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# From Outsourcing and Offshoring Strategies to Extreme Outsourcing

**Michela Pellicelli**

## Abstract

Technological innovation and competition have made products increasingly complex. This allows firms with complex production processes to specialize in one part only of the entire activity, outsourcing the other parts to specialized suppliers. The outsourcing strategies have undergone a profound evolution, from simple forms of production contracts made with third parties to agreements that involve functions and activities which, requiring core competencies, or being part of the core business, were until then considered inseparable from the company and not capable of being outsourced. The tendency today is to adopt global sourcing and offshoring. The propensity to outsource most of the functions and processes can take an extreme form, which we can define as extreme outsourcing, and lead to the formation of a virtual organization, a company characterized by the pure business coordination of its businesses, where all the productive and economic processes have been outsourced through the formation of a stable but flexible network.

L'innovazione tecnologica e competitive hanno reso i prodotti sempre più complessi. Questo consente alle aziende di effettuare complessi processi di produzione per specializzarsi solo in una parte dell'intera attività, esternalizzando le altre parti a fornitori specializzati. Le strategie di esternalizzazione hanno vissuto una profonda evoluzione, da semplici forme di contratti di produzione con terze parti, fino ad accordi che coinvolgono funzioni ed attività che, richiedendo competenze cruciali, o essendo parte del core business aziendale, erano fino ad allora considerate inseparabili dall'azienda e non in grado di essere esternalizzate. La tendenza attuale è di adottare approvvigionamento globale e delocalizzazione. La propensione ad esternalizzare molte funzioni e processi aziendali può prendere forme estreme, che possiamo definire come esternalizzazione estrema e che portano alla formazione di organizzazioni virtuali, aziende caratterizzate dalla pura organizzazione delle attività, dove tutti i processi economici e produttivi sono stati esternalizzati attraverso la formazione di uno stabile, ma flessibile, network.

**Keywords**: outsourcing, offshoring, virtual organization

## 1 - The Rationality Criterion Requires a Rethinking of Business and Organizations.

The reality of intense competition has required firms to pursue complex outsourcing goals that include efficiency, flexibility, innovativeness and sustainability (Kang et al, 2012). In a highly dynamic, interconnected and competitive capitalist environment, the only true general principle firms (and in general all pro-duction organizations) must abide by is that of business rationality, which states that every managerial action must be chosen based on the alternative that maximizes both economic efficiency and profitability (Mella 2008). These conditions guarantee the maximum production of shareholder value (Mella 2005).

The business rationality criterion is applied at both the business level and that of business functions and production processes. At the business level, this principle is valid regarding both the business portfolio, taken as a whole, and the individual businesses which make up the former. The business rationality criterion can be described by the following rules that specify how to select those businesses to include or remove from the portfolio in order to maximize the production of shareholder value (Pellicelli, 2007; 2009a; 2009b 2014):

1) when deciding whether or not to activate or continue certain businesses, it is necessary to take into ac-count their economic efficiency, the amount of

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capital invested for their start-up, and the available financing sources;

2) if there are two businesses being considered, choose the one with the higher average ROE over its life span (greater operating results and/or less capital invested and/or lower WACC, which is the average weighted cost of capital raised at the rates of return expected by financiers);

3) if two businesses have the same average ROE, choose the one with the shortest pay-back period;

4) businesses with a negative average ROE for their years of residual life must be eliminated from the portfolio.

At the organizational functions level, the business rationality criterion can be described by the following rule: only carry out those functions within the organization that provide services at a lower cost than similar ones that can be provided by outside firms, given the same level of reliability (quality and promptness) and risk regarding the continuity of supplies, outsourcing those functions that are "losers" with respect to the market.

Finally, the business rationality criterion is applied to business processes which are needed for production, based on the following rule: in order to maximize economic efficiency and business profitability, any activity which is not necessary for production must not be activated; any process whose cost is greater than that needed to acquire similar results from outside suppliers must be outsourced. As Doval (2016) point out, "The most important target of the strategic management is to find the best ways to maintain or increase the competitive advantage via the lower costs or the differentiation by comparing with the competitors on the market. One of the multiple ways to reach out this target is the outsourcing". The business rationality criterion represents the logical basis for justifying the increasingly widespread recourse to outsourcing.

