EFFICIENCY-SEEKING OR RECIPE-FOLLOWING? THE CASE OF OUTSOURCING

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Abstract

This paper examines outsourcing as a contemporary example of “best practice” to examine the relationship between historical narratives, managerial actions and management theories. We argue mangers are neither ruthless efficiency seekers, as Chandlerian business history would have us believe, nor blind followers of fads and fashions as proposed by neo-institutional approaches. We argue instead that there is a strong interplay between efficiency seeking criteria and business recipes, understood as institutionalized rules on managing businesses, measuring performance and so on.

We argue that outsourcing can be regarded as both a measure to increase efficiency, namely through increasing specialization and external economies of scale, as well as a managerial fashion who has led many businesses to embrace it but with fairly disappointing results. We use the industrial networks model of actors, resources and activities to explain how outsourcing can be overexploited, particularly in its latest offshoring incarnation, and induce tensions between the early and latter waves of outsourcing. We conclude our paper with a discussion of the relationship between historical narratives on the evolution of the business environment and management theories, and the need for a heightened awareness on how they influence each other.

Introduction

The last few years have been characterized by an increasing interest in the nature of business evolution. A particular aspect of this debate concerns the relationship between business history and management studies (Kipping and Üsdiken 2008). The relationship between the two fields was initiated by the publication of Alfred Chandler’s (1962) *Strategy and Structure* which has had an enduring influence in management studies. Chandler (1962: 1) was acutely aware of the potential synergies between business history and business administration: “Historians have provided social scientists with little empirical data on which to base generalizations or hypotheses concerning the administration of great enterprises. Nor have the historians formulated many theories or generalizations of their own”.

Chandler’s *Strategy and Structure* chose to focus on four large companies (DuPont, General Motors, Standard Oil and Sears Roebuck) after a survey of nearly one hundred of the largest corporations in the United States. Many of the notions found in *Strategy and Structure* such as the definitions of corporate strategy and structure or the distinction between the formulation and implementation of strategies, have left a lasting imprint especially in the subfield of Strategic Management (Whittington, 2008) and European Business Studies (Iversen, 2008), even if some of Chandler’s original hypotheses have become increasingly controversial or been discredited.

The second major contribution from Chandler (1977) and which has had an equally powerful impact on management studies is associated with the publication of *The Visible Hand*. The thesis of this second contribution was how “…the modern business enterprise took the place of market mechanisms in coordinating the activities of the economy and allocating its resources. In many sectors of the economy, the visible hand of management replaced what Adam Smith referred to as the invisible hand of market forces” (*ibid*: 1). As with *Strategy and Structure*, *The Visible Hand* did not just stick to the basic historian’s task of “…setting the record straight” (*ibid*:6). It provided a set of propositions concerning the emergence and the growth of what Chandler termed the modern business enterprise (MBE) – a multi-unit hierarchy managed by salaried executives. In particular, Chandler (1977: 6) associated the emergence of the MBE to situations “…when administrative coordination permitted greater productivity, lower costs, and higher profits than coordination by market mechanism”.

In short, Chandler was not merely concerned with supplying historical narratives for the evolution of the business landscape. He was himself involved in setting up generalizations and propositions based on detailed historical narratives that have had a lasting influence in the management studies field.

Aim and outline of the paper

The purpose of this paper is to revisit the relationship between business history and management theories and how these theories impact on, and are impacted by particular narratives of business evolution. Chandler's master narrative was concerned with business evolution in terms of the rise of the MBE and management as an efficient response to the limitations of markets. Later on Chandler reinforced the idea that efficiency acts as an impersonal force to steer the evolution of institutional forms. This view was adopted by other scholars, for example, in the claim that new organizational forms "…arise arise to correct the principal deficiencies of the forms currently in use" (Miles and Snow (1992: 53). However, this view has been questioned from a number of angles (Scranton, 2008). One such example is Lamoureux *et al* (2003), who argue that various organizational forms (such as markets, hierarchies, networks) always co-exist though the prevalence of one or the other may shift over time.

Our investigation of business evolution, efficiency seeking, and the role of organizational forms in these processes is structured in the following way. We begin by examining the legacy of Alfred Chandler and recent attempts at producing a post-Chandlerian historical synthesis that place his key theses in a broader historical context. We continue by exploring the features of a recent management trend: the rise of outsourcing. Outsourcing may be seen as a response to the limitations of Chandler's MBE and the surge in outsourcing over the last two decades provides plenty of food for thought regarding the limitations of hierarchy as the means to accommodate increasingly complex activities and deeper patterns of specialization. In this sense, outsourcing can be considered as an efficiency-seeking response to changing conditions in the business environment. However, the widespread adoption of outsourcing may also be explained as the outcome of mimetic processes, with firms imitating and following recipes that are perceived to be "best practices" regardless of whether or not they are suited to their specific circumstances and efficiency requirements. In the exploration of outsourcing as efficiency-seeking and/or recipe following, we rely on the industrial networks model of actors, resources and activities (Håkansson and Snehota 1995). We conclude with some reflections on the importance of pursuing a dialogue between business history and management theories.

