

# Supplying “Outsourcing Relationships”: A Case Study Analysis

## **João F. Proença**

University of Porto, Faculty of Economics  
Rua Dr. Roberto Frias s/n, 4200-464 Porto  
Portugal

[jproenca@fep.up.pt](mailto:jproenca@fep.up.pt)

## **Teresa Proença**

University of Porto, Faculty of Economics  
Rua Dr. Roberto Frias s/n, 4200-464 Porto  
Portugal

[tproenca@fep.up.pt](mailto:tproenca@fep.up.pt)

## **Luís M. deCastro**

University of Porto, Faculty of Economics  
Rua Dr. Roberto Frias s/n, 4200-464 Porto  
Portugal

[mcastro@fep.up.pt](mailto:mcastro@fep.up.pt)

## Abstract

This paper presents a paradigmatic case of Strategic Outsourcing – the case of an industrial firm that specialized in producing packages / containers for its industrial clients in modular manufacturing units located in the clients' premises, wall-to-wall or even inside their factories. The company provides a complete in house service in various dimensions: package / container development (CAD-CAM, quick prototyping, mould and packaging design), production (JIT), quality control, technical advice, all integrated with each of its clients operations. These solutions are provided to clients that operate in a variety of industries: food and drink stuff, body care, home care, lubricants, and PET pre-moulding.

The analysis of the case shows fluid firm boundaries as there seems to be a great deal of integration with its clients in terms of operating competences and dynamic capabilities in production activities in order to sustain the close vertical buyer-supplier relationships. We discuss the supplier-client relationship, the organizational and administrative tasks and the main characteristics of this industrial and services outsourcing. The research seeks to discuss how companies may develop and manage such characteristics and to debate the outsourcing theory or the boundaries of the firm. The case study research is based on managers' interviews, observation of the production activities and the analysis of documental material.

**Keywords:** Outsourcing Relationships, Business-to-Business Relationships, Firm Boundaries

## 1. Introduction

This paper discusses the business of supplying diverse clients with “Strategic Outsourcing”. We present a firm case study, whose core business is to develop manufacturing with services outsourcing solutions based on close and durable vertical buyer-supplier relationships. We discuss the supplier-client relationship, the nature of the organizational and administrative activities and the major characteristics of this manufacturing with services outsourcing concept. The research seeks to describe how companies may develop and manage such characteristics and to discuss some consequences of outsourcing for the boundaries of the firm. The case study research material is based on managers’ interviews, observation of production activities and analysis of documental material.

Each client in the supplier’s portfolio of outsourcing business relationship suggests a quasi-firm (Blois, 1972), despite the boundaries of the firms involved. The research shows fluid firm boundaries as there seems to be a great deal of integration in operating competences and dynamic capabilities in production activities, with its clients. The contractual dimension of the relationships is analyzed. In terms of duration the partnership business lasts for long periods of time, which is important given the investments involved. Despite the formal contractual dimensions of the relationships, the analysis also highlights many informal arrangements that characterize such industrial and commercial alliances.

The discussion of the case shows how the supplier contracts medium to long term partnerships with multiple, diverse and dispersed clients, by creating specialized production units *wall to wall* with the client: IPU’s – Integrated Production Units. These units are planned and designed from scratch to fit better the client’s product, process and pace, therefore creating a specific supplier / customer relationship. We discuss the high dependency between the partners, which may result in diminished flexibility inasmuch as the supplier enacts a strategy of creation of a web of mini-factories tailored to each client’s idiosyncrasies. The strategy adopted provides a drastic reduction in distribution and inventory costs. Further, the paper illustrates how physical proximity to ‘partners’, derived from the implementation of the concept of *strategic outsourcing*,

allowed the development of the interactive processes on a daily basis between the supplier and the client which helps to solve many operational problems between both.

## **2. Business-to-business industrial relationships and outsourcing relationships**

The IMP Group developed a conceptual framework of long-lasting business relationships in industrial markets and illustrated its applicability through numerous studies across several countries, especially in Europe. According to these studies, buying and selling when relationships matter should not be viewed as series of independent transactions but rather as a complex number of episodes in (often) long-lasting and complex relationships between buyer and seller (LaPlaca, 2004). Long-lasting business relationships tend to develop as risk reduction strategies, and as recognition of mutual dependence. The IMP Group's work (see, for example, Ford 2002) emphasised a description of business relationships as complex mixes of exchange processes and adaptive behaviour of firms. These occur through organisational interactions between firms, and also between individuals from a variety of functional departments and hierarchical levels at both the buyer and the supplier. Therefore, business purchasing is often part of a growing commitment to a particular supplier which results from a relationship between parties that often goes back many years. Buyers and sellers in business markets often have mutual convergence of interests. Each one may want resources the other one has, or be dependent on the other one in some way. Håkansson and Snehota (1995) propose three dimensions for business relationships: links between activities, ties of resources and bonds between actors, all this embedded in an aggregate structure: "the network". Any act of interaction of a company with a counterpart must be seen in the context of its relationships, being affected by other relationships of its direct partners, and indeed the pattern of relationships that surround it (Axelsson and Easton, 1992).

Thus, the IMP approach to business relationships aims to understand how relationships develop between organizations in a network context, how these nets of relationships evolve and how markets work and evolve from a network perspective (Ford 2002; Håkansson and Snehota 1995). Business markets are seen as arenas within which

buying and selling companies interact with each other, and where previous experiences in each relationship have important influence on subsequent attitude and behavior. In contrast, traditional studies see markets in an atomistic way, as consisting of a large number of more or less anonymous customers with whom marketers deal at arm's length (Ford 2002). Inspired by concepts from the social exchange theory, the IMP's interaction approach views inter-organizational relationships as strongly interdependent and reciprocal, based upon variables that moderate the impact of potential struggles for power, such as cooperation, trust and commitment (Axelsson and Easton 1992). This relational perspective was initially conceived as an alternative to mainstream marketing, a new approach more suited to marketing in inter-organizational and service situations where markets are heterogeneous, where buyers and sellers are both active, and where interaction and relationships are important. Thus, the IMP Group approach to business relationships can be helpful as a theoretical framework for a better description and understanding of the business of supplying diverse clients of "Strategic Outsourcing".

