Creating value through offshore outsourcing: An integrative framework

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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.

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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 production 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...
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
offered by the provider, a greater focus on strategic issues rather than routine activities or operational problems, alternative uses of the capital freed up by linking with the provider, increased innovation capabilities, and increased product market performance through better service delivery. These value enhancement avenues may enhance the outsourcer’s stock price performance, reduce operating costs, improve service performance, and generate an overall strategic advantage.

The literature exploring the relationship between offshoring and subsequent performance measures has found mixed results. Early studies, for instance Murray and Kotabe (1999) find that internal and foreign sourcing of services is actually negatively related to firm performance. In addition, Mol et al. (2005) while examining 200 manufacturing firms in Netherlands find no effect of international outsourcing on firm performance. Similarly, Bhalla et al. (2008) explore the linkage between a firm’s performance and the extent of its international outsourcing of IT-enabled services, focusing on large Western companies. These authors used accounting based measures of financial performance over a six year period from 1999–2004, and find no linkage between outsourcing and financial performance. On the other hand, Lewin and Peeters (2006) find that organizational benefits from offshoring for the client companies often exceed the initial expectations.

More recent studies, however, have found more positive results. For example, Nieto and Rodriguez (2011) find a positive relationship between R&D offshoring and focal firm innovation capabilities supporting the view that offshoring firms benefit from location-specific and specialization advantages. Likewise, Bertrand (2011) also finds a strong positive relationship between offshore outsourcing and export performance, arguing that outsourcing reduces productions costs and increases flexibility. Additionally, they also observe that certain firm-specific capabilities accentuate the positive effect of outsourcing on performance.

It is apparent from this discussion that although offshoring may provide certain benefits to the client firm, such benefits are not often easy to realize. Relocation of formerly co-located activities often involves unexpected challenges and uncertainties that are referred to as ‘hidden costs’ (Larsen et al., 2012). Such costs frequently offset the straightforward benefits that could have been derived from offshoring. Thus, companies that are able to surmount these challenges may outcompete their rivals that are also using offshore outsourcing as a strategic tool. Researchers addressing this issue have started to identify the mechanisms and conditions under which a focal firm may become successful. From a configuration view of strategy, Lampel and Bhalla (2011) suggest that relocation of high-value activities disrupts the existing configuration of the organization and often destroys the potential of value creation. Based on an in-depth case study, they suggest that the process of offshoring is often a ‘learning experience’ in which the focal firm may have to adapt and adjust the linkages that tightly couple the offshore activities with the core configuration. Similarly, Jensen (2012) explores what contributes to the resource-stock enhancement of client firms and identifies the factors that may hinder the resource building process.

From a somewhat different level, the DLE framework, as proposed by Kedia and Mukherjee (2009) contends that the juxtaposition of three sets of interrelated advantages that firms perceive can explain why they embark on offshoring (Kedia and Mukherjee, 2009). They argue that firms contemplate offshoring when they have advantages associated with the disintegration of the non-core activities from their value chain. These disintegration advantages likely stem from increased modularity in their structure or increased focus on their core capabilities. Another set of advantages results from location-specific resourcing: Firms attempt to harness superior external resources and move offshore if location-specific advantages, such as, a good infrastructure, low wage rates, and better quality intellectual capital, suggest non-core support activities can be completed outside their value chain. Finally, boosted by the advantages associated with externalization, such as co-specialization and organizational learning, firms might externalize the first two sets of advantages to independent offshore service providers.

Collectively, although the extant literature has identified an important set of antecedents that drive value creation through offshoring, the specific resource reconfiguration processes that contribute to value creation remain implicit. We attempt to fill this void. In this paper we go beyond the extent literature in suggesting that in order to more fully understand the question of value creation in offshore outsourcing we should look more closely at the resource management processes of a focal firm, identify specific capabilities, and emphasize the environmental contingencies under which the resource portfolio of the client firm is reconfigured. To gain a deeper understanding of these processes, we next discuss the notion of strategic resource management framework as developed by Sirmon and his colleagues (Sirmon and Hitt, 2009; Sirmon et al., 2007, 2008, 2011).

3. Strategic resource management and offshore outsourcing

In pursuit of the answer to the central question of strategic management—why do some firms perform better than others?—strategy scholars have investigated performance from several different vantage points. However, starting in the 1980s, the resource-based view (RBV) of the firm became a dominant framework to analyze this issue (Barney, 1986, 1991; Wernerfelt, 1984). RBV assumes resource heterogeneity (i.e., competing firms possess different bundles of resources) and resource immobility (i.e., resource differences may persist), such that organizations are heterogeneous bundles of resources that inhere to the firm in semi-permanent fashion (Barney, 1991; Wernerfelt, 1984). According to the RBV, resources combine or emerge over time to generate unique capabilities, which increases a firm’s competitive advantage (Amit and Shoemaker, 1993). In other words, firm-specific resources and capabilities that are unique, inimitable, non-substitutable, and rare form the bases for competitive advantage (Barney, 1991; Wernerfelt, 1984). Thus, the RBV has been extensively used to identify and explain persistent performance differences (Lahiri et al., 2012; Sirmon et al., 2011).