The Post-Chandlerian Synthesis of Business History

The passing away of Alfred D. Chandler in May 2007 was followed by a plethora of essays celebrating his work and assessing his considerable legacy (see in particular, *Enterprise and Society* 9(3), 2008 and *Business History Review* 82(2), 2008). Our purpose here is not to summarize these contributions but to reflect on key lessons emanating from Chandler's work and what critics of the Chandlerian approach have to offer. In his last two major works, *Inventing the Electronic Century* (2001) and *Shaping the Industrial Century* (2005), Chandler extended and refined the evolutionary model he had developed from his earlier publications. The focus is still on the large corporation and its leading role in vast swathes of the economy but with an added interest in innovation and the underlying reasons that explain sustained performance over time.

To recap, Chandler (1977: 285) portrays the rise of the MBE as a result of "…the integration of the processes of mass production with those of mass distribution within a single firm". The initial step in the creation of the MBE was the investment in production facilities large enough to achieve scale and scope, as in capital intensive industries high throughput is needed to maintain a minimum efficient scale. The second step, which often occurred simultaneously, was the investment in product-specific marketing, distribution, and purchasing arrangements. Exploiting the potential benefits of mass production required careful coordination not only of the flow through the processes of production but also of the flow of inputs from suppliers and the flow of outputs to intermediaries and final users.

Chandler (1977) went as far as saying that economies of speed were more crucial for manufacturing efficiency than economies of scale. Thus, the ability to coordinate the flow of materials through the plant was more important than the size of the factory and the subdivision of work within the plant.

This coordination, in turn, demanded the constant attention of a managerial team - or hierarchy. The potential for economies of scale and scope was related to the physical characteristics of production facilities. The actual economies of scale and scope, as determined by throughput, are organizational and "…depend on knowledge, skill, experience, and teamwork – on the organized human capabilities essential to exploit the potential of technological progress" (Chandler 1990: 25). The final step was the recruitment and organizing of managers to supervise production and distribution activities, to coordinate and monitor the flow of goods and to allocate resources for future production and distribution on the back of performance metrics and anticipated demand.

The study of high technology industries provided material to update and refine rather than discard the centrality of the large corporation for industrial development – "… by the early years of the present century, the "Chandlerian model" continues to dominate and permit the commercialization of new products (even from old technologies)" (Chandler 2005: 136). The focus on the development capabilities that had been in evidence since the publication of *Scale and Scope* (1990) was taken a step further with the notion that the build-up of internal capabilities depended on the accumulation and integration of a series of firm-specific knowledge bases.

Chandler (2001, 2005) proposed that successful high-technology were those that were able to harness technological knowledge and combine it with product development, manufacturing, marketing and distribution in what he termed an *integrated learning base*. The firms that were able to create such integrated learning bases were to enjoy first-mover advantages and lower unit costs due to the large, often global scale of their operations. Secondly, diversification into new products, often related as far as technologies and markets were concerned, provided these firms with opportunities to exploit economies of scope and scale. Thirdly, integrated learning bases provided these firms with clear paths of learning that grew into other technologies and/ or markets. And finally, Chandler (2005: 604) saw these leading firms at the centre of supporting networks of suppliers, providing critical products and services. As Miranti (2008: 300) notes, these network arrangements provided an important infrastructure to support the development of new product-markets by these first-mover, high-technology, integrated and largely global corporations.

Criticism of Chandler's theses

The critique of Chandlerian theses has proceeded along a number of fronts (see McCraw 2008). In this section we focus on two issues:

1) the focus on large corporations and the comparative neglect of alternative institutional arrangements;
2) the teleological model of industrial development implicit in Chandler's theses.

The first critique is best exemplified by Lamoreaux *et al*'s (2003) proposal for an alternative synthesis of American Business History and the attempts by Langlois (2003, 2004, 2007) to place the Chandlerian revolution in a broader historical frame. Both Lamoreaux *et al* and Langlois regard Chandler's narrative as essentially descriptive and set about supplying alternative theoretical frameworks that can underpin Chandler's synthesis without taking the MBE as the end point of history.

Lamoreaux *et al* (2003) are less troubled than Chandler by production and distribution efficiencies, focusing instead as organizational responses to incentive problems under asymmetric information conditions (the principal-agent problem). In their account, economic agents try to resolve problems of asymmetric information through various coordination mechanisms which they array along a continuum from market to hierarchy with long-term relationships as a midpoint between the two polar opposites – they claim that long-term relationships are distinctive and common enough to be identified as a third coordination mechanism. Unlike Chandler's insistence on a unitary model of industrial development, Lamoreaux *et al* (2003) contend that three coordination mechanisms they outline always co-exist though the prevalence of one or the other may shift over time. The concluding message is that maintaining an open and forward-looking perspective on economic change requires the acknowledgement that firms face a menu of choices at any one time and decision makers face a great deal of uncertainty as to what option to pursue regarding appropriate coordination mechanisms (see also Lamoreaux, 2001).