The term outsourcing emerged during the 80s to characterize the subcontracting of information systems (Rodríguez and Robaina, 2006). The term has since been applied to many other activities, as claimed by these authors that present many other interpretations. For instance, the term is used in "make or buy" decisions or in integrating/disintegrating activities. Rodríguez and Robaina (2006) review the academic literature on outsourcing and show that most authors agree that outsourcing means a firm going outside its boundaries to acquire some activities that are not internally processed. However, according to Rodríguez and Robaina (2006) transaction cost economics (TCE) has emerged as a predominant theoretical explanation of outsourcing. First, Coase (1937) showed that, under uncertainty, the firm should perform in-house activities, rather than transactions in the markets because it would be more efficient. This framework created the basis for the development of the transaction costs theory (Williamson, 1986), which has come to dominate the literature in outsourcing decisions (Rodríguez and Robaina, 2006). Thus, the analysis of the outsourcing phenomenon has traditionally focused on economic approaches. Contrasting with the dominant view, Rodríguez and Robaina (2006) discussed outsourcing from the resource-based point of view. To them outsourcing influences the resources allocated to business units as well as the level of vertical specialization of the firm's activities and, thus, may modify the

firm's boundaries. Thus, outsourcing can be a stable, long term relationship in which the supplier becomes a partner to exchange some activities.

Rodríguez and Robaina (2006, p. 52) define outsourcing as: "... a strategic decision that entails the external contracting of determined non-strategic activities or business processes necessary for the manufacture of goods or the provision of services, by means of agreements or contracts with higher capability firms to undertake those activities or business processes, with the aim of improving competitive advantage". We focus on two important characteristics of this definition. First, outsourcing is a strategic decision to pursue and to maintain competitive advantages. Second, outsourcing decisions are related to the firm decision not to keep resources and capabilities to perform certain activities, which instead are performed by others in a superior way. We present next a paradigmatic case of a firm, whose business essence is to supply diverse clients with "strategic outsourcing". This industrial and services outsourcing result in long term close business relationships.

### **3. The Case Study Research**

Next we present a case study research (Yin, 2003), which we consider illustrative of the business of supplying diverse clients with strategic outsourcing. This case study was found useful to illustrate how companies may develop and manage the characteristics of the industrial and services outsourcing relationships and, second, to discuss the outsourcing theory and the boundaries of the firm. The research unit of analysis was the business of supplying diverse clients of "Strategic Outsourcing". The research was done in Portugal and data were collected through managers' interviews and observation of the production activities of the supplying firm - Logoplaste. The interviews were based on open-ended, semi-structured and structured questions. They were tape-recorded and transcribed. Secondary material, from Logoplaste, like brochures, annual financial reports, statistics, and press reviews, etc. were also collected and cross-referenced. This research method allowed an encompassing view of the supplying relationships, which had important consequences, namely to consider the interactive nature of the relationships, and to focus on the processes of the relationships. Next, we present the case study.

Logoplaste is a Portuguese firm founded in 1976 that produces plastic packages. The firm is specialized in producing containers for its industrial clients. The company has its producing units located in the clients' premises, wall-to-wall or even inside their factories and provides a complete in house service in various dimensions: package / container development (CAD-CAM, quick prototyping, mould and packaging design), production (JIT), quality control, technical advice, all integrated with each of its clients operations. These solutions are provided to clients that operate in a variety of industries: food and drink stuff, body care, home care, lubricants, and PET pre-moulding. The portfolio of Logoplaste clients includes the biggest and well known firms in the beverage market, i.e. national and multinationals companies with leading positions in their respective markets. Presently Logoplaste manages 45 factories in Europe (Portugal, Spain, France, United Kingdom, Italy, Czech Republic, and Austria) and in Brazil. The firm is the 3<sup>rd</sup> largest European rigid plastics converter, and the 1<sup>st</sup> one in hole-in-wall operations in Europe and Brazil. In 2006, Logoplaste processed 133,322 tons of raw material and 6,435 million plastic packages and shows a record track of uninterrupted growth through a series of world-class industrial start-ups and acquisitions in new markets. Its sales show a compound annual growth rate of 19%, triple of the market increasing rate (Logoplaste, 2006). According to the Logoplaste CEO *"The competitiveness of Logoplaste relies on quality, on the abilities and skills of the people, and on the association with the suppliers (equipments and raw materials), the universities, and other partners."*

The business of supplying diverse clients of "Strategic Outsourcing" starts with the supplier proposal of medium to long term partnerships contracts to clients that are multiple, diverse and dispersed. The supplier creates specialized production units *wall to wall* with the clients: IPU's – Integrated Production Units. In some cases the supplier agrees to buy the clients production machinery and to receive or incorporate in-house the client former staff (usually blue collar workers and some middle managers) involved in those activities to start the outsourcing business. The production units and activities are planned and designed from scratch for better adequacy to the client's product, process and pace, therefore creating a specific supplier / customer relationship.

This outsourcing relationship is characterized by high dependency between the partners, which results in diminished flexibility to act in the market. The supplier enacts a strategy of creation of a web of mini-factories each of which tailored to each client's idiosyncrasies. The strategy adopted provides a drastic reduction in distribution and inventory costs. This outsourcing relationship is formalized through a contractual dimension, which reveals the high commitment between the partners. The relationship needs a duration of the partnership business for sufficiently long periods, given the investments involved.

## **4. Discussion**

### **4.1. Organizing for supplying diverse clients with “Strategic Outsourcing”**

One of Logoplaste major idiosyncrasies is the way it goes about organizing its business, and reveals how the firm is client focused. The organisation is based on close outsourcing supplier-client relationships, i.e. the organisation is a web of “quasi-firms” (see Fig. 1). The company history shows a track record of uninterrupted growth trough a series of start-ups and acquisitions of the production facilities of the clients. For each client relationship the firm negotiates a commercial contract and creates a new subsidiary firm, which establishes an industrial setting in the client's premises, wall-to-wall or even inside the factories (which is the most common situation). Then, a start-up emerges. This start-up will be responsible for this relationship with the focal client and it is totally dependent on this outsourcing relationship. The result is an inconspicuous network organizational structure that shows a complex web of embedded relationships, where the firm boundaries became fuzzy.

