A Transaction Cost Economics View of Outsourcing

Boniface Michael
Assistant Professor
California State University (CSU)
College of Business Administration
6000 J Street
Sacramento, CA, 95819
USA

Rashmi Michael
Research Associate
Human Resources and Organizational Behavior Place (HROB Place)
730 Agostini Circle
Folsom, CA, 95630
USA

Abstract

In this paper, we examine the incidence of outsourcing of jobs by US firms from a Transaction Cost Economics perspective. We also examine if there are adjustment difficulties that displaced workers face due to job loss. For this study, we analyzed Mass Layoff Survey (MLS) and Displaced Workers Survey (DWS) data for the period 1996 to 2004 collected by the Bureau of Labor Statistics (BLS). The analysis finds that Finance and Insurance, Information, and Professional and Technical Services sectors experienced an increase in the separation events due to Mass Layoffs. Displaced workers within the age group of 35 to 44 years were the longest out of a job with the time taken to find a job standing at 6.3 weeks. Those in the age group of 25 to 34 years found jobs in 3 weeks. Educated workers with advanced degrees were able to find alternate employment within 1 week, while those with a high school degree were out of a job for 7.1 weeks. Overall, displaced workers experienced a 7.2 percent earnings loss when reemployed. 26.4% of the displaced workers faced an earnings loss of over 20% when reemployed. These consequences have implications for policy makers, managers and workers.

Keywords:outsourcing, social product, mass layoffs, displaced workers.

Introduction

Just as any business activity creates a private product and a social product (Coase, 1960) so too with outsourcing. On the private product side, outsourcing has the ability to lower innovation costs and risks (Quinn, 2000), it also has the ability to improve financial performance (Crane, 1999) and increase productivity (Casale, 1996). Existing research has mostly focused on the private product of outsourcing around these themes of efficiency. There is limited research that has examined the social product of outsourcing, specifically around mass layoffs and the consequences on workers who lose their jobs. The question, what is the social product accompanying the decision to outsource from a Transactional Cost Economics (TCE) perspective is examined in this study. Outsourcing in the Information Technology sector is explained as an attempt to restructure the corporation around core competencies (Elmuti, 2003). Restructuring around core competencies is undertaken by delegation of non-core functions to specialized external service providers (Corbett, 1999). This involves deciding between conducting routine tasks in-house or through a vendor using the market-mechanism. TCE provides a way to understand this issue and accompanying consequences conceptually, to make in-house or buy from the market.. Firms are faced with a central economic problem: adopting a governance structure that minimizes transactional costs involved in undertaking economic activities.

Williamson (1998) suggests that there are two governance structures for undertaking economic activities.[1]One, is the firm that acts as an alternative to an alternative governance structure, which is the market mechanism. .

[1] Williamson (1998) also suggests a third type of governance structure: government bureaucracies. However, since I am focusing on for profit information technology firms, I do not develop review this third governance structure.

The governance structure that solves the central economic problem in the most efficient manner will be the structure that will be finally selected over the other governance structures.To answer the research question relating to the social product of outsourcing from a TCE perspective, I begin with a survey of literature on TCE, outsourcing, TCE's power to explain the outsourcing phenomenon, mass layoffs in information technology sector and the difficulties experienced by displaced workers. Section 2 deals with data drawn from the Mass Layoff Survey and Displaced Workers Survey conducted by the Bureau of Labor Statistics, USA between 1996 and 2004. In the final section I discuss the findings and conclude with some implications.

Literature Review

Transactional Cost Economics: The classical view of the firm is that it essentially serves a production function within the market mechanism. Firms are an economic system (Salter, 1930), a "specialized market institution for collecting, collating and selling input information" (Alchian & Demsetz, 1972, pp. 777). TCE views the firm as a type of governance structure (Williamson, 1998) that is an alternative to the market mechanism. The difference is that in the latter case firm governs through hierarchies that are within the organization and in the latter the market governs through the price mechanism. A central problem for all firms is the issue of coordination of work and the motivation of employees (Alchian & Demsetz, 1996). TCE views the central problem as a combination of autonomous adaptation and cooperative adaptation (Williamson, 1998). The former refers to external adaptation in response to the price mechanism and the latter refers to internal adaptation by administrating within the company itself. The decision to opt for the market or the organizational hierarchy will depend on which governance structure provides the most efficient adaptive capability for the firm.

