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From Relational Employment to Relational Contracting: Outsourcing and Dependent Self-employment in the British and Austrian Insurance Industry

Ulrike Muehlberger

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From Relational Employment to Relational Contracting:
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From Relational Employment to Relational Contracting: Outsourcing and Dependent Self-Employment in the British and Austrian Insurance Industry

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Abstract: Labour relations in business organisations are facing a profound change. This paper focuses on one specific change in labour relations, namely dependent outsourcing. Dependent outsourcing refers to contracts over products with little alternative use, where the subcontractor bears the entrepreneurial risk. From the perspective of the contractor, dependent outsourcing represents a business relationship to outsource the entrepreneurial risk. The lack or the high costs of an alternative use creates long-standing ties between the business partners, which allows them to overcome some of the difficulties with formal contracts and utilise their detailed knowledge of the situation to adapt to new contingencies as they arise. Drawing on 57 semi-structured interviews in the British and Austrian insurance industry, I identify the nature and logic of dependent outsourcing, deploying the dimensions control, dependency, support and incentives. Results reveal that the logic of dependent outsourcing is not straightforward. Instead, intensive field research shows widespread reasons for and against dependent outsourcing. In both countries, the changes in the cost structure, the passing of risk, the increase in productivity and the gains through specialisation are the most important reasons for tied agency. The reduction of control and mutual dependency are the main problems of insurance companies using tied agents or the key rationales why they do not deploy them. The paper highlights the hybrid position of dependent subcontractors between integration and non-integration. It is argued that blurring firm boundaries are pivotal to understand new developments in organisational governance.

Keywords: Outsourcing, Dependent Self-employment, Relational Contracts, Boundaries of the Firm, Organisational Governance, Insurance Industry.

1 Introduction

Both employment relationships and business organisations are facing a profound change (Crouch 1999; Supiot 2001; DiMaggio 2001). The driving factors behind these changes are manifold: the structure of the labour force, technology, business environment, and business and employment laws are some of the most important ones. This paper demonstrates how changes in organisational governance affect the organisation of work in a firm. More specifically, it shows how outsourcing blurs the boundaries of firms, transforming employment relationships to tied business relationships.

These changes have been going on for half a century. The "managed economy" of the 1950s to the 1970s in Europe was characterised by the importance of the manufacturing sector applying a fordist production regime with standard full-time non-temporary wage contracts (especially for male workers) and a paternalistic welfare state (Crouch 1999; Supiot 2001; Audretsch and Thurik 2001). By contrast, the "entrepreneurial economy" goes along with the sectoral shift towards services, the rising level of employee skills and qualification, the substantial entry of women into the labour market and flexible production regime with flexible forms of work and dependent outsourcing (Crouch 1999; Mühlberger 2000; Zagler 2000).

Dependent outsourcing or subcontracting refers to business relationships where the subcontractors are formally self-employed (or declares herself as self-employed) but their conditions of work are similar to those of employees. They are economically - and in extreme cases even personally - dependent on their contractor. The dependent self-employed persons bear the entrepreneurial risk without having the entrepreneurial possibilities of independent self-employed persons because they do not appear on the external market since they have only one contractor.[1]

From an organisational theory perspective, we can conclude that although

[1] A brief comment is in order on the definitions used in this paper. (Dependent) outsourcing and (dependent) subcontracting are used synonymously to express the *process* of contracting out parts of the production to other firms. Dependent self-employment refers to the *employment status* of the dependent subcontractor.

dependent self-employed persons are formally non-integrated, they are effectively treated as integrated parties. As a result, we have to think about these forms of business relationships in terms of intraorganisational instead of interorganisational networks. This paper will show that the conventional theoretical literature on relational contracting cannot cope with dependent forms of outsourcing.

Dependent self-employment is not only relevant from an organisational theory perspective, it has, furthermore, crucial implications for social and labour market policy. Of course, the employment status under which a person carries out his or her work matters. It matters because the access to employment rights depends on the employment status. More concretely, it matters because the application of rights and obligations concerning employment protection, social security and taxation varies across different employment stati. For instance, self-employed persons are widely excluded from employment protection and employment security law. Thus, the classification of employment stati is important not only from a legal, but also from a social point of view. However, most European countries face the problem of a high degree of uncertainty attached to the legal and social criteria by which workers are classified. Conventional classifications have become too rigid to deal effectively with the growth of non-standard forms of work. As a result, certain groups of workers are excluded from the social security system as well as from the protection of employment legislation. Dependent self-employed workers are definitely among those whose employment status is largely in doubt (Burchell et al. 1999). Consequently, some countries have enacted, only partly successful, laws to deal with those forms of work that depart from the model of the indeterminate employment relationship constructed around a full-time, continuous working week.

It has been argued that recent developments in industrial organisation – such as the greater stress on outsourcing and the rise in franchising activities – can be seen as important explanations for the growth of self-employment in the UK. Meager (1998), for instance, sees outsourcing as one of the main reasons for the rapid growth in self-employment in the UK during the 1980s. Moreover, there is evidence across Europe that an increasing part of outsourcing activities is based on dependent business relationships (Dietrich 1996; Burchell et al. 1999; Semlinger 1993). Although many governments have increased their efforts to foster self-employment, concerns about dependent self-employment have been raised in many European countries. Countries like Germany, Greece, Belgium, Italy and Austria have introduced special measures to control dependent self-employment (OECD 2000).

The rest of this paper is organised as follows. The next section clarifies the concept of dependent self-employment and gives two concrete examples. Section 3 analyses dependent self-employment from an organisational theory perspective. It is shown that conventional approaches to business organisations use a too narrow definition on firm boundaries. Hence, a classification scheme that uses the dimensions *alternative use* and *risk* is developed in order to introduce the concept of dependent self-employment to organisational theory. Section 4 presents case study research from the British and Austrian insurance industry. It demonstrates the logic of outsourcing and how dependency is created. It shows, moreover, that the institutional environment is crucial for the outsourcing decision. The final section summarises and concludes.

