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Models referring to outsourcing theory

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Abstract

This study presents various theories and models of outsourcing. This presentation was based on an extensive literature review, which led to the identification of ten different outsourcing theories and related models.

All these models have their own advantages and disadvantages, thus a critical analysis is required in order to achieve useful conclusions for the organizations who intend to implement such theories.

The review of the Outsourcing models is based on five phases: the preparation phase, the phase of selecting an external service provider, the transition phase, the management of the relationship phase and the review phase.

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Keywords : Outsourcing Theories, Outsourcing Models, Implementation of Outsourcing Theory, Preparation Phase, Transition Phase, Relationship Management, Review Phase, Service Provider.

1. Introduction

The business practice of outsourcing enjoys the ever-increasing attention of the scientific community, as its practical implementation is constantly spreading. Due to the high research volume, many different approaches on the interpretation, analysis and study of this phenomenon have come to the fore.

This paper provides a thorough presentation of the most important, diverse theoretical approaches provided by the international literature, in order to interpret and explore the business phenomenon of outsourcing during the past three decades.

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2. Outsourcing Theories

Outsourcing has a very complex structure, which consists of numerous activities and functions giving rise to series of administrative and managerial dilemmas. A number of theories have been used to help scientists understand the nature of these operations and activities, as well as to help the managers of enterprises and organisations handle these processes in an effective manner.

It is commonly accepted that any phenomenon can be described through a series of theoretical frameworks based on the corresponding approaches. Naturally enough, outsourcing has been approached applying a series of different theories, which can often lead to confusion among researchers (Busi & McIvor, 2008). This presentation will focus, with a few exceptions, on the models published during the past 25 years as they contain the solid knowledge of previous researchers and they ensure the minimum required timeliness.

2.1 *Transaction Cost Economics*

The Transaction Cost Economics (TCE) theory has traditionally been the most widely-used outsourcing theory. It is considered that the TCE theory provides the best decision-making tools in order to assist organisations in deciding which of their operations should be outsourced and, thereafter, to prepare themselves in order to implement the necessary organisational changes arising from outsourcing.

The characteristics of this model allow for its implementation both at the relationship management phase and at the reconsideration phase. Another extremely useful feature of the TCE theory is that it can be used for the analysis and selection of outsourcing contracts, which are often of great complexity.

A number of researchers have approached the phenomenon of outsourcing using the TCE theory. Firstly, in their research on decision-making with regard to the outsourcing of IT operations, researchers Lacity and Willcocks (1995) explored the phases of preparation, vendor selection, relationship management and reconsideration, from the viewpoint of the TCE theory.

Aubert, Rivard and Patry (1996) also proposed a model which combines the TCE theory with the theory of Incomplete Contracts, in order to formulate a model that explains the phases of Preparation and Relationship Management. Eight years later, the same researchers (Aubert et al., 2004) returned with a new model, which combines again the two theories in order to interpret exclusively the preparation phase of outsourcing.

Ulset (1996) explored the role of research and development in the process of outsourcing on the basis of the TCE theory, emphasising on the need of organisations to safeguard the intellectual property of their patents. His model analyses the phases of preparation, vendor selection and relationship management.

In another research effort, Brandes, Lilliecreutz and Brege (1997) explored the factors that determine the success of an outsourcing effort. Their model was based on the TCE theory and examined the phases of preparation, relationship management and reconsideration. The researchers reached the conclusion that when the decision to outsource is based on the TCE theory the outcome is better, as is the case when the vendor manages to develop a strong manufacturing basis.

2.2 *Core Competencies Theory*

The Core Competencies Theory is based on the Theory of Resources and is an evolution thereof. Researchers Prahalad and Hamel (1990) defined Core Competencies as the collective knowledge of an organisation, especially with regard to the ways of combining different productive skills and the integration methods of various different technologies.

An analysis of the vendor's competencies is, according to the Core Competencies Theory, the main factor that determines the success of an agreement. The Core Competencies Theory has also been used to study the phases of relationship management and reconsideration.

The Core Competencies Theory is the second most popular approach in the academic research related to outsourcing. Pinnington and Woolcock (1995) were based on the Core Competencies Theory in order to investigate whether the outsourcing of business operations related to the IT system of an organisation may improve its organisational skills. Their research focused on the phases of preparation and reconsideration.

Researchers Baden-Fuller, Targett and Hunt (2000) proposed a decision-making model during the preparation phase based on the Core Competencies Theory, aiming to improve the competitiveness of the organisation. The research of Arnold (2000), as set out in the TCE section above, was published in the same year and is worth mentioning at this point, given that the second theoretical pillar of the research is the Core Competencies Theory.