The firm's organization principles go beyond the traditional Key Account Management (KAM) where an individual manages a customer key account for the supplier (Pardo, 2001) or even beyond the Key Account Team (KAT) where a set of the suppliers resources are used for the management of a key account customer (op. cit, 2001). For a supplier of the outsourcing business, the KAM or KAT structures would not suffice to provide efficiently for the client needs. Each outsourcing relationship is so unique and

specific that it results in a new structure with specific assets - one industrial organization -, which must be financial viable.

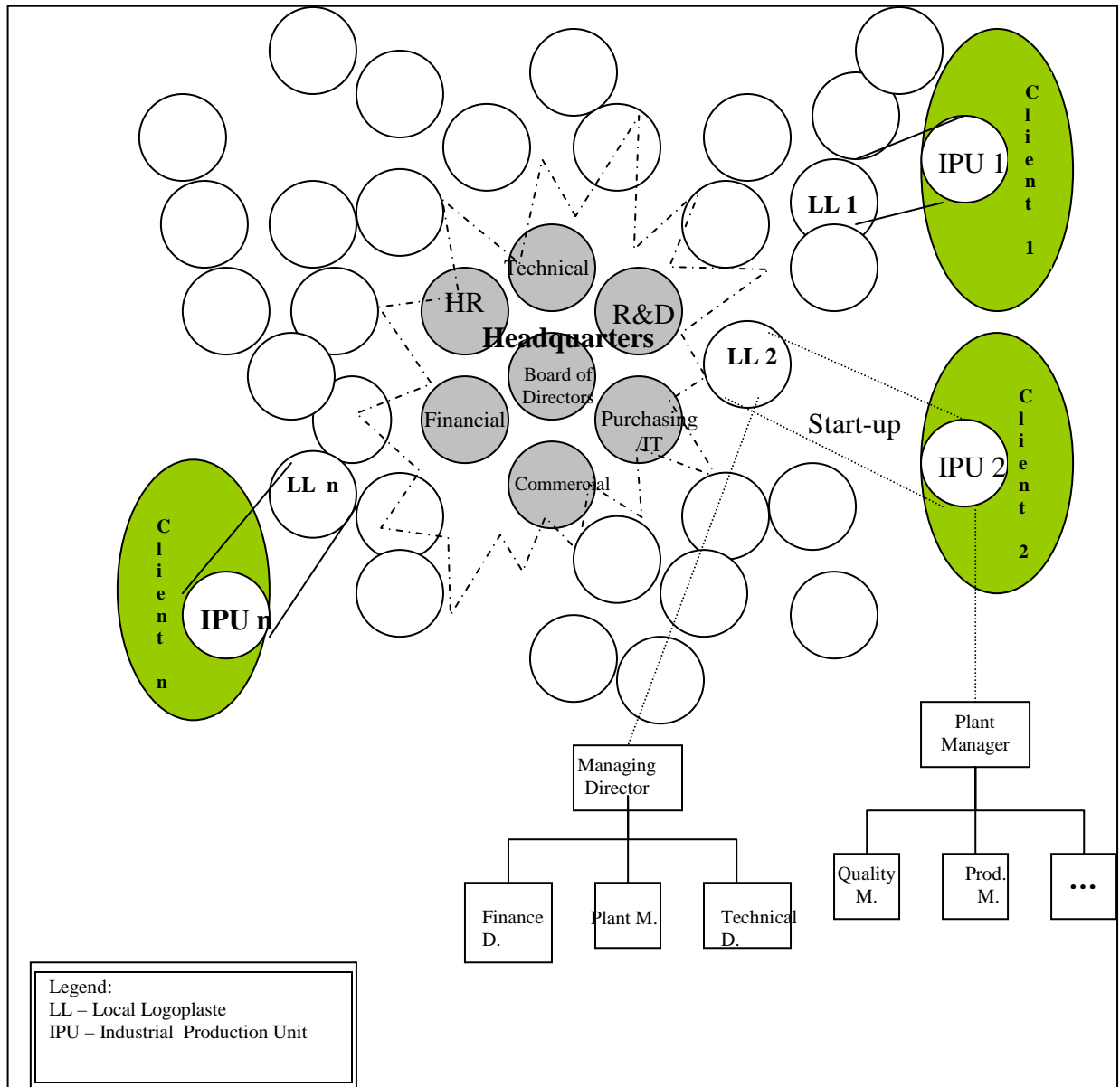


Figure 1 - Logoplaste organization for supplying diverse clients with “Strategic Outsourcing”

Logoplaste continuously seeks decentralization as a pattern in its internationalization process. In all the 45 sites it explores Logoplaste adopts a decentralised organizational structure where subsidiaries are given a high degree of operational autonomy. Logoplaste, as a multinational company, faces demands for local integration, strategic

integration and global learning (Almond et al. 2004). So, its strategic priorities play a key role in formatting its organizational structure. On the one hand, the CEO claims for local proximity or integration, which implies decentralization. Industrial management is a core activity, and centers upon each industrial setting. Each subsidiary layout is tailored according to the characteristics of the respective client. Thus, Logoplaste assumes a high degree of local responsiveness (Prahalad and Doz, 1987). On the other hand, the pressure from global competition, the need to collect and monitor information on competitors' in different countries and the high investment in R&D demand strategic integration and coordination. Coordination is achieved through a Managing team in each country, and a Holding that includes a Managing Director for each country. The country Managing Director coordinates all the local functions: financial, technical, management control, purchasing and raw materials, accounting, and planning activities with the client. Managing Directors also have the responsibility of finding new potential contracts or clients, but if this arrives the new client will be served by an autonomous operating organisation located on its premises. Further, the vertical integration of raw material (pet), which is now an important technological development centre of Logoplaste, is also a way for achieving coordination and scales economies. Finally, one of the major actual challenges for Logoplaste is its global learning effort, which involves the management of vertical, horizontal and diagonal relationships involving managers in different positions (intra-country; inter-country; inter-functional) and the development of Logoplaste's management capabilities. For this very reason, the CEOs have enlarged the Executive Committee, from two to several managers' directors to increase the participation and intervention of managers.