2 What is Dependent Self-employment? Some clarifications.

Roughly speaking, dependent self-employment refers to a type of contract that falls between independent self-employment and dependent employment, thus showing the characteristics of both. These workers are formally self-employed but they are economically and sometimes personally dependent on their contractors. Their working arrangements, so to speak, are those of an employee, but they maintain – or their employer/contractor maintains – that they are self-employed. Dependent self-employed workers do not have a labour contract, but nevertheless supply their labour - in form of a personal service or a produced good - to their contractor. Using business terms, we relate to them as upstream (i.e. the subcontractor) and downstream (i.e. the contractor) party, respectively.

Since it is tricky to categorise dependent self-employed workers, we can at least define what they are *not*.[2] An *employee*, to begin with, is an individual who is employed by a firm with an explicit or implicit contract of employment. The basic remuneration is normally not directly dependent upon the revenue of the firm for which she works. An employee uses the assets owned by others and is supervised by others. An independent *self-employed* person is an individual who provides labour or goods to various firms and/or customers, normally under a contract for services or a contract of purchase, and who is in business on her own account. The remuneration is directly dependent upon the profits derived from the goods and services produced and purchased. A *worker* is an individual who is deployed by a firm either as an employee or as an independent contractor (but not on her own account) and who is economically dependent on the business of the other (Deakin and Morris 1998).[3] The notion *dependent self-employed worker* expresses contractual situations where an individual is officially self-employed (or at least maintains this is so) but is economically dependent on her contractor. An important point is that the dependent self-employed worker does not appear on the external market since he or she has only one contractor.

What does it mean to be economically dependent on a contractor? *Economic dependence* basically means that the dependent self-employed worker takes the entrepreneurial risk. Since such workers have only one contractor they generate their whole income from this business relationship.[4] This means that the dependent self-employed person is dependent on the orders of the contractor. If we assume that the two parties do not usually agree on a constant

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[2] These analytical definitions, however, do not necessarily fit with legal definitions.

[3] This wider definition of dependent labour is already partly used in UK legislation, namely for the purposes of equal treatment legislation, the legislation concerning the payment of wages and for certain limited purposes related to employment protection legislation. Moreover, it has been adopted under the National Minimum Wage Act 1998 and under regulations implementing the Working Time Directive (Burchell et al. 1999).

[4] Even if we assume that the dependent self-employed person also does occasional extra jobs, he or she nevertheless generates the vast majority of his or her income from the business relationship with the main contractor.

quantity of orders but quite the contrary, namely that the quantity of business deals depends on the economic situation of the contractor (the downstream party), then the dependent self-employed person (the subcontractor or upstream party) obviously takes the entrepreneurial risk.

A more extreme form of dependence is *personal dependence*. This refers to dependence in terms of time, place, and content of the work. In the case of personal dependence, it is the contractor who determines when and where the work has to be carried out. Moreover, the contractor determines what has to be carried out and how it has to be done. A dependent self-employed worker is per definition economically dependent but is not necessarily personally dependent on her contractor. This problematic area is precisely the grey zone which these workers inhabit. Those who are both economically and personally dependent border on the employee status, while those who are only to some degree economically dependent are closer to the borderline of independent self-employment. Thus, although we are referring to all the workers in the grey zone between an employee status and independent self-employment as dependent self-employed workers, we are nevertheless addressing manifold forms of work.

The following presents two examples to make the concept of dependent self-employment more clear. A classic example of dependent self-employment is the private transport sector. Many of the big carriers pursue a dual organisational strategy to ensure a certain amount of flexibility. On the one hand they deploy employees who use the asset of the employer and on the other hand they deploy dependent self-employed workers who use their own lorries. However, they perform exactly the same kind of work, namely that of delivering freight to customers. The important difference between these two types of workers is that the employees do not bear the entrepreneurial risk. The dependent self-employed workers, in contrast, do for various reasons, bear the entrepreneurial risk. First, they often do not have a contractual fixed quantity of deliveries. Second, they have to ensure that their assets (i.e. the lorries) are ready for service when needed. Third, they face economic risk when they are prevented from carrying out the work due to technical problems with the lorry or when they get ill or take holidays. In other words, they do not get any money when they are prevented from carrying out their work. Baker and Hubbard (2002), Kerschner (2001) and Fernández et al. (2000) present research on quasi-integration and dependency in the trucking industry in the US, in Austria and in Spain, respectively.

Another example is the multi-channel distribution strategy in the life and pension insurance industry. Most insurance companies organise their distribution using different channels like direct sales agents, tied agents and independent agents. Again, these different workers and/or subcontractors, perform exactly the same kind of work, namely selling insurance contracts to clients. In contrast to tied and independent agents, direct sales agents are employees of the insurance companies. Both tied and independent agents are self-employed but have different types of contracts with insurance companies. While a tied agent is only allowed to represent one particular insurance company, an independent agent can sell insurance contracts of different insurance companies. These three distribution channels – i.e. the direct sales force, the tied agents and the independent agents – represent exemplary three forms of work: the employee status, dependent self-employment and independent self-employment, respectively. Again, while the direct sales force (i. e. the employees) of an insurance company do not bear the entrepreneurial risk, tied agents (i. e. the dependent self-employed workers) do. First, while the direct sales force earns a basic salary and a commission for every insurance policy they sell, the tied agent only receives a commission. Second, in contrast to the direct sales force, tied agents have to finance their assets (i. e. office, car, IT) themselves. Third, tied agents, like freight subcontractors, face economic risk when they are prevented from working (e. g. illness, holidays). Fourth, they invest in a highly specific human capital since they sell only insurance products from one firm. Thus, switching contract partner would cause them switching costs. Empirical research in section 4 of this paper will demonstrate the logic of outsourcing and the creation of dependency in the British and Austrian insurance industry.

Both examples show that the disadvantages for the dependent self-employed workers are, in turn, advantages for the contractors. Although the contractors have a certain amount of control over the asset, they do not have to maintain it. However, empirical research in section 4 shows that the reduced control compared to integration (i.e. employment) is crucial for the outsourcing decision. Moreover, the contractors do not have to pay social security benefits or any other benefits and do not bear the financial risk when the worker gets ill. Another advantage for the contractors, which may be even more important is that they do not face legal constraints of employment protection in terms of working time or security. In sum, employment protection laws are not applicable in such business relationships. Thus, from a social policy point of view, dependent self-employment undergoes laws that are designed to protect workers.