## 2 - Outsourcing Forms and What to Outsource

Outsourcing was used in 1982 (Van Mieghem, 1999) to identify those decisions in which one or more processes or activities necessary to obtain a product or component originally produced in-house by a certain organization is regularly entrusted by this organization (the outsourcee) to an external organization (the outsourcer, supplier or provider), who is responsible for producing it and selling it to the outsourcee.

The first characteristic of outsourcing from a production point of view is that the outsourcee "takes away" part of the processes carried out internally and simply acquires – "brings inside" – factors or services which until then had been produced by outside companies.

This characteristic is not always clearly understood. The Dictionary of Business (Collins, 2005), for example, defines outsourcing as: "the acquisition of components, finished products or services from outside suppliers rather than by producing them inside the company". This is done because turning to outside suppliers lowers costs or because outside suppliers have greater technical competencies or can offer more product variety (Pellicelli, 2007; 2014; 2016). The process can physically be carried out outside the perimeter of the outsourcing organization or inside it. In the former case, outsourcing can be considered a contracted-out service; that is, as the outsourcing of producer services or of services necessary for production (Domberger, 1998). The second case is an example of a service that is contracted-in, or co-sourcing; that is, internally carrying out production processes with capital resources and know-how belonging to others. The document "ISO/TC 176/SC 2/N 630R – ISO 9000 (2008) Introduction and Support Package: Guidance on Outsourced Processes", after stating that the Oxford English Dictionary defines the verb "outsource" as: "to obtain.....by contract from a source outside the organization or area; to contract (work) out", specifies that: "An outsourced process can be performed by a supplier that is totally independent from the organization, or which is part of the same parent organization (e.g., a separate department or division that is not subject to the same quality management system). It may be provided within the physical premises or work environment of the organization, at an independent site, or in some other manner". Outsourcing can be domestic – that is, carried out in the same country the organization operates in – or carried out in another country. The latter case illustrates offshoring (a term that derives from a combination of offshore and outsourcing), if the outsourcer's country is on another continent or, in any event, far from the outsourcee. Traditionally offshoring decisions have been evaluated from the perspective of the firm in terms of: 1) "efficiency" (cost reduction), 2) "exploration" (access to knowledge and talented people), and 3) "exploitation" (development of foreign markets) (Contractor et al, 2010: Grappi et al, 2013).

Forrester Research considers offshoring as production carried out at a distance greater than 500 miles from the site of the final assembly. Indeed the research on international business has proposed many definitions of outsourcing (Marchegiani et al, 2012): international outsourcing (Levy and Dunning, 1993), multinational sourcing (Birou and Fawcett, 1993), offshore sourcing (Frear, Metcalf and Alguire, 1992; Kotabe and Swan, 1994), offshore outsourcing (Bertrand, 2011), and international economics (Lommerud, Meland and Straume, 2009). Outsourcing also allows to embrace the inverse process of insourcing, or economical production, which derives from the decision to carry out internally processes, phases or activities originally provided by outside suppliers.

The second characteristic is the creation of a long-lasting and continuous supply relationship between the outsourcee and the outsourcer. This feature distinguishes outsourcing from apparently similar operations, such as subcontracting (Van Mieghem 1999). The outsourcing process can be divided up into the following areas:

a) Business Process Outsourcing, which designates the outsourcing process for the various phases of industrial production, distribution, R&D, maintenance, etc.;

b) Business Transformation Outsourcing, which indicates a broad outsourcing process involving all the business functions and represents a true program for transforming the business process, which turns to outsourcing as a resource to increase the firm's performance level.

Outsourcing is a flexible phenomenon. In theory everything can be outsourced, except for entrepreneurial and managerial activity. In general, the more processes and functions which can easily be replicated and standardized, the greater will be the advantages from outsourcing. In fact, outsourcing more frequently concerns:

1) the production of parts, components and finished products;

2) the production of industrial services, such as maintenance, quality control and the manufacturing of accessories;

3) research and development regarding new products and services; planning and design;

4) administrative services, such as accounting, management control, auditing and personal management;

5) the information systems sector, which represents one of the focal points of outsourcing;

6) management consulting;

7) logistics and transport;

8) the canteen and cleaning services;

9) the distribution network, promotional and publicity activities, and other marketing services;

10) cash management, company treasury, collections and payments services;

11) the search for sources of financing.

