

**Business relationship exit quality:  
Effects from Outsourcing and Insourcing on credibility**

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### **Abstract**

Business relationships can be seen to evolve through different phases and often the focus of research has been on one of the phases, such as initiation or termination of relationships. In studies with focus on termination, relationship ending is often seen as a process disconnecting the former business parties. However, even though trading has stopped, different types of bonds may still exist between the parties. This means that the ex-business relationship could be reactivated later on. In this paper our aim is to elaborate on the concept of 'business-relationship exit', especially we focus on the connection between termination and reactivation. We base our discussion on a two case studies of outsourcing and Insourcing. The two cases reveal different termination and re-activation processes – one successful and one less successful. A comparative analysis highlights a number of differences in the processes and that choice of exit strategy has a number of effects on the credibility of the focal firm.

**Keywords:** *exit, termination, business relationship, outsourcing, Insourcing*

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## 1. Introduction

Business relationships are not stable, but come to live, develop, and eventually come to an end. To understand how relationships evolve, business relationships have in some instances been portrayed as evolving through different phases (Dwyer et al., 1987), or different stages (Ford, 1980), or different states (Ford & Redmann, 1986). The different stages have, for example, been labeled as pre-relationship, early stage, development stage, long-term stage, and final stage (Ford, 1980). Most often the focus of the research has been on particular phases/stages/states such as initiation (e.g., Edvardsson et al., 2008) or termination of relationships (e.g., Giller & Matear, 2001). Since the 1980s when the phenomenon of ending of business relationships was acknowledged, research on the “final stage” has increased.

In the studies, often relationship ending is seen as a process where “... links, ties and bonds are broken, disconnecting the former parties from each other” (Halinen & Tähtinen, 2002, p. 166). Thus, the underlying assumption is that a relationship ending can be seen as total as nothing is left of the former relationship. However, even though trading has stopped, different types of bonds may still exist between the parties (Havila & Wilkinson, 2002). For example, the involved individuals may continue to interact even though they are not doing business with each other. This means that the ex-business relationship or the sleeping (Hadjikhani, 1996) relationship could be reactivated later on.

Most often research has focused on termination of specific types of relationship. For example, sellers terminating customer relationships (e.g. Holmlund & Hobbs, 2009; Michalski, 2004) or the termination process of business-to-business relationships (e.g. Halinen & Tähtinen, 2002). Some research also focus on termination situations that involve many different types of parties. One example is closure of a production line (Havila & Medlin, 2012) that influences both company-internal (such as employees) as well as company-external (such as customers and suppliers) parties. Another example of this type of complex situation is when a company is outsourcing parts of its production.

Less research has been devoted to reactivation of business relationships, and the connection between termination and reactivation. For example, Pressey & Matthews (2003) call for more

research on relationships that are “rejuvenated after some time” (p. 151). As Alajoutsijärvi et al. (2000, p. 1285) write, a “..poorly-handled dissolution can tarnish the reputation” of the company and thus make a reactivation difficult. Therefore, a “beautiful exit” (ibid.) is important. In this paper, our aim is to elaborate on the connection between termination and reactivation in complex situations when both company-internal and company-external parties are influenced. Therefore, we base our discussion on two case studies that focus on sourcing changes, including both outsourcing and later on insourcing. Here, we can see the connection between termination and reactivation of relationships and how the way the termination was done made the reactivation later on possible. In particular we are interested in understanding the way how termination was done has internal and external credibility effects.

## **2. Theoretical framework**

According to Dwyer et al. (1987, p. 15), the first phase in a relationship development process is when one party (Party A) becomes aware that "party B is a feasible exchange partner". Also, Håkansson & Snehota (1995, p. 35) agree that gaining the identity as a possible counterpart is a prerequisite of a further business relationship. In a similar way as in inter-personal relationships (see, e.g., Homans 1961; Thibaut & Kelly, 1959), interaction is the essence also in inter-company relationships. Håkansson & Snehota (1995, p. 199) express this as follows: "As numerous individuals interact as the interface between two companies, bonds develop in an intricate interplay of the individual and the collective level". This, in turn, means that if two companies decide to terminate an ongoing business relationship, the termination may be a complex and complicated process which may influence many parts within the companies as well as relationships the companies have with external parties.

