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Offshore outsourcing: A dynamic, operation mode perspective

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ABSTRACT

Based on a case study of the Danish company SimCorp and the development of its operations in Kiev, Ukraine, we analyze offshore outsourcing in a broader, longitudinal foreign operation mode context, and how it may contribute to mode change in the host country over a certain span of time. SimCorp had outsourced part of its software development work to two Ukrainian companies. The case study approach allowed us to explore the dynamic processes in depth. The study shows that involvement in the foreign market generates learning in various forms that provide a foundation for eventual mode development or change—beyond outsourcing specific learning. At the same time, restrictions on 3rd parties', that is, independent vendors' access to confidential client data, as well as protection of specific investments in human assets, may eventually become a driver for mode change, as in the SimCorp case, to ensure more effective control of the foreign operation. Finally, the case study shows how outsourcing can be used proactively as a springboard to deeper and changed operation mode activities in a foreign market.

1. Introduction

Offshore outsourcing—the delegation of specified value chain activities to one or more foreign provider(s)—has, for good reasons, received considerable attention from international business and management researchers over the last decade. This has been reflected in recent special issues on offshore outsourcing (as well as captive offshoring) in *International Business Review* (2011), *Journal of International Business Studies* (2009), *Journal of International Management* (2007) and *Journal of Management Studies* (2005). Outsourcing was the focus of a recent special issue of *Industrial Marketing Management* in which its impact on business-to-business marketing was examined. In the introduction to the special issue Ahearne and Kothandaraman (2009, 376) maintain: 'Increasing globalization has made companies focus more on their outsourcing decisions. Moving beyond the tactical companies has begun to incorporate outsourcing as a strategic weapon in their armory'. Recently, attention has been drawn to the growing importance of offshore outsourcing in the services sector (Bunyaratavej, Hahn & Doh, 2008; Griffith et al., 2009). Given the size of the services sector in advanced economies, this latter trend is of particular significance (UNCTAD, 2004). The ability to utilize offshore outsourcing has been facilitated by the development of large multinational companies providing outsourced production and other services on a global scale (Welch, Benito, & Petersen, 2007). Intermediaries like the Hong Kong-based company Li and Fung have emerged as specialists in handling the various steps in offshore outsourcing for their client firms—allowing companies effectively to outsource the outsourcing problem (Economist 2001; Einhorn 2009; Welch et al., 2007). In this article we focus on services and take the treatment of outsourcing, in offshore form, down a different strategic path by asking the questions: what follows, and what should follow, *after* offshore outsourcing?

Most of the research on offshore outsourcing examines the phenomenon at a certain point in time (see e.g. Bunyaratavej et al., 2007), whereas fewer studies apply a dynamic perspective (for an exception, see Lewin, Massini, & Peeters, 2009). As examples of dynamic issues, Dossani & Kenney (2007) and Manning, Massini & Lewin (2008) point to evidence of a change in outsourcing motives from basically being cost-focused towards a broader palette of strategic drivers. From substantial survey work, involving a full size range of European and US companies, Manning et al. (2008: 35) argue, that "reducing labor costs is no longer the only strategic driver behind offshoring decisions" (see also Harmancioglu, 2009; Fang, Gunterberg, & Larsson, 2010; Kinkel, 2012; Lewin & Volberda, 2011). Other drivers include speed to market, manpower shortages in areas such as technological development, proximity to key customers, new service needs and, environmental issues. Further, Maskell et al. (2007) find evidence of offshore outsourcing as a gradually expanding process in which companies initially outsource limited tasks, but—as outsourcing experience

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is accumulated—broaden the range of business functions being outsourced to foreign providers. Outsourcing of manufacturing and IT tasks seems to lead to the addition of other value added activities to be outsourced, such as human resource management, finance and accounting, and research and development. Put together, these dynamic perspectives suggest that offshore outsourcing is a phenomenon that fits with conventional internationalization process theory in which firms' foreign engagements evolve as an incremental learning process (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1977, 2006; Welch & Luostarinen, 1988); though with the important caveat that firms' offshore outsourcing location decisions may be less susceptible to a psychic distance logic (Hatönen & Eriksson, 2009) to the extent that the outsourcing location is affected by countries' factor endowments and their cost implications. Nevertheless, physical and cultural distance cannot be dismissed as location decision factors when outsourcing operations imply learning and close interaction between the contractee and the outsourcing firm and/or its clients (Liu, Feils, & Scholnick, 2011). Stringfellow et al. (2008) stress that interaction intensity and interaction distance (including language distance) have an impact on the extent of invisible costs in offshoring service work, and therefore its viability.

Although both static and dynamic studies have informed research about the offshore outsourcing phenomenon of the 1990s and 2000s, there is relatively little known about how this foreign operation mode intertwines with a firm's other modes of operation in the host country, and whether and how it might be used to develop foreign operation modes in the host market, or other markets including the home market, as part of firm internationalization. The extant literature on offshore outsourcing at the firm level basically deals with this operation mode *in isolation*, addressing questions like: what are the motives for offshore outsourcing and what are its managerial and operational challenges?