According to Coase (1960), when the value of production arising from the choice of a specific governance structure is greater than the costs for making the change, then the specific governance structure will be used to produce the good. Firms produce two types of products. One is a private product and the other is a social product (Coase, 1960). The private product is what the firm produces and values to sell on the marketplace while the latter is an accompanying consequence in the form of a cost that others have to bear in order for the firm to produce the private good. This gives rise to a problem that has a reciprocal nature. Producing the private good may harm others, and attempts to prevent this, for example not allowing the firm to produce the private product will harm the firm.

TCE implicitly assumes that contracts should factor both the transaction costs of producing the private product and the costs of the accompanying social product (Coase, 1960) in deciding on the governance structure to use. This assumption is made within the remediable ness criterion that TCE advances (Demsetz, 1969; Williamson, 1998). According to this criterion, wherever the net gains after costs of manufacturing the private product and the cost of social product is more than the net gains of undertaking the same task through an alternate governance mechanism, there it would make sense to opt for the first governance mechanism to undertake the economic activity.

Outsourcing: Historically, due to the nature of markets and firms, most of the economic activities were conducted within organizations itself. Typically backward integration to upstream activities such as raw material acquisition and forward integration with down stream activities such as marketing were undertaken within single firms (Chandler, 1962). However with the evolution of markets and increased number of specialized service providers within these markets, the scope for sourcing some of the non-core activities from beyond the firm boundaries has increased significantly (Jennings, 2002).

TCE's, approach to the boundary of the firm begins with a core technology (Williamson, 1998). Forward, backward or lateral integration sets the boundaries of the firm for each separate activity is based on the relationship for the activity to the core, the ensuing transaction costs and the costs of the accompanying social product. In some cases the net gains are evident and the decision is easy to make. In others this distinction is not clear and there has to be an in-depth analysis of these costs to decide on the governance structure that will be adopted.

Transaction cost economics provides a conceptual explanation of the outsourcing phenomena. Reasons for firms opting for the market mechanism even though on the face it appears that the difficulty of coordination and the threat of opportunism would have resulted in the organizational hierarchy being selected instead of the market mechanism.

One aspect of the transaction cost perspective is the social product that arises from deciding between the firm and market. Most of the focus in outsourcing is on the efficiency component of the decision. The costs of the social product are rarely examined if not considered at all. Social costs in the case of outsourcing of information technology would pertain to the loss of earnings on reemployment and duration of time for which a displaced worker is without a job.

Social Cost of Outsourcing: Research estimates that 3.3 million service jobs in America would move offshore by 2015 (McCarthy, 2004). 500,000 of these jobs would be in the Information Technology sector. Specifically these would be jobs within sectors such as Information, Insurance, Computers, Telecommunications and Banking. Wage differentials between the US worker and the offshore worker who does this job could be at times as high as USD 50,000 or more. Due to its great cost advantages this does not appear to be a short-term phenomena. Also the Mass Layoff figures of the Bureau of Labor statistics for 2003 accounted for 4 % of the 1.2 Million lay offs in the Private Non Farm sector under 2 categories - Overseas Relocation and Contract Cancellation – where it was 2% in 1996. However if import cancellation and reorganization within company are also included as reasons for layoffs, then the percentage of layoffs due to such reasons increases to 16.7%Data on job displacement solely attributable to outsourcing is not easy to come by. Outsourcing has been around for some time. The 1980s witnessed outsourcing of manufacturing jobs becoming the norm. More recently the service sector has been a subject of this device. There appears to be a loss of jobs in both the low skill segment such as in services call centers and the high skill segments such as the computer software segment.