### *Business-relationship termination in connection to outsourcing*

The intention to exit a relationship does not always lead to actual exit (Ping, 1995). Holmlund & Hobbs (2009) found that in cases when the seller initiated the termination process, lack of profitability was the most common reason. However, to make the final termination decision is a difficult, management level, step to take (Havila, Medlin & Salmi, 2012; Ritter & Geersbro, 2011).

Termination of business relationships can be seen as a process of dissolution (Halinen & Tähtinen, 2002; Hocutt, 1998), where for example trust and commitment of the parties successively decrease, and less resource ties and activity links connect them (Håkansson & Snehota, 1995). Thus, during dissolution process less and less will be left of the business relationship. Depending on what exit strategy has been used (Alajoutsijärvi et al., 2000) this may affect how credible an actor is perceived to be in the eyes of other actors. If the exit is poorly handled, a future reactivation process may be influenced negatively. For example, the former business parties may not see each other as credible any more. According to Keller (2009) corporate credibility could include expertise (problem-solving competence), trustworthiness (honesty, dependability and sensitive to others needs) and likeability (attractive, prestigious, dynamic, and so forth).

One type of termination process that often involves business-relationship exit is outsourcing. Outsourcing of some parts of a company's business means breaking down an existing sourcing solution and at the same time building up new sourcing solutions. This may include termination of different types of flows and arrangements within the companies and with partner firms.

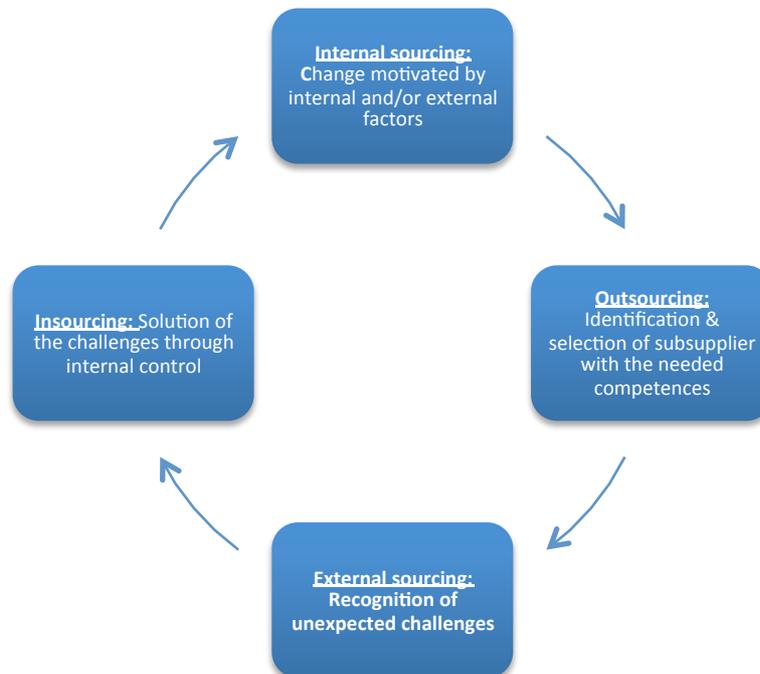
#### *Business-relationship reactivation in connection to insourcing*

At a later point in time, a firm may want to reactivate the flows and arrangements with a former partner firm again, that is, insource, which again means breaking down existing and re-establishing former sourcing solutions (Veltri et al. 2008). Figure 1 illustrates the dynamics in outsourcing and insourcing. In the sourcing literature (Fill & Visser, 2000, Gadde & Snehota, 2000, Halland et al 2005, Marshall et al., 2007, McIvor, 2008, Scheuing 1989, Veltri et at., 2008) outsourcing and insourcing is central issue. In accordance with Scheuing (1989) we distinguish between internal sourcing activities undertaken by a focal firm and external sourcing as sourcing from other firms in a network. Outsourcing reflects a process where activities previously was undertaken by a focal firm is undertaken by others in a network. Insourcing is when the process is reversed. Yet little is known how the reactivation process is taking place and how an earlier exit may influence the re-activation process and outcome.

For example, Dubois (1998) notices that it is important to monitor for possible changes, as such changes at a later point in time can hamper the possibility to choose a certain solution. Due to the dynamic nature of relationships and their contents (i.e. resources, activities and actors), it may not

be possible to walk right back and make use of previous solutions. In the same vein lost credibility may hamper the possibility to re-establish a relationship with both internal and external actors.