It must be noted that the RBV did not originally aim to explain firm boundaries (Barney, 1986; Peteraf, 1993). However, from a strategic perspective, the RBV suggests that competitive advantage is a function of the resources a firm develops or acquires to implement its product market strategy (Wernerfelt, 1984). Day (1994, p. 38) classifies resources in two categories: assets, or “resource endowments the business has accumulated,” and capabilities, which “are the glue that brings these assets together.” Hence,
resources are the tangible and intangible assets that firms control and capabilities are the ability to perform ‘a coordinated set of tasks utilizing organizational resources’ (Helfat and Peteraf, 2003, p. 999). Firms that can accumulate distinctive assets and capabilities achieve a competitive advantage over competitors (Barney, 1991; Lahiri et al., 2012).

Extending this argument, Sirmon and his colleagues posit that the firm’s ability to manage its resource portfolio affects its performance (Sirmon and Hitt, 2003, 2009; Sirmon et al., 2007, 2011). The presence of resources alone is unlikely to predict firm performance differentials; rather, resources provide competitive advantages only when they are managed strategically (Helfat et al., 2007). Accordingly, strategic resource management is not readily imitable by rival firms, is often idiosyncratic, and remains deeply embedded in the unique context of the focal firm (Lahiri et al., 2012; Sirmon et al., 2011). From an organizational design perspective, this process includes structuring the resource portfolio, bundling resources to form capabilities, and leveraging capabilities to create wealth (Sirmon and Hitt, 2003; Sirmon et al., 2011). The extension of RBV arguments to organizational design literature is not new. For example, Karim and Mitchell (2000) demonstrate how firms use acquisitions in order to reconfigure their business as well as their existing resource stocks. Karim (2006) integrates the strategy–structure literature with research on dynamic capabilities and suggests that a firm’s structure and its internal resource combinations are dynamic in nature and constantly evolving. Following this logic, we argue that by offshore outsourcing firms restructure their resource portfolio through disintegration; rebundle resource stocks with location-specific resourcing, and leverage externalized capabilities (acquired from offshore service providers) to create value.

4. Toward an integrative framework

There are three critical resource management stages in offshore outsourcing: restructuring of internal resources, acquiring offshore human capital, and leveraging externalized knowledge resources. Our conceptualization follows an intellectual movement that increasingly looks inward to identify sources of competitive advantage and value creation (Adner and Helfat, 2003; Helfat et al., 2007). We argue that an offshore outsourcing client firm creates value by restructuring and refining its existing resource stocks and improving their management and use.

Fig. 1 presents our value creation model. The arrow from location to externalization does not imply that externalization always takes place after the location decision; these decisions often are simultaneous (Hatonen, 2009; Jensen, 2009; Mudambi and Venzin, 2010). We also incorporate various sub-processes in each stage. However, because the firm must have resources to bundle into capabilities and because capabilities must exist for leveraging to occur, the resource management process is at least partially sequential in nature. Furthermore, the model incorporates possible environmental contingencies associated with each process. For

Fig. 1. Offshore outsourcing: an integrative framework for value creation. Adapted from Sirmon et al. (2007) dynamic resource management model, Fig. 1, p 276.
the sake of brevity and parsimony, our discussion mainly focuses on pertinent resources management processes and capabilities. The management of resources is dynamic, and change results from adaptations to environmental contingencies and exploitations of opportunities created by those contingencies. With Table 1, we attempt to facilitate the identification and differentiation of processes noted in the resource management model. We also identify how we can measure the key concepts of our framework in Table 1 in the right-most column.

4.1. Value creation at the disintegration stage and associated contingencies

Disintegration refers to the process of unbundling value chain activities into core (primary) and non-core (support) activities, divesting non-core resources, and redeploying scarce resources to core areas that represent the firm’s competitive advantage. Before we discuss each sub-process, we briefly note the environmental contingencies that lead to disintegration at this particular resource management stage.

The processes involved in managing resources depend on the environmental context in which a firm operates (Lichtenstein and Brush, 2001). Three types of environmental factors may affect resource management processes at the disintegration stage. First, heightened competition in the global world has shortened the periods of competitive advantage enjoyed by firms (D'Aveni, 1994); the best ways to organize resources and activities in such environments remain unclear. Firms might restructure their resource portfolio and disintegrate value chain activities; for example, one stream of research argues that organizations should be more flexible, leaner, and more focused on their core competencies to stay competitive and responsive in hypercompetitive environments (Jacobides, 2005; Schilling and Steensma, 2001). Second, the resource management process at the disintegration stage might provide a means to reduce institutional uncertainty. Researchers caution that to achieve the expected benefits from offshore outsourcing, organizations must undertake careful planning as part of their overall strategy (e.g., Quinn and Hilmer, 1994). Managers actively seek useful resources from their external environment, but institutional pressures may also prompt them to jump on the offshore outsourcing bandwagon, without fully evaluating the idiosyncratic risks and benefits. Third, the internal resource environment or the ‘stickiness of knowledge’ issue (Srikanth and Puranam, 2011) of the firm may lead to strategic uncertainty about which resources best serve the core competencies and what can be divested to reap optimum benefits.