Prior data (Farber, 2001) found that in the mid 1990s when the job market was strong, there was still a higher job loss rate than in the 1980s. This study was based on Displaced Workers Survey Data for the period 1981 to 1999. The findings were that while the job loss rate for more educated workers did increase, it was the lower educated workers who continued to have the highest job loss rate. Also the more educated workers had the higher post job displacement reemployment rates and their probability of getting full time reemployment was higher. However both the less educated and the more educated people who were employed after displacement, suffered significant wage declines in their new jobs. He also found that those employees who had the longest job tenure had the most significant wage decline in the marketplace. Job displacement from these findings appears to be most harsh on the less educated worker. Neal (1995) found that workers who find new employment in the same industry from which they were displaced earn more than do industry switchers. Therefore workers re-employed in the same industry "earn a return" on the pre-displacement tenure that they had. Those re-employed in a different industry do not earn any such return.

TCE has implicitly conceptualized the remediableness criteria for contracting through the correct governance structure. However it is not clear if the social product accompanying the decision to outsource, some of which have been briefly introduced above, have been adequately recognized and factored within this criteria. Our research question for this study therefore was: What is the social product accompanying the decision to outsource?

In the next section we will examine similar data in more detail that is generated by the Bureau of Labor Statistics through the Mass Layoff Survey and Displaced Workers Survey to identify some of the costs of the social product arising from contracting through the market mechanism for non-core activities.

Methods

Mass Layoff Statistics: The data for this paper is drawn from two different surveys done by the Bureau of Labor Statistics, US Department of Labor between 1996 and 2004. The first is the Mass Layoff Statistics Program (MLS) this is a standardized monthly system for tracking the effect of job cutbacks based on data from the state unemployment insurance database. Within this system a Mass Layoff is defined as situations that involve establishments which have at least 50 initial claims for unemployment insurance (UI) filed against them during a consecutive 5-week period regardless of duration of the separation. An Extended Mass Layoff event is where the duration of the separation is for more than 30 days. The MLS data is coded on the North American Industrial Classification System (NAICS) format. The Standard Industry Classification (SIC) was discontinued from January 2002. Previous survey data from 1996 has been converted and is reported as per the NAICS.

Displaced Workers Survey: The second source for data has been collected from a supplement to the February 2000 Current Population Survey (CPS).

The CPS is a monthly survey of about 50,000 households for basic employment and unemployment data. The supplement known as the Displaced Workers Survey (DWS) is conducted every two years. The survey tracks data on displaced workers who are classified as respondents who are 20 years and older who over the last 3 years lost or left a job because a plant closed or moved. The survey also collects additional information on what occurred before and after the job loss such as how long was the respondent unemployed. The analysis for this paper is based on the BLS's Monthly Labor Review and technical note, June 2001.

MLS Variables: The MLS provides two outcome variables. The Mass Layoff event, which represents the unemployment insurance claims by 50 or more persons who have lost their job in the same company. The second outcome variable that the MLS provides is the number of people who have lost jobs, which is termed as separations. Since the purpose of this research is on unemployment, I have taken the separation data as the outcome variable.

The MLS provides three criterion variables. The first is the industry. Second is reason for layoffs and third is demographics of layoff. Since I am examining demographics of displaced workers using the DWS, I have only examined the industry and reasons for layoff variables for this part of the research. Within the industry variable I have focused on industries that are central to the outsourcing phenomena in the Information Technology sector. These sectors are Information, Finance and Insurance and Professional and Technical Services. Within these sectors I have examined sub sectors like Computer and Electronics, Telecommunications, Insurance Carriers and Professional and Technical Services. The assumption for this is that these are the sectors that will be increasingly adopting the outsourcing model over other sectors such as Food and Apparel.

For the reasons for layoff variable, I have selected reasons such as Contract Cancellation, and Overseas Relocations. The assumption here is that these are the reasons that are more closely linked to outsourcing than other reasons such as Seasonal Work, Domestic Relocation, Financial Difficulty and Automation. These sectors are also examined to compare trends between reasons that may directly or indirectly use outsourcing and those that will not.

DWS Variables: The DWS provides a large number of variables that can be used as part of this research. These variables are categorized broadly under the headings - characteristics of displacement, the displacement experience, after displacement, the new jobs and regions. For the purpose of this research there are 3 specific variables within these broad categories that I have focused on are – educational attainment, weeks without work, earnings. The reason I focused on these variables instead of the others is that these variables will be more indicative of the social cost of unemployment over other variables such as regions, age and sex.

