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Offshore outsourcing of services: An evolutionary perspective

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ABSTRACT

Offshore outsourcing is gaining increasing importance and attention in both theory and practice. The purpose of this research is to use nine in-depth case studies to analyze the evolution of offshore services outsourcing with regard to how expectations and governance structures change over time. Five testable propositions are presented, building on institutional theory, transaction cost, and resource-based perspectives. The cases demonstrate that offshore outsourcing is initiated because of increasing internal and external pressure to conform and reduce costs. Moreover, companies “chase” efficiency improvements in other geographic locations. But after reducing costs, companies discover more strategic benefits such as the potential to increase quality and market share. Importantly, as buyer–supplier relationships move from tactical to more strategic, expectations and governance structures change.

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1. Introduction

The offshore outsourcing phenomenon has gained increasing importance and attention in both theory and practice and has been coined “the next wave of globalization” (Dossani and Kenney, 2007). Companies are increasingly offshore outsourcing internal business processes to low-cost locations outside of the buying firm’s country of origin (Drezner, 2004) that satisfy their requirements for highly competitive, well-educated employees. As such, offshore outsourcing is perceived as a way to reduce labor costs for services that are highly dependent on skilled labor for efficient delivery (Ellram et al., 2008). Overall, offshore outsourcing of services is a rapidly growing phenomenon in global business and there has been relatively little research to date in this area (Vivek et al.,

2008; Lovelock and Yip, 1996). Therefore, offshore outsourcing affords an interesting research opportunity. The specific focus on offshore outsourcing limits the scope of our analysis to the “buy” arrangements in the realm of offshoring (Jahns et al., 2006), thus allowing for more in-depth analysis.

Recent large-scale empirical research has indicated that in practice companies’ motives for engaging in offshore outsourcing change over time (Lewin and Couto, 2007). Nevertheless, in-depth company level case study and theory-driven research concerning this phenomenon is still relatively scarce. Therefore, the first purpose of this paper is to provide detailed insights into the evolution of the offshore outsourcing phenomenon through case study research with a particular focus on what motivates companies to offshore outsource and the governance structures these companies employ. This specific focus affords an interesting research opportunity because the company-level dynamics of offshore outsourcing are not yet well understood. The second purpose is to further advance the understanding of offshore outsourcing using three different theoretical lenses to frame propositions

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based on the case results: institutional theory, transaction cost economics (TCE) and resource-based view (RBV). These three theories were selected, because of the demonstrated applicability in extant research on offshoring. With this background, we set out to address the following two research questions:

- (1) *How does the governance structure and expectations for offshore outsourcing change over time?*
- (2) *How do institutional theory, transaction cost economics and the resource-based view provide insights into the phenomenon of offshore outsourcing of services?*

The three theoretical lenses of institutional theory, TCE and RBV will be further detailed in the literature review section, providing the basis for the later proposition development. Next, we present the research methodology. The results section then provides findings from nine case studies and presents five associated propositions, highlighting how the governance structure and expectations change in the case study firms. It is within this section that the evolutionary pattern of offshore outsourcing of services at the company level is described and linked with theory-driven, testable propositions. This section is followed by discussion and conclusions encompassing managerial and theoretical implications, limitations, and suggestions for future research.

2. Literature review

Offshore outsourcing is motivated by a combination of environmental pressure, efficiency, and competitive pressure. Looking at the phenomenon from a theoretical perspective, a number of factors motivate organizations to begin, and continue, to offshore outsource. From an

institutional theory perspective, organizations are influenced by pressure from external sources (Zucker, 1987). If they behave accordingly, they are rewarded through increased legitimacy, resources, and survival capabilities (Scott, 1987). Therefore, we apply institutional theory as a theoretical lens to understand the environmental factors that drive offshore outsourcing. TCE focuses on the situation where firms choose to use the market rather than hierarchy. TCE has been applied only recently in the offshore setting (Ellram et al., 2008; Madhok, 2002; Jahns et al., 2006). In the context of TCE, if firms that offshore outsource services perceive the offshore outsourced market to be more efficient, we would expect offshore outsourcing to grow. An RBV perspective considers whether certain resources or capabilities contribute to a firm's competitive advantage. If enhanced capabilities are experienced in offshore outsourcing, we would expect offshore outsourcing to proliferate.

Fig. 1 shows an initial overview of the three theoretical lenses. These intersection points are key in the evolution from initial offshore outsource efforts to the integration of offshore outsourcing as an important strategy in identifying the appropriate resources and gaining competitive advantage.

Prior attempts to analyze some combination of two of these theories to gain a deeper understanding of outsourcing decisions can be found in the literature. TCE and RBV have a considerable history of application to outsourcing (e.g. Lyons, 1995; Murray et al., 1995 for TCE; Aubert et al., 2004; Leiblein and Miller, 2003 for RBV) and are increasingly being discussed together (e.g. Holcomb and Hitt, 2007; Arnold, 2000). For information systems (IS) outsourcing, for example, Miranda and Kim (2006) focused on a combination of institutional theory and TCE, in order to embed the more TCE-based decision-making procedure into an institutional context. In the context of

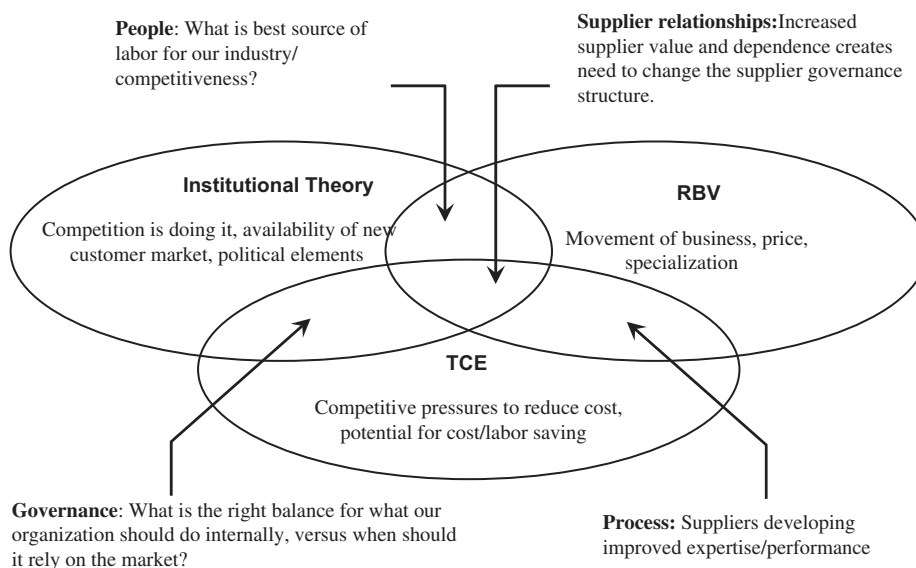


Fig. 1. Drivers of offshore outsourcing.

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