## 3 - Outsourcing as a Remedy for the Complexity of Processes

Technological innovation and competition have made products increasingly complex (Kang et al, 2012). The Ford Model T was made up of 700 parts, while modern cars have thousands of components. Given this context, manufacturers tend to manage the complexity of their products by entrusting part of their production to outsourcing.

This tendency does not only involve purchasing components through normal supply relationships, but acquiring systems of components externally that were once assembled internally. This allows firms with complex production processes to specialize in one part only of the entire activity, outsourcing the other parts to specialized suppliers. For example, some car manufacturers are specialized in fuel injection systems (Bosch), while others in electrical or breaking systems (Brembo). Thanks to production specialization, at all levels of production outsourcing can divide up growing complexity into more easily manageable parts.

With the decline in transport costs and the development of the merchant marine and container ships, globalization has begun to separate the "geography of production" from the "geography of consumption" (Mella 2007). However, with the gradual industrialization of several emerging countries, China and India above all, outsourcing has taken on new forms, with the delocalization of entire production processes and in many firms it is at the centre of the choices involving how best to compete. Global outsourcing and offshoring are the processes which best express this new tendency.

The object of outsourcing is also changing, with the birth of firms able to stipulate contracts for the supply of outsourcing services on a global scale. Indian companies such as TCS, WIPRO and Ifosys have eroded the position built up by companies such as EDS, Accenture and IBM. While in the past they exclusively sup-plied low-cost services such as software maintenance, now they provide complex functions, often in their clients' home countries. They compete in the areas of innovation, value added, and the analysis of the needs of the final users of the products or services of their clients.

Outsourcing is transforming production from a relationship involving the supply of material, components and services into a network of competencies, research and development, and planning and design. It has also entered into new fields, from customer service to R&D, the search for new business models, even health care services. For example, only a few minutes after admittance to a hospital in Philadelphia, the x-rays of a pa-tient are sent to a specialist in South Africa, who examines them and writes up a medical report, which the doctor in Philadelphia, through his computer-aided tomography (CAT), uses to recommend an operation.

The pharmaceutical industry is another example of the rapid evolution of outsourcing and its entrance into new areas (Arnum 2008). In this regard, Champy writes in his introduction to Koulopoulos and Roloff

(2006): "The forces of globalization have finally kicked in. … Material and product sourcing move between multiple countries as a function of price, quality, and speed. And customers are everywhere, expecting to be served with consistent quality and price, independent of location. The Internet has made markets global, even for the smallest company. In fact, information technology is the great enabler of those changes."

## 4 - Outsourcing: From a Make-or-Buy Decision to a Strategic Choice

"Make-or-buy" indicates the decision-making process a company undertakes to decide whether it is more convenient to produce in-house or to externally acquire activities produced "up the line" or "down the line", or even professional activities (Besanko et al., 2005; Espino-Rodriguez et al., 2008, Größler et al, 2013).

As mentioned in Williamson (1989), Chalos (1995), Roodhooft and Warlop (1999), from the theoretical point of view the propensity of firms to turn to outsourcing is a function of the difference between the price applied by the external producer (marginal cost of the external service market) and the marginal cost of in-house production.

The literature on outsourcing identifies in the following the main causes and drivers that influence firms' decision making (Marchegiani et al, 2012): 1) environment; 2) industry characteristics; 3) firm characteristics; and 4) outsourced areas.

Deavers (1997) used a survey of over 1,200 companies to identify five main factors behind the decision to turn to outsourcing:

1) the need for the firm to focus more on core competencies;

2) the need to guarantee access to the best (world-class) skills and competencies;

3) the need to speed up the benefits from reengineering, to the point of rewriting the processes of the firm starting from a "blank page";

4) the need to share the risks between the outsourcee and the outsourcer;

5) the possibility of freeing up resources in order to focus management's attention on the core competencies.

