Journal of International Management 15 (2009) 156–168

Contents lists available at ScienceDirect

Journal of International Management

Fox School of Business
TEMPLE UNIVERSITY®

Outsourcing to emerging markets: Theoretical perspectives and policy implications

Rajshekhar (Raj) G. Javalgi *, Ashutosh Dixit, Robert F. Scherer

Nance College of Business Administration, Cleveland State University, Cleveland, OH-44115, United States

ARTICLE INFO

Article history:
Received 8 January 2008
Received in revised form 19 August 2008
Accepted 21 August 2008
Available online 7 April 2009

Keywords:
Outsourcing
Emerging markets
Taxonomy of services sourcing
International strategy

ABSTRACT

Creating value through outsourcing has emerged as a popular competitive strategy for firms in various industries. In order to survive in the domestic and international marketplaces, firms, especially in developed countries, are seeking opportunities offshore, which is one focus of globalization. Offshore outsourcing has emerged as a popular competitive strategy and emerging markets have become increasingly attractive locations. As firms in developed countries (e.g., the US) continue to face enormous challenges to sustain competitive advantage, outsourcing to emerging markets is becoming an increasingly important source of business renewal and corporate transformation.

In spite of the growing strategic significance of sourcing, we have limited knowledge of offshoring and outsourcing to emerging markets. The objectives of this review are fourfold: (1) to provide a better understanding of the concepts of offshoring and outsourcing business models, (2) to discuss relevant theoretical perspectives related to outsourcing, (3) to present a taxonomy of outsourcing strategies drawing on the extant literature, and (4) to discuss public policy implications. Conclusions and direction for future research are provided.

1. Introduction

Over the past several decades, the economies of the world have become increasingly interdependent, and organizations have come under tremendous pressure to maximize productivity and profitability. Creating value through outsourcing has emerged as a popular competitive strategy for firms of all sizes in all types of industries. To survive in the domestic and international marketplaces, firms, especially in developed countries, are seeking opportunities offshore, which is one focus of globalization. As firms in developed countries strive for competitive advantage, outsourcing to emerging markets is becoming an increasingly important source of business activity and corporate transformation (Graf and Mudambi, 2005; Kakabadse and Kakabadse, 2005; Kotabe et al., 2008a,b; Kotabe and Zhao, 2002).

Sourcing refers to identifying which production units will serve which markets, and where will they get the components or processes required for production (Kotabe and Murray, 2004; Davidson, 1982; Kotabe, 1993; Swamidass and Kotabe, 1993). Outsourcing has become an activity in the firm's business value chain, whereby competitive advantage may be gained when products and services are produced effectively and economically by outside suppliers (Kotabe et al., 2008a,b; McCarthy and Anagnostou, 2004). In other words, outsourcing refers to contracting with an outside entity to perform a particular process or function for a firm (Kotabe and Zhao, 2002). For example, some components (e.g., raw materials), general parts and/or processes (e.g., accounting, data entry, and billing) can be procured more cost-effectively in low-cost emerging economies such as Brazil, Russia, India, and China.

Outsourcing is not a new phenomenon and has existed for a long time (Kotabe, 1993). The advent of the Internet in the last decade, coupled with globalization, has further expanded outsourcing possibilities. These possibilities have emerged due to

* Corresponding author.
E-mail address: r.javalgi@csuohio.edu (R.(R.)G. Javalgi).

1075-4253/$ – see front matter © 2009 Elsevier Inc. All rights reserved.
doi:10.1016/j.intman.2008.08.001

availability of highly trained low-cost manpower and natural resources in various emerging markets. The economic growth of Asian countries, coupled with trained manpower availability at much lower costs, have shifted not only the balance of international trade, but also has resulted in significant outsourcing to many emerging economies such as China and India. For example, Cisco Systems profitably outsources its business activities to many emerging economies to reduce costs and to utilize global skills to expand its manufacturing and systems capabilities. Recently, in an expansion wave, companies such as IBM, Accenture, and Capgemini have quietly expanded to India to take advantage of lower costs abroad (McDougal, 2006). In general, it is understood that outsourcing has the potential to bring about fundamental changes in a firm's value chain.

In spite of the growing significance of global sourcing, we have a limited knowledge of offshoring and outsourcing to emerging markets (Kotabe et al., 2007). This paper attempts to fill this gap. The objectives of this discussion are fourfold: (1) to provide a better understanding of the concepts of offshoring and outsourcing business models, (2) to discuss relevant theoretical perspectives related to outsourcing, (3) to present a taxonomy of outsourcing strategies drawing on the extant literature, and (4) to discuss public policy implications.

