



A passage to India: A dual case study of activities, processes and resources in offshore outsourcing of advanced services

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ABSTRACT

Research has shown that offshore outsourcing processes may influence the behavior and strategic choices of firms, but little is known about the determining factors that influence the evolution and outcomes of those processes. Furthermore, longitudinal studies able to generate such insights are lacking. This paper suggests a detailed, activity-based approach to the study of the process of offshore outsourcing of high-value, advanced service activities. While earlier research has considered either firm-internal or firm-external sources of resource building, this study offers a more comprehensive theoretical model that combines resource-based theory and international business network theory. It aims to investigate how determinants of the offshore outsourcing process contribute to the resource stocks of client firms. Based on two longitudinal case studies of offshore outsourcing to India, the study finds that offshore outsourcing operations, in general, make positive contributions to the resource stocks of client firms. Some determinants contribute to the building of resources (partnership commitment decisions, knowledge creation and learning, trust building, the interconnectedness of resources) while others impede resource building (time compression diseconomies, lack of resource mass efficiencies). Notably, the interconnectedness among onshore activities, offshore activities and the underpinning knowledge resources reduces the risk of erosion of client firm resources, although this remains a long-term risk.

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1. Introduction

Much has been written in academic journals about firms' motives for offshore outsourcing of services, and the potential benefits and risks for firms and nations arising from the relocation of business activities to offshore destinations. We know very little, however, about the operational processes that take place between client firms, located in high-cost countries, and their service providers, which in many cases are located in emerging economies with lower cost structures. Such processes are crucial, as they influence the outcomes of offshore outsourcing partnerships on both ends. In a book on international and domestic outsourcing, Mol (2007) argues that the academic literature largely ignores the relationship between process and outcomes: "In other words, scholars examine whether today's outsourcing levels are somehow related to today's performance levels. That, however, neglects the very real possibility that it may take time for outsourcing levels and outsourcing processes to run their course . . . some costs and

benefits of outsourcing may emerge long after an initial decision is taken" (Mol, 2007, p. 51–52).

This gap in the literature is particularly pronounced for the offshore outsourcing of services (Kenney, Massini, & Murtha, 2009). Although the offshore outsourcing of manufacturing activities has been a long-standing business practice and research area for years (e.g., Dunning & Lundan, 2008; Vernon, 1966), the emergence and growth of services offshoring (i.e., sourcing to other units in the international firm) and offshore outsourcing (i.e., sourcing to external partners) has added a range of new aspects and questions to the field (Doh, 2005; Graf & Mudambi, 2005; Kotabe & Murray, 2004). Previous studies of offshoring and outsourcing processes have focused on the various stages in the evolution of the offshoring/outsourcing strategy and operations (e.g., Bozarth, Handfield, & Das, 1998; Carmel & Agarwal, 2002), or on outsourcing in the domestic context. However, the determining factors that influence the evolution and outcomes of the offshoring/offshore outsourcing process are not clear (Hätönen & Eriksson, 2009; Kenney et al., 2009). Previous studies convincingly argue that process factors, such as accumulated learning and experience with domestic and international sourcing, play a role in firm behavior and strategic choices (Lewin & Couto, 2007; Lewin & Peeters, 2006; Maskell, Pedersen, Petersen, & Dick-Nielsen, 2007).

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This paper is positioned within the framework of resource-based theory, and explores the links between the offshore outsourcing process and the resulting outcomes for client firms. From a resource-based theory perspective of the firm (e.g., Barney, 1991; Peteraf, 1993), an understanding of the evolution and outcomes of offshore outsourcing processes is important because these processes influence firms' abilities to achieve and sustain competitive advantage. In this respect, resourced-based theory is a frequently cited framework in research on offshoring and offshore outsourcing (see Hätönen & Eriksson, 2009).

In addition to exploring the understudied question of offshore outsourcing process determinants, this study contributes to the literature in three ways. First, it takes an integrative theoretical approach and draws from the international business literature on the foreign sourcing of services as well as contributions from the literature streams on strategic management (especially resource-based theory) and organization. I propose a combined theoretical framework with a *firm-internal* approach to analyze the influence of processes on firm resources (based on Dierickx & Cool, 1989), and a *firm-external* approach, which builds on insights from international business network theory (based on Johanson & Vahlne, 2009). This framework is applied to uncover the influence of external sources on firm resources. In this context, "external sources" refer to the firm's collaboration with the offshore service provider firm. The framework consists of a set of determining firm and partnership factors that may build, or fail to build, firm resources in the offshore outsourcing process. The research question is closely related to one underexplored aspect of resource-based theory – how the heterogeneous resource positions of firms, which are essential for sustained competitive advantage, come into existence (Kraaijenbrink, Spender, & Groen, 2010; Maritan & Peteraf, in press). Whereas the issue of the sources of firm resource building has been treated *either* as a firm-internal question *or* as a matter of a firm-external activity (Maritan & Peteraf, in press), the joint consideration of firm-internal and firm-external determinants of resource building moves beyond the partial analysis to offer a more comprehensive theoretical perspective on offshore outsourcing process and outcomes.

