

# The Implication of Outsourcing Practices for Knowledge Management

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## ABSTRACT

*It is the aim of this paper to explore the nature of outsourcing and subcontracting practices and to identify the effects of using such policies for the accumulation and maintenance of knowledge in organizations. Using evidence from a case study research, conducted in three (3) medium size Tools industries, this study examines how outsourcing and subcontracting policies are set in practice and how the formation of such contractual inter-organizational relations affect the organizations as learning and knowledge entities. While it is argued that knowledge sharing between organizations requires mutual collaboration but also the construction of social environment, which promotes communication and sharing of cultures, it is shown in the research that contractors were not actually willing to share their expertise and their know-how. Additionally, the outsourcing of operations has affected the formation of people's identities in the organization and the will and ability of employees and managers to participate to the company's processes. It is therefore argued that outsourcing has reduced the absorptive capacity and the intellectual capital of the organization and has produced secondary negative effects such is organizational dependency from contractors and loss of the organization's ability to control and initiate innovation. The paper summarizes the findings within a model of 'vicious cycle' and suggests that outsourcing eventually leads to the addiction of the organization to 'buy' expertise and knowledge, in order to fulfill short-term goals, instead of trying to acquire or create new knowledge.*

**Keywords:** knowledge management, outsourcing, communities of practice

## INTRODUCTION

The basic aim of the study is to show how the use of outsourcing policies (outsourcing, out-tasking, subcontracting) affects the accumulation and circulation of knowledge in organizations and to elaborate a clear view on how organizations deal with this relationship. Although there is growing interest for the transformation of organizations into dynamic networks (Grandori & Soda, 1995) and the rhetoric of virtual enterprising gain attention (Hale & Whitlam, 1997), there is little interest so far for understanding the implications of the structural changes for knowledge management; organizational knowledge is treated in most studies using the perspective of the traditional organizational boundaries despite the fact that: "it is certainly the case today that all organizations are being reformed and they are increasingly dependent on external sources of knowledge" (Quintas, 2002: 7). Despite the fact that some articles are concerned about the connection of outsourcing with organizational knowledge (Misawa & Hattori, 1998; Takeishi, 2002; Hendry, 1995) it can be argued that not much has been said about how outsourcing practices affect organizations, especially in terms of knowledge management. The lack of such literature seems to be more important because of the increasing use of outsourcing and subcontracting by many enterprises (Chan, 1999: 1; Hendry, 1995: 193; Johnson, 1997).

## APPROACHING A DEFINITION FOR KNOWLEDGE MANAGEMENT AND OUTSOURCING POLICIES

### Outsourcing

It is true that under the current neo-liberal model, in most capitalistic economies, organizations give a great importance in short-term results and neglect certain aspects of long-term planning (Whitley, 1999; Lazonick & O'Sullivan, 2000). Under this short-term perspective, which has been often criticized as 'myopic', organizations have been increasingly using outsourcing and organizational

networks in the last decade as a mean to manage their operations economically (Jarillo, 1988; 1993). It is actually shown in many studies that the reasons for using outsourcing policies are usually economic (Budros, 1999; Quinn, 1992; Jarillo, 1993) or knowledge oriented (Takeishi, 2002; see Chan, 1994 for a classification of outsourcing reasons).

By the word 'outsourcing', we mean the use of outsiders and contracted work or the use of an external agent's services in order to fulfill operations that should normally take place 'in-house' (Embleton & Wright, 1998; Laabs, 1997). As argued in Johnson (1997:4-6), the term 'outsourcing' can be considered as a big umbrella covering all forms of contracted work provided by outsiders, although the word 'outsourcing' is usually used for information systems and facilities management projects (Vanson, 2001). Under this perspective, in this study the word outsourcing will be used to imply all forms of assigning work to outsiders such as formal outsourcing, out-tasking and sub-contracting. Summarizing the key elements from literature (Johnson, 1997; Hendry, 1995; Yakhlef, 2002).