This is a quasi-integration or quasi-disintegration solution depending on how we look at the outsourcing relationship: mid-way between hierarchy and market relationships. We can imagine the start-up firm as a reconfiguration of the supplier that emerges to answer to the needs of a particular client and, thus, the solution is totally customized. The reconfiguration is an inter and an intra-organizational outlook based upon the exchanges between the supplier and the customer and the exchanges between the support systems of the mother organisation of and the new start-up firm. Thus, each solution is so specific that the clients prefer to outsource the production and services activities related with the package / container in order to get a closer vertical buyer-supplier relationship.

#### **4.2. The contractual dimension of the outsourcing relationships**

Logoplaste has a similar contract for all its clients, but each of them displays specific features. The contracts are long term (5 to 10 years), but they are extremely simple. They include some norms that regulate the relationship as, for instance, the business minimum quantities to exchange, the patterns of quality obligations, the payback period, etc. It is important to highlight that 56,4% of current contracts are 7 to 11 years old, and some of them reveal partnerships that are 20 years old or even older. These long term partnerships can be viewed as stable business relationships sustained by links or bonds of different natures: economic, technological, informational, knowledge and social or legal bonds. According to the CEO of Logoplaste, their technical quality or industrial skills and performance are the main reason for the longevity of these contracts. With longer contracts Logoplaste is better capable to reduce its prices. More important is its history of full renewal of contracts, despite the more recent contracts being considered more aggressive and demanding because clients demand more gains and longer paybacks periods, and commercial competition is stronger: *“99% of the contracts are ‘naturally’ renewed”*. The few situations of contract termination were due to external factors as, for instance, the client stopping production,... *“for example, the production of analogical telephones finished all over Europe”*.

#### **4.3. The economic dimension of the outsourcing relationships**

The economic dimension of the outsourcing relationships is important, and it reflects on the contracts. Firstly, the supplier and the client draw an agreement according to which the client lends the supplier the premises where the latter will carry out its activities. Secondly, the agreement regulates the pricing issues of the outsourcing relationships.

The price of the exchanged products includes a variable and a fixed component. The variable component aggregates the variable costs incurred by the Logoplaste Production Unit to produce the packages and their caps, including maintenance and other variable overheads, such as energy, and margin. The fixed component of the price aggregates the fixed costs of the Production Unit, namely the maintenance and other fixed overheads,

such as depreciation and interest, based on the investments made. The price is revised in the beginning of each calendar year in order to reflect the changes in the cost of the components and/or annual volume adjustments.

Thus, the price depends both on the cost of the inputs (raw materials, energy, manpower, overheads, depreciation, financial costs and margin) required to produce the goods and of the investments made. If new products are added or new investments made, the price is changed and up-dated accordingly. The price is also changed at the beginning of each calendar year in order to reflect changes in input costs. Additional requests by the customer, such as the inclusion of new products, colours or raw materials or any other situation or event, like changes in market conditions, may increase the complexity of production activities at the Logoplaste PU, and imply price renegotiations. Anyhow, the price is revised monthly to reflect changes in raw materials costs<sup>1</sup>. According to contracts, the customer may, once per year, research market prices or search for alternative manufacturers and suppliers of similar products under similar conditions (specification, quality and quantity). If the customer finds a lower price, but this is based on a spot offer or on any other false or fictitious market condition, then the agreed price will not be revised. Otherwise, if the customer can produce evidence of a lower price, based for instance on the use of more advanced technologies, then the parties must find new ways or new investments in order to meet that price.

#### **4.4. The dynamic process of the outsourcing relationships**

Business relationships are stable although they can endure ‘noise’ or ‘stress’ periods as shown by Gadde and Mattsson (1987) and Proenca and de Castro (2005, 2004) for industrial or financial services relationships respectively. Outsourcing contracts may likewise change after a period of time, according to the development of the relationship with the client. However, a pattern of change was not found in Logoplaste’s outsourcing

---

<sup>1</sup> At the end of each calendar year the value of the quantities sold are compared with the price charged to the customer throughout that year, in order to determine if the price paid by the customer was the price that should have been paid (i.e., the parties know the quantities that should be bought by the customer during the year). If the price paid by the customer is higher than the amount that should have been paid, then Logoplaste reimburse the customer for the difference. If the price paid is lower than should have been paid, then the customer must pay Logoplaste the difference. In order to reduce the amounts to be paid or reimbursed at the end of each calendar year, the price may also be adjusted every month in accordance with the updated forecast volumes for the period.

relationships “...*there is a continuing dialog and continuous evaluation*”. Moreover, they go through a learning process, and change in one relationship may be transferred for other relationships, whenever the innovations will result in mutual benefits, particularly related with costs and productivity, or logistics. Most of the turbulent periods in the relationships are related to the economic dimension of the contract, i.e. with the cost of the goods exchanged or with the cost and the productivity implications of the production and logistic processes. However the CEO of Logoplaste stressed: “...*we never loose a contract due to economic issues...*”, which reveals commercial flexibility from the firm, and willingness to cooperate and openness to sustain all the relationships. The focal firm also pursues a good relationship atmosphere with its clients and the clients behave accordingly. For this atmosphere it is crucial that Logoplaste opens its books cost structure to their clients. “*The pricing dimension of the relationship is an ‘open book’* ”, as said by the Logoplaste CEO.