Langlois (2003, 2004, 2007) rejects Lamoreaux *et al*'s (2003) concern with the world of contractual hazards and asymmetric information. The world of production, by contrast, is implicitly regarded as a land of perfect and publicly available information. As in Chandler's account, Langlois (2004: 359) regards the acquisition and development of productive capabilities as relying on costly and limited knowledge. Managerial decisions are driven by the costs of acquiring the capabilities required to pursue specific profit opportunities – dynamic transaction costs. The magnitude of these costs depends on the pattern of existing capabilities and their locus (e.g. firms or markets), the nature of the change involved and the extent to which the required capabilities can be accessed or need to be developed from scratch.

Contra Williamson's (1985) comparative statics framework, Langlois argues that the notion that economic agents are faced with choice of acquiring capabilities through contract or hierarchy is unwarranted. Instead, and especially in times of economic change, hierarchies may emerge precisely because capabilities cannot be contracted and require development through internal governance. This is, according to Langlois, the scenario of the rise of the MBE and the managerial revolution that Chandler (1977) portrayed in *The Visible Hand*. But, as time passes, and capabilities begin to get better understood and productive tasks can be progressively decomposed, we should expect opportunities for specialized markets to develop and the advantages of hierarchy to decline. If technology or other factors render those market-based capabilities inadequate, the stage is set for another Chandlerian revolution and an increase in vertical integration.

Langlois (2004) contends that the last two decades have witnessed a decline of the Chandlerian firm under pressures from the development of larger, thicker markets supporting generic technologies and vertically specialized firms. As Langlois (2004: 372) put it: "A Chandlerian firm starting today can plug into modern financial markets, containerized shipping, Federal Express, personal computers and the Internet without having to reinvent those stages of production itself. This suggests that not only should we expect Chandlerian firms to occupy a smaller niche in the population of firms as the extent of the marker grows, but we should expect those firms to be less vertically integrated on average".

As far as the second criticism is concerned, Chandler's narratives are often portrayed as teleological or Whiggish – i.e. taking the present as an inevitable endpoint to which historical trajectories had been aiming for. Scranton (2008), who has provided a sustained critique of the dominance of mass production and large enterprises in industrial evolution) regards Chandler's work as a classic modernist project. Chandler seemed to be intent on providing the definitive and accurate representation of history and of providing "…an origin story for solid modernity in which rational and rationalizing enterprises are the natural and essential foundations for progress, for a society of reliable structures, durable careers and rising expectations" (Scranton 2008: 427).

Lamoreaux *et al* (2003, 2004) suggest that the way to escape the trap of Whig history is to regard the three coordination mechanisms they outline – market, hierarchy and long-term relationships – as alternative means of economic coordination whose different characteristics suit different historical and geographical contexts. There is thus no universally superior coordinating mechanism and their mix and influence can wax and wane according to different epochs and circumstances.

Similarly, Sabel and Zeitlin (1985, 1997) and Zeitlin (2008) take a strong stance against teleological, unilinear logics of progress and determinism and make a case for what they term "the historical alternatives approach". For these authors, industrial evolution is marked by multiple possibilities, contingencies and strategic choices by situated actors. In this scenario, economic agents are seen as reflexive agents seeking to make sense and shape the various contexts – market, technological, organizational – in which they operate as much as figuring out what adequate responses to take advantage of particular contexts. In this sense, economic actors do not simply follow a script written for them by the contexts and circumstances they confront; they are actively involved in shaping their own contexts. Thus historicism, understood as the notion that evolution is determined by the operation of some hidden logic of functional necessity (e.g. the pursuit of transhistorical concepts of efficiency), is rejected as a mechanism to explain industrial evolution, which takes us in the direction of a third critique of Chandler's theses.

Managers as efficiency-seekers and recipe-followers

Chandler's portrayal of managers as pragmatic problem solvers has been questioned by a number of authors, namely the historical alternatives approach pioneered by Sabel and Zeitlin (1985). In *Strategy and Structure*, Chandler (1962: 3) was at pains to point out that managers in his four case companies developed what they regarded to be a novel solution (i.e. multidivisional forms) to an idiosyncratic problem (i.e. accommodating related diversification): "There was no imitation. Each thought its problems were unique and its solutions genuine innovations, as brand new ways of administering great industrial enterprises. In time, the innovations became models for similar changes in many American corporations".