### Knowledge Management: The Social Dimension

This paper chooses to adopt a social perspective of knowledge management. According to Sardari 2002 Tsoukas (1996), most Knowledge Management approaches are rather formistic. In fact, the streams of functional knowledge management (Nonaka, 1994; Nonaka & Takeuchi, 1995; Choo, 1998) or the supporters of intellectual capital theories (Boudreau & Ramstad, 1997; Bukh et al., 2001; Stewart, 2000; Edvisson & Malone, 1997).

Therefore, organizational knowledge is treated here as a projection of organizational life and as embedded in organizational norms and cultures (Teece, 2001: 126; Weick, 1995; see also Blackler, 1995 about encultured and embedded knowledge).

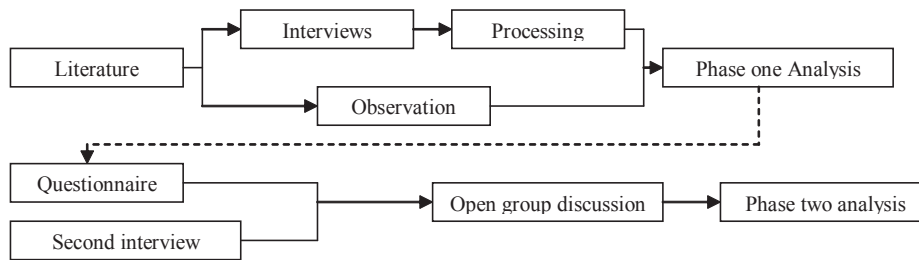
## RESEARCH METHODOLOGY AND DESIGN

Our research was conducted following the principles of a 'case study' approach (Yin, 1994), and in fact it is based on a 'multiple case study' analysis (Eisenhardt, 1989). The case study approach has certain advantages, especially for knowledge management research. It provides the researcher great opportunities to explore deeply the organizational realities and to identify the reasons and causes of certain phenomenon (Yin, 1994; Blaikie, 2000:215). Additionally the case study approach allows the researcher to use a mix of qualitative and quantitative data (Yin, 1989; 1994; Stake, 1994), although "qualitative methods are of primary importance" (Gillham, 2000: 10). In practical terms, choosing to do a case study is to choose to search for an explanation of the organizational realities and phenomenon's and requires a process of reasoning. In fact, case study is not a technique but more or less a mode for organizing data and evidence (Goode & Hatt, 1952; Gillham, 2000), a perspective on how to see and explain social facts.

Amaratunga & Bauldry (2001) support the common idea that a complete case study research design should include a variety of research techniques, which could help the researcher, secure the conclusions and generalize the findings. In this research, the aim of the research design was to gather information from the interviewees from all tools companies and to return and cross check their first opinions with questionnaires and second interviews. Then a last open group discussion was designed to provide a final feedback from the organization about the issues that have arisen during the research.

Research has finally included three (3) medium sized tools companies and the sub-contractors. The subjects of research are summarized below:

Figure 1. Research process for all eleven Tools companies



**OUTSOURCING PRACTICES IN THREE MEDIUM SIZED TOOLS INDUSTRIES**

It has been seen that in all departments where operations are outsourced there has been a lack of effective communication (see Henrikssen, 1999 for similar case) between outsourcing companies’ staff and the outsiders. In cases where contractors had to be present to the organization’s environment (accounting consultants, software developers), sharing of knowledge was low while in cases where operations were taking completely outside the physical boundaries of the company, knowledge sharing was extremely low (sales and promotions, production). It is argued that geographical issues are also correlated with the low levels of knowledge sharing. It was also generally seen that all collaborations failed to be developed as partnerships of mutual interest and to assimilate a form of alliance (Doz, 1996; Mowery et al., 1996). On the contrary it has been obvious that relations between staff and outsiders were focused on the contractual obligations; lack of time (McDermott & O’Deil, 2001) and the politics of contractors to protect their role and knowledge (Scarborough, 1995) lead to an important gap in communication. It is definitely the case that there was no will to exchange knowledge while the social environment would not assist such efforts.

**A STUDY ON THE EFFECTS OF OUTSOURCING FOR ORGANIZATIONAL IDENTITIES AND KNOWLEDGE MANAGEMENT**

Since knowledge management is treated as a social value and the accumulation of intellectual capital is well related with the quality of social capital (Stewart, 1997; Nahapiet & Goshal 1998),. In fact, the following diagram presents the effects that have been observed in the three (3) outsourcing companies.