Further, the atmosphere of each relationship is conditioned by a team that is established in the 1<sup>st</sup> day of the contract and forms a “task force”, composed by people from both the supplier and the client. This team includes people from various functions and activities on both sides. Those teams are established in order to search for gain saving opportunities, which can be anywhere in the value chain process, including customer service. “...*We look for opportunities in the electricity, the logistic, the work processes, the package design, etc.*” (Say the CEO of Logoplaste). Thus, each joint team for continuous improvements, meets quarterly and proposes action plans for potential savings and potential efficiency increases, along the manufacture and supply chain. The target of the team is the reduction of annual conversion costs, which are to be shared equally by the parties. It is expected that Logoplaste proposes the introduction of appropriate advances in technology, as soon as they become available. Any other cost benefits, after investment depreciation, that may arise from improvements in production efficiency are shared on an equal basis between the parties.

The quarterly meeting of the joint team involving the customer and Logoplaste assesses the cost/benefit from introducing any new projects such as new formats, colours or raw materials, for production by Logoplaste, or any sudden increase in customer line efficiencies, or even any other event that increases efficiency and/or causes extra complexity compared to the initial operating parameters. The purpose is to check

whether the increase in complexity can be accommodated with the existing Logoplaste resources, or it will require extra investment and costs to be reflected in the price and/or the term of the agreement is extended. Thus, despite contracts being long lasting and relationships long term, they, both, change and develop.

#### **4.5. The employment relationship and the outsourcing relationships**

Logoplaste coordinates its activities with the clients', both wholly integrated in the client's production operations. Thus, the operations of the client, and the activity of its operating managers and blue (and white) collars impinges on fabrication and logistics by Logoplaste (the reverse is also true). Supply chain management requires conceptualizing the outsourcing manufacturing firm as a boundary less firm, which bestows new challenges on human resource management. So, the employment relationship doesn't follow a traditional "linear" pattern, i.e., a relationship between employer and employee (Rubery et al. 2002; Earnshaw et al. 2002). According to Rubery et al. (2004) this definition of the employment relationship has been increasingly recognised to be unsatisfactory in a context of diversification of organisational forms, as is the Logoplaste case.

The Logoplaste industrial employee works in interaction with the client's employees (in some of subsidiaries Logoplaste's industrial equipment is located among the client's). In most Logoplaste firms its workers share the canteen and other social physical spaces with the customer's. In Italy or Brazil even unions are cross boundary. The demand for a close connection between the supplier and the client during the start-up period of Logoplaste's firms is even stronger and it regards mostly issues of output quantity and quality. This requires constant personal coordination with daily interactions. Such proximity is bound to interfere with workers' commitment to organizational goals. Guest (1998) argues that the concept of organizational commitment is at the heart of any analysis of HRM, and is one of the main concerns of employers in recent times. Further, it is important to research whether employees are committed to and identified with the client or the employer. How do workers perceive their identity and the social groups in which they participate? The answer to these questions may be important in determining

whether organizational boundaries are constructed differently today (Barley and Kunda, 2001).

According to Rubery et al. (2004) workers' commitment might depend, on the one hand, on the relative power of the organisations, both in relation to the commercial contracts between them, but also in relation to their attractiveness to workers. On the other hand, organizational culture might be used as a unifying force. In one of its oldest outsourcing relationships, Logoplaste's employees find that their work context and pay conditions are more appealing than those of the client's "*... our colleagues find that our work space is similar to a lab, due to its cleanness and orderliness ... our pay conditions are better ... they envy our conditions ...*" At the same time, they socialize within the client's culture by being present in their social meetings, for instances the Christmas parties, though, they also enjoy their employers' Christmas party, and they seem proud of belonging to Logoplaste. So, these employees' commitment and identity seem to partly cut across organizational boundaries.

Nevertheless, outsourcing relationships may also undermine the consistency of the principles on which human resource practices should be based, as discussed by Baron and Kreps (1999). For instance, in general, every employee of Logoplaste has a bonus included in his/her salary structure, but bonuses may differ depending on the client they serve. In Spain, bonuses also depend on targets related to industrial efficiency. In Italy, there is a bonus to reduce absenteeism, negotiated with the unions. Also, Logoplaste tries to offer the same levels of salary increases as the client workers serve.

Each Logoplaste subsidiary firm has some autonomy to set its own HRM policies. However, inter-organizational relations impact upon the politics of HRM and upon the degree of job security offered to employees. In fact, if the client renews the contract, then the jobs of the workers assigned to that client's contract are safe. The great majority of Logoplaste's clients have been consistently renewing their contracts, and technology improvement is mostly responsible for reductions in the number of employees assigned to a specific contract. However, the employees thus made redundant have been reassigned to another Logoplaste contract or been hired by the client of the contract concerned. Also, the client provides for the safety of the physical work context. Further, health and security training is provided in association with the

client. Therefore, “*inter-organisational relations impinge upon and react with internal employment relations show that the bargain that underpins the employment relationship, far from being a bargain between a single employer and employee, is in fact embedded in a set of inter-organisational relations that may shift risk or responsibilities, both between organisations and between employers and employees*” (Rubery et al. 2004, p. 9).

We argue that these strategic outsourcing relationships involve a type of externalization different from the traditional outsourcing relationships. In the current strategic outsourcing case, the client or contractor is always interested in the internal labour processes of the subcontractor or supplier. Contractors are also interested in the labour processes of the supplier, which are planned and improved by both sides of the relationship. The supplier is constantly pressured by the contracting clients to adapt and adjust to their own internal processes, in order to be able to meet both the specific contract requirements in terms of production activities and logistics, and prices. Nevertheless, the Logoplaste internal network cuts across different clients and countries, and involves other problems and challenges, particularly related with the management of the relationships between managers at different levels: intra-country; inter-country; inter-functional.

#### **4.6. The in-the-client’s-house activities of the outsourcing relationships and the boundaries of the firm**

This outsourcing relationship is an “in (client’s) house” production endeavor because the supplier’s producing units are off-course located inside the clients’ premises. This physical intertwining between each dedicated subsidiary and its exclusive client increases the daily requests and pressure upon the task forces. Logoplaste prefers to consider its clients as partners instead of clients, having in view the long lasting, very close and interactive relationships. The CEO characterizes these as “...*very demanding management relationship[s] ...*”. Every industrial unit is planned and designed from scratch to better fit its client’s product, process and pace, therefore creating a specific supplier / customer relationship. The activities and functions involved in each Logoplaste-Client relationship are tightly coordinated. Joint industrial planning and quality control processes pursue and achieve efficiency/costs savings for both firms.

