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A longitudinal examination of partnership governance in offshoring: A moving target

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ABSTRACT

The complexity of the global marketplace is driving the growth of new corporate strategies that are centered on creating "synergistic alliances in procurement, distribution, marketing, and technology". This study employs a grounded qualitative approach to investigate a growing belief that perspectives of relational governance and the resource-based view of the firm should be integrated to help explain the evolution of *offshoring relationships* in international marketing and supply chain settings. Specifically we ask—how well do general theories of organization correspond to governance in offshoring relationships? The premise of our longitudinal study found that offshoring relationships begin with calculative trust and opportunism, which later gives way to resource-based competency building and non-economic trust. Over time the offshoring relationships focus on building dynamic capabilities to increase process value through a trust-based relationship. In this way, offshoring relationships are a moving target in terms of governance of relationships from transactional to resource complementarity to a phase where trust and long-term orientation governs the offshored process or processes.

1. Introduction

Outsourcing of business processes has increasingly become an accepted strategy across the globe (Huws, 2002). A 2002 Forrester report suggests that over 3.3 million jobs worth US $136 billion would migrate from the U.S. to lower wage countries between 2000 and 2015 (McCarthy, 2002). However, skepticism has also increased surrounding the success of offshoring of processes and services. Popular media is replete with reports suggesting that many offshore outsourcing arrangements seem unable to sustain an organized cultivation of value (Bielski, 2006; Shahani, 2007). Firms often fail to maintain a cohesive sourcing strategy or even develop the right approach for assessing the skills and tools required to manage a successful relationship with offshore partners. Such reports point towards an increasing need for researchers to better understand the governance of offshore outsourcing (Youngdahl, Ramaswamy, & Verma, 2008). Much of the previous research in offshoring has primarily focused on manufacturing (see McCarthy & Anagnostou, 2004; Takeishi, 2001). Although these studies have used different theories to understand governance (Arnold, 2000; Auburt, Rivard, & Michel, 2004; Ellram et al., 2007; McCarthy & Anagnostou, 2004; Murray & Kotabe, 1999), most studies have used cross-sectional data sources which are likely to be better explained through the use of a single theory of organization.

No research to date has followed the evolution of offshoring partnerships or whether the commonly used Transaction Cost Economics (TCE) framework explains all of the stages of development of an offshoring relationship (Vivek, Shankar, & Banwet, 2008). Thus, this study is among the first attempts to understand the governance of offshoring using longitudinal data. The specific purpose

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of this study is to investigate the governance of offshoring relationships over time, and attempt to examine the theoretical foundations. We use a grounded theory building approach to study the evolution of offshoring relationships and suggest that this new form of work organization can only partially be explained by a single theory of the firm. The findings of our study suggest that it is unlikely that TCE alone can explain the dynamics of governance in the offshoring of processes. The unique aspects of the evolution of offshoring relationships are only explicable by an integration of the theories of TCE, resource-based view of the firm (RBV), and relational governance. We define offshoring as the *relocation of business processes to a region different from the home base of the business* (van Eenennaam & Brouthers, 1996).

The ultimate goal of this research is to create a holistic theoretical integration and robust understanding of the theoretical shifts in the governance of offshoring. Focusing on the offshoring of firm processes to new locations, we address the appropriateness of applying the theories of TCE, RBV, and relational governance to the offshoring context based on the progression of the relationship, above and beyond traditional decisions of structure and entry. Specifically, we examine the strategic initial focus of the offshorer; the roles of cost and opportunism; the impact of specific investments, uncertainty and transaction frequency; and the overall appropriateness of employing the above mentioned theories to the study of offshoring. In examining these issues, we attempt to build a more healthy understanding of the domain of offshoring research and assist in creating a stronger grounding for future research in this area. We also shed light on the dynamics of shifting governance approaches across a longitudinal frame of reference.

This manuscript will begin with a review of the chief theoretical foundations. Research questions will follow—as will our grounded theory-based qualitative methodology. Results will be discussed including an analysis of the governance related assumptions of bounded rationality and opportunism and dimensions of uncertainty, specific investments, and frequency of transactions in an offshoring context. Finally we provide a discussion and conclusion section including both research and managerial implications.

2. Literature review and research questions development

To develop a full understanding of the domain and range of interorganizational offshoring relationships, we now briefly discuss the major theories important to grounding this study: transaction cost economic (TCE), the resource-based view of the firm (RBV), and the relational governance perspectives. Additionally, we use this review of the literature to draw important research questions impacting academia and practice.

2.1. Transaction cost economics: governance as cost and opportunism maintenance

TCE was originally proposed by Williamson (1975), who built on the earlier work of Coase (1937). It has since been modified and extended by many others (Grossman & Hart, 1986; Jones, 1983; Klein, Crawford, & Alchian, 1978; Ouchi, 1980; Rugman & Verbeke, 1992; Wilkins & Ouchi, 1983; Williamson, 1979), but still receives criticism for providing a somewhat limited view of relationships (Morgan & Hunt, 1994). Despite this, TCE provides valuable insights and remains a popular theory in which the costs associated with economic exchange play a key role in determining the nature of exchange (Dahlman, 1979). TCE advanced two commonly used governance perspectives in international marketing: (1) the resource-based view of the firm (RBV) (Griffith & Harvey, 2001; Griffith & Myers, 2005; Kogut & Zander, 2003; Sheng, Brown, Nicholson, & Poppo, 2006) and (2) relational governance or the relational-based view tied to interorganizational relationship marketing (Lee, Hui, Tinsley, & Niu, 2006; Mackenzie & House, 1978; Morgan & Hunt, 1994).

TCE is concerned with the management of transactions in an efficient manner through the least cost form of governance and is based centrally on the assumption of firm opportunism (Balakrishnan & Koza, 1993; Hennart, 1988, 1991; Williamson, 1991). Williamson (1979) cited factors such as uncertainty in determining appropriate governance mechanisms which include competitive pricing, difficulty in monitoring, enforcing post-contractual performance, and the necessity of specialized (transaction-specific) investments. Each is a major source of transaction costs for clients. Key attributes of TCE include the specific assets needed to execute a function or process, the frequency of transactions, and the level of uncertainty involved in decision making.

TCE argues that there is a range of alternatives available for firms to choose from when exchanging a product or service (Williamson, 1975). These choices extend from a contractual relationship with an external supplier to hierarchy-based governance or specifically *within firm integration*. In between are governance hybrid forms, such as joint ventures and franchises. Costs may be reduced by the organization through a variety of non-market or structural mechanisms, including bureaucratic administration. Firms involved in international ventures may now choose the offshoring alternative that achieves innovation and/or reduction of transaction costs, places limitations on internal governance costs, and/or controls uncertainty.

Williamson (1999) ultimately adopted the view of a manager who is not perfectly rational in his or her decision making due to incomplete information—a rationally bound manager. Considering inter-temporality, TCE also makes a distinction between *ex ante* considerations, before commitment of transaction specific investments, and *ex post* considerations, after the commitment has been made forgetting non-rational economic behavior (Morgan & Hunt, 1994). TCE further concedes the absence of opportunism as "utopian fantasies" (Williamson, 1999, p. 1099) and thus disregards trust that is central to newer relational perspectives of interorganizational governance (Morgan & Hunt, 1994). Essentially, the transaction cost perspective argues that trust does not add to existing economic analysis of firm partnerships. Based solely on TCE, we can make at least two specific predictions about