Figure 1 Dynamics in outsourcing and insourcing



As figure 1 illustrates, we see sourcing as an ongoing process where we particularly have an interest in the processes where task first is taken care of internally, then outsourced and finally is insourced for being taken care of internally again. In the sourcing literature, a number of drivers for internal versus external sourcing has been found (Freytag et al 2012; Veltri et al. 2008). Different drivers are often mentioned in the literature, but the drivers are often described as focus on core business, lowering cost, creating flexibility, spreading the risk, lowering investments and gaining access to knowledge. When this drivers of outsourcing provide problems, gains are not as expected, firms will re-consider the decision made (Gadde & Persson, 2004). As our focus is on termination in connection to outsourcing and reactivation of relationships in connection to insourcing and not on the drivers of sourcing process as such, we have chosen to look at similar cases with regard to why they were outsourced in the first place. Since the 1990s, the core-centered cooperation (Prahalad & Hamel 1990, Sharpe 1997) has gained much attention. By concentrating on what has been defined as the core competences of the firm, competitive advantages could be achieved. To discuss whether

this is a somewhat narrow understanding of a firm and the importance of its network is not a theme of our discussion (Gadde et al. 2003), but only the fact that concentration on the core business has been the argument for going from internal to external sourcing. Instead we are interested in the reputational effects internally and externally of first stopping and then taking internal sourcing up again. How will the expertise, trustworthiness and likeability of the firm be affected when choices made have to be re-done due to the fact that the new solution doesn't live up to the expectations? To gain an understanding of the effects on credibility in the reactivating of relationships we will apply a case study approach.

### **3. Method**

We are aware that outsourcing activities performed at one point in time take place within a certain environmental setting, and will both influence internal and external relationship between the buying firm and the supplying firm and between different departments and individual actors in both firms. For example, partners may choose a firm not only due to the firm's resources and competences alone, but due to a firm's relationships with other partners (Håkansson et al., 2004). Internally the decision to outsource will influence the relationship between departments and how they perceive each other and work together. An in-depth understanding of the contingencies is therefore of vital importance and also the possibility to learn and reformulate research questions during the research process (Dubois & Gadde, 2002 & 2012). Our aim is it to learn about how disconnecting at one point in time may influence reactivation later on. To highlight possible effects of how disconnecting was done we focus on credibility effects defined as effects on expertise (problem-solving competence), trustworthiness (honesty, dependability and sensitive to others needs) and likeability (attractive, prestigious, dynamic, and so forth). The chosen cases had to qualify in a number of respects (Yin, 2003). First and foremost the case should make a theoretical grounding possible (Stake, 2005, Miles & Hubermann, 1994). Second, the process of ending a relationship and the reactivation of it should have taken place. The two cases are about outsourcing and insourcing which has taken place (see table 1) but where the case from clothing industry (M&C Clothing) had considerable internal and external effects on the credibility, whereas the case from the windturbine industry (WTC Windturbine) only had little effect internally and externally. Third, it should be possible to get data access as not all firms are willing to report on situations where they have to

change a decision first taken. Fourth, to learn about termination and re-activation we chose cases of maximal variation with regard to maturity and complexity of industry and products. Fifth, we have applied a critical incident approach (Flanigan 1956) to understand the major changes in the sourcing process and the consequences of these.

Table 1 Selection criteria examples of out- and insourcing within the selected firms

<i>Case selection criteria</i>	
<i>Critical event</i>	The critical event should have taken place
<i>Effect</i>	The effects of the action taken should be known
<i>Activity</i>	The type of activity may differ but it should be of major importance
<i>Process</i>	The cases should include the process of internal sourcing, outsourcing, external sourcing, insourcing and internal sourcing

Ideally we should have had data from the focal firm, the supplier outsourced to and other actors in the network. Due to the nature, potential loss of credibility, we only got access to the two focal firms in the two cases. In the case with clothing firm we was allowed to contact the subsupplier. The subsupplier didn't want to participate as the case was seen as problematic for the reputation of the firm. Although the supplying firm was willing to confirm the description of the process faulty or as they stated "you can describe the process like this" and at the same time indicating that who was to blame why it went wrong could be discussed. In the windturbine case we where not allowed to contact the subsupplier "as the matter is now solved".