Industrial planning is done in a daily basis, more so when package diversity is required. Such inter-linked coordination and control activities that connect the supplier and the client's day-by-day operations have consequences both for the organizational and management processes and for the management of human resources. Such intertwining of resources and activities suggests that the notion of blurred firm boundaries may be of help for a better discussion and understanding of the issues involved.

Chandler (1992) conceived the firm as a clear-cut legal and an administrative entity related with suppliers, customers, distributors and employees, where we find a division of labor both within the firm and between its inside and outside. The activities carried out inside were mostly performed by the firm's employees for the market and coordinated by its managerial hierarchy. This conception of the firm deals with its formal and legal borders similarly to Grossman and Hart (1986)'s, who took the firm as a set of assets under common ownership. But, what are firm boundaries? Abbott (1995) considers that an entity exists when a set of defensible boundaries exists and Araujo, Dubois and Gadde (2003) considered that boundaries allow the differentiation and the *stamina of entities* (emphasis added). They argued that boundaries both separate and connect the firm to its environment. For Araujo, Dubois and Gadde the influence of an entity is not simply related to how well protected its borders are but also to how well connected the entity is (i.e., its network influence). Thus, they highlight the firm capabilities to interact with external actors and discuss boundaries as bridging functions linking actors and also their relationships with other actors. They consider boundaries through the lens of the interactive process dealt between intra and inter organizational relationships, which is a much richer and more complex perspective than merely differentiating the inside and the outside of the firm. Araujo, Dubois and Gadde (2003, pp. 1257) say that "... the setting of boundaries is also a decision on how to relate the capabilities of the firm to the [direct and indirect] capabilities of other significant actors in the firm's environment". In contrast to the property rights approach (Grossman and Hart, 1986; Hart, 1990) the firm's assets and complementary assets should be 'owned' and managed in common, and the power decisions about those assets would coincide with the boundaries of the firm. But "ownership cannot be regarded as the sole incentive to resolve hold-up problems and there are plenty of empirical examples where collaboration thrives even in the absence of clearly delineated property rights or adequate protective safeguards", Araujo, Dubois and Gadde (2003, p. 1259).

The Logoplaste in-house client activity can be analyzed as involving hold-up problems related to the “opportunistic nature of the economic actors” and to the specialized nature of assets required for efficient production (Williamson, 1999; Dietrich, 1994; Lazonick, 1991). For Williamson (1999) firms and markets are alternative modes of governance (although, more recently he has acknowledged the possibility of “hybrids”). Clear and formal boundaries allow the management of specialized assets that are necessary to achieve an efficient production. For transaction cost economics (TCE), firms are vulnerable to the opportunism of trading partners when they invest in specialized and complementary assets. Williamson seems to always see transactions as zero sum games and does not take in consideration idiosyncratic capabilities and complementarities that may not exist in alternatives. In contrast, the case study presented in this paper illustrates that outsourcing may also mean cooperation between firms when they make reciprocal investments and become mutually dependent to create added value that may be more difficult or uncertain to obtain internally or with alternative partners. In a way, they “exchange hostages”. Thus, outsourcing can be seen as a coordination mechanism between firms, which challenges the classic concept of clear cut firm’s boundaries. Moreover, the case study presented in this paper is a good illustration of the multiple boundaries of the firm as suggested by Araujo, Dubois and Gadde (2003). These authors departing from the problem of economic coordination find mechanisms of integration “...that sustain the division of labour amongst agents with incomplete, dispersed and disparate knowledge as well as help the process of creating and testing new knowledge” (op. cit., pp. 1256). These authors examine the vertical boundaries of the firm from a capabilities perspective and present a definition of firm’s boundaries based on the insights of Penrose (1959), Richardson (1972) and Loasby (1998a;b).

Penrose (1959) had discussed the notion of the division of labour and the growth of the firm, differentiating between the firm’s resources and the services they render. Resources provide a variety of productive services, which, in turn, may modify the attributes of resources and thus facilitate the provision of new services. This view embodied two important ideas: the firm controls productive resources, which are a pre-package of possible services, and not “rigid attributes”. Later, Richardson (1972) discussed the capabilities and activities of firms to address the division of labour and the coordination of capabilities in industrial systems, which would establish the firm’s boundaries. The author argued that firm’s activities are specialized where it has some

capability comparative advantage, despite not defining what capabilities are. He argued that the combination of activities is explained by the structure of the firms' capabilities. Where we find complementary specialized activities between firms, we also see a fine coordination between them. But, it is known that diverse complementary activities may be coordinated through market exchange, where the 'invisible hand' of the market acts, in contrast with Richardson (1998). The author considered that close complementary activities may require conscious and planned direction due to the complexity of matching those activities. Finally, Loasby (1998a, 1998b) argued that the firm's capabilities are related with the know-how it requires for its productive activity. This knowledge is learned on time by the firm on ongoing activities, but can be direct – the firm knows how to do something by it selves - or indirect – the firm knows how to get something done. Therefore the firm can access the capabilities of other firms and can organize those (external) capabilities, specialized activities and know-how.