4.2. Restructuring the resource portfolio through disintegration

In this stage, a firm restructures its resource portfolio by evaluating its core and non-core areas, divesting less valuable resources, and refocusing scarce resources in the areas where the firm has competitive advantage. We briefly discuss each sub-process’s contribution to value creation.

Table 1
Factors affecting the creation of value through offshore outsourcing.

<table>
<thead>
<tr>
<th>Disintegration considerations</th>
<th>Accompanying processes</th>
<th>Measures and sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic intent</td>
<td>• The process of identifying core and non-core areas (Evaluating)</td>
<td>• Core related specificity (Barthélemy and Quelin, 2006); Process Knowledge Stickiness (Srikanth and Puranam, 2011)</td>
</tr>
<tr>
<td>Emphasis on innovation</td>
<td>• The process of shedding off the non-core resources (Divesting)</td>
<td>• New scale developed from Sirmon et al. (2010) and Wang et al. (2012)</td>
</tr>
<tr>
<td>• Developing organization-wide support systems for redeploying scarce resources in core areas</td>
<td>• Process of redeploying scarce resources to core areas (Refocusing)</td>
<td>• Percentage increase in investment (R&amp;D, Marketing etc.) (Kor and Mahoney, 2005)</td>
</tr>
<tr>
<td>Location considerations</td>
<td>• Process of choosing the right vendors for areas already divested (Locating)</td>
<td>• Location choice scales (ORN surveys)</td>
</tr>
<tr>
<td>Environmental scanning to select of capable vendors/human capital worldwide</td>
<td>• Process of choosing and contracting suitable vendors and/or human capital worldwide (Recruiting and Selecting)</td>
<td>• Global vendor management (Ranganathan and Balaji, 2007)</td>
</tr>
<tr>
<td>• Developing internal capabilities for developing suitable contracts</td>
<td>• Process of acquiring, keeping, and managing external human capital (Retaining)</td>
<td>• HR practices and Managerial support (Doh et al., 2011)</td>
</tr>
<tr>
<td>• Developing internal resources and knowledge management systems to support offshore partners</td>
<td>• Process of integrating external resources into the internal knowledge management system (Coordinating)</td>
<td>• Coordination mechanisms (Srikanth and Puranam, 2011); Process Integration (Luo et al., 2012)</td>
</tr>
<tr>
<td>Adoption of a collaborative mindset within and across the organization</td>
<td>• The process of organizing relevant internal resources to support the external relationship (Collaborating)</td>
<td>• Partnership quality (Lahiri et al., 2012)</td>
</tr>
<tr>
<td>• Intent to work closely and learn from offshore partners</td>
<td>• Process of extending current capabilities and producing new capabilities that render competitive advantages (Transforming)</td>
<td>• Innovation performance (Grimpe and Kaiser, 2010)</td>
</tr>
<tr>
<td>• Developing suitable absorptive capacity and systems supporting co-creation with offshore partners</td>
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4.2.1. Evaluating

The first step entails an evaluation of the activities and resources that can be offshored and those that must stay within the firm boundary. Tangible resources such as financial capital or equipment and intangible resources such as domain expertise relate to any given function or value chain activity. Some activities are core to the business; others refer to peripheral functions, systems, and infrastructure set up to support the company’s value proposition, product line, or core business activity. These support systems include human resource management, customer relationship management, sales, accounting, and general and administrative functions or services. Thus identifying core versus non-core or primary and support areas is not easy. Identifying the benefits of two different procurement methods for the same transaction requires an intricate, nuanced analysis of the value chain (Tadelis, 2007).

The evaluation also is not straightforward. Make-or-buy decisions have long been central to manufacturing environments though. For example, Li & Fung, which produces and exports private-label consumer goods, orchestrates a global network of vendors from 40 countries to deliver its high-quality products. A parka might be assembled in China with fabric from Korea; label, elastic, and studs from Hong Kong; and a zipper from Japan. In contrast, business and knowledge processes tend to be more closely connected, with intensive human capital elements. To deal with the challenges of determining which processes can or cannot be disintegrated effectively, prior research suggests two criteria. The first criterion refers to the offshore sensitivity of the business process—that is, how closely connected and interdependent the processes in question are. The second criterion determines whether the focal firm should disintegrate certain tasks, irrespective of their offshorability. The loss of control that results from changing ownership might erode a firm’s core capabilities and resources, compared with retaining those activities and processes in house (Lei and Hitt, 1995). Reizeig and Wagner (2010) argue, for example, that outsourcing might disrupt incremental in-house learning processes. Companies should consider several issues to evaluate the offshorability of a business process.

Even when they have been disintegrated and outsourced, the delivery of processes must be synchronous and support real-time interactions with customers and entities within the firm. However, language and cultural differences may become exacerbated when executing a business process outside the firm. Performing the processes often requires deep idiosyncratic knowledge of the company and its products and services, which can be acquired only over time. Furthermore, unlike tangible products that feature easily partitioned components, business and knowledge processes are interdependent. Accordingly, the complex evaluation stage includes identifying core and non-core areas, then dissociating value chain activities and related resources.