The remainder of the paper is arranged as follows: section one presents the background on the offshoring and outsourcing models. Section two presents theoretical perspectives on outsourcing. More specifically, the section discusses three theories: resource-based view (RBV), transaction cost economics (TCE), and resource dependence theory (RDT); section three presents a discussion of Kotabe and Zhao's (2002) taxonomy of sourcing strategies in the manufacturing sector, followed by the discussion of the taxonomy of outsourcing of services. Finally, the paper concludes with public policy implications.

2. Definitions and dimensions of outsourcing

In the literature, outsourcing and offshoring are extensively discussed but less clearly understood. The basic question to ask, "What exactly is meant by offshoring?" is subject to considerable variations in the literature (Jahns et al., 2006). As discussed in the extant literature, it can mean anything from "outside a country's boundaries" (Monczka and Thomas, 1995), to not domestic nor a border country (Shamis et al., 2005) to remote, low-cost locations (Robinson and Kalakota, 2004) to descriptions such as "outside the first world" or that it means to something being located outside of the continent (Lowson, 2001). Others broadly define offshoring as the geographical relocation of specific business functions abroad, irrespective of whether or not such functions continue to be performed by a subsidiary of the firm, or are contractually outsourced to an independent party (Prasad and Prasad, 2007).

To distinguish between offshoring and outsourcing, researchers have used boundary spanning business functions (in-house vs. outsourcing) of a firm and geographic scope (domestic vs. foreign location) for business activities to be performed (Domberger, 1998). If a firm decides to perform business functions internally, it can do so domestically (in- house) or it may decide to relocate its business processes to another country, especially to those emerging markets that offer location advantages (e.g., natural resources such as land or labor, and advanced resources such as human skills). Offshoring occurs when firms transfer jobs abroad for work that has traditionally been done in their home country (Stack and Downing, 2005).

Based on the extant literature (e.g., Jahns et al., 2006), offshoring business models can be classified into three types: "captive offshoring," "offshore outsourcing," and "offshore development centers." When a company decides to produce goods or services by setting up its own subsidiary abroad in order to gain control of its business activities and take advantage of locational factors (e.g., access to cheap labor and human talent), then it is choosing a business model called "captive offshoring." For instance, when an American company establishes its subsidiary in China and produces goods there, or sends its call center operations to India, it is offshoring work and jobs from America to emerging markets. The typical firms that choose this option are large multinational firms. General Electric and British Airways, for example, have set up in-bound call operations offshore, especially in emerging markets such as India and China.

Offshore outsourcing, on the other hand, is the delegation of some of an organization's recurring internal business functions and decision rights to a third party (or vendor) in a foreign country, who specializes in those functions. The strategy behind an offshore outsourcing is based on creating value through low cost. The decision to offshore outsourcing frees up capital that can be used for other critical areas (Tayles and Drury, 2001). Many new companies find this option the best option as it is a successful business model and allows company managers to focus their efforts on core competencies. Although it takes practice to enhance this model, including learning how to contract with offshore service providers and to govern the relationship effectively, an offshore outsourcing can bring sustained cost savings. Delta Airlines, for example, contracted with firms in India and the Philippines to handle a percentage (or all) of its reservations (Stack and Downing, 2005). This is an example of an American company that offshored and outsourced its work, which used to be done internally, to vendors in emerging markets. Companies such as Hewlett-Packard, Dell, and GE, to mention a few, were the early adopters of offshore outsourcing practices to India.

The third type of business model, referred to as offshore business development centers, reflect joint ventures, which are common in the software industry (Robinson and Kalakota, 2004). In this type of arrangement, the client firm retains a higher level of control than in the fully outsourced model while transferring some aspects of business activities of a captive center to a third party service provider. When a firm uses this model, it is critical to select a service provider who can be trusted and offers the best possible solutions that best fit the client firm's business needs (Foster, 2006). Cisco Systems, for example, has used a blend of both *de novo* operations and third party vendors to manage its R&D requirements. It operates its own R&D center in India, and complements its resources with partnership arrangements with Indian vendors (Youngdahl and Ramaswamy, 2008). Another recent example is the case of Motorola's announcement to form two joint ventures in India for mobile phone software creation (Jahns et al., 2006).