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Creating value through offshore outsourcing: An integrative framework

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ABSTRACT

This article proposes an analytical framework to explain value creation through offshore outsourcing by addressing a key question: How do firms create value by outsourcing their business functions to foreign external providers? The growing prevalence of offshore outsourcing as a dominant business practice in global business makes this question worthy of further research attention. Situated within the organizational design literature, our proposed value creation framework also draws from strategic resource management, disintegration, location-specific resourcing, and externalization (D–L–E) and contingency perspectives. Our analysis shows that firms embarking on offshore outsourcing create value by effectively managing their internal and external resources in accordance with a changing global environment. The framework has significant implications for theory and practice and suggests avenues for further research.

1. Introduction

Offshore outsourcing occurs when firms relocate business functions that previously were performed in-house to independent service providers located overseas. The use of offshoring as a strategic device is typical among firms from advanced economies, primarily because it helps client firms reduce productions costs in the short run (Maskell et al., 2007), and has potential to become a strategic device for value co-creation in the long run (Contractor et al., 2010; Liesch et al., 2012). Increasingly standardized business processes as well as high valued-added activities, such as engineering, R&D, and product design are currently moving to offshore external vendors (Jensen and Pedersen, 2011a, 2011b; Mudambi and Venzin, 2010). In addition to the cost savings they achieve from wage differentials in emerging markets, firms may engage in offshoring to increase service quality, fend off competition, and augment their existing resource base by acquiring qualified human capital around the world (Demirbag and Glaister, 2010; Doh et al., 2009; Larsen et al., 2012).

As offshore outsourcing moves to the next level and includes more value-added activities, the realization of such diverse objectives may become challenging, giving rise to complex questions such as how it can create value (Doh, 2005; Mudambi and Venzin, 2010). Indeed, the extant scholarly literature and a quick scanning of the popular business press indicate that in spite of the acknowledged benefits of offshoring, many firms fail to realize the same. For example, Larsen et al. (2012) note that many companies have started to comprehend the difficulties and complexities associated with managing a globally dispersed organization. This realization indicates that as companies relocate their value chain activities across country borders, value creation becomes an increasingly difficult proposition. Recently, scholars have started to address this issue by adopting an organizational design perspective (Andersson and Pedersen, 2010; Lampel and Bhalla, 2011). For instance, Srikanth and Puranam (2011) while studying the distributed work setting of

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business process offshoring, identify a distinct set of coordination mechanisms that can offset the adverse performance consequences of interdependence between onsite and offshore locations. Similarly, Andersson and Pedersen (2010) shed light on how to best design the configuration of globally distributed R&D activities and underscore the importance of appropriate coordination and control mechanisms that can create value by mitigating the costs arising from the complexities associated with offshoring. Collectively, this stream of literature argues that offshoring is an organizational design issue which entails significant reconfiguration of a firm's value chain activities and value is created through the development of firm-specific capabilities that help in the process of subsequent reintegration (Larsen et al., 2012). This proposition is in tune with the findings in the realm of strategy literature that suggest that a firm's ability to manage internal and external resources and capabilities is an important determinant of value creation in an increasingly competitive, complex, and uncertain global marketplace (Karim, 2006, 2009; Karim and Mitchell, 2004; Sirmon et al., 2007, 2011).

Despite this acknowledgement that offshoring is primarily an organizational design issue (Kumar et al., 2009; Larsen et al., 2012), the scholarly literature has surprisingly paid scant attention to better understand the resource management processes and capabilities that are important for the success of offshoring as a strategic tool. As offshoring activities gain impetus and as complex tasks spanning several locations and centers of innovation and multiple regional service delivery bases arise, more research is needed to better understand the specific success factors associated with this strategic device (Kenney et al., 2009; Larsen et al., 2012; Mudambi and Venzin, 2010).