The Indianapolis-based Conseco insurance and finance company offers a case in point. In April 2002, Conseco acquired a firm that specialized in customer service and back-office outsourcing to India and planned to move 14% of its U.S. jobs to India in the following two years. But Conseco quickly backed away from its plan and announced that it had sold its interest in the outsourcing firm, as part of its effort to refocus its resources and management on core businesses. Conseco also decided to return many of the outsourced jobs to its U.S. facilities, for two main reasons: a reduced volume of business and the need to exercise close control over the processes that directly affected its relationships with current customers and distribution partners. The company admitted that it found some of these processes difficult to manage successfully from a distance.

4.2.2. Divesting

Recent management literature stresses the significance of flexibility in modern competitive landscapes (Lahiri and Kedia, 2011; Mudambi and Tallman, 2010). Firms must develop core competencies and human capital to achieve strategic flexibility and modularity (Hitt et al., 1998), which then help them become more responsive to external demands. By divesting its unwanted resources, the offshoring firm can achieve greater flexibility and create value. Resource divestment refers to “the disposition of an asset from the firm’s resource portfolio and the associated factor market transfer of that resource to another firm in the industry” (Moliterno and Wiersema, 2007, p. 1065). Moliterno and Wiersema (2007) also argue that resource divestment is an organizational capability comprising a two-stage process: the focal firm’s motivation to divest, and then the decision about which resources to divest. That is, divesting encompasses the process by which firms shed resources associated with their non-core areas and transfer them to the strategic factor market to create optimum value. If they divest less valuable resources, firms might acquire more valued resources from strategic factor markets (Berry, 2010; Sirmon et al., 2007). Thus, resources that are abundant, less profitable, and related to offshorable business processes can be divested.

Firms also must determine if it will be profitable to seek outsourcing contract services for redundant support functions or sell them as an aggregate unit (Østbo et al., 2010). Divesting can instantly reduce operating costs, increase financial capital, and erase non-performing assets from the balance sheet, without sacrificing any competitive advantage. Indeed, a recent trend by the offshoring firms has been to divest their non-core captive centers to the top BPO players in exchange for better outsourcing rate and long term contracts. In 2008 Citibank sold its Indian back-office business to TCS for around $505 million and Citi Technology Services for around $127 million to Wipro. These transactions were coupled with the assurance of $3 billion business to TCS and Wipro. In a win-win situation, the Citigroup benefited from freed-up financial resources that were tied with their non-core business.

Thus, divesting profitably offers both an opportunity (Berry, 2010; Nees, 1981) and a value-creating capability. However, divesting alone cannot create value, which instead demands subsequent refocusing of crucial resources in core areas.

4.2.3. Refocusing

As a process of allocating freed resources to the most vital areas of core competencies, refocusing primarily has been discussed at the corporate level: Companies with unrelated businesses under their corporate umbrella might attempt to regroup related business units to gain synergistic benefits (Bigley and Wiersema, 2002). The underlying logic is that regrouping supports increased coordination, helps the focal firm narrow its strategies, and sets clearly defined goals (Rondi and Vannoni, 2005). It also helps the firm concentrate its effort on what it does best, such that the firm may benefit from superior resource alignment in
its core revenue-generating areas (Berry, 2010; Lahiri et al., 2012). Redeployment also leads to more efficient usage of scarce resources, which is crucial for long-term growth prospects.

5. Value creation in the location-specific resourcing stage and associated contingencies

Offshore outsourcing, compared to domestic outsourcing, creates unique challenges due to cultural differences, geographic distance, and/or language barriers between the client and vendor countries (Lahiri and Kedia, 2011; Larsen et al., 2012). Furthermore, time zone differences and specific institutional features of offshore countries, such as their infrastructure, security, political conditions, or intellectual property regulations, must be taken into account in offshore outsourcing arrangements (Brown and Wilson, 2005; Graf and Mudambi, 2005). Client firms need relationships with a wide range of organizations and individuals, including local employees, suppliers, intermediaries, banks, and governmental institutions. They also need to transfer management methods and values, decide on appropriate arrangements for organizing their business activities, and adapt their organizational structures and processes.

All of these challenges are location-specific, because they arise only when the offshore vendor is located in a country or geographical region different from that of the client. We note three location-specific value-creating capabilities and resource management processes of offshore outsourcing firms that may help firms surmount these location-specific challenges.

5.1. Locating

The geographic distribution of firm’s processes, defined as the extent to which a firm’s value chain activities spread and coordinate across country boundaries, determines its geographic scope. The main attraction of a greater geographic scope through offshoring involves the availability of low-cost inputs and talent, exposure to new markets, and benefits from location-specific advantages (Kumar et al., 2009; Liesch et al., 2012). Moving offshore may facilitate firms’ ability to understand the business environment and establish their presence in foreign markets. In a global economy, few firms can neglect major outsourcing destinations (e.g., India, China), which provide rich resources, cheap labor, and growing product markets. For example, Dell has no manufacturing base in India, but it enjoys major brand recognition because of its India call center operations. Dell’s growth in India thus has been significantly greater than the industry average. A shortage of suitable talent in the U.S market and increased restrictions on hiring foreign talent have also contributed to offshoring of activities to locations with superior talent base (Manning et al., 2008). A limited talent pool implies that firms may have difficulty retaining global talent as “talent poaching” and salaries increase quickly.

