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Making the locational choice
A case approach to the development of a theory of offshore outsourcing and internationalization

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ABSTRACT

Offshore outsourcing is one of the most sustained management strategies of the 21st century, and researchers are paying attention to this contemporary, yet complex and controversial phenomenon. Despite the increasing amount of research, from the theoretical and managerial perspectives several important aspects remain inconclusive. The focus in this article is on theory development in two complex areas. The first concerns the location, the idea being to identify the factors that influence the final decision, in which ownership is not the mode of control. Secondly, the aim is to explore whether offshore outsourcing facilitates international expansion. Through a process of theoretical rationalization and inductive case analysis propositions are arrived at according to which non-locational factors most heavily impact the firm's decision to outsource offshore and its subsequent internationalization. The results indicate that this subsequent internationalization may be a by-product of offshore outsourcing, or it may be an intentional strategy. The article thus adds new aspects to the existing theory on outsourcing decision-making, which forms the basis of an emergent theory for future academic research.

1. Introduction

Outsourcing is a phenomenon that has been one of the most sustained (Lewin and Peeters, 2006; Sanders et al., 2007) yet controversial trends over the past few years (Venkatraman, 2004), and consequently researchers have found it attractive. In particular, offshore outsourcing has become one of the mainstays of several different research disciplines, including international business, strategic management, supply-chain management, and information systems (e.g., Dibbern et al., 2004; Maskell et al., 2005). In spite of its growing importance in various disciplines, however, several aspects remain unclear (Ramamurti, 2004). One of these concerns the making of the location decision, which, despite the recent growth in interest, has still received limited attention (Bunyaratavej et al. 2007; Doh, 2005; Kotabe and Murray, 2004).

Even on the conceptual level, offshoring and offshore outsourcing often create confusion among researchers and practitioners. This is because offshoring as a concept has been used to describe these two similar yet distinct phenomena (Pyndt and Pedersen, 2006). In order for a strategy to be referred to as offshore outsourcing, two conditions have to be met. Firstly, the location of the activity has to be transferred to a foreign country. Although the term ‘offshore’ is used to describe the transfer of a production activity, an offshore operation may be wholly owned by the parent company or it may be outsourced to a specialized provider (Hagel and Brown, 2005). Accordingly, ‘offshoring’ covers multiple modes of foreign involvement located on a market-hierarchy continuum. In research terms, the fundamental difference between offshore outsourcing and other offshore modes is that in the former the firm transfers ownership of the process to a vendor. Simultaneously, control shifts from internal hierarchical to

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contract-based governance. Thereby, and secondly, there has to be a simultaneous transfer of ownership and control, which means that the activity is carried out by an external supplier [externalized] rather than an in-house unit [internalized] (Pyndt and Pedersen, 2006). Accordingly, offshore outsourcing as a concept refers to the transfer of production activities previously carried out internally to an external party located in a foreign location (e.g., Barthélemy, 2003).

Although it is quite obvious that forfeiting the hierarchical control of an activity raises different managerial concerns, different aspects of offshore outsourcing are often explored in the light of various theories and existing research on making ownership-based [equally captive] foreign investments, i.e. foreign direct investments [FDIs] (see e.g., Graf and Mudambi, 2005; Hätönen and Ruokonen, 2007). For instance, the application of Dunning's (1980, 1988) eclectic paradigm facilitates elaboration when the specific advantages of ownership (O) and location (L) apply, but not the advantages of internalization (I) (Hätönen and Ruokonen, 2007). In other words, companies benefit from producing an activity abroad, but not if they use internal resources. There exists no "internalization advantage" when the benefits of external production outweigh those of internal production (Dunning, 1988), and as a consequence companies shift towards 'buying' instead of 'making'. However, although much research on offshore outsourcing leans on FDI literature (e.g., Graf and Mudambi, 2005; Bunyaratavej et al., 2007; Palvia 2004), with regard to the location decision it still remains largely unclear whether the same factors that promote ownership-based offshoring encourage the firm to make an outsourcing investment in which ownership and thereby hierarchical control is passed to the foreign vendor/partner. This leads to the first research question addressed in this article:

> Research question 1: What factors influence the offshore-location decision when ownership of the activity is transferred to the foreign vendor?

When a company forfeits control of an activity, in contrast to captive offshoring, a key variable comes into play that may influence the location decision: the right choice of partner is often seen as the key to success in outsourcing agreements (e.g., Amoribieta and Bhaumik, 2001). Arguably, the choice of location cannot be separated from the choice of partner: they are two interrelated and intervening processes (Graf and Mudambi, 2005). However, it is equally likely that in some circumstances the partner or the location is chosen first (Doh, 2005; Narula and Hagedoorn, 1999). The second research question elaborates on this contingency and sequence:

> Research question 2: When and under what circumstances do firms choose partners prior to choosing the location?

Although the factors behind the final location decision and the sequence in which firms choose partners prior to choosing locations remain unclear, previous research has shown rather conclusively that the primary motives for offshore outsourcing relate to cutting costs, acquiring skills or resources that are unavailable internally, and improving and rationalizing internal processes (Lewin and Peeters, 2006, see also Heikkilä and Cordon, 2002; Kakabadse and Kakabadse, 2002; Quélin and Duhamel, 2003). According to the current FDI research, such motives are related to the seeking of resources, rationalization and efficiency concerns, and the search for strategic assets (Dunning, 1993, 2000, also 1980, 1988). However, these motives do not support the fourth main, and perhaps the most common, type of foreign-investment activity in terms of ownership-based offshoring, which is market seeking[1]. This leads to the third question addressed in this article:

> Research question 3: Does an internationalization-focused strategy affect the choice of offshore-outsourcing location?

Regardless of whether or not such strategic leaning affects the location choice, previous research has identified strong links between 'inward' and 'outward'[2] internationalization in that previous inward operations such as sourcing, licensing and franchising in a given country influence the initiation and/or success of the future degree of internationalization (Andersen and Christensen, 2005; Carstairs and Welch, 1982; Karlsen et al., 2003; Korhonen et al., 1996; Korhonen, 1999; Welch, 1990; Welch and Luostarinen, 1993). However, it still remains largely unclear whether such inward–outward connections[3] apply to offshore outsourcing as a somewhat distinct strategy from other inward operational modes. This leads to the fourth and final research question addressed:

> Research question 4: Does offshore outsourcing facilitate the future degree of internationalization, and if so under what conditions?

In addressing these questions the article is structured as follows. First, the relevant literature on the location decision related to offshore outsourcing and consequent internationalization is reviewed, and then developed further by means of an empirical study. The chosen method and the research context are described, and the reasoning behind the choices explained. The data-collection and analysis process is introduced, and the two exploratory case studies on InsuraSoft and FinaSoft are presented. The results are then contrasted with the concurrent literature, and suggestions for further research are given. The article closes with a summary, and some implications for managers, researchers, and policy makers.

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[1] Market-seeking motives of FDIs refer to motives aimed at expanding the firm's international market presence.For instance, setting up a wholly-owned foreign sales subsidiary is a market-seeking FDI.

[2] Inward international operations refer to supply-related operations and could be seen as the mirror image of outward, market-related operations (Korhonen et al., 1996). Whereas outward internationalization refers to the various means of penetrating foreign markets (Welch and Luostarinen, 1993), inward operations cover a multiplicity of forms such as the importation of goods and services, finance and technology through franchising, licensing, direct investments, alliance agreements, and the like (Luostarinen and Welch, 1990).

[3] Inward–outward connections refer to various ways in which inward operations in some way influence and facilitate the later international expansion of the firm, i.e., outward internationalization.