

Analysis of interactions among core, transaction and relationship-specific investments: The case of offshoring

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Available online 4 March 2007

Abstract

Through the use of core, transactional and relational specificity constructs, the paper studies how the emphasis of clients' who move business processes offshore, changes over time to represent complex relationships between investments in core, transaction and relationship-specific assets. The complex combination of these investments helps clients attain evolving objectives in offshoring alliances. Interpretive Structural Modelling (ISM) has been used to establish changing emphases of the specific elements in offshoring alliances.

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Keywords: Offshoring; TCE; RBV; Core specificity; Relationship investment

1. Introduction

Over the past decade, offshoring alliances have evolved as value-bearing assets for partners constituting the alliance. A longitudinal view of offshoring alliances brings out three prominent trends in sourcing of services—an evolution from tactical to strategic objectives, a tighter integration of processes between clients and service providers and evolving ownership patterns. We use the notion of asset specificity from the theories of Transaction cost economics (TCE) and Resource-based view (RBV) to explain these evolving trends in offshoring and suggest that this new form of organization, i.e. offshoring of processes, cannot be explained solely by one of these theories. In the spirit of discovery, we use a grounded theory building approach to study the

transactional, core and relationship-specific investments made by the clients that mark the above mentioned trends in offshoring alliances. Gathering evidence from five case studies, we suggest that as offshoring objectives evolve from tactical to strategic; the specific investments made by the clients mirror the complex, dynamic relationship between investments in core, transactional and relationship-specific assets. We use Interpretive Structural Modelling (ISM) to represent the inter-relationships among various elements of these three specificity constructs. In this paper, we first present various issues in offshoring alliances, followed by some a priori themes from the literature. We will then discuss how we collected and analyzed the case data, present a short description of the cases, and make cross-case comparisons. The subsequent sections of our study discuss the ISM methodology, develop the analytical framework using ISM, and discuss the obtained relationships. Contributions, future research implications and managerial implications follow the discussion.

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A large number of studies illustrate the importance of global sourcing of goods as a tool for competitive advantage, but research in services outsourcing is in its nascent stages (Lovelock and Yip, 1996). Previous studies have focused on foreign direct investment in service industries (e.g., Weinstein, 1977; Terpstra and Yu, 1988) and foreign market entry modes for service companies (e.g., Erramilli, 1990; Erramilli and Rao, 1990, 1993). In the 1990s, locational and ownership aspects of internal sourcing of services were examined by Murray and Kotabe (1999). They found that internal sourcing relationships are moderated by the level of inseparability and transaction frequency and that internal sourcing is negatively related to a service firm's market performance. While firms have accepted sourcing as a part of their strategy, there are issues and concerns around this mode of reorganization. Managers are grappling with issues such as diffusion of technology (Pries-Heje et al., 2005), limitations on firms ability to develop valuable competencies (Barthelmy, 2003), effective exit strategies (Howard, 2003; Doyle, 2004), and most of all, operational and structural risks in administering outsourcing relationships (Hoffman, 2006; Aron and Singh, 2005; Kakabadse and Kakabadse, 2002). The issues related to administration focus on effective phasing of outsourced processes, successful management of contracts, determining trade-offs between tight contracts, and leveraging the potential competencies resulting from a rich client-service provider relationship.

2. A priori themes from the literature

Published literature has used theories from the transaction cost economies (TCE) or the resource-based view (RBV) of the firm to study alliances in the manufacturing and operations context (Rindfleisch and Heide, 1997; Coates and McDermott, 2002; Williams et al., 2002; Grover and Malhotra, 2003). However, the focus of these studies has been on understanding tangible aspects of performance differences in manufacturing supply chains. Grover and Malhotra (2003) reported 19 studies in manufacturing and operations context that applied TCE, of which 6 focused on manufacturing alliances. Williams et al. (2002) applied TCE and RBV to study the drivers of capabilities and transactions management in global aerospace supply webs. Coates and McDermott (2002) used RBV to view strategy in a production environment. More recently, Hult et al. (2006) made a shift by proposing that knowledge can serve as an intangible strategic resource and is crucial to create unique value. Cousins and

Menguc (2006) explored socialization and integration as mechanisms for enhancing buyer–supplier relationships. However, little investigation has been made in the strategic value of the intangibles associated with the evolution of inter-organizational alliances aimed at offshoring business processes. Through this research we apply the constructs of core, transactional and relationship-specific investments – drawn from the theories of TCE and RBV – to the evolutionary trends in offshoring alliances. We then develop an analytical framework to obtain the interrelationships among the tangible and intangible elements representing the three specificity constructs and their levels.

Two major theoretical perspectives in the strategic management literature relate with the evolution and advancement of sourcing: the transaction cost (TC) and the resource-based (RB) view of the firm. The TC perspective concerns with the management of transactions in an efficient manner through the least cost form of governance, under the assumption of opportunism (Coase, 1937; Williamson, 1975, 1979, 1991; Hennart, 1988, 1991; Balakrishnan and Koza, 1993). Three key attributes of TCE are: transaction costs, transaction attributes and governance structures (Williamson, 1975, 1979). Williamson (1979) cited factors such as uncertainty in determining appropriate and competitive prices, difficulty in monitoring and enforcing post-contractual performance, and the necessity of specialized (transaction-specific) investments as major sources of transaction costs. Transaction attributes build a characteristic space in which the transaction is located. Key attributes are the asset specificity needed to execute the activity, the frequency of transactions and the level of uncertainty involved.

The RBV is concerned with the management of resources in a manner which increases the competitive advantage of the firm (Schumpeter, 1942; Penrose, 1959; Lippman and Rumelt, 1982; Wernerfelt, 1984; Barney, 1986; Dierickx and Cool, 1989; Hamel et al., 1989; Prahalad and Hamel, 1990; Eisenhardt and Schoonhoven, 1996; Conner and Prahalad, 1996; Teece et al., 1997; Dyer and Singh, 1998). The RBV explains how firms relate to their markets by defining alliances as a collection of tangible and intangible resources (Eisenhardt and Schoonhoven, 1996). Differing from the TC theory, RBV focuses on the ability of the firm to create core competencies through capabilities rather than avoid negative market conditions (Prahalad and Hamel, 1990). Taking a view that the strategic options are driven by resources, Wernerfelt (1984) proposed that firm resources impact performance, resource positions build barriers to entry and competition, and

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