However, these benefits might be overshadowed by the risks of doing business in a foreign environment. A lack of physical infrastructure, labor quality, distance (i.e., language, culture, legal, time), and the political environment all can counter the advantages of wage differentials and highly available labor pools. The risks of unstable government, taxation or regulation policy shifts, or even outright expropriation may require the firm to seek safeguards of its service sourcing from the host country vendors. Thus, a client firm needs to understand which location is best for each kind of activity. Moreover, companies need to take a long-term view on their choice of location, because moving would be expensive from any perspective.

The complex location decision depends on various factors: Client companies from Western Europe often prefer eastern European countries over India, China, or the Philippines as offshore destinations because of their time zone advantages. Client companies also might divide the task and distribute it to different companies across the globe, such that the completed task relies on a global delivery model. For example, R&D may be located in India, whereas customer support centers appear in the Philippines. The sourcing company has the responsibility of learning the unique attributes of multiple offshore distributions and choosing the correct location, according to each country’s mix of strengths and weaknesses (Vestring et al., 2005). Some firms respond by spreading their foreign operations and offshoring relationships over a broader, balanced mix of regions and countries (Vestring et al., 2005). Accordingly, locating constitutes an important organizational capability that is pertinent to the offshoring process and represents the first step in resource rebranding. Jensen and Pedersen (2011a) provide an example of Vestas, a wind turbine producer from Denmark that highlights the intricacies and interconnectedness of the importance of the location decision. Vestas has R&D centers in Denmark, Singapore, India and the U.S. for different reasons such as access to the latest technological breakthroughs as well as to stay abreast with the market trends in the important markets in China (through a center in Singapore) and the U.S. (through a center in Texas) (see Jensen and Pedersen, 2011a for details).

5.2. Managing global talent

Recruitment, development, and retention of employees are central factors of organizational survival. A focus on people as a source of superior performance has gained notable prominence in offshoring contexts (Kenney et al., 2009). In particular, recruiting, developing, and retaining global talent are important for location-specific rebranding (Manning et al., 2008). These global talent management capabilities should allow the offshore outsourcing client companies to manage their global talent in multiple locations, find and integrate human capital in new locations, and collaborate with external partners worldwide. In short, these organizational capabilities support companies’ uses of human capital, which may not be confined to a single process or provider but instead could span multiple processes and providers simultaneously.

Selecting the best offshore service provider from a set of pre-identified ones and preparing the best contract or service level agreements are two significant organizational capabilities (Mayer and Argyres, 2004). The focal firm must actively evaluate the credentials of its selected provider, including past performance, reliability, trustworthiness, resourcefulness, and market reputation.
The contract preparation should address the inclusion of relevant clauses that ensure it is balanced, complete, and at the same time flexible enough to accommodate future contingencies (Barthélemy, 2003). The risks of improperly executed outsourcing moves are vast, including “hollowed out” corporations, loss of strategic intent, loss of an existing knowledge base or organizational learning, loss of employee morale, reduced organizational innovation, and lack of control over outsourced activities (Barthélemy, 2003; Hoetker, 2005). In turn, the focal firm must also ensure that its requirements are clearly understood by the service provider. Moreover, it should acquire thorough knowledge of the provider’s capabilities, to avoid unforeseen deviations from the contract (e.g., delay in supply, degradation of supply quality) and ensure that the client receives its desired value from this strategic relationship (Feeny et al., 2005).

Developing and retaining global talent is the next resource management phase. We assume that the independent service provider is mainly responsible for managing its talent, but the client firm still must ensure the transfer of best practices with regard to the development and retention of employees. Turnover rates in emerging economies tend to be very high. In India for example, a recent estimate suggests that a 25% difference in the turnover rate equates with a million-dollar organizational expense to replace professional workers for every 50 positions in a company (Doh et al., 2011). Appropriate performance management and reward systems should be in place to get the best out of global talent (Tymon et al., 2010). In short, we maintain that locating, recruiting, developing, and retaining capabilities all are important value-creation elements of location-specific rebundling.

6. Value creation by leveraging externalization and associated contingencies

Learning from external partners generates both proximate and distal benefits, such as improving productivity, incremental innovations, and particular dynamic capabilities that consistently improve competences in stable environments by increasing the efficiency of knowledge searches, absorption, and combination (Mudambi and Tallman, 2010). In alliance management literature, an external partnership leveraging capability has been identified as a source of competitive advantage (Dyer and Singh, 1998; Kedia and Lahiri, 2007). We argue that three distinct resource management processes are involved at this stage: coordinating (Sirmon et al., 2007), collaborating, and transforming (Kedia and Lahiri, 2007). That is, the success of an externalized offshoring relationship is contingent on an effective coordination effort, a successful collaboration between the client and the service provider, and the transformation of knowledge generated through their co-specialization.