3 Explaining Dependent Self-employment from an Organisational Economics Perspective

In burgeoning literature, the economics of business organisations has inquired why firms exist at all. More concretely, organisational economists have focused on the question why a task is performed inside a firm (vertical integration) or outside the firm (outsourcing). Firm boundaries, it is argued, are determined by the performance of firms compared to that of markets. In his seminal paper, Coase (1937) concluded that a firm will only exist (or vertically integrate) as long as it performs better than markets. Williamson (1975) looked closer on the functioning of firms. Having deployed a narrow definition of market functioning, he suggested that firms perform better because they can rely on relational contracts. Indeed, Williamson's conclusion fitted the actual organisational trend of vertical integration, which was observed during the 1960s and 1970s.

The tendency of vertical disintegration since the 1980s has been followed by research on relational contracts between firms (Williamson 1985; Powell 1990; Powell and Smith-Doerr 1994; Baker et al. 2002). This research has stressed that relational contracts do not only exist in the form of permanent employment contracts but also in the form of business networks and long-term business relationships on a relational basis. Relational contracts basically refer to informal agreements, unwritten codes of conduct and understandings that strongly affect the behaviour of individuals within firms mostly due to the existence of a *quid pro quo* logic within business relationships. As a result, however, relational contracts must be self-enforcing since they cannot be enforced by a third party (e.g. a court). In this context, self-enforcing means that the long-term gain of a relational contract must be sufficiently high so that neither party wishes to renege, i. e. to deliberately choose not to carry out a promise or contract to the detriment of the other party (Baker et al. 2002; Milgrom and Roberts 1992).

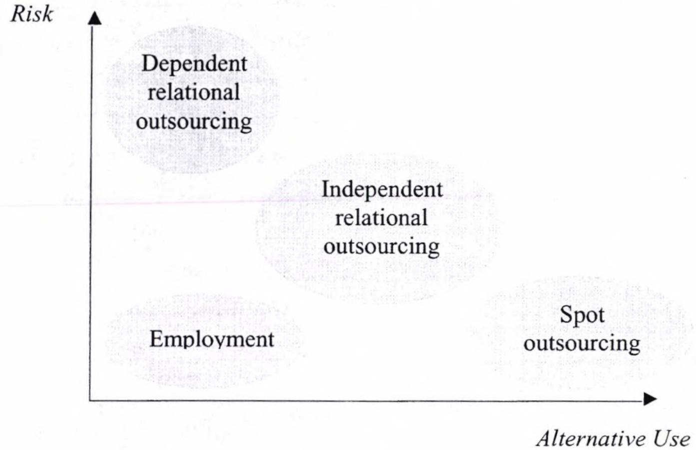
Williamson (1985) and Baker et al. (2002) have developed a classification of organisational governance to contrast the market and the internal firm as a sphere of production. While Williamson (1985) distinguishes between relational contracting, market governance and unified governance (i.e. vertical integration), Baker et al. (2002) define four organisational forms, namely spot outsourcing, spot employment, relational outsourcing, and relational employment. Both classification schemes are examples to demonstrate that the literature on business organisation has a very strict definition of firm boundaries. The concept of dependent outsourcing, however, shows that business boundaries can be fuzzy. The assignment of integration and non-integration might not be straightforward. Although dependent self-employed persons are formally not integrated, they are effectively treated as (at least partly) integrated parties. Thus, dependent outsourcing is a concept that hardly fits into common classifications of organisational governance.

The following discusses a classification scheme that uses the dimensions *alternative use* and *risk*. It is argued that these two dimensions are crucial to understand dependent outsourcing. Baker et al. (2002) argue that the question whether the goods or services, which are the object of contract, have an alternative-use value is pivotal for the outcome of a business deal. As discussed above, there are various reasons why dependent subcontractors may have no alternative use for their goods or services. First, one important feature of dependent outsourcing is the exclusiveness of the contract. This means that the subcontractor is only in business for one contractor and thus he or she has no other business partners. Even if her goods or services had an alternative-use value, the subcontractor does not have established business relations with other firms with which she could trade. Consequently, the alternative use would cause contracting, searching and switching costs. For example, if a dependent self-employed person decides after the firm (the downstream party) has reneged on her bonus to look for other uses of her assets, she has to find another firm to deal with. Such a switch is followed by high costs, since all assets are concentrated for only one business relationship (i.e. no risk sharing of deployed assets). Second, if the produced good or the delivered service is highly specific, it may have no alternative value. For example, consider a subcontractor who delivers a special customised computer software package. This customised good is of no use for another firm (at least not in its original version). Finally, an alternative use can be forbidden through the contract between the two parties. In sum, we can conclude that the possibility of 'alternative use of products or services' is a pivotal dimension of dependency.

Another dimension to capture the essence of dependent outsourcing is risk. The unit of analysis is the risk associated with a specific task. Suppose a contract partner has to furnish a specific task prior to the business deal. If the business deal cannot be realised, the burden of the risk associated with the effort invested into the accomplishment of the task has to be shared between the contract partners, ignoring the risk born by the client. In the case that the task is carried out by an employee, the risk is entirely born by the employer, which is the one extreme of the risk continuum. That describes the usual entrepreneurial risk. At the other side of the continuum we find dependent outsourcing. A dependent subcontractor bears the entrepreneurial risk if the customer of the contractor denies to buy the good or service.

Combining these two dimensions, we can define four different organisational forms (see Figure 1). First, as already discussed above, if the person who carries out the task is an employee, she bears no risk, even if the customer, for whom the good or service was produced, reneges from the purchase. On the other hand, the employee does not own the produced good or service, which means that she has no alternative use.

Figure 1: Combinations of 'Risk' and 'Alternative Use' that Define Four Organisational Forms



Second, dependent (relational) outsourcing combines the features of high risk and no (or low) alternative use. The dependent subcontractor (the upstream party) bears, on the one hand, the entrepreneurial risk and has, on the other hand, no alternative uses for the produced goods or services if the business deal fails due to the above discussed specific features of such business relationships. Thus, from the viewpoint of the contractor (the downstream party), dependent outsourcing represents a business relationship to outsource the entrepreneurial risk. Moreover, the contractor profits from the relational contract she has with the subcontractor. Consequently, the business partners can overcome some of the difficulties with formal contracts and can utilise their detailed knowledge of the situation, to adapt to new contingencies as they arise, relying on informal agreements and unwritten understandings. From the viewpoint of the subcontractor, dependent outsourcing, however, means that although she bears the entrepreneurial risk, she has not all the entrepreneurial possibilities independent entrepreneurs usually have.