The data on which the M&C case (Clothing) was collected was through semi-structured in-depth interviews with respondents (Carson et al. 2001). Three managers where interviewed and each interview lasted on average 1,5 hours. One of the 3 interviews was conducted with the CEO in the firm which outsourced. Further two interviews were completed with managers from different departments (logistics and sales). The aim was to identify experience gained after first ending and thereafter re-activating internal resources and processes. In particular, the focus was on what was seen as the overall drivers and challenges in the process of ending and re-activating resources and

processes internally and on the credibility effects externally on the focal firm. Both these managers had experience with changes made in the supply process and in the arrangements made with different actors internally and externally. The interviews followed a semi-structured protocol and were recorded and transcribed. Apart from this a number of internal documents were obtained describing the aims of the outsourcing process and some of the figures revealing the problems with chosen supplier.

In the WTC case (Windturbine) the CEO of the division has been interviewed twice. Also a supply chain manager was interviewed and finally the firms communication department was also contacted. A case description was based on these interviews and the cases included in this article was approved by the firm.

#### **4. Two cases of outsourcing and insourcing**

##### ***M&C – clothing firm***

M&C is a smaller Danish firm (app. 100 employees) which has been an active firm within the textile industry for over 100 years. Earlier the firm developed the design, produced, marketed, stored and distributed women's underwear all by itself to retailers. Production was outsourced during the 1970s to Supplier B, and around 2001-2002 the plan came up to outsource warehousing and distribution. The reason for this was that the board and the managing director wanted to concentrate on "core value activities". Outsourcing of warehousing and distribution to retailers was seen as problematic by M&C's middle management who had a number of doubts about this solution. However, the decision to outsource was made, and the warehousing and distributing to retailers was taken over by Supplier B. This also meant that contracts with employees were terminated and the warehouse leased for other purposes. Thus, flows of goods from production to retailers were changed as the third company, Supplier B, became involved.

In the process of changing the sourcing solution, communication was widely used. During the second half of 2001, retailers were informed about the changes to come in 2002. Also after the change of sourcing solution, retailers were informed about the change process and what was done to make the process to become a success. Further, M&C announced that after a short period of time the new solution would work just as good as the old one and in some cases even better.

However, the decision to let Supplier B take over the warehousing and distribution to retailers turned out to be problematic from the very start. A number of the retailers lost confidence in that the new solution would ever get to work satisfactorily. Finally, after five years of not very satisfactory performance by the supplier, a decision was made to insource the warehousing and distribution to retailers.

The operations made by Supplier B had high costs for M&C. For example, Supplier B had not been able to handle smaller consignments or to fill up the assortments. As a consequence M&C turnover had gone down almost every year after the decision was made to outsource. A number of the retailers had also decided to use new producers who could answer the demands. The main reason why M&C chose to insource was that, in spite of dramatic cutbacks on warehouse staff, M&C had retained a core number of warehouse employees with knowledge of stock management. In addition, the original warehouse facilities were made available by stopping the lease of the warehouse facility. Also, a new contract with a transporter of goods to the retailers was signed. Therefore, it was possible to re-establish the warehouse functions. M&C felt that, even though Supplier B seemed to be interested in the relationship, they had not put enough effort into it. And when the relationship was terminated, M&C was not sure if the problems were caused by different perceptions of the importance of the activities, or if Supplier B lacked the capabilities to manage the activities, or both.

### ***WTC – Windturbine firm***

One of the global windturbine cooperations (WTC) has during the last decade had a strategy where WTC concentrates on its core business activities. Technology and business practices, which are seen as core and non-core business activities, have been defined. All activities that have been described as non-core have gradually been outsourced.

In this process, production of selected glass fiber subcomponents for a new blade type has been defined as an activity that should be outsourced to sub suppliers. Production of blades is based on a relatively well-known technology. It should therefore be relatively easy to get the manufacturing going so that production takt times could be held and prototype production could be kept on timeline.

The outsourcing process of the glass fiber subcomponents went smoothly due to the selection program of suppliers and only globally capable suppliers were selected. Although after a short while a number of challenges came up. Foremost the challenge was that the selected glass fiber material was more unstable in production than anticipated. The handling processes are therefore critical together with blade drawings illustrating all details of the blade design.

As the detailed drawings were not ready for the subsupplier it gave challenges with producing the right component quality. Also, the handling of glass fiber component when they were packed for transportation gave problems. All too often an extra process was necessary to secure that the component had the precise dimensions. Cutting the glass fiber component in running production to make sure that all details were as wanted created extra cost and were time consuming. The consequence was that the production of the selected glass fiber components was insourced by WTC during the initial prototype production. The insourcing of the glass fiber component worked relatively smoothly even though the timeschedule was tight.