We attempt to provide such insight by conceiving the value creation in offshore outsourcing as an organizational design process by which resources and capabilities of the offshoring organization are restructured, re-bundled and leveraged. We integrate organizational design (Karim, 2006, 2009; Karim and Mitchell, 2000; Kumar et al., 2009) and resource orchestration perspectives (Sirmon and Hitt, 2009; Sirmon et al., 2007, 2008, 2011) with disintegration–location–externalization (DLE) framework of offshoring (Kedia and Mukherjee, 2009; Mukherjee and Kedia, 2012) to establish the foundation for our analysis. Our framework goes beyond the DLE framework (Kedia and Mukherjee, 2009) by conceptualizing the phenomenon of offshore outsourcing as a set of strategic actions that help firms reconfigure, acquire, and modify their organizational structure and ultimately their resource bases to keep pace with environmental changes (Capron and Mitchell, 1998; Capron et al., 1998; Karim and Mitchell, 2000). More specifically, our framework identifies the specific resource management processes and associated environmental contingencies that enable offshore outsourcing firms to create value by managing their internal and external resources and capabilities in a dynamic environment.

The process of offshore outsourcing entails the firm-specific *disintegration* of different functions or activities, the pursuit of suitable *location*(s) for appropriate service provider(s), and the *externalization* of those processes to an independent provider in a foreign country (Kedia and Mukherjee, 2009). Consistent with this, we conceptualize three components of the resource management process model—resource restructuring, resource rebundling, and leveraging externalized resource bundles—in an offshore outsourcing context and integrate these stages with the DLE framework. Our theoretical framework addresses the following research questions:

- What resource management processes and capabilities are required to achieve value creation in offshore outsourcing?
- What factors affect the development of these capabilities?

By noting the dynamics of value creation through offshore outsourcing, we contribute to the existing literature in two ways. First, we respond to recent calls for integrative research that recognizes that global sourcing is an organizational design issue which encompasses both ends of the firm's value chain and the need to explore firm-specific mechanisms that create value by offsetting the complexities and uncertainties associated with the process (Kumar et al., 2009; Larsen et al., 2012; Manning et al., 2008). Second, we identify various factors underlying different resource management stages and investigate how they affect the value creation process. By adopting an organizational design view of offshoring, and by specifying the associated contingencies in each stage, we significantly extend the extant literature that discusses value creation (e.g., Doh, 2005; Kedia and Mukherjee, 2009). Our discussion on the contingencies contributes to the contingency theory of firm (Chandler, 1962; Lawrence and Lorsch, 1967) and emphasizes the viewpoint that the processes involved in managing global resources also depend on the domestic and global environmental context in which firms operate. With our proposed framework, we offer both theoretical and practical guidance for value creation in the context of offshore outsourcing.

The remainder of this article is organized as follows: First, we elaborate on the importance of value creation in offshore outsourcing and the concept of value as discussed in the extant literature and from an organizational design perspective. Second, we provide an overview of offshore outsourcing in the context of strategic resource management frameworks with a focus on organizational reconfiguration literature. Third, we introduce our integrated value creation framework to describe how value creation occurs, along with a detailed discussion on how to understand value creation in each of the resource management stages. Fourth and finally, we explicate the importance of our proposed framework for both researchers and practitioners.

2. Value creation in offshore outsourcing

The notion of value creation has received considerable attention from business scholars. There is consensus amongst researchers and practitioners that wealth or value creation is the principal purpose of business (Conner, 1991). In general, *value* refers to the difference between the benefits derived and the costs incurred in pursuing a particular strategy (Sirmon et al., 2007). In the context of offshore outsourcing, the process of value creation remains a central issue (Doh, 2005; Jensen and Pedersen, 2011b; Kedia and Mukherjee, 2009; Liesch et al., 2012). For example, Bryce and Useem (1998) argue that the concept of value differs for outsourcers versus providers. For the offshoring organization, sources of value creation include access to the expertise and economy of scale