Third, independent relational outsourcing refers to long-term business relationships between two independent firms. Since the subcontractor is supposed to have various contractors, she can pool the risk across various business deals which lowers the aggregate risk. Whether the subcontractor has alternative uses for the produced goods and services depends in fact on the nature of these goods or services. Assuming that the subcontractor produces both customised and non-customised goods or services, we find such relational business relationships on a medium level on the alternative-use-axis.

Forth, spot outsourcing refers to one-shot business transactions between two independent firms. Since the supplier is supposed to have many customers for whom she delivers mostly non-customised goods or services, she bears hardly a risk due to risk-diversification and due to various alternative-use possibilities. For example, if one customer does not take the agreed delivery of e.g. screws (for whatever reason), the supplier may simply sell them to the next customer.

In sum, this scheme with the dimensions 'risk' and 'alternative use' helps us to understand the logic of dependent outsourcing. Again, the two most important features of dependent outsourcing are that the dependent subcontractor bears the entrepreneurial risk without having the entrepreneurial possibilities (i.e. no alternative use for the products or services). This fact, however, raises the question of the motives of the dependent subcontractor. In other words: Why are there dependent subcontractors? From an economic point of view, one can argue that they are compensated for the risk they bear. The amount of this risk compensation depends on the outside opportunities they have. This logic works like a reservation wage: They supply employment in form of dependent subcontracting as long as the certainty equivalent[5] of the subcontracting income exceeds the pecuniary and non-pecuniary return from the outside opportunity, which can either be a regular employment relation or unemployment. These outside opportunities, however, are determined by institutional and political factors such as welfare states and family structures. Thus, the institutional surrounding is crucial to fully understand the driving factors of dependent outsourcing. Our comparison between the British and Austrian insurance industry in the following section shows that not only the supply decision, but also the demand decision (i.e. the vertical integration or outsourcing decision) are strongly influenced by the institutional environment.

4 The Nature and Logic of Outsourcing and Dependent Self-employment in the British and Austrian Insurance Industry

Tied agents in the Insurance Industry. As described in the second section of this paper, most insurance companies organise their distribution using different channels like the direct sales force (employees), tied agents (dependent self-employed persons) and independent agents (independent self-employed persons). While a tied agent is only allowed to sell insurance contracts from one particular insurance company, an independent agent (independent financial adviser or broker) can sell insurance contracts of different companies.

The following case study, which includes 9 British and 8 Austrian insurance companies, analyses the driving factors of dependent outsourcing (i.e. tied agency) and the creation of dependency. A comparison between the UK and Austria is interesting for various reasons. First, both industry and labour market regulation differ dramatically in these two countries. Thus, a comparison allows us to examine the effect of different levels of regulation. Second, the insurance markets differ not only in obvious issues like the size of the market but also in the distribution strategies, the industrial labour market, the openness of the

[5] A certainty equivalent is the amount of risk-free income which makes the individual just indifferent between the risky and the certain event.

market and the international orientation of the insurance companies.

The main difference in the distribution method between Austrian and British insurance companies is that, in contrast to the UK, Austrian companies increasingly use the tied agent channel. In Austria, a French insurer entered the market through the acquisition of a middle-ranked Austrian insurance company in the early 1990s, being the first who established a comprehensive tied agency system. Eventually, all major insurance companies followed this example, introducing a tied agency system as well. In the UK, only few insurance companies use the tied agent channel. The rest of this section aims at analysing the reasons for these different organisational approaches and their consequences. Section 4.1 focuses on the rationales of the firms, section 4.2 looks at the motives of tied agents, and the last section identifies dependency between tied agents and insurance companies.

Research Design. The following qualitative empirical research is based on 27 interviews in the British insurance industry and 30 interviews in the Austrian insurance industry. Interviews were conducted between November 2000 and May 2001. I interviewed not only managers from insurance companies, but also salespeople representing different forms of work (i.e. dependent employment, dependent self-employment, independent self-employment): employees of the companies' direct sales force, tied agents, multi-tied agents and independent financial advisers. In addition, officials from trade unions and professional associations were interviewed to discuss employment trends in the insurance industry.

The semi-structured interviews with managers focused on the organisation of distribution, methods of recruitment, training and payment, differences in the working method and productivity of the different distribution channels, callcentres, gender, all aspects of tied agency, the reason for multi-channel distribution and tied agency as well as cooperation with trade unions. Employed direct sales persons, tied agents and independent financial advisers were asked about personal background, education, former occupation, training, payment, control, support, working hours and alternative working forms. With officials from interest organisations I discussed general (restructuring) trends in the industry, distribution strategies, level and intensity of the cooperation with insurance companies, (collective) bargaining issues, effects of tied agency as well as labour market and social policy issues.

4.1 Firm's rationales

Costs and Cost Structure. Undoubtedly, costs are the most important rationale for companies to work with tied agents. Although managers query whether tied agents reduce the total costs of distribution, they do, however, transform fixed into variable costs. Tied agents do not receive any fixed wage components but work exclusively on commission. Thus, the insurance company has to pay their tied agents only after a successful sale has been achieved.

> We've always said that our agency model does not save costs and this is correct. We controlled that for the first agencies and we recalculated it for those who switched from the employed direct sales force to tied agencies – the transfer of these people does not save us costs, we limply manage, but yet quite well, to be cost neutral in sum. But there is a major point: we transform fixed to variable costs. *[Head of Sales of an Austrian insurance company. Company J]*.

The conversion of fixed costs into variable costs is closely connected with employment law, social security contributions and collective bargaining agreements. Labour regulation tends to increase the cost of vertical integration by setting constraints to the employment relationship. This partly explains the fact that mainly Austrian insurance companies use the tied agent channel as they are confronted with a tightly regulated labour market. By contrast, weak labour regulation in the UK is associated with comparatively low fixed costs. Additionally, the collective bargaining system and greater power of Austrian unions imposes a minimum wage for employed insurance agents which constitutes a fixed part of the compensation.