According to Sharpe (1997), outsourcing arose to reduce the costs to the company from economic changes, and thus as a means of creating flexibility. For Abraham and Taylor (1996), on the other hand, companies target manufacturing and service transformations for outsourcing in order to stabilize production cycles and gain advantages from the specialization of other companies.

Heshmati (2003) instead notes that the decision to outsource is a complex one due to the presence of "sunk costs"; outsourcing is not simply a make-or-buy decision based solely on a comparison of explicit costs but must also refer to previous investments that give rise to sunk costs. If their amortization has not terminated, then the "sunk costs" can have a negative impact on the decision to outsource production.

In recent years outsourcing, as a pure choice to adopt a make-or-buy tactic, has tended to become part of a strategy involving changes in the way of doing business. In fact, originally firms traditionally thought of outsourcing as a solution to short-term problems, such as a sudden or unexpected increase in demand, an interruption in the functioning of plants or equipment, or the launch of a new product.

Today firms consider outsourcing as a network of stable agreements with specialized suppliers from a long-term, and thus strategic, perspective.

Quinn and Hilmer (1994) have clearly summed up the four main advantages of outsourcing from a strategic perspective in order to optimize company resources:

1) outsourcing maximizes the yield of internal resources by concentrating investments and effort on what the firm "knows how to do best";

2) it develops the core competencies by erecting barriers to block present or future competitors who try to enter into the company's sphere of interest, thereby protecting its competitive advantages;

3) it utilizes the investments of outside companies, their innovations, skills and specializations that otherwise could have been kept in-house only through continual investment and innovation;

4) it reduces the risks due to rapidly changing markets and technologies; an outsourcing strategy transfers the risks from having to keep pace with technological changes and R&D costs to the outside, thereby shortening the production cycles and allowing companies to respond more rapidly and flexibly to the needs of their clients.

Prahalad and Hamel (1994) identify the core competencies in a particular type of capacity: one characterized by more specialist functions, a particular technology, product design and know-how, so long as this capacity gives the company the possibility to enter more markets or segments, contributes to creating benefits for the client, is difficult to imitate, acts across all the functions, and is rooted in the organization and thus persists even when certain individuals leave the company.

In the new millenium outsourcing and offshoring have by now become the rule for companies who are constantly searching for new frontiers in terms of their ability to compete worldwide.

In reality, some companies that already have a well-defined outlet market – particularly in the agro-food and tiles sectors, as well as those sectors characterized by goods that benefit from brand as well as functionality – produce a certain product internally as well as acquire some of it from outside producers in order to market it under their own brand.

This policy is usually defined as concurrent sourcing, since it shows that the company produces some of the product internally and obtains some of the same product/service from outside (Porter, 1980; Harrigan, 1984).

## 5 - Outsourcing as a Strategic Factor

Without claiming to be exhaustive, here are some strategic approaches that view outsourcing and offshoring as policies for obtaining or consolidating competitive advantages.

One such approach favoured by outsourcing, in contrast to the mass production strategy as an instrument to reduce the unit cost of production, allows companies to divide the vertical production chain into a lean production one, thereby leading to:

1) a reduction in the retooling times (preparation) of machinery and complex systems;

2) an increased utilization of machines and facilities through better planning;

3) easier quality control during all stages of the production process.

Even in marketing decisions we can observe a growing loop between production efficiency and marketing efficiency. On the one hand, cost reduction is facilitated by increasing market share, and thus by aggressive policies on prices, promotions and distribution. On the other hand, such policies are possible only if the firm manages to propose products with a high value in the eyes of customers but at reduced production costs.

The latter two aspects are perceived through the "customer defection rate"/unit cost ratio. The former is an indirect indicator of customer loyalty, which in turn depends on the company's ability to satisfy its customers with products that have a maximum utility/cost ratio for them. This means that a reduction in the customers defection rate is fundamental in procuring significant cost economies.

If a function or phase of the vertical chain is outsourced, the company concerned must closely control the quality of the production of components, especially in the case of finished products. If outsourcing concerns outgoing logistics, from packaging to shipping, it is fundamental for the company to maintain direct control over deliveries to clients. This control is even more necessary and vital for companies that outsource their entire production while concentrating their activity on design and marketing.