It must be noted that the research of Gottschalk & Solli-Sæther (2005), examining the phases of preparation, relationship maintenance and reconsideration, concluded that the Core Competencies Theory is one of the two approaches that better illustrate the success factors of the outsourcing process.

2.3 Relational Theory

The Relational Theory provides explanations on how enterprises may acquire and maintain a competitive advantage with regard to their relationships with other organisations (McIvor, 2005). This model has been used to study the phases of transition, relationship management and reconsideration. Therefore, the Relational Theory is the only approach that may be applied to the investigation of all phases of the outsourcing process.

Willcocks and Choi (1995) explored the possibilities of laying the groundwork, through proper planning, for turning the outsourcing process from a simple partnership into a strategic alliance. Using the Relational Theory, they examined the factors that may be used to make decisions at the phases of preparation and relationship maintenance, aiming to make choices that will contribute to the creation of strategic alliances. Espino-Rodríguez and Rodríguez-Díaz (2008) proposed a relational model aiming to analyse the effects of an organisation's ability to develop a relationship with the vendor at the phases of vendor selection and relationship maintenance for the development of competitive advantage, based on technology (Sakas, Vlachos, Nasiopoulos, 2014).

Yahnhong (2011) described an outsourcing model based on the Relational Theory, aiming to interpret the phases of Preparation, Vendor Selection and Relationship Maintenance. The research reached the conclusion that the benefits of the outsourcing process are determined by the quality of the relationship at its establishment and by the care given by contracting parties to the development of the relationship.

2.4 Resource-based Theory

The main premise of the Resource-based Theory is that resources and capabilities can differ significantly among organisations and that these differences remain stable (Barney & Hesterly, 1996).

When the resources and capabilities of an enterprise are mixed and used in an appropriate manner, they may create a competitive advantage for the enterprise. This theory applies mainly to the Preparation phase of the process in order to identify the operations that must be outsourced, as well as to the Vendor Selection phase, allowing for the selection of the vendor with the most appropriate resources. The theory has also been used to explain the decisions made by the organisation during the Relationship Management and Reconsideration phases (Kutsikos & Mentzas, 2011). A 2010 research (Alvarez-Suescun, 2010) proposes a model that combines the Resource-based Theory with the TCE theory in order to interpret the implementation of outsourcing processes in respect of IT operations. The model mainly focuses on the Transition phase and suggests that the Resource-based theory is the most appropriate approach for its interpretation.

The research of (Roy & Aubert, 2001) used the Resourced-based theory in order to shape a model which aims at identifying the factors affecting the success or failure of outsourcing at the Preparation phase. (Barthelemy & Quelin, 2006) proposed a model based mainly on the Resource-based theory, and to a lesser extent on the TCE, in order to explain the Preparation, Vendor Selection, Relationship Management and Reconsideration phases.

2.5. Evolutionary Economics Theory

Despite the fact that it first emerged in the 19th century, the interest in the Evolutionary Economics Theory has been revived after the publication of a research by Nelson and Winter in 1982. The backbone of these premises comprises, according to Andersen (1994), a series of six basic assumptions. The first assumption is that individuals

and organisations can never be fully informed and that they must adjust and optimise their performance at the local instead of the global level.

The second assumption is that the decision-making process of individuals and organisation is subject to rules, norms and institutions. The third assumption is that individuals and organisations may imitate, to a certain extent, the behaviour and rules followed by their peers in order to gain self-knowledge and create innovation.

The fourth assumption relates to the fact that the imitation and innovation processes are, to a great extent, stable, continuous and cumulative. However, they may be interrupted by occasional disruptions due to exceptional circumstances. The fifth assumption focuses on the fact that the interaction between individuals and organisations takes place in an unbalanced manner. Therefore, its success or failure is conditioned by external factors, the persons involved and their methods.

Finally, the processes of change occur within a framework determined by the aforementioned five assumptions. These assumptions create a framework where changes have an unpredictable result; they are irreversible.

Mahnke (2001) uses Evolutionary Economics in order to develop a broad model, which attempts to explain four out of the five phases of the outsourcing process, i.e. the phases of Preparation, Transition, Relationship Management and Reconsideration. Mirani (2006), proposes a theoretical model based on the theory of Evolutionary Mathematics, aiming to explain the Relationship Management phase.

2.6 Knowledge-based View

The Knowledge-based View provides an understanding of how individuals cooperate to produce goods and to provide services. The Knowledge-based View establishes two methods for knowledge-sharing among partners (Nasiopoulos, Sakas, Vlachos, 2014).