For Araujo, Dubois and Gadde (2003) the notion of indirect capabilities is important because firms can specialize and develop direct capabilities trough them, which is particularly clear to access complementary but dissimilar capabilities. Thus, capabilities can cross the firm's formal boundaries. They are embedded in the interaction processes that develop between firms and are organized in complex business networks of relationships. Thus decisions to determine the boundaries of the firm from a capabilities perspective, are always embedded in the ongoing pattern of interdependencies the firm has created and often require multiple and connected adjustment to those patterns. This view contrasts sharply with notions that boundaries emerge as a result of discrete decisions on make-or-buy of individual items. Their argument is intimately associated with the structure of relationships where the firm is embedded in and the means through which the firm can access and influence complementary capabilities controlled by external parties. This view is determined by the interaction of the firm's direct and indirect capabilities with other actors. The notion of indirect capabilities highlights how firm boundaries may respond to the distribution of capabilities in the economy as well as the modes of access to complementary and external capabilities. Thus, Araujo, Dubois and Gadde (2003, pp. 1255) "... conclude that the evolution of firm boundaries must be understood in the context of decisions on how the firm relates to other actors in its environment". They consider inter firm relationships as a form of coordination alternative to markets and hierarchies, whereas the space between had previously been

looked upon as hybrid territory. These hybrid structures can be seen in opposition to the markets and firms competition using of the price mechanism as seen in Coase (1937). Here, the boundaries of the firms separated the organization from the markets, and the firm would internalize all the activities when the internal costs of management equaled the costs of transacting in markets. But, in hybrid structures there would be a mix of pure coordination instruments (price and authority), as pointed by (Powell, 1990). In this vein, Araujo, Dubois and Gadde (2003) argue that cooperation between firms is a distinctive coordination mechanism, which challenges the boundaries concept drawn from a capabilities perspective: "...the boundaries of the firm are determined by the capabilities necessary to undertake productive activities as well as by the capabilities the firm requires to interact with its customers, suppliers and other external actors." (op. cit., 1256). The authors labeled the first set of capabilities "direct or core capabilities" and the second type of capabilities "indirect or ancillary capabilities" based on Langlois and Robertson (1995) and on Loasby (1998a). For them, firms need different types of indirect capabilities to access the complementary capabilities they require, depending on the form of access: market or relationship-based. They argue that the boundary of the firm will have to expand when the firms access complementary capabilities through inter firm relationships. And, the boundary of the firm expands to incorporate those indirect capabilities. Conversely, the authors argue that "...the more firms rely on markets to access dissimilar but complementary capabilities, the more the boundaries can contract and the less specialized the range of indirect capabilities the firm needs to retain." (op. cit., 1257).

## **5. Conclusion**

This paper looked at a peculiar case of a strategic outsourcing supply business that renders packaging services to diverse manufacturing clients, from varied industries (foods and drinks, body care, soaps and detergents, lubricants, etc.) in 9 countries, including the USA and Brazil, by installing and operating tailor made bottling and canning production units within (or wall to wall with) its clients premises. Each of these units is a dedicated firm that is started up purposefully for a specific client, operates in strict coordination and integration with that client's operations and, more often than not, evolves, develops and grows (and eventually dies) with it.

The result is a network organization that displays a complex web of embedded relationships with fuzzy boundaries between the actors involved. This demands both decentralization and local integration and, at the same time, central coordination and global learning. Management must assure the functioning and development of vertical, horizontal and diagonal relationships involving managers in different positions from diverse countries – intra country, inter country and inter functional relationships, and the development of the supplier firm's own coordinating and development capabilities.

This may be seen alternatively as quasi-integration or quasi-disintegration, depending on how we perceive the outsourcing relationship, halfway between hierarchy and market coordination mechanisms. In fact, each solution offered is designed and managed so closely and enmeshed with the clients that they perceive significant advantages in foregoing the capabilities required to perform those operations themselves crucial as they may be for their functioning, survival and development. Conversely, the supplier co-evolves and learns with each relationship and this learning and processes can be useful to develop specific solutions to other relationships. This is true, not only regarding the bottling and packaging solutions but also, and especially, with relation to costs and efficiency, and logistics, i.e. both for products/services and processes/routines. Crucial as they are for the clients, the operations performed by the supplier are not part of what they see as their core businesses. This allows the supplier to keep an open book policy with each one and all the clients and to appropriate solutions developed with one client in order to apply them elsewhere without this being seen as breach of trust.

These 'borderless' ways have significant managerial consequences. The relationships of the supplier with its employees are permeated and strongly conditioned by the relationships of the firm with the clients and the relationships between the employees of both. Loyalty, commitment and identification issues can be raised. Remuneration policies (salary structures, bonuses, etc.) must, at the same time, follow central policies and take in consideration local legislation and industrial relations in the host countries, and the various clients' own HR policies.

Some other important conclusions can be drawn from this case study. Firstly, the outsourcing relationship discussed here requires and fosters the development of cross boundaries capabilities, which may become valuable invisible assets (Itami 1987).

Secondly, those capabilities generate organizational learning, including inimitable inter-organizational routines and dynamic capabilities. Finally, the assumption that the firm is embedded in a complex web of interdependencies and processes of continuous mutual adaptation with other firms suggests that the boundaries of the firm should be perceived from a capabilities perspective, which contrasts with the notion that boundaries are stable and emerge as a result of discrete decisions. Related with these arguments Araujo, Dubois and Gadde (2003) support the idea that what differentiates firms is the complex pattern of relationships and knowledge associated to teamwork and continued interaction. The specialization of those activities, embedded in a complex web of inter-firm interactions, means that the services they provide can not be easily accessed by pure market transactions. They argue (*op. cit.*, p. 1262): “This degree of specialization means that these types of services can no longer be replicated easily or accessed in the open market.” Thus, we can see the essence of a firm as coherent net of activities and capabilities, rather than the purely professional knowledge or skills, or even routines, of its members, teams, and hierarchy.

