CHAPTER 2

LITERATURE

REVIEW

2.1 Definitions and dimensions of outsourcing

The term outsourcing, offshoring and offshore outsourcing have been interchangeably used and extensively discussed in many literatures but the fact remains that it is often less clearly understood or even misunderstood by many. Offshoring or offshore outsourcing can be defined as "outside a country's boundary" (Monczka and Thomas, 1995), "not domestic nor a border country" (Shamis et al., 2005), "remote, low cost locations" (Robinson and Kalakota, 2004) or even "outside the continent" (Lowson, 2001). There are also other broad definitions such as geographical relocation of business abroad, irrespective whether or not such functions continue to be performed by a subsidiary of the firm, or are contractually outsourced to an independent party (Prasad and Prasad, 2007).

While it may be defined differently by various literatures using a variety of syllabus, the common underlying word seems to be "boundary". To differentiate between outsourcing and offshoring, boundary spanning business functions of an organization (in house vs. outsourcing) or geographic scope (domestic vs. foreign location) where the business activities are to be performed (Domberger, 1998) can be used. Simply put, offshoring occurs when organizations transfer jobs that have been traditionally worked in their home country (Stack and Downing, 2005).

Basically offshoring business models can be classified into three types which are "captive offshoring", "offshore outsourcing" and "offshore development centers" (e.g., Jahns et al., 2006). When an organization sets up its own subsidiary abroad to produce products or services primarily to gain control of its business activities and capitalise on cheap labor and human capital, it is called “captive offshoring”. Most large multinational firms usually opt for this option where they set-up subsidiaries in emerging markets such as India and China. When an organization delegate or transfers its recurring internal business functions to a third party (Vendor or Service Provider) in a foreign country who specializes in the function, it is called “offshore outsourcing” (R.(R.)G. Javalgi et al.,2009). This option is mainly chosen to create value through low cost and free up capital to be used in other critical areas (Tayles and Drury, 2001). New companies mainly find this option beneficial as it allows them to concentrate on their core competencies and provide sustained cost savings. “Offshore development centres” are mostly joint ventures and most commonly found in the software industry (Robinson and Kalakota, 2004). This option retains a higher level of control with the client firms and it is crucial to find the best fit of Vendor (*also interchangeably used as Service Provider throughout this paper*) to meet the exact business needs (Foster, 2006).

2.2 Evolution of outsourcing practice

Historically most companies in almost all the industries were vertically integrated or more commonly known as conventional industrial organizations (Stigler, 1951) where all the value chain activities were completed internally within the organization. A classic example would be 7-Eleven that used to deliver its own gasoline, make candy and ice on its own and even owned cows to produce milk which is then sold to customers (Gottfredson et al., 2005). The 7-Eleven that is seen today is a far cry from the one that has just been described. There are many other companies that would fit the above description. These changes did not occur overnight but grew in small phases over a period of time.

In the book called “The Outsourcing Revolution”, Corbett (2004) describes outsourcing as a phenomenon that is not new but one that has skyrocketed in recent years. According to him, it not only gathered momentum in terms of volumes but also grew in terms on its importance as a strategy to the overall business objectives. Corbett (2004) had identified three broad and overlapping phases of outsourcing development: the era of Big Bang, the era of Bandwagon and the era of Barrierless Organizations.

The first phase of outsourcing called “the era of Big Bang” typically explains the way it gained momentum and popularity. It happened with a ‘big bang’ and with such a high intensity. The concept of outsourcing was initially used by manufacturing firms in the late 1970s (Corbett, 2004) before it was officially introduced. One decade later it was referred by Harvard Business Review as one of the great management ideas of the past century (Sibbet, 1997). Although the history of outsourcing as a corporate strategy can be traced back to the 1950s (Dibbern et al., 2004; Quinn and Hilmer, 1994), it only became a prominent viable business strategy towards 1980s especially when organizations started farming out call centres and other service-oriented operations (Lacity and Hirschheim, 1993). The first wave of outsourcing which lasted until the end of the 1980s witnessed organizations outsourcing non-core business processes and the main objective was to reduce costs. All outsourcing meant at that time was a means to achieve cost efficiency for profit maximization. Most of the outsourcing activities occurred domestically at that point of time.

During the 1990s, outsourcing started gaining momentum (Morgan, 1999) as the positive outcomes which were experienced by the early birds who adopted outsourcing prompted many other organizations to adopt the same (Lacity and Hirschheim, 1993). This era was known as “the era of bandwagon” as more and more companies adopted outsourcing and joined the ‘bandwagon’. Hamel and Prahalad (1990) introduced a new management thinking replacing the Strategic Business Unit (SBU) concepts which prompted many managers to rethink and re-evaluate their competitive edge. This resulted in many companies to begin outsourcing functions that are not their area of expertise. Seeking external skills, competence and knowledge sidelined the sole need to achieve cost efficiency through outsourcing. A new word called ‘strategic outsourcing’ emerged (Alexander and Young, 1996b; Quinn and Hilmer, 1994). Organizations started stretching their boundaries to gain competitive advantage and started building closer relationships with the Vendors. New management ideologies “focus on your core competence and outsource the rest” (eg. Porter 1996) gained popularity and organizations started viewing international resource pools for competitive advantage.

