Abstract

In the decision whether to vertically integrate or outsource, a key strategic issue is legal liability and social responsibility for environmental sustainability, labor rights, and other business practices. By outsourcing, the brand may be able to avoid some liability and responsibility. However, under outsourcing, the brand has less control over the actions that give rise to liability and responsibility. Here, we analyze the trade off between avoidance of liability and control. (i) The brand’s preference for outsourcing increases with the extent that it can avoid liability and responsibility through outsourcing. (ii) Evasion of law and responsibility increases with the scale of production. So, under outsourcing, the brand depresses the order quantity to induce less evasion. (iii) Under particular conditions, welfare is discretely higher under outsourcing than vertical integration. The reason is that, under outsourcing, the quantity of production and consumer benefit are lower, while evasion and social harm are higher. Hence, vertical integration raises welfare.

Keywords: Law, corporate social responsibility, outsourcing, vertical integration

JEL: L2, F2, J3