Fligstein (2008: 244) characterized Chandler's view of management as a solution to the coordination problems posed by mass production and distribution. In the Chandlerian story, managers are problem solvers whose mission was to devise strategies and structures to deal with those problems. Their solutions, when successful, allowed markets and their firms to expand in size. Once successful, these solutions became templates for rivals to emulate.

Alternative approaches place more emphasis on the notion that historical outcomes may be the result of isomorphic pressures to conform to what is widely perceived to be "best practice" regardless to whether or not the outcome can be deemed as efficient (DiMaggio and Powell, 1983). Managers may thus be prone to adopt standardized solutions that are deemed to be legitimate according to widely adopted criteria (e.g. "best practices" as defined by experts) rather than customized answers to their own specific problems. Even if Chandler's (1962) four case firms simultaneously invented the multidivisional form, further adopters of this structure may have simply replicated what they regarded as a legitimate and successful recipe.

In summary, the prescriptions embodied in "best" practices tend to become institutionalized as "business recipes" (Spender, 1989; Whitley, 1992). Business recipes are particular ways of "…organizing, controlling, and directing business enterprises that become institutionalized as the dominant form of business organization" at particular times and locations (Whitley 1992: 125). This notion implies that managers are less of pragmatic problem solvers and more followers of fads and fashions (Abrahamson, 1996; Kieser, 1997), prone to the influence of experts such as management consultants (Kipping and Engwall, 2002; McKenna, 2006) who set themselves up as purveyors of "best practices". The notion of business recipes is important for managers since they "…rarely know what is economically efficient" and therefore have to construct views of what constitutes efficient action (Fligstein 1990: 302).

The aim of the following sections is to explore the relationship between efficiency and recipe-following as exemplified by contemporary outsourcing trends. Outsourcing is a relatively recent phenomenon that shows traits of being both an efficient response to particular coordination problems as well as a business recipe whose spread is fuelled by a discourse of historical inevitabilities aided by the helping hand of professional expertise. Our starting point is that mangers are neither ruthless efficiency-seekers nor blind followers of fashion. The interplay between efficiency-seeking and business recipes is what interests us in this paper. Actions that successfully solve particular coordination problems are likely to be candidates for business recipes. Once these actions become coherent programs of action and acquire the status of recipes, they will have a strong impact on what is perceived to be the appropriate mechanism for coordination. In this sense, business recipes gain currency and legitimacy as they are able to promote and operationalize their own efficiency criteria to the detriment of alternative ways of conceptualizing and measuring efficiency.

In short, outsourcing is a particularly interesting trend to use as an empirical case since it constitutes in many ways, a dismantling of the MBE whose rise Chandler (1977) chronicled in detail. A more comprehensive discussion of the receding limits of the MBE can be found in Gadde and Araujo (2007).

Outsourcing as efficiency-seeking

In an historical review of purchasing Morgan (1999: 90) claims that in the reengineering on the supply side of companies starting in the 1980s a main issue was "…taking an operation or function traditionally performed in-house and jobbing it out to a contract manufacturer or third-party service provider". The impact of outsourcing was substantial. One example is the changes in the proportions of in-house manufacturing and deliveries from suppliers for Ford Motor Company. In 1980 the value of components and systems manufactured in-house accounted for 70 % of the total value of a Ford car. By 2000 suppliers accounted for 70% of the total value, while the portion of in-house manufacturing had decreased to 30% (Quinn 1999). Similar changes occurred for most car manufacturers although many of these started from an in-house proportion lower than Ford. The outsourcing trend first diffused to other industries based on the assembly of components and systems, such as home appliances and telecommunications and later to services like information technology (see e.g. Barthelemy and Geyer 2001), general business services (Kakabadse and Kakabadse 2002) and logistics (Razzaque and Sheng 1998; Carbone and Stone 2005).

The dismantling of the integrated hierarchy was driven by efforts to improve both efficiency and effectiveness. From an industrial networks perspective, substantial benefits could be reaped across all three layers: resources, activities, and actors. As far as resources are concerned, the MBE relied on ownership control of all critical resources. The interfaces with the resources of business partners were standardized to circumscribe interdependencies and potential hazards related to becoming locked into the technologies of other companies. The downside of this strategy was that the MBE became locked into its own technological base, getting little inspiration or creativity from the outside. Severe problem with this model were exposed when the technological frontier expanded dramatically during the late 1990s. This expansion was particularly concerned with greater inter-relatedness between formerly distinct fields of technology (Fai and Cantwell 1999).

These developments provided opportunities for recombining of resources and modifications of their interfaces. For the individual firm, these conditions implied an enormous expansion of the resources required for design, development, manufacturing and distribution. This widened range of processes and technologies needed for the operations of a company made it necessary to rely on the resources of others since "…there is no way that knowledge, especially 'knowledge-how' that is required … can all be collected in one centre or understood by any cohesive group of people (Loasby 1999: 6).