> The one is employed and is subject to the whole regulation of the labour law for employees, labour constitutional law, collective agreement and all these things. And the tied agent is self-employed. This is a major distinction for us from a business point of view. The direct sales force causes high fixed costs [...]. The tied

agent only produces variable costs. [...] Being a tied agent, being self-employed, however, also means to bear the economic risk. For instance, illness: In this case, the tied agent has no security at all if he does not do anything by himself. This is different for the employed direct sales force. Of course, this produces fixed costs for the company. *[Managing Director (Sales and Marketing) of an Austrian insurance company. Company P]*.

Productivity and Motivation. In both countries, several managers describe motivation as a key characteristic of tied agents. Tied agents, so the argument, become those who were successful in the direct sales force. Thus, it is argued that self-selection takes place. The idea of self-selection indicates that persons who face a choice between a job with a fixed wage component and one whole on a commission basis tend to prefer the former if they expect themselves to be relatively unproductive and to prefer the latter in the opposite case.

> This implies that the nature of the tied agent is in self-employment and, connected with that, perhaps a higher motivation. Tied agents become those who were already successful in the direct sales force. The typical agent is a former, extremely successful, member of the direct sales force who became self-employed and who is rather a soloist. They have mostly an existing client bank, they do not start from nothing. They come mostly to us or we to them, asking them whether they want to become tied agents, or they say, they want to become tied agents if we offer them certain rules, because they do not want anymore to follow certain rules of the holding company. And because they are so convinced by themselves, they want to define their own rules. This is the classical agent. *[Head of Human Resource Management of an Austrian insurance company. Company O]*.

Managers found that tied agents are individuals that are interested in a certain amount of flexibility and autonomy on the one hand, but also in work simplicity and support on the other hand. As the self-selection criteria imposes, many insurance companies found that the tied agent channel is more productive than the direct sales force. In addition, insurance companies set incentives in form of a multi-level compensation system. Those tied agents who are successful in selling earn more per unit than the others. One could argue that they work with the incentives of an efficiency wage system from a certain level onwards.

> [...] when it first started [...] one of the issues then was in terms of meritocracy. A lot of companies had an employed direct sales force and they paid them a salary and bonuses, and I think that largely came quite expensive [...]. The reason for [our company] was by paying people fees and commissions based on what they sell. In fact if you are paying them more, they are actually producing more for the

> company. Whereas if you have to pay a big salary to start with, you have an awful lot of sales just to cover the salary. A few years ago we had an employed sales force [...] and we found it was not as productive as a sales force based on a self-employed contract. It is very much the true hierarchy that the ones who sell the most earn the most. [...] [Our] tradition has always been the self-employed direct channel. [Our company] has tried other ways but it has never been that successful. *[Corporate Planning Director of a British long-term insurance company that deploys 5000 tied agents. Company B]*.

Austrian managers stress that the introduction of the tied agent channel aims at increasing productivity since most employed direct sales forces are of low productivity. Although they employ some highly productive insurance agents, the average productivity of all employed insurance agents is low. Consequently, with the introduction of a tied agent system, insurance companies outsource the risk of low productivity as they do not have to directly bear the costs of unproductive tied agents.

> The problem of the employed direct sales force is that there are highly productive colleagues, but also unproductive colleagues. In sum, the productivity is quite low. The best employed agents are as productive as brokers or tied agents. But the mix of the employed direct sales force is quite bad. A bad broker does not bother me because I do not bear his costs. In the worst case, I do not make any business with him. But the direct sales force causes fixed cost which I have to bear, no matter whether they sell anything or not. *[Head of Human Resource Management of an Austrian insurance company. Company O]*.

Corporate Culture and Multinational Companies. Although only few British companies work with tied agents, outsourcing the direct sales force is, nevertheless, an issue for British managers. Still, the history of a company and company culture are seen as reasons why they have not outsourced their direct sales force yet.

> Yes, we constantly review [outsourcing]. And it [i.e. costs] is one of the reasons why the direct sales force has been reduced considerably. [Our company] goes back into 18something, so it is a very old established company. And the direct sales force and visiting the customer at home is what [this company] started off doing - for the first hundred years it did nothing else. So, we are very reluctant of getting rid of that although in the hard business terms we would have to. *[Sales Operations Support Manager of a British long-term insurer. Company I]*.

> We operate in many countries of the world with tied agents propositions and when we look at them – as we are thinking about what we can learn to apply in the UK –

> what you keep coming back to is the culture of that community is different. The history and tradition is different. *[Sales Operation Manager of a British general insurance company. Company H].*

Especially for insurance companies that are part of foreign holding companies, the pressure to introduce tied agency is powerful. International insurance companies that have success with tied agent in their original or in other countries, impose pressure on their subsidiaries to also introduce tied agency.

> Our mother company [...] asks us why we still have an employed direct sales force at all, because in Italy [or Germany] they do not have one at the first place. [...] This means that we want to stay abreast of this trend through brokers and tied agents. *[Sales Director of an Austrian insurance company. Company M].*

Control and Regulation. Managers of British insurance companies without tied agents emphasise that control is one of the most important arguments for not deploying them. The regulation of the British long-term insurance industry following the pension mis-selling scandal,[6] demands to closely monitor the sales process. Consequently, control is a highly crucial issue in the UK and pivotal for resulting governance structures. Therefore, most British insurance companies employ their sales force to have a strong influence on the sales process.

> [...] generally we believe that you are able to control these people less than if they are employed by you. So, you can have more influence over how they sell, how much they sell and all those things. [...] But, yes, there are arguments in both ways. I don't think that it [i.e. the use of tied agents] is necessarily something we have discounted forever and there are continuos thoughts that we might do it.*[Sales Operations Support Manager of a British long-term insurer. Company I].*

[6] The recent regulatory development of the insurance industry in the UK was heavily influenced by the so-called pension mis-selling scandal in the late 1980s. This far-reaching scandal was followed by falling consumer confidence and by regulatory actions by the government. In the late 1980s, the Conservative Government changed the pension system, giving people the option of not being part of a company pension scheme. Additionally, people were encouraged to set up their own private pension scheme. The weak regulation of the insurance industry in the late 1980s and early 1990s, however, created a pension mis-selling scandal where people where encouraged to not join company pension schemes but to set up their own, ending up far worse of by setting up their own scheme when they should have actually joined the company pension scheme.