Second, the majority of previous research discusses offshore outsourcing on the aggregate level without taking the characteristics of the sourced activities into consideration (Doh, Bunyaratavej, & Hahn, 2009). Inspired by earlier seminal contributions to strategy literature made by Johnson, Melin, and Whittington (2001), and Porter (1985, 1991), this study adopts an activity-based perspective on the offshore outsourcing process. This level of analysis enables an examination of the way in which value is created on the operational level of offshore outsourcing partnerships. The study demonstrates that certain attributes are embedded in advanced, high-value service activities and that these attributes differ from the attributes of, for example, more tangible or codified activities. This difference influences the evolution and outcome of the offshore outsourcing process.

The study investigates how the offshore outsourcing process related to advanced services influences the building of resources in the home/client firm. The focus on the client firm is thus an important delimitation of the study. However, as implied by the term "partnership", the dyad includes the service provider firm. The study's research question may therefore be reversed to consider the influence of the process on *host/service provider* firm resources (see, e.g., Ireland, Hitt, & Vaidyanath, 2002; Mikkola, 2003). Indeed, the perspective of the developing country firm in partnerships between developed and developing country firms is not well explored in global sourcing research (Hansen, Schauburg-Müller, & Pottenger, 2008), although a few authors have addressed this question (Jensen, 2009; Kedia & Lahiri, 2007; Kedia & Mukherjee, 2009). In order to allow for a deeper analysis and a

more detailed description of the influential factors in the process, only one side of the offshore outsourcing partnership – the client firm perspective – is included here.

Finally, the analysis of two longitudinal case-studies of the offshore outsourcing of advanced services makes a third contribution as this study provides new insights into an issue that is at the core of the offshore outsourcing discussion: the balance between the potential benefits of offshore outsourcing and the risk of hollowing out client firm resources due to outsourcing. This study finds that offshore outsourcing partnerships with Indian firms offer a range of benefits to the Danish firms, and that such partnerships make positive contributions in terms of resource building. The long-term risk of resource erosion cannot, however, be ruled out. Some process determinants are found to help build the resources of home firms, while other process determinants hinder or impede resource building. In this regard, client firm resources are influenced by the acquisition of resources and by the internal accumulation of resources.

The paper is structured as follows. First, I review key contributions from the offshore outsourcing literature and outline the theoretical framework for the study. The subsequent section outlines the research design and methodology. I then present findings from the case studies and interpret these findings through the lens of eight process determinants outlined in the theoretical framework before discussing the managerial relevance of the study. The conclusion section summarizes the main points, and outlines the theoretical and firm-related implications of this study.

2. Theoretical framework: activities, processes and resources in offshore outsourcing of advanced services

2.1. The offshore outsourcing literature and the linkages to firm resources

How the offshore outsourcing of business activities influences the resources, competitive position and performance of firms has been a persistent focus in the academic literature and among practitioners. As the literature on offshoring and outsourcing is founded on different (and, to some extent, competing) theories, there are different views on the benefits, costs and risks associated with such outsourcing (Hätönen & Eriksson, 2009; Kotabe, Mol, & Murray, 2009). No clear indication of which activities are particularly advantageous or risky to outsource offshore have been found (Hätönen & Eriksson, 2009), although researchers generally agree that core capabilities (resources), or capabilities close to core, are essential to the firm and ought not to be outsourced (e.g., Quinn, 1999). As Kotabe and Mudambi (2009) note, opposing opinions on the long-term implications of foreign sourcing strategies are related to differing views on the sustainability of firms' core competencies, particularly when firms begin to increase their reliance on independent partner firms (Kotabe & Mudambi, 2009; Mol, 2007). Table 1 summarizes a range of the frequently cited advantages and disadvantages related to offshore outsourcing, and lists a selection of research contributions that focus on these aspects. Potential implications for the resources of the firm are listed in the table's right column in order to establish a link between the potential advantages and disadvantages and the resource-based framework.

These different views may be summarized into two overriding and competing perspectives on the ways in which offshore outsourcing and associated processes may influence client firms' resources. On one hand, it may be argued that the process of offshore outsourcing of advanced services enables firms to engage in collaborations with partner firms that complement their own resources, and that support the creation and building of their own resources. On the other hand, it may be argued that the process of

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