In the activity layer, the effect of outsourcing is increasing specialization. This concentration in the activity layer provides a company with advantages in two respects. On the one hand, it can focus on a limited part of the total pattern of activities that are important to its operations. In this way, both improved performance and economies of scale can be obtained both in the undertaking of activities and in knowledge development. Moreover, since activities are outsourced to suppliers that normally work at a larger scale, economies will also occur in these operations. Outsourcing of activities to suppliers or say, logistics service providers required modifications of the linkages among activities. The MBE had synchronized its internal activities in order to reap potential benefits from economies of speed. When some of these activities now outsourced, it was necessary to retain a degree of integration and so the internal activities of the outsourcer required synchronization with the activities of its business partners.

The modifications in the resource and activity layers required changes in the actor layer too. Previous recommendations regarding dependence avoidance and maintaining arm's-length relationships with suppliers had to be reconsidered. The view of what constituted efficiency in relationships with business partners changed significantly since it became increasingly obvious that avoiding dependence also implied foregoing the benefits of high-involvement relationships. By developing close relationships with its business partners, a company could make substantial gains in both productivity and innovation. Resource sharing and activity synchronization across the boundaries of firms called for closeness in the relationships between companies. Moreover, the operations of a particular supplier had to be coordinated with the operations of other suppliers.

These conditions made it necessary to reduce the size of the suppler base, since close collaboration and coordination are resource intensive and can only be pursued with a limited number of partners.

Through outsourcing and specialization, companies were able to improve their performance and a main objective of outsourcing was to provide the buying company with "…full utilization of external suppliers' investments, innovation and specialized capabilities that would be prohibitively expensive to acquire or even impossible to duplicate internally" (Quinn and Hilmer 1994: 43). As far as efficiency-seeking efforts on the supply side were concerned, outsourcing became as an integral part of the transformation observed in the mid to late 1990s. Outsourcing was regarded as the main driver of these strategic changes. It contributed to a specialization in the activity pattern and it provided access to the resources of suppliers that were vital for improvements in productivity and innovation at the buying firm. Numerous success stories on the benefits of outsourcing in terms of cost reductions, shortened lead-times and innovation-enhanced processes contributed to the fast diffusion of the outsourcing recipe. Business consultants preached the advantages of this medicine and researchers developed analytical frameworks highlighting the potential benefits stemming from outsourcing (e.g. Bryce and Useem 1998; Vinning and Globerman 1999; Quinn 1999, 2000; Gilley and Rasheed 2000; Momme and Hvolby 2002; Kim 2003; McIvor 2003; Berggren and Bengtsson 2004; Abdel-Malek *et al* 2005; Buehler and Haucap 2006; Jiang *et al* 2007).

The trend culminated in the recent application by IBM to the US Patent and Trademark Office, dated 26th March 2009, of a patent entitled "Method and System for Strategic Global Resource Sourcing", outlining plans for a technology that would automate many of the steps involved in identifying activities for outsourcing and offshoring. [1] The patent application, which has now been withdrawn, noted that: "An important challenge in shifting to globally integrated enterprises is planning the location and capacity of the global workforce". There is thus a need to: "… provide a robust and reusable sourcing template to identify new/expand existing global resource pools, analyze trade-off qualitative and quantitative aspects across multiple global locations, and model the global nature of resource sourcing."

There is no doubt thus that outsourcing became a critical ingredient in the transformation of Chandler's MBE, building on ownership control of all critical resources, the hierarchical coordination of interdependent activities and the buffering in relation to the operations of other companies. Once

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[1] See e.g. for a report on the patent application entitled: "Patent filing describes IBM's new offshoring math: Application details mathematical model for assessing 'global resource sourcing" posted by Patrick Thibodeau on 31st March 2009. Please see: http://www.computerworld.com.au/article/297431/patent_filing_describes_ibm_new_offshoring_math?fp=39&fpid=26145 (accessed 9th April 2009)

these rules were relaxed or abandoned, the MBE became open to influences from outsiders who could improve on the performance of the company's resource collections and activity structures.

Outsourcing turns toward recipe-following

Due to its initial success, outsourcing went further and further in both the number of tasks that have been deemed candidates for outsourcing and the extent to which those tasks have been transferred to suppliers. Moreover, in efforts to extend the gains from cost savings, operations were progressively transferred to suppliers located in far flung places. Offshoring, or sourcing from low-cost countries, promised to deliver another round of dramatic cost reductions. If outsourcing refers to tasks or processes that were once performed inside the firm but are now contracted to external suppliers, offshoring captures the spatial as well as the institutional fragmentation of production – when an activity is offshored, it is carried out in a foreign location either by external suppliers or by a captive subsidiary (Sako, 2006).