6.1. Coordinating

International business literature has long recognized the importance of coordination mechanisms for multinational companies (Kogut and Zander, 1996; Martinez and Jarillo, 1989). Coordination aims to integrate acquired capabilities from the offshore partner effectively and efficiently to create internal capability configurations for the focal firm. Proactive coordination involves combative, experienced-based routines for integrating capabilities to implement a subsequent leveraging strategy effectively and thus create value for customers, as well as for the focal firm (Sirmon et al., 2007). The effective coordination of capabilities encourages knowledge exchange between two parties that help the focal firm to better integrate capabilities into effective configurations (Sirmon et al., 2007). For example, companies such as Accenture, SAP, Emerson, and IBM, have established “global innovation networks” as coordination entities that help promote knowledge sharing among R&D labs and local teams in countries such as India, France and Germany (Manning et al., 2008).

What kind of knowledge should be coordinated though? The offshore outsourcing of business process/IT or knowledge services often involves colocation of the service provider’s staff with the focal firm’s in-house employees, including project managers from each side, who must interact to ensure the resultant services are complements and fit the clients’ business requirements. Outsourced IT services that do not complement the rest of the client’s IT system or fail to meet the client’s business needs add little value; in the worst case, they even might destroy the value of the client’s IT system (Hui et al., 2008).

A client might transfer its application domain knowledge to the vendor, including knowledge about the business processes and the user information needs, to be reflected by the software application. Moreover, the vendor should gain a solid understanding of the client’s existing technical infrastructure, including source and target applications of the software application to be developed or maintained. Having adopted the necessary client domain knowledge, the vendor could specify major functional requirements and perform the design, coding, implementation, and testing stages. Alternatively, the client could perform the majority of the requirement specification (or even its design). For instance, Tata Consultancy Service (TCS), a well-known offshore service provider tests thousands of automobile engine components by using computer generated models, and suggests design improvements to one of the largest Detroit-based automobile company (Economist, 2013).

Both these activities require the client to invest time, effort, and resources to support transfer of knowledge and specification. Accordingly, these complementary procedural coordination strategies likely need to be balanced in any offshore outsourcing of application development and maintenance (Mirani, 2007). Typically the parties agree to a transition phase, during which key vendor personnel move onshore for a period to support the transfer of knowledge from the client to the vendor (Mirani, 2007).

Effective coordination also demands advanced technologies that allow for free-flowing exchanges of information, ideas, and best practices to and from the client and the offshore firm. Coordination of value-adding activities across the globe helps the focal firm exploit its location-specific comparative advantages and achieve offshoring objectives (Hatonen, 2009; Mudambi and Venzin, 2010). The coordinating capabilities (i.e., sharing information and strategic integration of geographically dispersed knowledge) then can be conceptualized as organizational capabilities that provide the focal firm with a value-creating market advantage.
6.2. Collaborating

Closely related to the notion of coordination is the concept of collaboration. Collaboration captures the need for relationship integration “for partners to combine resources and integrate their activities in the course of undertaking a joint task” (White and Lui, 2005, p. 914). The importance of collaboration and the establishment of close relationships based on trust also has been stressed by various scholars (Kedia and Lahiri, 2007; Kedia and Mukherjee, 2009; Manning et al., 2008). The benefits of close collaboration between a client and partner firm are many. For example, Darr and Kurtzberg (2000) find that strategic similarity between partners is even more important than customer or locational similarities for predicting knowledge transfer. Agency theory describes partner alignment as a means to reduce agency costs in contractual relationships, and transaction cost economics asserts that better alignment between partners can lessen the transaction costs associated with monitoring and coordination (Williamson, 1999).

The importance of collaboration is particularly salient in offshore outsourcing, which suffers high threats of opportunism in the form of shirking, data leakages, loss of control, or performance measurement difficulties. In such situations, informal contracting mechanisms, such as trust and relationship specificity, can serve as safeguards. Direct performance monitoring is easier in captive offshoring deals, when the client firm has more control. In third-party offshoring though, service providers often refuse to allow the client firms to exercise such control over service delivery (Manning et al., 2011). Thus traditional monitoring mechanisms give way to informal incentive alignment mechanisms, such as longer and more flexible contracts or frequent interactions with various boundary spanners. Such involvement also allows the service provider to develop a solid, client-specific expertise.

6.3. Transforming

Offshoring partnerships can be important conduits of organizational learning for focal firms (Kedia and Lahiri, 2007). The combined importance of both partners and their learning scope can generate outcomes that are transformational in nature. Research has highlighted the importance of such partnership-based learning in the context of strategic alliances, joint ventures, and other types of interorganizational relationships (Hatonen, 2009; Jensen, 2009). Moreover, when offshoring firms search for the best service providers, through negotiations with potential partners, they learn more about the industry-specific needs and the environment, which should help them compete. We argue that through offshoring and externalization of non-core activities, client firms also can achieve business transformation (Linder, 2004). Resources or capabilities acquired externally also can become valuable when combined with the skills and knowledge of workers and other internal resources (Kogut and Zander, 1992). If these combinations point to new uses for previously existing resources, they could be a source of economic rent.