These are knowledge generation and knowledge application. The Knowledge-based View applies to outsourcing in order to demonstrate that knowledge-sharing at the relationship management phase of the outsourcing process is positively related to the success of the outsourcing agreement (Sakas & Kutsikos, 2014) (Kutsikos & Mentzas, 2012).

The Knowledge-based View is the foundation of the model proposed by (Lee, 2001), which attempts to explain the management of the relationship between the two contracting parties of the outsourcing process. The model, which also uses the Core Competences theory, reached the conclusion that knowledge-sharing is one of the key success factors of an outsourcing process.

2.7 Agency Theory

Initially, this theory focused on the relationship between an organisation's management and all other stakeholders (agents) (Jensen & Meckling, 1976). However, this concept was later extended to explain the relationships between different organisations.

This theory has been applied to outsourcing in order to interpret the relationship between the organisation and the vendor. The theory suggests that the use of continuous monitoring and the reinforcement of the ties between two organisations (Barney & Hesterly, 1996) can address any problems which might arise (Arrow, 1985).

In addition to relationship management, this theory has been used to explore the Preparation phase and, in particular, the stage where the organisation considers all potential Vendors and decides on which type of relationship it wishes to develop with them, whereas it has been used, to a lesser extent, to analyse the Reconsideration phase.

2.8 Neoclassical Economic Theory

According to Hodgson (1994), the Neoclassical Economic Theory has three characteristics. Firstly, the assumption that people and organisations act rationally in order to maximise their benefits, always on the basis of their preferences. Secondly, emphasis is placed on striking a balance or moving constantly towards balance. Finally, this theory does not recognise the issue of the absence of adequate information on behalf of individuals or organisations. This theory has been heavily criticised due to its inability to explain modern business operations.

In particular, the assumptions of rationalism and the absence of the chronic problem of lack of information, have been criticized as unrealistic and outdated. However, Gottschalk and Solli-Sæther (2005) have demonstrated that the Neoclassical Economic Theory may be applied to explain critical success factors of the outsourcing process during the Reconsideration phase.

2.9 Social Exchange Theory

The Social Exchange Theory interprets interpersonal transactional relationships by using the economic cost-benefit analysis as a requirement for social participation and social exchange. The theory assumes that the sharing of resources (material or social-intangible) is a fundamental form of human interaction.

Therefore, Social Exchange is an ongoing reciprocal process in which the actions of individuals or organisations depend on the rewarding reactions they receive from others (Gottschalk and Solli-Sæther, 2005). The theory has been used in combination with the TCE Theory in order to interpret the behaviour of organisations at the reconsideration phase.

The research of Whitten and Wakefield (2006) has been based on the Social Exchange theory and, to a lesser extend, on the TCE in order to propose a model that interprets the phase of reconsideration during the outsourcing process. The Social Exchange approach is also used in the highly theoretical work of Gottschalk and Solli-Sæther (2005;2006).

2.10 Economy of Information Theory

It has been widely accepted and acknowledged that, in the real world, as opposed to the assumptions of Classical Economic Theory, information is never complete or perfect. As a consequence, new economic models have emerged in an attempt to interpret situations in which the two parties have unequal or no information.

One of the first such models was the development of the Search Theory (Stigler, 1961). The determination of sellers and the prices they offer is only an example of the extent and importance of information search in economic theory and practice.

Another basic concept of the economy of information theory is “signalling”. This concept was developed by Spence (1973) and focuses on the influence of signals transmitted from entire markets or individual organisations on the decision-making process of others.

3. Conclusions

The application of most theories in the field of outsourcing focuses on exploring specific phases of the process and/or specific issues arising within the context of these phases.

This review demonstrates the primacy of the TCE theory over other theories, which has attracted the interest of researchers in the field of outsourcing as expressed through a very large number of published models following this specific theoretical approach.

In addition, as shown from the analysis conducted so far, as expected, the majority of the models investigate the preparation phase of outsourcing which involves the crucial decision on whether the organisation will finally outsource any of its operations.

In the future, building on the aforementioned theoretical foundations, scholars should provide empirical evidence about the critical elements of the outsourcing process such as culture (Trivellas, Reklitis & Santouridis, 2006), IT infrastructure (Marinagi et al., 2014), strategy (Reklitis & Trivellas, 2002; Trivellas, Reklitis & Konstantopoulos, 2007), R & D operations, (Trivellas, 2012), and leadership style (Trivellas & Drimoussis, 2013; Trivellas & Reklitis, 2014).

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