**INDIVIDUALS’ IDENTITIES**

A primary finding during the research in companies was that the outsourcing of certain activities had a dramatic effect on people and their identity in the organization. EmpJoye~5 and managers’ role has become less important and people who were close to the processes ,in the past seemed to take a certain distance from the situation. Most of them expressed the concern that not only did they lose part of their power in the organization but that in a way they have been marginalized and have been unable to understand their role; a form. of alienation has been observed

(Wheeler, 1996). It has been seen that the lack of effect communication with contractors caused the alienation of employees (Levinson, 1973)

**Disintegration of Communication and Social Capital Pathology**

It is arguable then that in PROEL, the traditional groups of people dealing with issues have been dissolved; teams with had the responsibility for doing the job have been replaced by teams from outside the firm (Lin, 2000). As analyzed in previous chapters, communities of practice require a certain degree of cohesion and must be concentrated on certain goals, to have a specific identity (Lave & Wenger, 1991). Previous sections’ evidence presented, show that the individuals’ identities have been affected and so were the identities of workgroups and items.

**Addiction to Outsourcing: Losing the Absorptive Capacity**

While outsourcing has affected identities and as a result the formation and the role of communities, it has also produced effects for organizational learning and for the maintenance of knowledge itself. What was found to be very important is that not only companies did lose parts of knowledge but that the disintegration of communities of practice, the lack of observation and experimentation (see Barley,1996; Orr, 1990) combined with the poor social environment created dynamics for further and continuous worsening of the situation. The disintegration of learning processes in the organization took the form of a snow slide.

**SECONDARY EFFECTS: EXPLORING THE VICIOUS CYCLE OF KNOWLEDGE DEPENDENCE**

The above situation produces secondary negative effects for the organization as a whole and it has been shown in our cases that the loss of absorptive capacity and the disintegration of knowledge in communities lead to further negative results. A main effect is the one of organizational dependence since the three (3) outsourcing companies are now relying on firms and outsiders to maintain their business activities. As argued in Fine (1998) and Takeishi (2002), relying to the knowledge of outsiders creates an expected level of dependence of the company. What was seen from our research was an increased dependence from the outsiders’ knowledge and skills. During the research it was possible to identify certain cases where lack of organizational knowledge and the inability of the organization to have access to specific know-how costed a lot of time and money. Most incidents

Table 1. Matrix showing contractual relations of outsourcing among the eleven \_companies-subjects of research

Company/sub-contracts	Accounting & consulting	Promotion operations	Information system	Some Manufacturing Processes
PROEL SA	Thesis Ltd	Independent group of salesman(A)	Q-Logic SA	PH&T Iran
IA Tools Ltd	(In-house)		Infinitum Software Solutions Ltd	An Tools PROEL SA
MEDION Ltd	Large Auditing	Independent group of salesman(B)	(Mostly In-house)	PROEL SA

