

<b>Report No.</b>	HIAS-E-32
<b>Title</b>	The Value of Relational Adaptation in Outsourcing: Evidence from the 2008 shock to the US Airline Industry
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<b>Abstract</b>	<p>In this paper, we theoretically analyze, and empirically test for, the importance of relational adaptation in outsourcing relationships using the airline industry as case study. In the airline industry, adaptation of flight schedules is necessary in the presence of bad weather conditions. When major carriers outsource to independent regionals, conflicts over these adaptation decisions typically arise. Moreover, the urgency of needed adjustments requires that adaptation be informal and hence enforced relationally. Our model shows that for relational adaptation to be self-enforcing, the long-term value of the relationship between a major and a regional airline must be at least as large as the regional airline's cost of adapting flight schedules across joint routes. Thus, when facing a negative economic shock, the major is more likely to preserve routes outsourced to regional airlines that have higher adaptation costs, and hence higher relationship value. We analyze the evolution of U.S. airline networks around the 2008 financial crisis, and we find that consistent with our predictions, routes outsourced to regional networks with worse average weather, and hence higher adaptation costs, were more likely to survive the shock.</p>
<b>Keywords</b>	Relational contracting, adaptation, airlines, outsourcing
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