The outsourcing process of the glass fiber components demonstrated a number of critical issues: Details should have been sorted out in advance; drawings are essential so that production can run smoothly; internal communication is also essential to secure that problem only occur once. For example, handling and drawing problems were seen at least in two cases in two different countries. The aim is still to outsource the glass fiber components. Although this can only be done when drawings are totally in place and when the handling of the glass fiber components for transportation is described in details. This is now the case and the glass fiber components may be outsourced again.

During the outsourcing process, communication and collaboration between the different departments at WTC was essential. Processes have internally to be aligned and described before these successful can be outsourced. The case also demonstrated that preparation of sourcing activities is essential. Timing was one essential issue as the ramp-up for the production was short. Also the role that different departments played was essential. Management at WTC was especially paying attention that the outsourcing strategy of non-core activities went on timely. Construction was especially interesting getting drawing right as a substantial number of drawing is needed for all the details of the glass fiber components. The assembling team in the production unit paid

especially attention to doing the right thing without notifying that the quality didn't have the right quality. The subsupplier was not aware that there had been a problem due that there had been no complaints.

## 5. Case analysis

Both cases demonstrate that firms operate in dynamic environments where concentration on core business activities is often used to comply with the wants and demands from the market. In such a context relationships with suppliers are essential to create competitive advantages. Therefore, the choice of supplier and the handling of the sourcing process becomes essential means.

### *Critical events during outsourcing and insourcing*

As demonstrated in both cases this process is not always without challenges and the decision made has to be redone. How the process earlier on has been handled will play an important role as the focal firm again will have to rely on a solution used earlier on. Eventually the process of going forth and back again can have severe influence on the credibility of the focal firm that is outsourcing and insourcing. The history of the sourcing will matter in the sense that some of the actors involved again will be asked to tackle tasks which have changed hands earlier on. Internally, the focal firm's employees and managers will remember the earlier outsourcing process and how it took place. This may have an impact on how they look at the credibility of their own firm and its management. In the same vein the process of out- and insourcing can affect how the credibility of the focal firm is seen from the perspective of other firms. Especially, if the effects of the failed sourcing solution are experienced by other firms. In table 1, we will portray the sourcing process through the lens of the critical events taking place and communication taking place.

Table 1 Critical events in the two cases

Sourcing solutions – critical events	Effect in M&C - Clothing firm	Effects in WTC - Windturbine firm
<b>Internal sourcing:</b>	Warehousing and transportation handled by the firm it self	Production of wing parts handled by the firm it self
<b>Event:</b> Management decision about activities	Board and managing director's decision to stop internal sourcing regarding warehousing and transportation.	Stopping internal sourcing motivated by concentration on core business – production of component seen as non-core-business. Operations expressed
<b>Effect:</b> Stopping making use of		

internal resources, actors and activities	Middle management expresses doubts.  Planning of the outsourcing process.	doubts about the ramp-up time  Planning of the outsourcing process.
<b>Outsourcing</b> <b>Event:</b> Search & activation of external actors and resources  <b>Effect:</b> Activation of new resources, actors and activities	Selected subsupplier seen as expedient for solving the task.  Plan & ramp-up of warehouse and transportation activities. Communication within and across the firms about the process of transfer of the task.	Selected subsupplier seen as expedient for solving the task.  Plan & ramp-up of production & transportation activities. Communication within and across the firms about the process of transfer of the task.
<b>External sourcing</b> <b>Event:</b> start-up of activity  <b>Effect:</b> Communication about how the task is solved	Overtaking transportation & warehousing  Communication about problems with fulfilling customer orders (- warehouse & transportation problems)	Overtaking production & transportation  Communication about the problems with solving the task probably (transportation & quality control problems)
<b>Inourcing</b> <b>Event:</b> Reactivating internal use of actors and resources and running the activities  <b>Effect:</b> Degree of problem solution	Taking over control of transportation and warehousing  Solving the problems of re-stocking retailers' inventories, but loss of reputation and customers.	Taking over control of production and transportation  Solving the component quality problems and lowering the cost.