The DWS data focused on long tenured workers who left jobs that they held for 3 years or more. The 3 years period is based on an assumption that this represents a "nontrivial employment relationship" and therefore any job lose reported here will be due to labor market conditions and not as a result of a "bad match" with the employer.

Limitations: The data analyzed here has not been explicitly collected for evaluating Outsourcing. The analysis is based on assumptions that Mass Layoffs in sectors that rely on information technology will increasingly be due to outsourcing. Also, the Displaced Worker Data is for job loss due to many more reasons than just outsourcing. However the analysis here too is based on the assumption: difficulties faced by displaced workers associated with job loss will be similar irrespective of the reason.

Data Findings

Separations by Industry Sectors: Examining the MLS by industry reveals changing trends in the number of separations due to extended mass layoffs accounted for by selects sectors. From 1996 to 2003 the separations within the Manufacturing sector increased from 350,784 to 384, 329, which was an increase of 33,545 or 9.56% increase over the 8 years period (Refer Table 1). However in the Information sector there was an increase of 16,968 separations for the same 8 years period, indicating a 34.48% increase. In the Finance and Insurance sector the percentage increase was 39.69%, where in absolute numbers the separations increased from 28,670 to 40,049 over 1996 to 2003. For this same 8 years period, the Professional & Technical Services sector saw separations increase from 26,054 to 40,252, which was a 54.49% increase. The share of the separations in the manufacturing section within the overall private nonfarm separations fell between the periods 1996 to 2003.

In 1996 the Manufacturing sector accounted for 37% of the separations of the Private Non Farm separations. In 2003 this percentage fell to 31.58%. In absolute numbers the change was from 350,784 out of 948,122 to 384,329 out of 1,216,886.

Table 1: Mass Layoffs in select industries

	Pvt Non Farm	Manufacturing					
	Overall Sector	Overall Sector		Food		Apparel	
	Nos	Nos	%age	Nos	%age	Nos	%age
1996	948,122	350,784	37.00%	72,098	20.55%	38,504	10.98%
1997	947,843	323,531	34.13%	90,663	28.02%	34,977	10.81%
1998	991,245	469,069	47.32%	67,606	14.41%	35,912	7.66%
1999	901,451	356,112	39.50%	84,482	23.72%	31,063	8.72%
2000	915,962	366,070	39.97%	75,618	20.66%	24,778	6.77%
2001	1,524,832	627,930	41.18%	72,079	11.48%	32,328	5.15%
2002	1,272,331	454,034	35.69%	79,217	17.45%	27,792	6.12%
2003	1,216,886	384,329	31.58%	78,224	20.35%	16,959	4.41%

	Pvt Non Farm	Information		Finance & Insurance		Professional & Technical Services	
	Overall Sector	Overall Sector		Overall Sector		Overall Sector	
	Nos	Nos	%age	Nos	%age	Nos	%age
1996	948,122	49,211	5.19%	28,670	3.02%	26,054	2.75%
1997	947,843	58,104	6.13%	20,689	2.18%	33,397	3.52%
1998	991,245	43,818	4.42%	22,520	2.27%	21,920	2.21%
1999	901,451	23,076	2.56%	21,911	2.43%	24,304	2.70%
2000	915,962	14,937	1.63%	31,407	3.43%	22,222	2.43%
2001	1,524,832	60,232	3.95%	33,671	2.21%	51,218	3.36%
2002	1,272,331	58,661	4.61%	38,692	3.04%	57,907	4.55%
2003	1,216,886	66,179	5.44%	40,049	3.29%	40,252	3.31%

