1. Introduction

To assist the Air Force in developing a strategic sourcing policy, we have examined the economics and business management literatures to find theories and evidence regarding the “insourcing vs. outsourcing” or “make vs. buy” decision; and, given the decision to outsource, how best to conduct source selection, contracting, and post-contract management. This report, originally prepared as a briefing, synthesizes the results of our literature review and discusses implications for Air Force outsourcing policy.
Outline

• Transaction Cost Economics (TCE)
• Evidence regarding transaction cost theory
• The business management approach to outsourcing
• Evidence from the business management literature
• Implications for the Air Force

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First, we will discuss the paradigm of Transaction Cost Economics (TCE), which suggests that transactions between providers and users of goods or services should be organized to maximize value net of production and transaction costs. Second, we describe the statistical evidence relating the characteristics of transactions to the most efficient forms of organization. In general, this evidence is consistent with the predictions of transaction cost theory. Third, we present the recommendations of the business management literature, which focuses on the process of outsourcing, including identifying activities to outsource, source selection, contract design, and post-contract management. Fourth, we discuss evidence from the business management literature on vertical integration, strategic alliances, and buyer/supplier relationships. Finally, we summarize the implications of the economics and business management literatures for the Air Force’s outsourcing policy.