## References

- Abbott, A. (1995), "Things of boundaries", *Social Research*, Vol. 62, n.º 4, pp. 857-882.
- Almond, P.; Clark, I. and Tregaski, O. (2004) "HRM in multinationals: a comparative international perspective" in Beardwell, I., Holden, L. and Claydon, T., *Human Resource Management: a contemporary approach*. England: Prentice Hall.
- Araujo, Luís; Dubois, Anna and Gadde, Lars-Erik (2003), "The Multiple Boundaries of the Firm", *Journal of Management Studies*, 40: 5 July, pp. 1255-1277.
- Axelsson, B. and Easton, G. (eds.) (1992), *Industrial Networks - a New View of Reality*, Routledge, London.
- Barley, S.R. and Kunda, G. (2001) "Bringing Work Back In", *Organization Science*, Vol. 12, No. 1, January-February, pp. 76-95.
- Baron, J. N. and Kreps, D. M. (1999), *Strategic Human Resources: Frameworks for General Managers*, New York: John Wiley and Sons.
- Blois, K. J. (1972), "Vertical Quasi-Integration", *Journal of Industrial Economics*, Vol. 20, N° 3, pp. 253-272.
- Chandler, A. D. (1992), "What is a firm - a historical perspective", *European Economic Review*, Vol. 36, 2-3, pp. 483-492.
- Coase, R. (1937), "The Nature of the Firm", *Economica*, (New Series) 4, pp. 386-425.
- Earnshaw, J., Rubery, J. and Cooke, F.L. (2002). *Who is the Employer?* London: Institute for Employment Rights.
- Ford, D. (ed.) (2002), *Understanding Business Marketing and Purchasing*, 3rd edition, Thomson Learning, London.
- Dietrich, M. (1994), *Transaction Cost Economics and Beyond. Towards a New Economics of the Firm*, London: Routledge.

Gadde, Lars-Erik and Mattsson, L.-G. (1987), “Stability and Change in Network Relationships”, *International Journal of Research in Marketing*, 4 (1), pp. 29-41.

Grossman, S. and Hart, O. (1986), “The costs and benefits of integration: a theory of vertical and lateral integration”, *Journal of Political Economy*, Vol. 94, n.º 4, pp. 691–719.

Guest, D (1998), “Beyond HRM: commitment and the contract culture”, in Sparrow, P and Marchington, M (eds), *Human Resource Management: the New Agenda*, London: Pitman.

Håkansson, H. and Snehota, I. (ed.) (1995), *Developing Relationships in Business Networks*, Routledge, London.

Hart, O. (1990), “An economist’s perspective on the theory of the firm”, in Williamson, O. E. (Ed.), *Organization Theory. From Chester Barnard to the Present and Beyond*, Oxford: Oxford University Press, pp. 154-171.

Itami, H. (1987), *Mobilizing Invisible Assets*, Cambridge, MA: Harvard University Press.

Langlois, R. N. and Robertson, P. L. (1995), *Firms, Markets and Economic Change: A Dynamic Theory of Business Institutions*, London: Routledge.

LaPlaca, Peter J. (2004), “Letter from the editor”, *Industrial and Marketing Management*, Vol. 33, pp. 167-168.

Lazonick, William (1991), *Business Organization and the Myth of the Market Economy*, Cambridge University Press, New York, USA.

Loasby, B. J. (1998a), “The organisation of capabilities”, *Journal of Economic Behavior & Organization*, Vol. 35, n.º 2, pp. 139-160.

Loasby, B. J. (1998b), “The concept of capabilities”, in Foss, N. J. and Loasby, B. J. (Eds), *Economic Organization, Capabilities and Co-ordination. Essays in Honour of G. B. Richardson*, London: Routledge, pp. 163-182.

Logoplaste, (2006), Annual Report, Global Presentation, Lisbon, Portugal.

Logoplaste, (2005) , Annual Report, Global Presentation, Lisbon, Portugal.

Pardo, C. (2001), “Key Account Management in the Industrial Field. The Account Team for an Efficient Reconfiguration of the Supplier - Customer Relationship”, *CR Rom Proceedings of the 17<sup>th</sup> IMP Group Conference*, Oslo, Norway.

Penrose, E. (1959), *The Theory of the Growth of the Firm*, Oxford: Basil Blackwell.

Powell, W. W. (1990), “Neither market nor hierarchy: network forms of organisation”, in Staw, B. M. and Cummings, L. L., *Research in Organizational Behaviour*, Vol. 12, Greenwich, CT: JAI Press, pp. 295-336.

Prahalad, C.K. and Doz, Y. (1987) *The Multinational Mission: Balancing Local Demands and Global Vision*. New York: The Free Press.

Proenca, João and deCastro, Luís M. (2005), “Stress in business relationships: a study on corporate banking”, *International Journal of Bank Marketing*, Vol. 23, N° 7, pp. 527-541.

Proenca, João and deCastro, Luís M. (2004), “Business Relationships Dynamics and (In) Stability: A Comparative Case Study in Corporate Banking”, *Journal of Customer Behaviour*, Vol. 3, n° 3, pp. 235-256.

Richardson, G. B. (1972), “The organisation of industry”, *The Economic Journal*, Vol. 82, September, pp. 883-896.

Rodríguez, Tomás F. and Robaina, Victor Padrón (2006), “A review of outsourcing from the resource-based view of the firm”, *International Journal of Management Reviews*, Vol. 8, Issue 1, pp. 49-70.

Rubery, J.; Carroll, C.; Cooke, F.L.; Grugulis, I. and Earnshaw, J. (2004), “Human Resource Management and the permeable organization: the case of the multi-client call centre”. *Journal of Management Studies* 41 (7), 1199–1222.

Rubery, J. and Earnshaw, J. (2004), “Employment policy and practice; crossing borders and disordering hierarchies”, in M. Marchington; D. Grimshaw; J. Rubery and H. Willmott (eds.), *Fragmenting Work: Blurring Organizational Boundaries and Disordering Hierarchies*, Oxford: OUP.

Rubery, J.; Earnshaw, J.; Marchington, M.; Cooke, F.L. and Vincent, S. (2002), “Changing organizational forms and the employment relationship”, *Journal of Management Studies*, 39 (5): 645–672.

Williamson, Oliver E. (1999), “Strategy research: governance and competence perspectives”, *Strategic Management Journal*, 20, 12, 1087–108.

Williamson, Oliver E. (1986), “What is Transaction Cost Economics” in Williamson, Oliver, E., *Economic Organization: Firms, Markets and Policy Control*, Wheatshoof Books, pp.174-191.

Yin, Robert K. (2003), *Case Study Research - Design and Methods*, third edition, Applied Social Research Methods Series, Vol. 5, Sage Publications.