Various definitions and terms have been applied to outsourcing activity in the research literature on the topic (Hatönen & Eriksson, 2009; Welch et al., 2007). Indeed, outsourcing as a term has only come into vogue in recent times, even though the phenomenon itself is much older (Hatönen & Eriksson, 2009). However, terminology and definitional consistency seems to be emerging around what has been proposed by UNCTAD (2004). In simple terms, offshoring refers to the relocation of one or more processes or functions to a foreign location (Deloitte Consulting, 2008). This relocation can be carried out either in-house, as a tied or captive form of operations via the firm's own subsidiary; or through the use of an independent external supplier in the foreign market (what we refer to as outsourcing). Thus, in this article, we concentrate on the latter category: international or offshore outsourcing (Kedia & Lahiri, 2007). Effectively, through offshore outsourcing, a company is able to tap into another company's production facilities and/or service provision capacities in a foreign location (Ahearne & Kothandaraman, 2009).

In this article we analyze offshore outsourcing in a broader and longitudinal foreign operation mode context (Benito, Petersen, & Welch, 2009). To our knowledge this is the first attempt to do so. Our unit of analysis is not just the offshore outsourcing operation, but includes the type of changes associated with its use that lead to operation mode alteration in the host country over a certain span of time, including within mode change. Given the lack of previous research on these issues, our study is exploratory, both conceptually and empirically, although we draw on the extensive literature on foreign operation modes (reviewed in Welch et al., 2007). The focus on a single case, the Danish company SimCorp's development of operations in the Ukraine, allowed us to explore the dynamic processes in depth.

A key contribution of our analysis is to show the ways in which the process of offshore outsourcing may support a company's ongoing foreign operation mode development path(s), firmly placing the issue in an internationalization context, including the consideration of its use early or later in the development of international operations. We uncover some of the mechanisms underlying foreign operation mode changes, and show how outsourcing can lead to various forms of organizational learning and relational outcomes which may facilitate the extension of outsourcing activities or lead to new foreign organizational arrangements that perversely might involve the demise of outsourcing. In doing so, we change the focus away from cost reduction. Empirically, we contribute by providing an in-depth case investigation of outsourcing in the services area: bringing an insight into the process (from initial outsourcing idea to eventual subsidiary establishment) and the co-evolutionary factors that over time underpinned eventual mode change, considered from the perspectives of both contractees (in Kiev), the contractor (HQ and project management staff in Kiev), and the external consultant. In doing so, we follow Lewin and Volberda's (2011: 241) "plea for a more encompassing, co-evolutionary perspective of global sourcing stressing the interactions between managerial intentionality, path-dependent experience and knowledge accumulation, as well as the institutional and selection forces". Specifically, we unpick the type of learning and its links arising from outsourcing that support eventual mode change. While the internationalization process model stresses the importance of learning as a driver of international progression (via e.g., mode change), with an emphasis on experiential learning, the elements of relevant learning have not been well established, even less so with regard to the place of outsourcing in this overall picture.

Our article is organized as follows: we begin with a brief discussion of the broadening of strategic roles for outsourcing in companies' international operations. We then set offshore outsourcing within the context of firm internationalization—both as an initial foreign market activity, and as a subsequent step. SimCorp's evolving operations in Kiev are described and analyzed. We conclude with case findings and analysis, including the development of a conceptual framework, and outline managerial and research implications.

2. Changing focus in offshore outsourcing: from cost to competence

Much of the extant literature on offshore outsourcing traces its development and explains its rise (Trent & Monczka, 2003, 2005), although recently going beyond explanations that concentrate on relevant cost differences between countries (Bunyaratavej et al., 2007; Kinkel, 2012). ORN (Offshoring Research Network) survey results—which trace developments over time through annual surveys (see e.g. Lewin et al., 2009)—indicate that companies are thinking about outsourcing at a more general strategic level: 'more and more companies are formulating and disseminating corporate-wide strategies for guiding outsourcing and offshoring decisions …and are integrating offshoring decisions into the overall corporate strategy' (Manning et al., 2008, 49). While governments in general have exhibited concern about, even attempting to restrain, the extent of outsourcing because of concerns about domestic job losses, at the same time there has been recognition of the need to use outsourcing as a means of accessing the global pool of skilled talent in areas of domestic shortage—even by governments (Lewin et al., 2009). Carson (2007: 49) comments that 'firms increasingly outsource new product development activities to external organizations…the popularity of outsourcing is due in part to firms' ability to reduce development costs, shorten time to market, improve flexibility, and gain access to the specialized resources of external suppliers'. This seems to be applicable in many fields, including software and IT services (Lewin et al., 2009).

From a company perspective, the appeal of outsourcing's potential to reduce costs is understandable—as is the interest in outsourcing's capacity to relieve shortages of high level manpower (Manning et al., 2008). The popularity of outsourcing solutions to such concerns (Kshetri, 2007), has nevertheless led other researchers to raise questions about the possible impact on a company's basic competitive

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