The institutional and spatial fragmentation of production often reinforced each other. As Feenstra (1998: 31) put it: "The rising integration of world markets has brought with it a disintegration of the production process, in which manufacturing or service activities done abroad are combined with those performed at home. Companies are now finding it profitable to outsource increasing amounts of the production process, a process which can happen either domestically or abroad".

There is a major problem, however, related to this enhanced role of the outsourcing recipe. Despite the voluminous literature dealing with outsourcing and its potential benefits, the actual realization of its promised benefits is less well covered. For example, Berggren and Bengtsson (2004: 211) claim that cost savings "…tend to be taken for granted, but detailed analyses of actual outcomes and potential side effects are hard to find". In the particular area of outsourcing to logistics service providers, it is claimed that "…there are actually very few empirical studies of logistics outsourcing performance" (Deepen *et al* 2008:76). Lambert *et al*. (1999) conclude that while some realized benefits of third-party logistics are well documented, the pitfalls and problems have received less attention. Furthermore, there is clear evidence that in some cases "…logistics outsourcing has become a source of corporate failure and disappointment" (Boyson *et al*., 1999:73).

There are a number of examples of problems related to the pursuit of outsourcing, offshoring and low-cost country sourcing. One of the main findings is that "…offshoring is often done with little or no understanding of its true costs" (Hogan 2004: 76), with the effect that companies "…overestimate the savings to be had from going abroad" (Venables 2005: 7). Similar features seem to characterize sourcing from low-cost countries where the focus is often on the reduction of direct costs, particularly labor costs. But a low unit product cost "…is only one part of a very complex equation and must be considered against the direct, indirect, and hidden costs of longer and more complicated supply lines" (Smyrlis 2006: 6).

Due to these conditions many companies have reconsidered their outsourcing decisions. In a survey organized by the American Management Association, three quarters of the respondents stated that outsourcing outcomes had fallen short of expectations, and more than half had brought at least one outsourced activity back in-house (Bryce and Useem 1998). Lacity and Wilcox (2001) found that a third of the companies in their survey had canceled outsourcing contracts. The technology research and consulting firm Gartner reports that 52% of small-business and 42% of mid-sized business contracts are backsourced once the contract has been discontinued (Brown 2004). JP Morgan Chase & Co returned all IT-functions back in-house after having them outsourced to IBM (Cowley 2004). A recent Compass poll of executives from 70 outsourcing companies in North America found that only 4 percent of these organizations would not consider taking all or some services back in-house when their contract term was to expire (Fowler – Compass 2006). A survey of the British Bankers' Association by the Management Consultancies Association reported in the *Financial Times* (14th November 2008), found that 54% of those inquired felt their organizations knew how to extract good value from outsourcing and only 24% felt the same about offshoring. The survey results suggest that the operational skills required to deliver a service in-house are far removed from the skills required to managing outsourcing relationships, namely in the areas of contracting, governance, strategy and innovation.

The main explanation to the shortcomings related to the extension of outsourcing seems to be the lack of analytical rigor when decisions are taken. For example, it has been found that "…business people often do not fully understand the complex relationship among outsourcing and corporate sources of competitive advantage" (Lei 2007: 21) and that "…the fundamental query 'to outsource or not to outsource' has been beyond the analysis" (Berggren and Bengtsson 2004: 221). These quotes are illustrative of situations where outsourcing decisions are less driven by efficiency seeking than by recipe-following. Outsourcing has evolved into a business recipe making the pressure to outsource irresistible and the idea that "…it is not appropriate is fast becoming inconceivable" (Hendry 1995:196). In similar vein, Kuwahara (2006) claims that "…many companies have outsourced because of 'groupthink' rather than because careful investigation showed that it made sense". It seems thus as the outsourcing recipe has been overexploited and the coming section will explore some potential reasons for this.

A network explanation for the troubles with extended outsourcing

In order to understand the problems with extended outsourcing, particularly in terms of offshoring and low-cost country sourcing, we have to revisit the features of activities, resources, and actors in the business environment after the dismantling of the MBE. The main characteristic of the activity patterns in these network arrangements was the significant integration of business processes

across firm boundaries. The synchronization of activities within and between manufacturing and logistics processes became a top priority and resulted in considerable interdependencies among activities. These effects arise from enhanced attention to activity configurations in terms of just-in-time deliveries, extensive customization and increasing reliance on build-to-order production.
The potential impact of offshoring and low-cost country sourcing on these arrangements may be significant. Business processes building on connected and synchronized activities will be decomposed and require the establishment of linkages to the activities of a new business partner and also linkages between the partner and other companies along the supply chain. Such close coordination of activities across the boundaries of multiple firms is problematic. For example, outsourcing of logistics activities caused severe disturbances in the inbound logistics flow of a car manufacturer relying on responsive customer driven operations (Svensson, 2001).
Outsourcing and specialization is beneficial to the performance of activity patterns in general, since specialization tends to improve the efficiency of individual activities. However, specialization will require coordination since the output of the specialized activities must be integrated to form a total solution for the buyer in terms of, for example an assembled product, a logistics service or an information system. The relationship between these two dimensions is straightforward: the higher the degree of specialization, the more coordination is required to integrate what has been divided. In short, the benefits from increased specialization may be outweighed by the increased costs of coordination of specialized and dispersed activities.