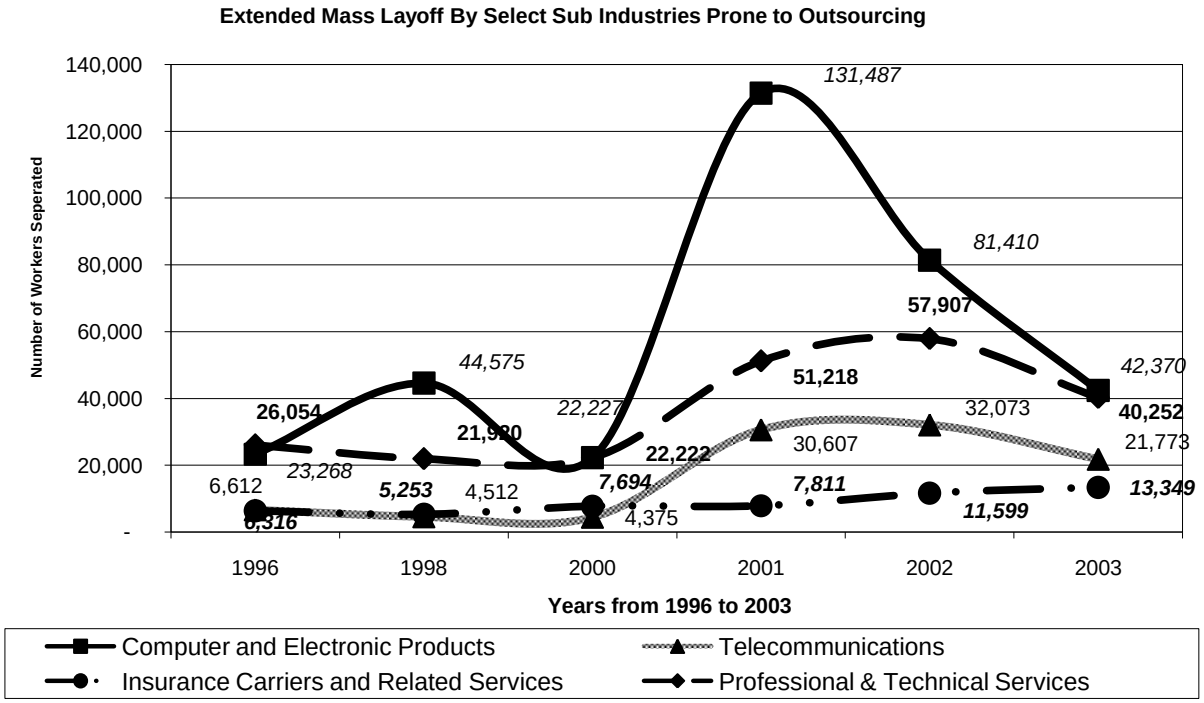
Source: Mass Labor Survey

Conversely the share of mass layoffs of the information, financial and information services and professional and technical services from the overall mass layoffs in the private non-farm sector for the same period increased. The percentage of separations accounted for by the Information sector increased from 5.19% to 5.44% for the same period. For Finance and Insurance the percentage increase was from 3.02% to 3.29%, while for the Professional and Technical Services the increase was from 2.75% to 3.31%. Though these percentage increases appear small, within each specific sector the percentage change for the absolute numbers over the same period shows an interesting trend.

Separations By Industry Sub Sectors: The trend in three sub sectors within the manufacturing sectors were also examined. These sub sectors were the Computer and Electronic Products, Apparel and Food sector. The proportion of separations accounted for by the Food sector for 1996 was 20.55% and 20.35% in 2003. For the same 8 years period, the Apparel sectors share of separations within the Manufacturing sector fell from 10.98% in 1996 to 4.41% in 2003. The proportion of separations accounted for by the Computer and Electronics Products sub sector however increased over the same period. In 1996 there were 23,268 separations, which accounted for 6.63% of the separations within the Manufacturing sector. However in 2003 this number rose to 42,370, which was 11.02% of the separations within the Manufacturing sector. This increase of 19,102 separations within the Computer and Electronic Products sector between 1996 to 2003 was an 82.10% change (Refer Figure 1).

Within the Information sector, the Telecommunications sub sector also saw an increase in the percentage of separations. In 1996 there were 6,612 separations in the Telecommunications sub sector, which represented a 13.44% of separations in the Information sector. This proportion increased to 32.9% in 2003 when 21,773 separations were reported. The percentage increase within the Telecommunication sector for this period was 229.3%.Within the Finance and Insurance sector the Insurance Carriers and Related Services sub sector experienced an increase in separations also. For the period 1996 to 2003, the increase was from 6,316 to 13,349. As a share of the total separations within the Finance and Insurance sector this was an increase from 22.03% to 33.33%. However the increase from 6,316 to 13,349 is a 111.35% increase for the 8 years period for the Insurance Carriers and Related Services sub sector.