Offshore service providers often possess innovative talents and world-class service delivery models. The world-class delivery model of offshore outsourcing providers also benefits clients that receive focused solutions, especially with compressed delivery timeframes. Tata Consultancy Services (TCS) as a service provider is a case in point. It has six R&D labs (Engineering & Industrial solutions, Insurance, Telecom, Travel & Hospitality, Retail, and IT). TCS has 72 patents and more than 800 applications pending (Tata Consultancy Services, 2012). Furthermore, these providers specialize in certain activities that are continually externalized to them. Their competencies include in catering to a wide array of services related to audiovisual connections, business, computers and allied areas, higher education and training, finance, health, or various other professional services (Kedia and Mukherjee, 2009). Accordingly, they invest heavily to recruit suitable talent and give them the required business skills, such as effective communication, negotiation, leadership, team-building, technology, and business analysis, through in-house or overseas training (Lahiri et al., 2012). The offshoring firms benefit from this high-end skill base, collective domain expertise, and industry-specific knowledge, which can produce integrated, innovative solutions. Such resources help clients initiate rapid improvisational changes or achieve turnarounds in failing businesses.

Software giant SAP’s co-innovation labs are a case in point. To drive benefits from engaging external partners, SAP made promoting co-innovation as one of the key pillars of its growth strategy in 2007 and set-up ‘co-innovation lab initiative’ in 2007. The idea was to set-up dedicated facility within SAP Labs to offer an environment in which ISVs, system integrators, and technology partners could work with SAP and with customers on new technologies. The first co-innovation lab facility located inside SAP Labs Palo Alto opened in June 2007 with Cisco, HP, Intel and NetApp acting as founding sponsors and committing substantial resources to the initiative. Such advantages related to working closely with external partners have helped these labs to become centers of strategic growth (SAP, 2007). Thus, transforming current capabilities and creating new ones from current resources is the last phase of resource management in offshore outsourcing.

7. Discussion

7.1. Implications for research

This analysis expands understanding of value creation processes in offshore outsourcing by focusing on the internal resource management processes of focal firms and external environmental contingencies at each resource management stage. Situated within the language of organizational design (Karim, 2006, 2009; Srikant and Puranam, 2011) our framework suggests that effective resource management is critical to the process of value creation. In addition, we note external factors that influence the strategic resource choices of offshoring firms. The framework identifies sub-processes involved in each resource management stage. Thus, our analysis clarifies the conditions in which resource choices made by firms are likely to succeed or fail.
We thus contribute to extant literature in several ways. First, our paper explores a relatively underdeveloped, implicit, important question pertaining to offshore outsourcing: How does offshore outsourcing create value? Answering this question is important, because it relates directly to firms’ performance. In addition, this issue has significant political, corporate, and societal implications. Several researchers have addressed the question somewhat inadvertently (Doh, 2005; Farrell, 2005; Kotabe and Mudambi, 2009; Liesch et al., 2012); perhaps offshore outsourcing can even create value for the national economies through significant economic changes (Farrell, 2005). Lahiri et al. (2012) also indicate that offshore outsourcing creates immense economic benefits for offshore service providers.

Second, framework has crucial implications for organization design and reconfiguration literature. The resource restructuring stage involves the disruption of the existing configuration of resources. It includes the evaluation of the activities as to what extent they are interdependent and also entails the decision on what activities can be fine sliced and dispersed. Tightly-coupled sticky activities that are often tacit, intangible and ambiguous (Kumar et al., 2009) are likely to remain collocated. Such knowledge intensive sticky activities are only offshored when the focal organization invests significantly to reduce the stickiness through frequent information sharing, investing in bridging technology and increased cross-cultural training of relevant personnel or by traveling physically to the offshore location (Kumar et al., 2009). Next, activities and associated resources that are considered obsolete or adding very less value are divested. The last step at this stage involves refocusing resources to support important tasks or activities. From a reconfiguration perspective the focal firm gets itself reshuffled from a tightly-coupled position to a loosely-coupled one, adds or deletes appropriate resources and gets back to a tightly-coupled position. Resources that can support the offshored processes in future are often identified and retained at this stage.

The location-specific resourcing stage involves selecting, recruiting and retaining global service providers or human talent. Thus, at this stage, the internal and external value chains of a firm are reconfigured to suit the new design of orchestrated system (Kumar et al., 2009; Larsen et al., 2012). The focal firm attempts to account for the increased configurational complexity both structural and operational (Larsen et al., 2012). Larsen et al. (2012) argue that when an activity or a process is offshored it creates new interdependencies among organizational units and also among newly created fine sliced processes that are now located across country borders. Firm-specific capabilities discussed in our framework are responsible for managing these new set of complexities and remain flexible at this stage. Finally, the leveraging externalization stage entails managing social complexity that arises from lack of physical interaction, trust, and other differences such as culture, language between the client firm and the offshore vendor (Larsen et al., 2012). At this stage it is also important for the client firm to reintegrate the knowledge resources created by the external partner. Thus, from an organization design perspective the focal organization attempts to recombine its newly acquired external resources to produce new knowledge solutions. The capabilities we identify at this stage—coordinating, collaborating, and transforming help overcome the configuration complexity issues under such conditions. Our analysis also extends the strategic resource management and resource orchestration framework to the realm of offshore outsourcing.