The risk is that, together with the R&D activities, even the most innovative and closely-guarded business ideas will be outsourced, thus clearly revealing to the outsourcer the current and planned production strategies in the business transformation.

For many companies the R&D function thus represents an essential one for the core business, and its outsourcing should be undertaken with extreme care and attention.

Table 1 summarizes these conclusions.

**Table 1 – The role of outsourcing in developing efficiency and productivity.**

| Function | Role / effects |
|---|---|
| Production | Positive effects<br>▪ An increase in efficiency through economies of scale otherwise precluded.<br>▪ Bringing forward the positive effects of the learning curve.<br>▪ Negative effects<br>▪ Transferring to others the positive effects of learning.<br>▪ The positive effects from flexible production may be lost. |
| Marketing | 1) An increase in efficiency, above all for the production of components and services.<br>2) If the strategy is differentiation with respect to competitors, the outsourcer must keep under tight control those outsourcing activities that entail direct contact with customers. |
| R&D | 3) The *outsourcing* of R&D increases efficiency if it facilitates production through the simplification of products and through the innovation of production processes.<br>4) The risk that core competencies will be transferred to others. |

Particularly interesting among the most recent empirical studies is the one by A.T. Kearney in 2005, 2007 and 2008, which uses a sample of global companies that have adopted outsourcing.

A number of results were obtained from these studies, the most interesting of which is that the outsourcing drivers can be grouped into three broad categories, each of which includes four particularly significant drivers (Figure 1):