Figure 2. Pathology of knowledge management when outsourcing operations

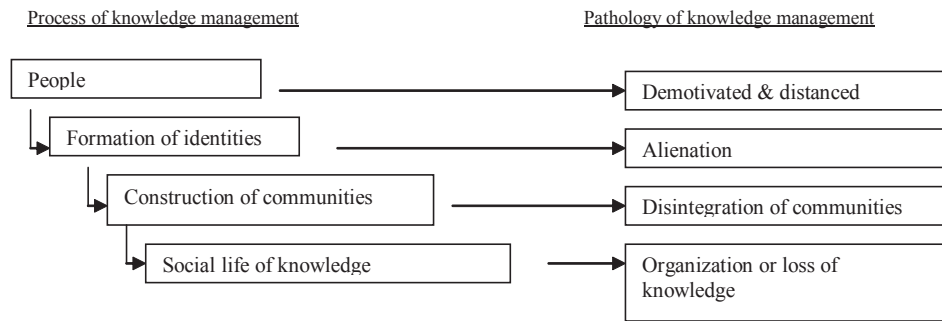
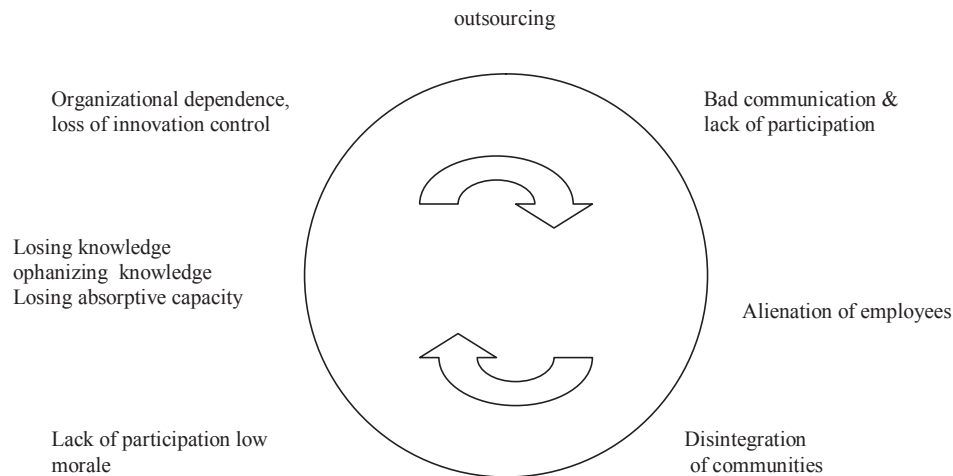


Figure 3. A summary of effects of outsourcing for knowledge management in organizations



have been presented to the companies in matrix forms. To a certain extent what was also observed, as a result of dependency, was a raising insecurity (Embleton & wright, 1998; Hendry, 1995; Takeishi,2002) and a lack of trust in organizational capabilities to face problems; such situation is still creating an increasing dependence from those who know how to do the job. In other words, outsourcing has become a one-way process to import knowledge in the organizational boundaries and solve problems.

The above findings could be described as a `vicious cycle` of effects which have the form of a continuous chain reaction.

So, a main issue is that the use of outsourcing initiates further needs for outsourcing within the same department or even in different operations. Both organizational dependence and innovation outsourcing have created to most managers the impression that the company could not survive without the contractors` knowledge; an interesting issue coming but of the questionnaires is that most of them would approve more outsourcing because "it seems that we do a better job when being in position of control instead of doing things" (Sales Manager of lapharm). This idea of recycled outsourcing, missing from current literature, is very interesting and should be further studied and elaborated.

**CONCLUSION**

The vicious cycle of outsourcing effects should be considered as the main implication of this research. It has been shown that the use of outsourcing and subcon-

tracting initiates certain social effect which finally produce further changes to the organizational life and to the intellectual capital of the organization. A continuous process of alienation (Erikson, 1990; Wheeler, 1996), disintegration of communities (Lave & Wenger,1991; Wenger, 1998) and organizational de-identification (Dukerich et al., 1998) takes place while the company is transformed from a learning entity (Easterby-Smith, 1999) into an expertise purchaser (Chan, 1994) This study takes a negative stand against outsourcing, critically objecting the focus of management and shareholders on downsizing and reducing costs, neglecting important long-term aspects of organizational life (Lazonick & O`sullivan, 2000; Kasey, 1995; Whitley,

1999) and the importance of knowledge management and accumulation. It is argued that before transforming the policy of outsourcing into specific management decisions, a consideration of issues concerning the organizational culture, identities and finally knowledge should take place (Embleton & Wright, 1998; Chan, 1994; Vanson, 2001; Hendry,1995).

I argue that there are three typical approaches which can be followed:

- a. Building and supporting inter-organizational mixed teams and communities.
- b. Transforming the nature of relationship, several studies argue for a conversion of outsourcing contracts into strategic alliances.
- c. Formalizing knowledge in order to achieve conversion of tacit and experience knowledge into typical, codified information flows.

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Further research, currently conducted by the authors, focuses on specific organizational or functional mechanisms which would assist the company to preserve and accumulate knowledge while changing the internal structure, while outsourcing or downsizing.

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