OUTSOURCING WHEN INVESTMENTS ARE SPECIFIC AND INTERRELATED

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Abstract
Using the universe of large Canadian manufacturing firms in 1988 and 1996, we investigate to what extent outsourcing patterns concord with the predictions of a simple property rights model. The unique availability of disaggregate information on outputs as well as inputs permits the construction of a detailed measure of vertical integration. We rely on five measures of technological intensity to proxy for investments that are likely to be specific to a buyer-seller relationship. A theoretical model that allows for varying degrees of investment specificity and interrelatedness—externalities between buyer and supplier investments—guides the analysis. Property rights predictions on the link between investment intensities and optimal ownership are strongly supported, but only for transactions with low interrelatedness. High specificity and low risk of appropriation strengthen the predictions in the model and in the data. (JEL: L14, D23)