A) reduction of costs

- reduction of operating costs

- reduction in investments

- Variability of costs
- managing of downsizing

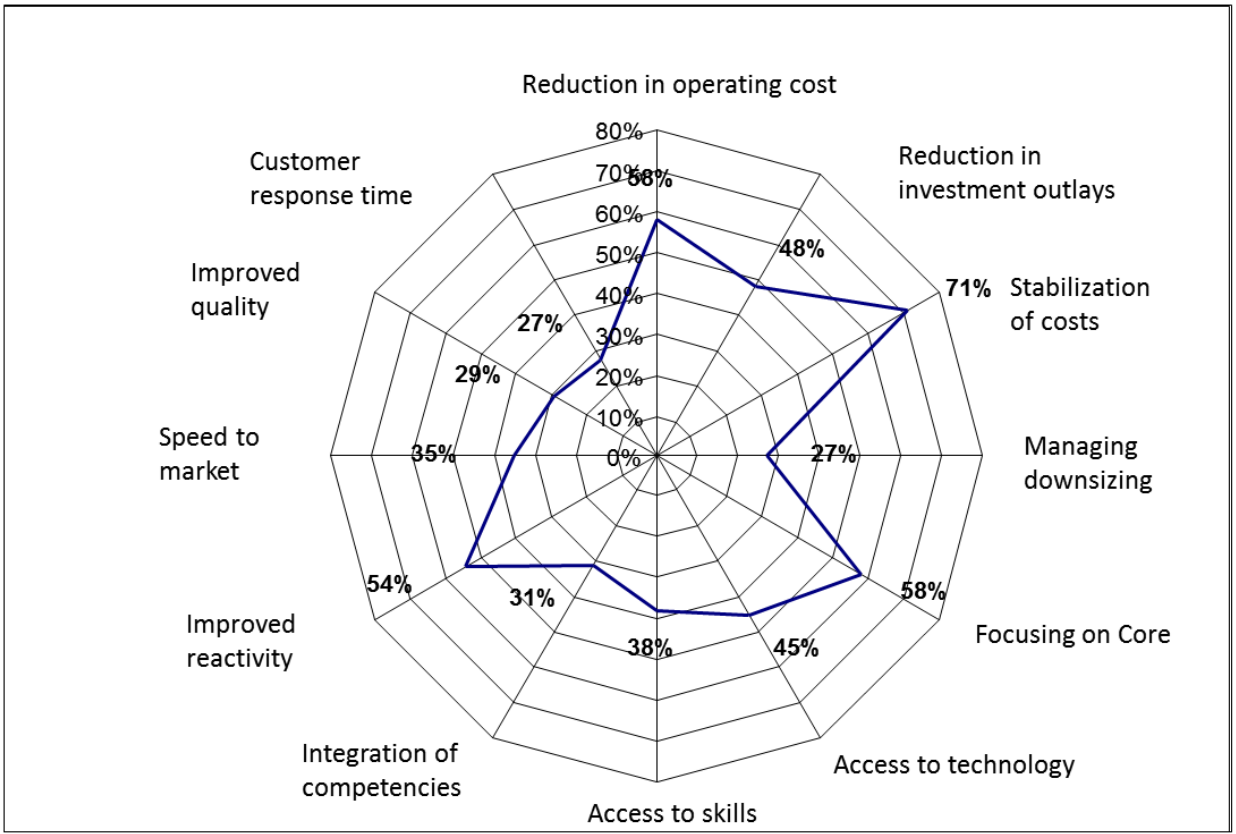
B) access to competencies

- focusing on the core business
- access to technologies
- access to skill
- integration of competencies

C) increase in turnover

- improved reactiveness
- speed to market
- quality improvement
- client response time

**Figure 1 – Quantitative relevance of the drivers of outsourcing**
**Source: adapted from Kearney (2005).**




## 6 - Outsourcing and Offshoring Redefine Company Boundaries

The push toward outsourcing has brought out two fundamental conceptions regarding the choice of company boundaries: the “tactical” conception, according to which the boundaries of the company's processes are defined by short-term “tactical” planning, and a “strategic” conception that sees these boundaries as determined by long-term strategic planning. According to the “tactical” conception, the economic boundaries of the company extend, in a “natural economic” way, only to those processes whose in-house costs are lower than those obtained by outsourcing those processes. Continual reference to the make-or-buy choices would guarantee the correct extension of such boundaries. Moreover, these boundaries are defined by the possibility of transforming part of the fixed costs – by reducing investment in machines and equipment (Bettis et al., 1992) for internal processes that would end following the adoption of outsourcing – into variable costs, represented by the prices paid to the outsourcer, thus obtaining greater flexibility with the added advantage of having access to the most recent technology without any need to invest (Lei and Hitt, 1993).

The “strategic” conception focuses on an analysis of the capacity to compete, competitive advantages, and the competitive position with respect to competitors. Londsale and Cox (1997), Ford and Farmer (1986), and Welch and Nayak (1992) criticize many of the choices in the past as showing short-sightedness, at a time when outsourcing was considered a “tactical” instrument par excellence for reducing costs. These authors conclude that a “strategic” vision can produce better results for companies than those that could be obtained by only considering the cost factor.

Considering outsourcing from a strategic viewpoint means, on the other hand, also considering a set of key factors such as recourse to strategic alliances (Hamel and Prahalad, 1989; Reich and Manking, 1986), the concentration of resources on the core competencies, the analysis of activities that are part of the value chain, and the relations with suppliers and clients inside the value chain itself, thereby assessing and producing stable long-term, sustainable competitive advantages.

The most important reason for viewing outsourcing from a strictly "strategic" point of view is linked to the company's need to redefine the perimeter of its business portfolio and concentrate resources not only on the core competencies – thereby allowing management more time to focus on strategic activities (Blumberg 1998) – but also, and above all, on the core businesses (Dess et al., 1995; Kotabe and Murray, 1990; Quinn, 1992), thereby concentrating resources on the businesses for those markets/sectors it knows best and can develop more efficiently, leaving the outsourcer to search for the efficiency factors in the production that concerns the outsourced businesses (Quinn and Hilmer, 1994).

Kedia et al. (2005), using Porter's (1985) concept of generic strategies, deals with the problem of how to choose functions, processes and, in general, activities that could be outsourced, noting that, for this choice, management must carry out an in-depth analysis that leads to:

1) a clear specification of the company's value chain;

2) a distinction between the core competencies and the "non-core competencies";

3) a definition of the value chain of the core competencies;

4) a distinction between essential and non-essential activities;

5) a separation of "core" or "quasi-core" activities from "non-core" ones.