Furthermore, British managers stress the importance of the brand. Using tied agents, so the argument, it is not possible to control how they treat the brand, the brand values and the customer relationship. Surely, the brand name is valuable because insurance companies have invested in it and it economises on consumers' search costs.

> No, we would never consider it [i.e. tied agency]. Never consider it! Because the brand is the most important thing, the customer relationship, the brand and the believe in the brand values. That's the important thing. And someone selling [Company B's] products last year, how can he [or she] be passionate about [our] products this year? *[Corporate Planning Manager of a British Bancassurer. Company G]*.

> We've got a brand and we have to be very careful about who is going to represent us. [...] If our tied agent doesn't demonstrate [our brand values] to [our customers], then they will actually destroy our brand. And for an organisation of our size that's just not a place to be. *[Sales Operation Manager of a British general insurance company. Company H]*.

Interestingly, the issue of controlling tied agents was mainly discussed by British managers. Austrian managers, by contrast, emphasise that control over tied agents is only a matter of contract arrangement. However, since most Austrian insurance company have only recently introduced a tied agent channel, managers still lack experience. Moreover, interviews have shown that the brand name is a much more serious issue in the UK than in Austria. It is argued that this is a direct consequence of the different levels of competition in the two insurance markets. Although the European Directives have started to open the Austrian insurance market, it is still a more protected market compared to the British market.

4.2 Agent's Motivation

Security and Restructuring. Especially Austrian employed insurance agents claim that social security, fringe benefits and the compensation system for employed agents is a main motive for employment. This is due to the fact that the marginal benefits of employment compared to self-employment are higher in Austria than in the UK. Consequently, Austrian insurance agents have more incentives to be employed than British agents.

> Yes [company K has already approached me regarding a tied agency], but I couldn't accept this offer, because opposed to employees, self-employed persons are disadvantaged regarding the social security net. [...] This starts already with the pension. [...] [Or] if I get ill, being self-employed, I don't have such a social security net compared to an employee. *[Employed Insurance agent of an Austrian insurance company. Company K].*

Most tied agents were formerly employed as an insurance agent. Some British tied agents report that redundancies following industry restructuring forced them to become self-employed. In both countries, insurance companies dramatically reduced the number of their employed sales force, increasing pressure on those who remained.

> Companies have dramatically reduced their employed direct sales force, those who remain are being squeezed out. It is a very tough environment, one has approximately 15 appointments per week. Control becomes stronger through new IT equipment. IT equipment is, on the one hand, additional support, but, on the other hand, it also means that there is much more control since company managers know exactly what the direct sales force does (in fact, every hour). Realistically, one can only justify the basic income because it is hard to earn any bonus on top of that. Being in a direct sales force used to be very comfortable, one has a provided client base, fixed payment, a car, administrative support and so on. But this situation has changed very much. It is very, very pushy now. They push, push, push. *[Tied agent of a British long-term insurance company. Company B. Reconstruction.]*

As mentioned by this British tied agent, IT equipment increases control due to decreasing monitoring costs. However, IT does not only enhance the pressure on the direct sales force, but fosters outsourcing as argued further below.

Simplicity, Autonomy and Support. Compared to independent financial advisers or insurance brokers, the establishment of a tied agency is associated with a considerably lower amount of money. Thus, insurance agents who wish to become self-employed without investing a high amount of money and/or effort, prefer a tied business relationship. Moreover, tied agents underline the simplicity of their work, the freedom to determine the quantity of work and the reduced control in comparison to an employment relation.

> I just love what I do and I find it simple, the job itself is so simple. I totally agree with you that you would be able to sell more products as an IFA and that you have

> more security as an employed agent. The reason why I do what I do is that I like the freedom to write my own pay check. *[Tied agent of a British general insurance company that sells insurance products and additionally manages a team of 15 tied agents. Company A].*

Of course, being tied to only one insurance company facilitates business cooperation and the content of work considerably. Interviews reveal that in comparison to independent financial advisers, tied agents are clearly more risk avers, esteeming the support of the outsourcing insurance company. This shows clearly that tied agents are hybrids also from a supply side perspective. Although these people wish to be self-employed, they appreciate, on the other hand, the support of their principles and the simplification of their work. Thus, a tied agent is not a Schumpeterian entrepreneur but a supported owner-operator.

> Compared to an independent business, tied agency is better because it is easier and cheaper to set up because facilities are provided. One has more security, more autonomy and more freedom. *[Tied agent of a British long-term insurance company. Company B. Reconstruction.]*

Further motives for tied agents are time flexibility, tax benefits, reduced legal liability or the advantage of the close connection to only one insurance company.

4.3 Identifying Dependency

The hybrid position of tied agents between employment and self-employment means that the position of tied agents within the organisation is quite unclear. Tied agents themselves describe their position as hybrid, being neither part of the company nor independent.

> The manner my function is – in the middle, a quasi-hybrid position – I feel sometimes. Surely, I ask myself whether this is the correct way or whether another would be better. [...] With this close relationship I am nearly part of the company, but at the same time, I am not. *[Tied agent of an Austrian insurance company. Company N].*

This section will show that dependency is not only created by the fact that tied agents are only allowed to contract with one insurance company (i.e. exclusiveness of the contract), but also by the actual organisation of the tied agency. On the one hand, support and service help the tied agents to manage their own business, but some measures increase, on the other hand, the degree of dependence. It turns out that firms create dependency, first, by offering a high degree of support to tied agents, and, second, by control and incentive measures. However, the close relation between customers and agents makes firms, in turn, depend on their agents, thus creating mutual dependency, as will be discussed at the end of this section.