When it comes to the resource dimension, the main impact of the dismantling of the MBE concerned the joint resource exploitation with business partners. The performance of such resource arrangements depends on the ways resources are combined and adapted to each other. Through successive combining and recombining, interfaces between resource elements evolve and increasingly relate resources to each other (Håkansson and Waluszewski 2002). The bigger the effort invested into systematic resource combining in order to make resource constellation efficient and effective, the better the performance extracted from those resource constellations.
Extended outsourcing may have important implications for established resource constellations. These constellations involve combinations of resource elements like manufacturing facilities, logistics infrastructures, information systems, warehouses, and other resources. If some of these interfaces are changed through extended outsourcing, the whole constellation will be affected. Some resources will lose part of their value since they will lose their connections to particular constellations. The resource replacing this element needs to be combined with the remnants from the current constellation and such combinations will always require significant investments in order to develop new interfaces. The challenge is that the better the integration of resources in a constellation, the more difficult it will be to successfully combine them with new resource elements.

Activity synchronization and resource combining across the boundaries of firms was a driving force in the transformation of the MBE. Handling these issues significantly impacted on the actor layer since they required close business relationships. The exploitation of relationship benefits called for investments in adaptations to individual partners as well as efforts to encourage connections among these business partners, thus strengthening the bonds in the actor layer. These bonds could themselves be seen as investments undertaken to improve performance in the activity and resource dimensions.

Extended outsourcing will break some of these bonds and indirectly impact on others. This means that previous investments lose at least part of their value, and that new efforts and investments are needed in order to establish bonds with a new actor and between this actor and others. Previous research indicates that companies tend to underestimate the efforts that are required for relationship building. This is a problem since the features of these relationships have been used to explain both successful (Lewin and Peeters 2006) and unsuccessful (Whitten and Leidner 2006) outsourcing. An issue of particular concern for the actor layer is the impact of outsourcing on the buyer's control ambitions. Losing control over activities and resources is often perceived as problematic and this dilemma is frequently tackled through contracts specifying in detail the obligations of business partners (Bolumole *et al*, 2007). But these specifications will often constrain the operations of the supplier and make it difficult for them to use their resources and capabilities in the most efficient way. It is often claimed that many unsuccessful arrangements take place because firms thought they could outsource "…through a contract and then do little to monitor and manage the client-vendor relationship" (King 2005: 2).

In summary, extensive outsourcing and offhsoring do not necessarily go hand in hand with other strategic aims on the supply side. On the contrary, extensive outsourcing may stand in direct opposition to the interests of companies across all three network dimensions. It should come as no surprise that many outsourcing arrangements have not lived up to expectations, are considered failures and have resulted in backsourcing and insourcing. It is thus easy to agree with the conclusion drawn by Cohen and Young (2006) that outsourcing became the victim of its own success. The success of initial outsourcing has turned many companies into what Cohen and Young identify as 'compulsory outsourcers' – i.e. companies that outsource more and more business with increasingly irrational expectations of success.

Conclusions

Our analysis of the interplay between business evolution, managerial initiatives and business history evolved from observations in previous research that deserved further exploration. The first concerned whether the activities and strategies applied by management emerged from efficiency-seeking, practical problem-solvers or should be seen as recipe-following where managers adopted strategies and techniques considered to be “best practice”. The second issue regarded the benefits that may flow for both managers and management theorists from paying further attention to lessons drawn from business history. In both cases, we were interested in the interplay between management theories and historical narratives on the evolution of business.

In addressing these issues we used outsourcing as an illustrative case. In relation to the first issue, we showed that the increasing popularity of outsourcing is the outcome of both efficiency-seeking and recipe-following. Initial benefits from outsourcing related to the transformation of the MBE placed outsourcing at the top of the managerial agenda in most companies. It soon acquired the status of a “best practice” and evolved into a tried and tested business recipe. Like other business recipes, it gained momentum and in many cases, it was applied uncritically since it was perceived as *the* way to improve firm performance. Our network-inspired analysis showed that recent extensions of outsourcing, namely offshoring, often counteracted the benefits outsourcing provided in transforming the character of the MBE.