Figure 1: Mass Layoffs in select sub sectors (Percentage of Total Annual Layoffs)



Reasons for Separations: Separations accounted for by overseas relocation increased from 4,326 in 1996 to 13,205 in 2003 (Refer Table 2). This represented at 205.25% change for the 8 years period. Also, as a proportion of total private non farm separations Overseas Relocation accounted for an increase from 0.46% in 1996 to 1.09 % in 2003. Contract Cancellations also experienced an increase in the percentage of separations accounted for by it out of the private non-farm separations. The separations on account of Contract Cancellations increased from 17,143 in 1996 to 35,096 in 2003, which was a percentage change of 104.72% over the 8 years period. As a percentage of non-farm private separations this was a percentage increase from 1.81% to 2.88%.

It maybe noted that separations due to Overseas Relocation were 15,693 in 2001 and 17,075 in 2002. These numbers are higher than the separation figure of 13,205 in 2003. However this maybe explained by firms under financial pressure due to recession may have decided to take advantage of lower costs that outsourcing offers. The BLS in their release for the last quarter of 2001 attributed the "sharp increase" in separations due to seasonal reasons, financial difficulty, slack business and bankruptcy. Other reasons for separation such as Domestic Relocation and Financial Difficulty remained more or less unchanged. In the case of Automation it fell from 0.58% in 1996 to 0.08% in 2003. The trend seems to indicate that separations due to Extended Mass Layoffs are increasing in Computer and Electronics, Telecommunications, Insurance Carriers and Related Services and Professional and Technical Services sectors. These are industries that typically use outsourcing models for the conduct of their business. While the link between these separations and outsourcing cannot be conclusively drawn, the MLS data shows that reasons for separations accounted for by Overseas Relocation and Contract Cancellations have increased over the last 8 years.

Post Displacement: Demographics & Weeks without job: In the 2000 survey, the median period between jobs for long tenured displaced workers was 5.3 weeks (Refer Table 3). The data also showed that those between the age group of 25 to 34 spent only 3 weeks on the average without work. While those in the age group of 35 to 44 spent the most time without work which was 6.3 weeks and 6.2 weeks for displaced workers in the age group of 45 – 54 years.

Table 2: Select Reasons for Separation including Overseas Relocation and Contract Cancellation

Year	Pvt Non Farm	Seasonal Work		Domestic Relocation		Financial Difficulty	
	Nos	Nos	%age	Nos	%age	Nos	%age
1996	948,122	308,154	32.50%	11,221	1.18%	52,723	5.56%
1997	947,843	353,594	37.31%	15,425	1.63%	38,668	4.08%
1998	991,245	261,428	26.37%	15,966	1.61%	33,197	3.35%
1999	901,451	282,897	31.38%	9,743	1.08%	48,845	5.42%
2000	915,962	297,650	32.50%	11,488	1.25%	60,275	6.58%
2001	1,524,832	297,433	19.51%	18,652	1.22%	152,934	10.03%
2002	1,272,331	330,674	25.99%	19,907	1.56%	99,964	7.86%
2003	1,216,886	329,010	27.04%	15,805	1.30%	68,190	5.60%

Year	Pvt Non Farm	Automation		Overseas Relocation		Contract Cancellation	
	Nos	Nos	%age	Nos	%age	Nos	%age
1996	948,122	5,530	0.58%	4,326	0.46%	17,143	1.81%
1997	947,843	2,150	0.23%	10,439	1.10%	11,890	1.25%
1998	991,245	1,403	0.14%	8,797	0.89%	11,902	1.20%
1999	901,451	463	0.05%	5,683	0.63%	13,432	1.49%
2000	915,962	1,495	0.16%	9,054	0.99%	13,329	1.46%
2001	1,524,832	1,397	0.09%	15,693	1.03%	30,823	2.02%
2002	1,272,331	1,707	0.13%	17,075	1.34%	34,282	2.69%
2003	1,216,886	1,016	0.08%	13,205	1.09%	35,096	2.88%

Source: Mass Layoff Survey

The more educated persons typically spent less time without work. Of those who found jobs, individuals with a bachelor's degree were only 4 weeks without a job while those with an advanced degree were without work for the shortest period of 1 week. Displaced workers who were high school graduates were without job for 7 weeks on average, which was the longest period of time. The median number of weeks high school dropouts spent without work was 4.4, which was relatively low also.