### *Credibility in exit*

The type of termination of contracts during the outsourcing process had high importance for how the reactivation of these contracts took place (see Figure 2). Firstly, when the distribution and warehousing was outsourced, M&C let the employees train the employees of Supplier B on how to handle the goods. In this process the employees were treated fairly and some of them were offered a job at Supplier B. Some were offered to continue to work at M&C with other tasks and the rest got help with searching for a job in other firms. Thus, contracts were terminated with quality. Secondly,

M&C's warehouse could not be sold, but was rented out which meant that warehousing facilities were not a problem when the decision to insource was taken. Thirdly, flows from producers were only changed with regard to port of arrival which was not seen as an issue of importance by the producers. And lastly, flows from warehouse to retailers changed as the transporter changed. Contracts with transportation firms were terminated, but announced in due time in advance. Thus, M&C's termination of contracts was handled in a way that was satisfying for the parties involved. This means that the company made "a beautiful exit" (Alajoutsijärvi et al., 2000).

However, during the coming years retailers experienced a missing ability of the supplier to handle small consignments and filling up their stocks, which meant that the retailers' expectations were not met and trust on Supplier B had decreased. Due to decreased sales, retailers were not satisfied with M&C and some of them had even decided to stop selling M&C's products. After insourcing, it was very much uphill for M&C to become credible in the eyes of the retailers again. In particular the confidence in the ability to handle transportation and re-stocking was lost and overall the promises made by M&C had gone down.

In the WTC case the external loss of credibility was limited. Apart from minor time delays no quality problems occurred. Compared to the M&C case the little effect on external credibility may seem somewhat unexpected. Although, a major difference between the two industries is that the windturbine industry is much younger as an industry, products are much more complicated to handle and time delays are common due to safety issues. Still the process in the windturbine case revealed problems in the procedures when outsourcing and problems internally about knowledge sharing when quality problems arise and has to be solved.

Seen from WTC's top-management point of view the need for insourcing raises concerns about the selection process of suppliers and the ability to control the quality of the delivered goods. The issues about selection and control raise concerns about the expertise and trustworthiness of WTC's ability to source expediently from outside. Seen from middle management's point of view control and selection of suppliers are also a concern, but also brings up the question of what is core business and what is not. Choice of components for outsourcing was in this case seen as a matter for discussion and holds potentially important implications for middle managers' perception of top-managers' expertise and insights in production.

To sum up the two cases demonstrated different aspects of on how credibility is important in sourcing process and the importance of being aware of these issues both internally and externally. In particular the differences between the industries and complexity of products revealed different credibility issues.

## **6. Concluding discussion**

In this paper we have discussed business relationship termination and especially the concept of exit quality. Earlier research often assumes that termination is a process that will end when trading stops. However, as the case of outsourcing and insourcing illustrates, termination is not a clear-cut issue. In the two case studies, some parts were easy to reactivate, for example warehouse contracts and some employee contracts in the M&C Clothing firm case. Whereas, other parts were not possible or difficult to reactivate, for example trust of some retailers on the distribution logistics. Therefore, we argue that when studying business relationship termination, exit quality need to be one element of a study because the type of exit can hamper the possibilities to go back and to reactivate a relationship.

In the two cases different aspects of credibility were highlighted. For example, employees were willing to go back and reactivate the relationship as the top management and the board at M&C had not lost their credibility in the eyes of the employees. From this case, it appears that the employees still see the top management and the board as trustworthy and capable of running the firm even though severe problems had occurred due an earlier decision. Further, retailers had experienced other type of consequences of the out- and insourcing process. They had lost turnover, earnings and customers and had doubts about M&C's credibility. As M&C over a longer period had not been capable of solving the problems resulting from the outsourcing, doubts about the problem solving abilities and trustworthiness of M&C had been established. In the WTC case the external loss of credibility was limited as only some timing problems came up. Internally the sourcingprocesses gave some reasons for concern. From the management side how to make sure that the sourcing process could be handled more expediently in the future and if this case was only a single incidents or there was a need to look more fundamentally how outsourcing was handled in similar cases. From the view of middle managers the case raised the question of how core business is defined and

if the production of wing parts is not a core business activity. Credibility issues can therefore be said to reflect different concerns about expertise and trustworthiness.

Both from a theoretical and managerial perspective several issues emerge from the above which needs more attention in the future. First, what role do conditional effects have on reputational effects, such as credibility? Being employed or being an independent retailer reveals different power conditions and may influence on how lack of credibility is expressed in re-activations processes. Second, how will different exit strategies which are more or less self-oriented (Alajoutsijärvi et al., 2000), effect credibility in re-activation processes. Do certain trade-offs exit between exit strategy elements and elements of credibility? Third, what are possible long time reputational effects of re-activation of a relationship across relationships? How firms handle each other not only affect the directly involved firms, but has possible effects on other relationships as well.

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