Dependency and Support. Basically, the tied agent's dependence on the outsourcing insurance company goes along with the degree of support. Insurance companies offer their tied agents a wide range of support and incentives in order to solve the classical principal-agent problem. This is conventionally solved by transferring all incentives to the agent. Besides incentives (e.g. incentive compensation), insurance companies offer their tied agents support to motivate them to act on behalf of the company. For example, insurance companies allow their tied agents financial support for office equipment only if they fulfil the company's criteria.

> There is the whole business around tariffs, marketing material. Furthermore, respective IT support. [...] There is, moreover, the possibility to open offices franchise-like, but this must fulfil our criteria: It is fixed that our logo has to be presented and how it has to look and which kind of furniture the office has to have. And if he [or she] fulfils that, then he [or she] is entitled to according support. *[Managing Director (Sales and Marketing) of an Austrian insurance company. Company P]*.

Support starts with the development of the business plan. Some insurance companies even develop the tied agents' business plans by themselves. Other companies only offer the tied agent their entrepreneurial knowledge for the preparation of a business plan. Another important source of support when newly opening a tied agency is financial support. In most cases, insurance companies pay their new tied agents a certain amount in advance, depending on the business plan. Some tied agents and labour union officials, however, stress that these payments in advance effectively increase the tied agent's dependence on the insurance company.

Besides assistance for business start-ups, insurance companies provide entrepreneurial know-how for accounting, IT, tax consultancy, business management and training.

> The main focus is, on the one hand, – if one starts with the establishment of an agency – supporting measures for the establishment, support regarding accountancy, IT support or auditing support. This means everything around the establishment and the management of an own company. The second block is knowledge from a training point of view, general training. [...] The third point is, from our point of view, sales support. [...] [This means] the necessity to offer special training [...], for instance, pension specialists. [...] Finally, the forth point is cooperative support in the field of office organisation, furniture, establishment and support for backoffice employees. *[Head of Sales (Direct Sales Force) of an Austrian insurance company. Company L]*.

According to legal regulations in both countries, tied agents are obliged to have professional experience, which means that insurance companies do not have to provide basic training. Nevertheless, special product training and further sales training are crucial in briefing the tied agent, first, to sell those products the insurance company wants to sell and, second, to sell the products in a way the insurance company intends them to sell.

Furthermore, insurance companies oblige their tied agencies to exclusively follow their corporate culture. This refers not only to issues like marketing, advertising and corporate design, but also to customer interaction, corporate strategy and representation.

> This means control; this means the warranty that our company's goals, our strategies, our representation, our appearance is according to our vision. *[Head of Sales of an Austrian insurance company. Company J]*.

Basically, there are two different methods to finance the various support measures. First, insurance companies pay their tied agents a lower rate of commission to finance their services. Second, insurance companies pay their tied agents a higher rate of commission (i. e. roughly equal to that of brokers), but the tied agents have to pay for the services they use. Interviews with tied agents, however, have shown that the first method is sometimes a source of misperception because some argue that services are free of charge.

Incentive measures to motivate tied agents are very similar to those focusing on employed insurance agents. This is not only in terms of financial rewards but also in terms of non-pecuniary recognition.

> It is very much a meritocracy. What happens is those who produce the most business get the greater rewards, much in the level of fees they earn. That is per definition, those who are selling more are earning more. Plus a recognition within the peer groups. *[Operations Manager of a British long-term insurance company that deploys 5000 tied agents. Company B].*

Clearly, the rationale behind these support measures and services is to bind the tied agents to the insurance company. Moreover, as discussed above, support measures and services induces the tied agent to act according to the company's vision.

> We finance, for instance, an office, IT investment, we simply finance things in order to bind him as an agent to the company. *[Head of Human Resource Management of an Austrian insurance company. Company O].*

The consequence, however, is that the borderline between employment and self-employment becomes blurred.

> There are some agencies, even quite big ones, that engage in lawsuits against [company K], where they claim that they have an employment relationship with all the consequences – for instance, social security contributions. There is the borderline, where one has to pay attention not to cross the border between agency and employment regarding the social security system or the finance law. This is a tightrope walk. *[Head of Sales (Direct Sales Force) of an Austrian insurance company. Company L].*

Control and Incentives. By introducing tied agency, insurance companies wish to have, on the one hand, a similar control over their agents as over the direct channel and, on the other hand, they want to profit from the advantages of outsourcing.

Control over tied agents is exercised in various ways. British tied agents, for example, report that the insurance companies check whether the products sold are appropriate for the customers. Furthermore, a compliance team is responsible to control whether the tied agents work according to regulatory rules. Regular meetings with company managers make sure that the insurance company is permanently informed about business development and other issues.

> [The insurance company] checks everything what we do. So, if we've gone for a product that gives more commission when it wasn't the right thing to do then they won't put it through, they'd send it back. [...] Yes, there is control. There is a compliance team, they come out and make sure that everything is ok. They inspect files and that sort of things. [...] I've somebody who looks after me, called the business development controller. He visits me once a week. *[Tied agent of a British long-term insurance company. Company E]*.

Legal contracts explicitly define rights and duties of both, the tied agent and the insurance company. The actual business relationship between the insurance company and their tied agents, however, is not only based on explicit contracts but on relational contracts. Relational contracts are additionally based on informal agreements and unwritten codes of conduct and understanding that strongly affect the behaviour of the business partners due to the existence of a *quid pro quo* logic within the business relationship (Gibbons 2000).

Insurance companies control whether tied agents fulfil the contract through various control instruments. An Operations Manager of a British long-term insurance company, for instance, emphasises the control through the compliance department, the quality team and the local managers.

> We don't have huge problems but we need to strike a careful balance because the franchisee are self-employed, they run their own business. They would not want us muddling with. But otherwise they do franchise with us. That means that we will sign off how they present themselves in the market place (for example, how they call themselves). So, we have control in a number of ways. One is through our compliance department, the compliance check that goes on throughout the year in the business centres. [...] Also in each area we have what we call our quality team. They would go out checking the quality of sales, the quality of the fact-finders, whether they are compliant to the PIA [Personal Investment Authority]. We also have a typing approvals area where any adverts going out to be advertised in a local community, they would have to be signed up by someone in the headoffice first. And again, the local managers will also control. Within the business centres where they work, there are employees of [our company] who possibly try to do what is necessary. They know whose business it is, we would not want them to do things that would compromise our brand or compromise our relationship with the regulator. *[Operations Manager of a British long-term insurance company that deploys 5000 tied agents. Company B]*.