These drawbacks have led many companies to resort to approaches such as back-sourcing, home-sourcing, near-shoring and insourcing, as the means to counter the excesses of outsourcing. Our suggestion is that outsourcing has not generally been overexploited as a business recipe. Changes in the division of labor with consequent impact on the mix of outsourcing and insourcing, are crucial ingredients in driving business evolution. Thus outsourcing is still an important factor in business development. However, decisions to outsource must be more firmly rooted in holistic analyses of its potential consequences and, as we suggested earlier, the industrial networks model provides one theoretical lens to examine those consequences. Increasingly, theses analyses should consider insourcing as well as outsourcing since changes in the division of labor have been somewhat neglected in the period when the outsourcing recipe prevailed.

When it comes to the interplay between management theories and business history the main lesson is that what appears to be innovative may not be so novel after all. What is perceived as novel is strongly affected by the framing of a particular business reality – the lenses through which reality is observed, described and explained. In this framing, established business recipes play a highly significant role when it comes to conceptualizing contemporary realities and accounting for the trajectories that brought us here. For example, there seems to be a widespread consensus that the business landscape after the industrial revolution underwent two major transformations: the first when the integrated hierarchy replaced the invisible hand of markets and the second, when the MBE was superseded by the network-like constellations that have accompanied outsourcing. Piore and Sabel (1984) identify these transformations as the first and second industrial divides. These transformations, in turn, have impacted considerably on our view of business evolution and what is perceived as appropriate business behavior for each of these periods.

But business history can provide us with alternative pictures of these trajectories. Over time, business reality became obscured by the narratives depicting each of these two transformations. In fact, these epochal transformations appear now to be apt descriptions for a tiny part of the entire business landscape they were purportedly addressing. The widespread attention to these two dramatic transformations owes more to the gripping power of these narratives than to the multifaceted realities of business. In this respect, we share the opinion of Lamoureux *et al* (2003) concerning the coexistence of three governance modes (markets, hierarchies and networks/relationships) and their varying mixes at particular times and places. Sabel and Zeitlin (1997) and Scranton (1997) criticize the common understanding that the first industrial divide represented a transition from a community of decentralized, handicraft production to a world of concentrated factories where specialized machines turned out standard products. This epochal perspective is considered a simplistic view of the development of the business landscape since in reality "…the epochs are less epochal and the choices less stark" than is commonly reported (*ibid*. p. 4).

For a variety of reasons, however, there is a tendency to regard specific time periods as dominated by one or the other of the three governance modes outlined by Lamoreaux *et al* (2003). The main cause is that "…at any time actors tend to organize themselves, adopt rules of exchange, and utilize means of compliance that are typical of one governance mechanism more than another" (Lindberg *et al* 1991: 32). These are the conditions leading to the "epochal" narrative where the invisible hand is followed by the MBE which, in turn, is followed by outsourcing and network forms of organizing. Any narrative tends to focus on some aspects of the business landscape and downplay others. For example, in the middle of the period of what is assumed to be the era of the invisible hand regime, a network lens on reality as portrayed by historians, would lead to quite different interpretations regarding the main features of the business landscape. Allen (1929: 56-57) describes some interesting characteristics of the gun-making factories in Birmingham 150 years ago in the following way:

> "The master gun-maker….seldom possessed a factory or a workshop…. Usually he owned merely a warehouse in the gun-quarter and his function was to acquire semi-finished parts and to give these out to specialized craftsmen, who undertook the assembly and finishing of the gun. He purchased materials from barrel-makers, sight-stampers, trigger-makers etc. All of these were independent manufacturers executing the orders of several master gun makers.
> Once parts had been purchased from material makers…. the next task was to hand them out to a long succession of "setters-up" each of whom performed a specific operation in connection with the assembly of finishing of the gun".

These features of the institutional arrangement surrounding gun-making 150 years ago are not very different from what in the 1990s was perceived a new form of economic organizing, when firms started to outsource operations to suppliers. Rather than relying on ownership control of critical resources, the master gun-maker obviously found it beneficial to access the resources of other firms. Nor is it likely that the exchange between the gun-maker and its business partners was characterized by market features since gun-making involves mechanically precise work, requiring tight adaptations between the master and its sub-contractors.

The reason for the discovery of networks as a third and "hybrid" organizational form in the 1980s was not that these structures started to evolve at this time. Rather the network lens was needed to account for the features of a business reality that a framework limited to markets and hierarchies as coordination modes, failed to explain. Following the logic of our discussion we also need to make clear that despite the fact that network organizing today seems to be a dominating feature of the business reality both markets and hierarchies are still important coordination modes in the contemporary business environment. And in the same way that the first industrial divide was questioned by Sabel and Zeitlin (1997), strong doubts have been raised concerning the occurrence of a transformation towards networking organizing. Some ten years after the second industrial divide was supposed to have happened, Whitaker (1992: 197) expressed "…significant difficulties with the notion that some such fundamental shift is occurring". Similarly, we would suggest that network organizing did not emerge as a novel phenomenon in the 1980s but was re-discovered at this time as a theoretical framework and historical narratives needed updating to account for novel business realities.

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