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The reshoring of business services: Reaction to failure or persistent strategy?

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ABSTRACT

This paper investigates whether reshoring of business services is the result of company response to performance shortcomings of the initiative offshored or instead is motivated by persisting with original offshoring strategy (disintegration advantages, accessing new markets and cost-saving), regardless of offshoring performance. Our empirical analysis, based on data from the Offshoring Research Network, shows that both arguments hold. Moreover, when offshoring had been motivated by accessing to new markets and its performance is unsatisfactory, companies are likely to relocate. However, unsatisfactory performance of activities offshored for efficiency reasons or search of talent, do not necessarily lead companies to relocate elsewhere.

1. Introduction

> "No phenomenon is a phenomenon until it is an observed phenomenon" (Niels Bohr)

For several decades, firms in developed countries have strategically offshored[1] manufacturing and production activities to emerging economies mostly to exploit cost advantages, while locating value-adding, knowledge-intensive activities in advanced countries to benefit from knowledge pool (Contractor, Kumar, Kundu, & Pedersen, 2010; Doh, Bunyaratavej, & Hahn, 2009). Over time, production activities have become increasingly technology intensive, resulting in the evolution of firms' specialization in emerging economies towards more knowledge-intensive production systems. The improvement of technical capabilities and the advances in ICT have also facilitated the relocation of high value added activities (such as R&D, engineering services and product development) to emerging economies (Bunyaratavej, Hahn, & Doh, 2008; Dossani & Kenney, 2006; Lewin, Massini, & Peeters, 2009). After decades of offshoring of both production and services (the latter still a growing phenomenon), some companies have started to relocate their offshore activities either back to home countries or to other offshore locations.

The phenomenon of relocating offshored business services has been labelled with several different terminologies (e.g., reshoring, on-shoring, in-shoring, back re-shoring). In this paper, we adopt the term "reshoring" to indicate the voluntary (i.e. not forced by host country governments) partial or total relocation of business initiatives previously offshored, whether to another location or back home.[2] In particular, we refer to the relocation of business processes and activities of companies operating in manufacturing and service industries. The relevance of the phenomenon has been acknowledged by the economic press (The Economist, 2013b), consultancy companies (Sirkin, Zinser, Hohner, & Rose, 2012),

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[1] In this paper, we refer to offshoring as the relocation of firms' activities abroad, either in-house (i.e. offshore captive) or through an external supplier (i.e. offshore outsourcing). While outsourcing is "the subcontracting or contracting-out of activities to [. . .] organizations that had previously been performed within the firm" Doh, Hahn Lewin, Massini, & Bunyaratavej, 2011, p. 71), offshoring is "the transnational relocation or dispersion of service related activities that had previously been performed in the home country" (Doh, Bunyaratavej, & Hahn, 2009, p. 926), regardless of the mode of entry.

[2] The term "reshoring" is used here to indicate a generic change of location with respect to a previous offshore country. This includes further offshoring (i.e. the relocation to another offshore location) and back-reshoring (i.e. relocation to the home country), which are two different specifications of the generic decision of changing location. However, we reckon that the drivers underlying these two different relocation choices are likely to be similar (e.g. performance shortcomings might trigger the decision to either find a new and more profitable location or go back home).

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transnational institutions (UNCTAD, 2013) and policy makers. The U.S. Administration, for instance, is challenging traditional free-trade cornerstones to bring back home some production activities (Tate, 2014), and, recently, the European Union is considering (or designing) policies to support the re-industrialization (EPRS, 2014). For example, The German government has recently launched the "Industrie 4.0" program, making € 200 million available to boost the manufacturing activity in the country, which embraces also the attraction of economic activity from abroad (including further-reshoring and back-shoring) (Stentoft, Olhager, Heikkilä, & Thoms, 2016). Although the debate has mostly regarded manufacturing activities, some companies are beginning to bring service jobs back home; for instance, General Electric and General Motors have decided to reshore IT services (The Economist, 2013a).

Despite the rising interest by the mass media and in the public opinion towards reshoring, there is relatively limited scholarly research on the reshoring of manufacturing operations (e.g., Arlbjørn & Mikkelsen, 2014; Ellram, 2013; Ellram, Tate, & Petersen, 2013; Fratocchi et al., 2016; Gylling, Heikkilä, Jussila, & Saarinen, 2015; Kinkel & Maloca, 2009; Martìnez-Mora & Merino, 2014; Tate, Ellram, Schoenherr, & Petersen, 2014; Stentoft, Olhager, Heikkilä, & Thoms, 2016), and there is almost no research on the reshoring of business services (an exception is Albertoni, Elia, Fratocchi, & Piscitello, 2015). This may be due to the lack of systematic data available on this phenomenon, and its relatively small scale.

