subject to a careful analysis of internal resources and core competencies for successful outsourcing strategies.



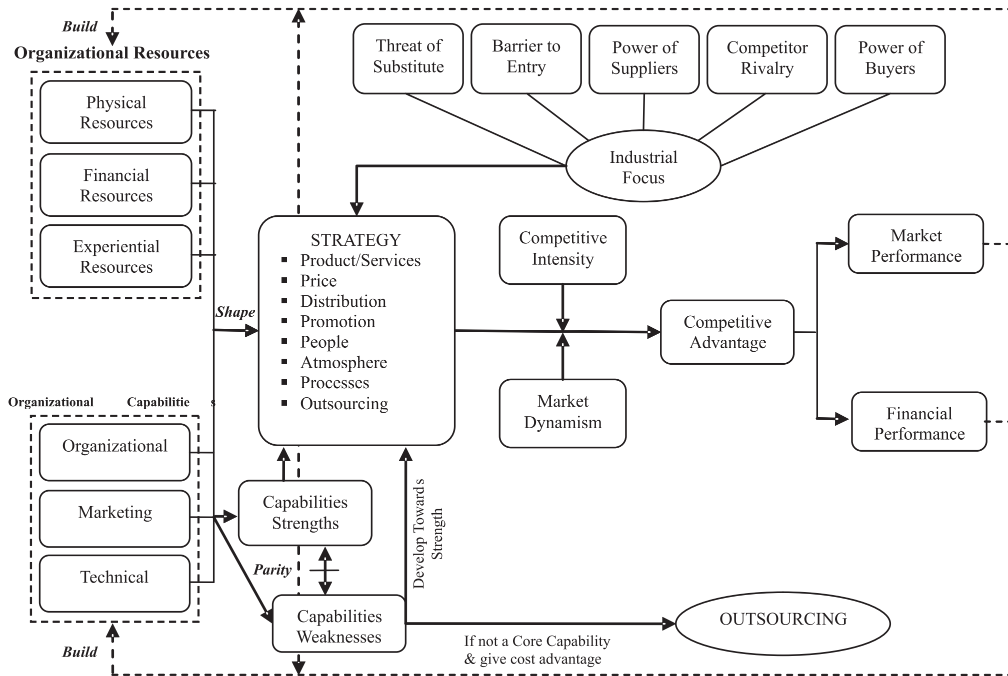
Source: James Brian Quinn & Frederick G Hilmer,
The Mckinsey Quarterly 1995 Number 1

The above figure presents a comprehensive depiction of strategic vulnerability and competitive edge. When these two factors are high, the company needs to invest heavily in its competitive strategies. It may enter into joint ventures or start business expansion projects to become stronger and more competitive. A company should only go for outsourcing when its internal capabilities and in-sourcing opportunities are insufficient to give it competitive advantage against its industry rivals. Although in-sourcing is easier, less expensive, and more time and cost-efficient strategy, a company should only choose it if it believes that it will help it in maintaining the existing market share and level of competitiveness. Some companies keep on investing in their internal capabilities and in-sourcing and neglect the significance and positive impacts of outsourcing for greater competitiveness and profitability. These companies fail to maintain their market position and lose their customer base.

Elaborated Theoretical Model

Our detailed literature review gave us insight into developing a robust theoretical model. In the integrated framework, all components have an impact on the type of strategic decisions taken by a firm. Since, in the original model, the author presented strategies in the general frame but outsourcing strategy which is being ignored at this point of time with the changing dynamics of the country. Specifically, when we have vendors system moving in, then

outsourcing will become critical strategy which has to be linked with the company's capabilities. The original model (by Frank-2008) does not provide comprehensive look in capturing the whole frame and ignore the areas of weakness where outsourcing comes in. Therefore we are going to present that integrated decision making model incorporating the strategic outsourcing decision.



An Integrated Decision Making Model for Strategic Outsourcing

Our proposed "integrated Decision Making Model for Strategic Outsourcing" explains how the tangible and intangible resources of an organization help in shaping up the strategy. Porter 5 forces model guidelines help us in achieving objectivity in industrial analysis that is a vital part of a firm's strategy development. Normally for any strategic decision, people would carry out the external analysis suggesting a framework. Capabilities (competencies – strengths) aid into successful strategy development and execution. Research suggests that an organization's strengths and capabilities support each other which are ultimately helpful for the organization in achieving competitiveness and superior operational and financial performance.

Since different environmental factors impact a firm's performance in one way or another, the firm's capabilities strength may not sustain for a longer period of time and thus parity effect occurs. To avoid parity effect, the firm should continue to build capability strengths. Original model has actually ignored certain critical factors like competitive intensity and market dynamism which affects competitive advantage. Therefore, we are incorporating them as moderators. In one of the strategic choices, outsourcing, as explained in our proposed model, is alternative to those capabilities weaknesses. Weaknesses of the capability which is usually ignored but logic says that if it is not in the core capability area then it should be outsourced which means that it is not your strength. Last, we propose that strategy alone is not enough in building the firm's resources and capabilities but positive financial performance will also be vital in the firm's resourcefulness.

Conclusion

This paper has attempted to integrate the issue of weakness emanating out of the capability frame in terms of strategic decision in outsourcing. With the help of our integrated Decision Making Model for Strategic Outsourcing, significant advantage can be achieved by successful combination of some critical approaches. Firms capitalize on their resources, for example, they improve their operational and financial performance by investing in manufacturing processes, research and development, quality management, inventory management, etc. These sound business practices accompanied by the core organizational resource improve their Return on Investment (ROI).

Secondly, a continued effort to develop core competencies through strategic capabilities upgradation (strengths) and minimizing strategic liabilities (weaknesses) also help them in gaining competitive advantage.

Thirdly, companies can execute the outsourcing strategy in order to leverage full utilization of outsourcing partners with innovations, investment and specialized professional capabilities that are costly to acquire internally.

Finally, in a rapid technological shift and robust market dynamics, outsourcing strategy minimizes risk, improves manufacturing capabilities, operational efficiency, and customer relations.

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