Since for every company the strategic intent is always to increase the economic efficiency and profitability of the outsourcee, outsourcing and offshoring are based on a single offshoring strategy that transforms national companies into multinational ones. By adopting offshoring from a "strategic" point of view, such companies widen their field of application and evolve towards a global sourcing strategy, based on which they develop a global view of the supply available for international outsourcing, thereby extending and stabilizing the ties among companies located in different countries and advancing stable cooperation in an ever-vaster production network (Kotabe and Helsen, 1998).

Innovation and change in the infrastructures of international exchange, progress in communications and transport, as well as new financial instruments have made it easier to adopt offshoring. This trend has made it easier for companies using components to obtain products from suppliers at more favourable conditions than those permitted by in-house production.

As Lo et al (2015) highlight, offshoring strategies have fascinated the scholars of transaction cost economics, the resource-based view and international business (Boehe, 2010; Bunyaratavej et al, 2011; Contractor et al, 2010; Ernst, 2000; Farrell, 2005; Kotabe, 1990; Manning et al, 2008; Mudambi and Venzin, 2010; Murray and Kotabe, 1999; Williamson, 2008). "Offshoring connotes sourcing products or services from either a foreign-based supplier that is independent of the domestic firm (outsourced operation) or a foreign-based subsidiary of the firm whose home country is where the headquarter is located (captive operation)" (Lo et al, 2015).

Therefore offshoring is described as "an organizational reconfiguration in which originally co-located activities are relocated across distances in captive or outsourced arrangements, which must subsequently be reintegrated" (Mudambi and Venzin, 2010) and firms are often presented with new complexities and uncertainties, which have an impact on decision makers' abilities to estimate the costs of offshoring (Larsen et al, 2013). "There is widespread agreement about the pitfalls of offshoring complex processes and products that require ongoing adjustment and redesign to distant locations where control from the home country is often difficult or only partial" (España, 2015).

## 7 - Extreme Outsourcing. From Offshoring to Virtual Organizations

The spread of global sourcing through the expansion of outsourcing and offshoring, together with the formation of stable relationships between the outsourcee and its suppliers/outsourcers, is changing the way firms conduct business.

From systems of unitary transformation with definable production and economic and financial boundaries, companies are taking on a less clearly-defined form: a series of new structures, "a network", also defined, as a whole, as holonic networks (Mella and Provasi, 2005; Davidow and Malone, 1992), which broaden and continually shift the perimeter of reference for a company's economic activities, at the same time making it more difficult to determine its boundaries.

The typical structure of a networked firm involves a group of companies linked by outsourcing or offshoring contracts, which allow them to be autonomous while at the same time to cooperate and coordinate operations through the network, which makes them similar to a single economic enterprise (Mella, 2005; 2012; 2014).

For this reason networked companies are also called holonic, or virtual organizations: "An holonic organization is a group of autonomous operational units that act in an integrated and organic manner within a system of holonic networks in order each time to best organize themselves as a chain of value that is most suited to take advantage of the business opportunities presented by the market." (Merli and Saccani, 1994: 17).

Even in groups that arise from those outsourcing processes characterized by direct corporate control, a network of companies can form when stable productive and economic relations develop as a result of outsourcing.

being analogous to autonomous organizations. These structures can arise from specific aggregations, though normally they are the result of strategic outsourcing relations where all the companies in the network interact by making their competencies available to all the others. In both the cases new business models are developed which are implemented by outsourcee/supplier companies that outsource functions, processes and competencies in order to develop a co-makership system, thereby favouring the spread of knowledge to all the units in the network. This tendency to outsource most of the functions and processes can take an extreme form – which can be defined as extreme outsourcing – and lead to the formation of a virtual organization, a company engaged purely in the business coordination of its activities, where all the productive and economic processes have been outsourced through the creation of a stable but flexible network (Mella, Pellicelli, 2012; Pellicelli 2014).