However, this phenomenon is likely to become more pronounced. Market adjustments are weakening imbalances between advanced and emerging economies in terms of the main drivers underlying the offshoring of business services, i.e. the quest of cost savings and the recruiting of qualified personnel (Lewin, Massini, & Peeters, 2009; Manning, Massini, & Lewin, 2008). Over time, labour costs are raising in emerging economies and declining in advanced countries where unemployment rates indicate over supply in the labour market (Arlbjørn & Mikkelsen, 2014; Van Den Bossche, Gupta, Gutierrez, & Gupta, 2014). These trends suggest that reshoring of business services (as well as of manufacturing activities) is much more than a managerial fad and it represents a raising opportunity, as well as a threat, for managers and policy makers in advanced and emerging economies.

In order to discuss the economic and social implications of this phenomenon, a deeper understanding of the underlying dynamics and more systematic empirical analyses are required. Using original data from the Offshoring Research Network (e.g. Lewin & Peeters, 2006), this paper aims at shedding more light on reshoring decisions of business services previously offshored. The literature explains reshoring of manufacturing mainly as a consequence of performance shortcomings (Fratocchi, Di Mauro, Barbieri, Nassimbeni & Zanoni, 2014; Kinkel & Maloca, 2009; Kinkel, 2012). We argue that reshoring of business services may be due to not achieving the objectives underlying offshoring decisions (i.e., a somewhat unsatisfactory performance) and that it can also be related to the desire of persisting with the original offshoring strategy, regardless of the performance of the offshoring operation (e.g. because the host country does not offer opportunity for further improvements, or the company has reached its strategic goal in that country and therefore a new location is considered). Offshoring decisions have been discussed within the framework based on disintegration, localization and externalization advantages (DLE) (Kedia & Mukherjee, 2009); here we investigate whether and how these factors, in addition to performance shortcomings, can explain reshoring decisions.

The remainder of the paper is organized as follows. The second section illustrates the conceptual framework explaining offshoring and reshoring of business services as driven by DLE factors. The third section provides empirical evidence from the Offshoring Research Network data and presents econometric estimates on determinants of reshoring. Finally, the last section draws some managerial and policy implications, and discusses possible future research avenues.

2. The reshoring of business services: failure vs. coherent offshoring strategy

Reshoring of business services may be due to a response to performance shortcomings with respect to the original drivers of the offshoring initiatives, which might arise from changes in external conditions or from managerial mistakes. Alternatively reshoring may be due to the company's persistence to capture the offshoring advantages underlying the original offshoring strategy when the external conditions of the host or other locations change or when the company has reached his strategic goal in that specific host country.

The literature has traditionally associated offshoring of business services to three main factors: disintegration, location-specific and externalization (i.e. DLE) advantages (Kedia & Mukherjee, 2009). Disintegration may allow greater focus on core competencies and greater flexibility. Localization advantages can be related to the main drivers of internationalization: penetration into new markets, desire to obtain some cost savings, access to natural resources, and identification of new strategic assets (Dunning, 1993, 2000). In particular, with regards to the latter driver, the offshoring of high value adding business services is driven by the quest of new technical and engineering talents at the offshore location (Lewin, Massini, & Peeters, 2009; Manning Massini, & Lewin, 2008). Regarding externalization advantages, the literature has focussed on the make or buy decisions outside national and firms' boundaries (offshore outsourcing) (Ellram, 2013; Griffith, Harmancioglu, & Droge, 2009) based on traditional transaction cost economics arguments (e.g., Contractor, Kumar, Kundu, & Pedersen, 2010; Buckley & Casson, 1976; Ellram, Tate, & Billington, 2008).

In the next two sections, we first discuss the DLE factors as motivations for offshoring, and how they could also explain reshoring decisions; we then discuss how reshoring decisions can be triggered by performance assessment too.

2.1. The DLE framework and reshoring decisions

2.1.1. Disintegration

The disintegration of the value chain provides firms with multiple advantages. First, companies can decrease the complexity of managing foreign initiatives while gaining higher organizational flexibility. Additionally, firms can learn more quickly and adapt more rapidly to market and technology changes, thus reducing the costs, and increasing the effectiveness, of transferring knowledge across boundaries (Kotabe, Parente, & Murray, 2007). Moreover, splitting business functions into smaller modules also reduces the exposure of proprietary knowledge to third parties, thus reducing misappropriation risks (Gooris & Peeters, 2016). Finally, the disintegration of the value chain enables firms to choose the best location for each single task, by selecting the geographic areas where it is possible to develop innovative capabilities and exploit external agglomeration economies (e.g. selecting an industrial cluster specialized in the delivery of a best-of-breed products or services, see Manning, 2013).

However, a disintegration strategy also requires subsequent reintegration to reinstate the inter-connections along the value chain. While some activities present a high degree of modularity that enables their offshoring, when the inter-connections are strong, they are more difficult to disintegrate and require more effort for their reintegration as well as higher coordination costs, which may affect negatively their net benefits (Griffith,