Post Displacement: Earnings: For the period 1999 and 2000 reported in the 2002 DWS, earnings of workers who were reemployed after displacement fell by 7.2% (Refer Table 4). Though it maybe noted that for the DWS conducted in 2000, the median weekly earnings fell by only –0.4%. In the 2000 survey, the percentage change in median wage was negligible. However in for the same period before it was –4.1%.

Over half of the workers who were reemployed, did not experience any decline in their earnings while the other half experienced a decline. 26.4% of those who were reemployed experienced an earnings loss of 20% or more in the 2002 survey. Also for the same time period, another 22.9% experienced earnings loss of up to 20%.
Persons in the age group of 45 – 64 years were the only age group that suffered the most earnings losses. Younger displaced workers fared better on their new jobs. Also for the 2000 survey, it appears that the more educated workers with Associate Degrees and Bachelors Degrees lost out on wage earnings. For the former it was –6.7% while for the latter it was –1.4%.

There is also other research that uses the DWS data to study post displacement employment. The research findings are that displaced workers suffer periods of unemployment and that earnings on jobs held after displacement are substantially lower than pre-displacement earnings.

Faber (2002) analyzed the earnings loss of displaced workers and estimated that average wage gain for the 1999 – 2000 period was 7%. The compounded earnings loss factoring actual earnings loss and an imputed loss on account of foregone earnings if the employment had continued was 15.2%. Therefore while the average real wages did not fall, there were imputed losses due to the fact that displaced workers would have received higher wages had there been no break in tenure.

Table 3: Post Displacement Employment

Characteristic	**Weeks without Job**					
	Less than 5 weeks	**5 to 14**	**15 to 26**	**27 to 52**	**52 weeks or more**	**Median Weeks without work**
Age						
Total, 20 years plus	757	340	200	184	60	5.3
25 - 34 yrs	183	60	34	18	6	3
35 - 44 yrs	219	124	73	68	19	6.3
45 - 54 yrs	204	97	66	47	23	6.2
55 yrs above	127	53	22	43	13	5.7
Education						
Less than high school diploma	71	36	6	25	2	4.4
High School	217	120	88	55	19	7
Some Coll no degree	162	65	50	56	3	6
Associate Degree	68	27	18	20	18	6.1
Bachelors	161	71	30	14	13	4
Advanced Degree	77	22	8	14	4	1

Source: Displaced Workers Survey

Table: 4 Median Weekly Earnings of Long Tenured Displaced Full Time Wage and Salary Workers on their Lost Jobs and on Jobs held at the time of the survey

Survey Date and Reference Period for Job Loss	**Earnings loss or gain relative to those of lost job**				**Median Weekly Earnings**		
	-20%	**-20% to 0**	**0 to 20%**	**20% or more**	**Lost Job**	**Job Held at Survey Date**	**Percent Change**
February							
1994, 1991 – 1992	34.4	17.8	28.4	19.4	553	473	-14.5
1996, 1993 – 1994	33.7	19.8	25.2	21.3	539	461	-14.5
1998, 1995 – 1996	26.1	19.3	30.2	24.2	558	535	-4.1
2000, 1997 – 1998	23.7	15.7	34.5	26.1	567	565	-0.4
2002, 1999 – 2000	26.4	22.9	20.7	20.0	695	645	-7.2

Source: Monthly Labor Review, June 2004

Discussion

Outsourcing is increasingly being used as a process tool in industrial sectors such as Manufacturing, Information, Insurance and Professional Services. Explaining this practice through a Transactional Cost Economics viewpoint, the theory provides a credible explanation why certain activities might be candidates for outsourcing by stressing efficiency gains in terms of transaction and production costs.

However the costs arising from the social product in this exchange could rise or fall depending on the level of displacement and post displacement employment opportunities. The present data available with the BLS pertains to a period during which the labor market was tight. The data analyzed here indicates that separation events due to outsourcing increased between 1996 and 2004. Also separation events in industries that possibly use this process have also experienced an increase. This data indicates that in tight markets, such as post 2008, we can expect workers will continue to be faced with outsourcing with costs being a pressure point for managers. This will mean that displacement will have more severe consequences for displaced workers. Essentially indicating that the social product accompany outsourcing will increase.