As already discussed above, controlling agents is facilitated by the use of IT. Online connections between tied agents and insurance companies allows the latter a permanent control of the tied agent's performance.

Insurance companies use different incentive structures to influence control and corporate governance. Incentives are pivotal in understanding how managers and tied agents behave in organisations. Moreover, as already discussed above, incentive structures are the most important instruments for companies to solve the principal-agent-problem since any kind of disciplinary measures are inapplicable. A classical instrument is money, obviously. Insurance companies influence not only overall performance but also the customer structure or the products that are sold through a specific mix of commission and bonification. For example, when insurance companies aim at boosting the long-term insurance business, then they change the commission and bonification for these products.

> It is clearly agreed how the environment, the appearance outwards has to look like. Moreover, it is clear, what we expect from the agencies in terms of performance. We agree upon sales goals according to regions; there is a new sales plan every year which indicates the goals we set and which incentives and bonifications we offer to fulfil them and we pay attention that we fulfil our goals more or less. *[Head of Sales of an Austrian insurance company. Company J]*.

In addition, some insurance companies pay out a part of the commission in the form of a pension. Other financial incentives are loans which are either interest-reduced or interest-free, depending on the turnover. Again, interviews reveal that such incentives increase dependency.

Besides pecuniary incentives, insurance companies use non-cash incentives to motivate and control tied agents. A classical example of non-cash incentives is a list of the ranking of the best selling agents in the firm-internal newspaper.

Mutual Dependency. It is important to note that dependence is mutual in some issues. The loss of direct access to customers, the difficulty to control tied agents, the increased risk exposure, problems of loyalty, the importance of the brand and the uncertain long-term costs of tied agency are pivotal reasons for insurance companies to not work with tied agents. For instance, insurance companies are keen to improve the direct contact to customers in order to have access to their information.

> At the moment we kind of come from an environment where backoffice contact, if

> the customers calls the contact centre that's treated as accidental. It is not treated as part of the management of the customer relationship. [...] The advisers see them as their customers and they don't want us to do anything with them and they really don't want us to help, they don't want to share information with the headoffice about their customers. They are very sensitive to that. *[CEO Assistant of a British long-term insurance company that deploys 5000 tied agents. Company B].*

As already discussed above, insurance companies that do not work with tied agents claim that direct access to customers is an important issue in this corporate decision.

> [The] direct [sales force] is good because you have direct control over the customer. You are in direct contact with the customer and therefore the ability to influence the customer's decision as to whether they renew with you or don't renew with you. It is very convenient. *[Sales Operation Manager of a British general insurance company. Company H].*

Another reason for mutual dependence is the client bank, which is the asset in these kinds of business relationships. In both countries, the client bank legally belongs to the insurance company. However, both parties emphasise that this is in fact only theory, because only the clients decide with whom they do business.

> If you asked the franchisee they would say they earn the client bank. If you ask the company, we say we do. If the franchisees moved to another insurance company than they would not be allowed to approach the clients to move with them. But obviously when clients want to move with them, they would find a way of doing that. So we do try to protect that as much as we can. When the franchisee is leaving, we have a 3-months notice period where the business manager will go out to see the clients. If they go independent we can't stop clients to go with them. The contracts with the clients are with [the company] not with the franchisees but you can't really define the ownership of a client but all the information, all the data is owned by [the company]. *[Corporate Planning Director of a British long-term insurance company that deploys 5000 tied agents. Company B].*

Furthermore, managers argue that entrepreneurial success of the tied agents is enormously important for the company since they represent the brand in front of the customers.

> The argument is that they [i.e. the tied agents] are our figureheads out there. And it would be unpleasant if the one or the other tied agent went bust. This is not only his [or her] problem but also ours – not because we are so morale, but for business reasons. *[Head of Sales of an Austrian insurance company. Company J].*

To some extent, mutual dependency is, in turn, an advantage for the tied agents. Tied agents in both countries accentuate the advantage of a close connection to only one insurance company. Being tied to only one company means that they get more information and that they can negotiate special prices for valuable customers.

> There is a close relationship to one insurance company, one is simply better informed. A broker, who works together with 15 different insurance companies, doesn't have these contacts. We've room for movement, we have authority that brokers do not have. This is the advantage of tied agents. *[Tied agent of an Austrian insurance company. Company K].*

5 Conclusions

This paper has shown that dependent self-employment refers to a type of contract that shows characteristics of both dependent employment and independent self-employment. We have argued that conventional classifications of organisational economics (e.g. Williamson 1985; Baker et al. 2002) cannot cope with this hybrid form of work since they deploy a rather strict definition of firm boundaries. The concept of dependent self-employment, however, shows that business boundaries can be fuzzy. Although dependent self-employed workers are formally non-integrated, they are effectively treated as integrated parties.

In order to introduce the concept of dependent self-employment to the organisational economics literature, this paper has suggested a classification scheme along the dimensions alternative use and risk. These two dimensions are crucial to understand dependent outsourcing since high risk and no (or low) alternative use for goods or services provided by dependent self-employed workers are the main features of dependent outsourcing which clearly distinguish this hybrid form of work from dependent employment and independent self-employment.

Case study research in the British and Austrian insurance industry has analysed the logic of outsourcing and how dependency is created in tied business relationships. Having drawn on 57 semi-structured interviews with managers, employed insurance agents, tied agents, multi-tied agents, independent agents and officials from interest organisations, I identify the nature and logic of dependent self-employment, deploying the dimensions control, dependency, support and incentives. Results reveal that the logic of dependent outsourcing is not straightforward. Instead, intensive field research shows widespread reasons for and against dependent outsourcing. In both countries, the changes in the cost structure, the passing of risk, the increase in productivity and the gains through specialisation are the most important reasons for tied agency. The reduction of control and mutual dependency are the main problems of insurance companies using tied agents or, in other words, the key rationales why they do not deploy them. The paper highlights the hybrid position of dependent subcontractors between integration and non-integration. It is argued that blurring firm boundaries are pivotal to understand new developments in organisational governance.

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