| PHASES | PRINCIPAL ACTIONS |
|---|---|
| 1. The objectives.<br>Allocate outsourcing as part of the general strategy. | Define the long-term strategy for the function to be outsourced.<br>Consider the impact of the outsourcing decision on the chances of achieving the organization's mission and strategies, including costs, quality, flexibility and time frame.<br>Consider the changes in the business environment that would entail a change in strategy. |
| 2. Which activities to outsource.<br>Collecting information. | Identify the products/services to outsource and the expected performance levels.<br>Give a clear definition of these products/services. Identify the "core" competencies.<br>Determine the current costs of the products/services to be outsourced and estimate the potential savings from outsourcing.<br>Obtain references about the supplier. |
| 3. Choosing the outsourcer. | Identify the number of suitable suppliers in order to have a vast and rational choice.<br>Document the technical and managerial capacities of the candidate firms, their organizational cultures, and the potential fit (degree of integration with the outsourcer). |
| 4. Negotiating the contract. | Negotiate a fair and equitable agreement.<br>Specify the performances expected from each partner, how these should be measured and remunerated, and how any controversies that may arise are to be settled.<br>Clearly specify contingency clauses and how any subcontractors are to be managed. |
| 5. Preparing a plan to transfer the outsourced activities to the supplier. | Set up a temporary working group to control and organize the transfer.<br>Actively involve those employees whose activities may be affected by the transfer.<br>Ensure that the managers of the functions or of those parts of the organization outsourced are actively involved in the decision-making process. |
| 6. Choosing the appropriate outsourcer-supplier relationship. | Partnership, strategic alliances, ongoing relationship, upstream integration. |

**Table 2 – The phases of an outsourcing strategy. Source: adapted from Jennings (1996), pp. 393-405.**

The most typical holonic networks are manufacturing networks composed of operational units which are relatively independent from a financial, economic and organizational, though not legal, point of view,

## 8 - Conclusions

After deciding which activities to outsource, the outsourcee must plan how to implement this decision. The most important and complex phase is the choice of outsourcer, especially if the company already has a network of relationships with outside suppliers, each of which specialized in a particular area. The decision-making process entails the phases described in Table 2.

The most important and necessary phases of an outsourcing strategy are the decisions about the objectives to achieve through an outsourcing strategy and the activities to outsource (Meo Colombo, Pellicelli, 2013). In the first phase the firm must assess whether outsourcing is a feasible strategy for the organization given its current strategic objectives. Jennings identifies the following necessary steps (Jennings 1996: 393-405): 1) define the long-term strategy for the function to be outsourced; 2) consider the impact of the decision to outsource on the achievement of the mission and strategies of the organization, including costs, quality, flexibility, and the meeting of deadlines; 3) consider changes in the environment that require a change in strategy.

In the second phase the firm must gather and analyse the information on the products/services to outsource and those to produce in-house and decide which to outsource. In this phase the firm must (Jennings 1996): 1) identify the products/services to outsource and the expected performance levels; 2) give a clear definition of these products/services and identify the core competencies; 3) determine the present costs of the products/services it intends to outsource and estimate the potential economies; 4) gather references on the supplier.

The other phases that concern the selection of suppliers, contract negotiation, the transfer of activities, and the relationship to enter into with the supplier require in any case a careful evaluation, and they must therefore be adequately planned in order to ensure a successful outsourcing strategy (Meo Colombo, Pellicelli, 2013).

The spread of global sourcing through the growth in outsourcing and offshoring, and the formation of stable relations between the outsourcee and the outsourcers/suppliers, is changing the nature itself of firms.

The tendency to outsource most of the functions and processes can take on an extreme form, which we can define as extreme outsourcing, and lead to the formation of a virtual organization, a company characterized by the pure business coordination of its businesses, where all the productive and economic processes have been outsourced through the formation of a stable but flexible network.

In order to decide whether or not to adopt outsourcing and to formulate a satisfactory outsourcing contract – setting the objectives, choosing the type of relationship to have with suppliers, and defining the type of contract, all choices made by top management – it is fundamental to identify the "strategic intent" behind the choice to outsource, since this depends on the organizational culture of the two sides in question, which are often diverse and lead to different evaluations regarding the functions and processes to outsource.

Precisely for this reason, the greater the strategic importance assigned to the outsourcing, the more important it is for all parties involved that top management be given the responsibility for managing the outsourcer-outsourcee relationship.

Therefore, from unitary systems with definable productive, economic and financial boundaries, firms are taking on a nuanced form in a series of new "network" stuctures that widen and make more fluid the boundary of the firm's economic activities, at the same time making it increasingly difficult to circumscribe its boundaries.

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