Finally, this analysis systematically integrates apparently diverse but inherently related literature streams: the organizational design perspective, resource management/resource orchestration framework, and the recently introduced DLE framework. In addition we also situate our framework within a broad contingency theory of firm which argues that organizational value creation is enhanced by an external fit between its task environment and the design of its internal structure (Chandler, 1962; Lawrence and Lorsch, 1967). In fact, the organizational design literature was largely triggered by Chandler’s core thesis that an organisation’s environment shapes its strategy and economic inefficiency results from a mismatch between organizational structure and strategy. The works of Lawrence and Lorsch (1967), Thompson (1967) suggest that organizational value creation is largely contingent on its ability to achieve a fit between its internal structure and design and the changing external demands (Sinha and Van de Ven, 2005). Our framework suggests that to create value, focal firms must make effective resource choices or arrangements at each stage. However, we also emphasize that although resource configuration processes are internal in nature, they are constant interaction with an offshoring organizations task environment and such environmental contingencies affect firm-specific resource choices. A fit between these environmental contingencies and internal resource configuration is important for value creation.

To assess the effectiveness of the resource management framework we presented above, it would be important to empirically test its different components. Extant literature offers some guidelines on how to operationalize different components of the resource management framework. In Table 1, we present a summary of different measures which can be adopted with little or no modification. Some of these measures, such as relative change in investment in R&D and marketing activities (Kor and Mahoney, 2005) can be derived from secondary sources, while others need to be collected through surveys. In addition, some recent studies have operationalized focal firm value creation by measuring offshore outsourcing performance (e.g., Martinez-Noya et al., 2013). Partner firm value has been measured by Lahiri et al. (2012). New scales need to be developed to measure customer value.

The challenge in designing a survey to test our framework is that the psychometric properties of some of the scales are not well established. This would mean that researchers may have to first conduct smaller pilot studies to assess the reliability and validity of scales, followed by large scale surveys to collect the data for empirical testing. As the field progresses, there is going to be a greater critical mass of studies and a greater availability of instruments to conduct more empirical studies in this domain.

7.2. Implications for managers

Our analysis has several implications for managers of focal firms that participate directly or indirectly in offshore outsourcing. First, our framework offers guidance for managers and organizations regarding how they should manage their resources during offshore outsourcing processes. Second, we identify specific environmental factors that appear associated with the offshore outsourcing decision-making processes. We stress, in particular, the internal facilitators that may help overcome the potential challenge of
uncertainties. For example, operating managers and employees should obtain a sophisticated understanding of the link between their own employees and offshore vendors or human capital to accrue long-term benefits for both partners. In so doing, organizations and individuals can develop collective trust, which is conceptually similar to other types of shared resources. Developing various organizational systems also can help managers and employees overcome potential barriers to trust—such as an organizational culture that supports trust orientation, frequent interactions of key boundary spanners with the offshore service provider, and so on. Firms also might provide training and educational opportunities to enable and enhance employees’ communication behavior. Training and development opportunities should enhance managers’ competencies, skills, and capabilities, especially in the areas of shared leadership, contract management, performance management, unambiguous communication, and absorptive capacities. As managers increase their specific relationship management skills through training and development, they are more likely to initiate and exercise those abilities to the benefit of offshore outsourcing initiatives.

Finally, effective resource management provides a source of competitive advantages (Helfat et al., 2007; Sirmon et al., 2007, 2011). Environmental and competitive pressures push organizations toward flatter and nimble core structures with multiple external partnerships. Organizational researchers in turn have started to put greater emphasis on trust-based interorganizational processes; some scholars even argue that trust-based relational capital offers a source of competitive advantage. Yet these changes can come about only with greater monitoring and control, increased trust between employees and management, or some combination thereof. The limits of employee monitoring mean that high levels of mutual trust between client managers and offshore employees likely are critical to the success of offshore outsourcing efforts. Companies that anticipate and implement these changes, designing their organization and encouraging their managers to initiate and establish collaborative relationships, will be well positioned for the future to exploit the benefits of offshore outsourcing.

8. Conclusion

It is noteworthy that most prominent offshoring destinations (e.g., India, China, Philippines, and Russia) are emerging economies, with relatively weak institutional frameworks, inefficient legal systems, poor intellectual property right protections, and weak contract enforcement. The externalization and creation of value in such environments thus requires the effective management of resources by client firms. In knowledge-based economies, innovation and learning are vital for value creation. Myriad researchers have pointed out that firms develop strategies based on their core knowledge and capabilities but also work to restructure, rebundle, and leverage their external partnerships to create further value in dynamic environments. These processes—or strategic resource management—are essential for enhancing the firm’s core knowledge base and creating new value. By drawing logical connections to strategic resource management literature and DLE perspective positioned within the language of organizational design, we derive a nuanced analysis of how firms can strategically manage their resources to create new value through the offshore outsourcing. We hope that the analysis presented here represents a step forward in understanding this important topic.

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