The costs of job losses from mass layoffs due to outsourcing are real as they are for any worker displaced due to reasons such as plant closures and seasonal work. Employment probabilities are reduced substantially. There is a social cost since lost employment also means lost earnings. These costs appear to be larger for those employees with lower levels of education. Also certain age groups of people are most adversely affected by such displacement. Workers with long tenure re-employed faced substantial earnings loss in the post displacement job as well as on account of the lost earnings that would have stemmed from the job in which the person held long tenure. One cost that is not accounted for in most research is the loss of earnings that occur during the period in which a person remains unemployed until finding the new job.

The Bureau of Labor Statistics based on a survey reported that many companies were not able to meet the goals for outsourcing and as a result over half the respondents had brought back one or more previously outsourced functions in house (Monthly Labor Review, 1997). Jennings (2002) finds that it is not uncommon for companies to experience deterioration in cost and other aspects of performance as a result of outsourcing. The question of social cost is of particular concern especially when the decisions that cause them may be reversed later on. Legislation may help incorporate the social cost into the decision for outsourcing and thereby serve as a source of transactional costs too (Williamson, 1996). National or global legislation could also result in an increase or decrease in transactional costs thereby resulting in more or less outsourcing. The World Trade Organization (WTO) could possibly be a source of such costs. Due to globalization and increased competition, countries may be faced with larger or smaller prospects of outsourcing depending on the nature of trade related policies that get formulated at this level.

Organizations that increasingly integrate vertically through the outsourcing mechanism will also be increasingly displacing workers. This paper identifies some of the adjustment difficulties that such displaced workers face. The remediableness criteria that TCE advances (Demsetz, 1969; Williamson, 1998) does not seem to be adequate within the contractual arrangements underlying outsourcing. It is not clear if the existing system of contractual arrangements adequately factor these costs at the time of separation. The implications for the firm is do the existing advance notice, separation pay and outplacement services offered by organizations ensure adequate support for the displaced worker. Alternatively, contracts may explore replacing separation pay with clauses that provide for skills training. Also this has external implications for evaluating the adequacy of existing income support and worker retraining and reemployment policies. Finally it has implications for legislations that that will help incorporate these social costs within the internal decision making of organizations.

Conclusion

In this paper, I examine the incidence of outsourcing of information technology jobs by US firms from a Transaction Cost Economics perspective. I also examine if there are adjustment difficulties that displaced workers face due to the job loss. To identify these consequences, a set of assumptions are made and data generated by the Bureau of Labor Statistics (BLS) is analyzed. This data is drawn from two different surveys of the BLS. Mass Layoff Statistics are from the Mass Lay Off Survey (MLS) that is conducted annually by the BLS. The second survey from which data has been culled out is the Displaced Workers Survey (DWS). These data pertains to time series data from three surveys of the DWS. The first in 1994 for the period 1991 – 1992 and the second for the period 1999– 2000 from the survey in 2002.Sectors that adopt the outsourcing process experienced an increase in the separation events due to Mass Layoffs. These sectors were Finance and Insurance, Information and Professional and Technical Services.

Workers experienced adjustment difficulties after job loss. Displaced workers within the age group of 35 to 44 were the longest out of a job with the time taken to find a job standing at 6.3 weeks as against those in the age group of 25 to 34 who found jobs in 3 weeks.

Furthermore the educated workers with advanced degrees were able to find alternate employment within 1 week while those with only a high school degree were out of a job for 7.1 weeks. Overall there was a 7.2 percent earnings loss for those who were reemployed. Over half the displaced workers who were reemployed experienced some form of earnings loss. 26.4% of the displaced workers were reemployed at an earnings loss of over 20% while another 22.9% of the displaced workers were reemployed with earnings loss of up to 20%.The data findings indicate that outsourcing has increased between 1996 and 2004, and that there are adjustment difficulties that displaced workers face after job loss that has implications for managers, workers, and government legislation.

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