In the new millennium, outsourcing became a norm rather than an exception (Lawton and Michaels, 2001). Global access to vendors, reducing interaction costs and improvement in information technology and communications further provided avenues and possibilities for companies to restructure their businesses (Doig et al., 2001). This led to the current phase in outsourcing called “the era of Barrierless Organizations”. Another new word called “Transformational Outsourcing” became popular and created radical business models that are able to generate competitive edge to firms and change the rules in the industries (Engardio, 2006). While ‘traditional outsourcing’ is about reducing costs and ‘strategic outsourcing’ focuses on acquiring capabilities which organizations are lacking, ‘transformational outsourcing’ is all about changing the paradigm such as targeting a new adaptive enterprise (Linder, 2004; Linder et al., 2002; Mazzawi, 2002). Outsourcing today has evolved to a stage where firms can achieve operational efficiencies and flexibility without incurring the costs associated with bureaucracy. It has changed the way businesses operate in the global market and restructured many industries (Quinn, 2000) bringing various challenges as well as opportunities with it.

2.3 Drivers of outsourcing

Existing literatures have identified many reasons which drive businesses to embark on outsourcing initiatives. Generally these drivers can be classified into two major categories as internal and external drivers. In this research, we have termed the internal drivers as the ‘pull factors’ as these reasons normally motivates and pulls businesses to adopt outsourcing strategies whereas the external drivers have been termed as the ‘push factors’ as these factors not only spurs the growth but also accelerates the pace of outsourcing strategies globally. The external drivers are beyond the control of any organization and the changes are bound to take place whether it is desired or otherwise.

2.3.1 Internal drivers – the 'pull factors'

According to Fisher et al. (1999); Heikkila and Cordon (2002), outsourcing drivers refers to the motivation, objectives and goals of an organization's outsourcing efforts. These drivers often relate to the supply chain processes and activities which are normally re-evaluated and restructured to gain competitive advantages. Hence organizations embark on outsourcing strategies to gain and sustain a competitive advantage and most often than not, competitive strategies such as cost leadership, differentiation and focused provider (Porter, 1980) are usually the most common drivers. These competitive strategies are translated into competitive priorities through operational action plans (Hayes and Schmenner, 1978). Competitive priorities are in essence the business objectives and goals (Koufteros et al.,2002) with the most common ones being cost, time, innovation, quality and flexibility (Leong et al., 1990; Ward et al., 1998). These competitive priorities can be classified as internal drivers. In other words, these are the very reasons which motivate an organization to adopt outsourcing initiatives. In fact this has been a widely researched area where many researchers have argued that the need for organizations to be more flexible, leaner and focused in their core competencies to stay competitive have also driven them to opt for outsourcing strategies (Achrol, 1997; Jacobides, 2005; Schilling & Steensma, 2001). In line with this, another research concluded that structuring of an organization should be compatible with the design of its value chain (Dess, Rasheed, McLaughlin, & Priem, 1995; Porter, 1980; Prahalad & Ramaswamy, 2004) which will eventually generate value not only for the organizations but also the customers. This was very aptly described by Achrol:

Large-scale downsizing, vertical disaggregation and outsourcing, and elimination of layers of management have gutted the mighty multidivisional organizations of the 20th century. Replacing them are leaner, more flexible firms focused on a core technology and process, laced in a network of strategic alliances and partnerships with suppliers, distributors, and competitors. The magnitude of the socioeconomic change that network organization portends may be as great as the Industrial Revolution. (1997, p. 56, 57, 61)

In another related study, B.L. Kedia and D. Mukherjee (2009) identified a DLE framework which was concluded to drive outsourcing. DLE generally stands for disintegration-related advantages, location-specific resourcing advantages and externalization advantages. They have attempted to answer the question on “why firms embark on the practice of offshoring?” using the DLE framework. According to their research, disintegration-related advantages allows an organization to focus on their core competencies which brings forth the ability to innovate, allows superior capabilities through resource allocation and increased quality of products and services. It also paves way for advantages related to modularity such as increased speed, flexibility and reduced cost. On the other hand, location-specific resourcing advantages refer to infrastructure, governmental policy and human capital competencies which will be discussed further under external drivers. The final advantage is externalization which primarily refers to advantages related to relationship capital, co-specialization and mutual organizational learning. B.L. Kedia and D. Mukherjee (2009) concluded that these are the primary reasons for an organization to embark on outsourcing. Again, these advantages have to be related back to the underlying need and 'pull factors' which drives an organization to adopt outsourcing in the first place.

While it is undeniable that the factors which were discussed thus far motivates and drives organizations to embark on outsourcing, the question remains if there are other drivers which spurs and promotes the growth of outsourcing at a macro level.

2.3.2 External Drivers – the 'push factors'

Globalization has often been connected to the growth of outsourcing. In fact, the revolution of outsourcing, especially offshoring have proven that globalization has been a key factor in promoting the rapid growth of outsourcing. As such, while organizations have a 'pull factor' within them to embark on outsourcing strategies such as the internal drivers, it is apparent that there is a 'push factor' existent that has spurred and continuously promotes outsourcing. These can be classified as external drivers such as globalization, technology, economic, political, social and legal aspects of a country as well as the environment or more specifically hypercompetition.

Globalization opened the doorway for many organizations to venture into other markets from various different countries as a growth strategy and to achieve higher efficiencies. It is very common to see the more established companies to gain entry into emerging markets. This was also facilitated by the technological advancement which made it easier for organizations to operate in various different locations to that of their home country.

Corbett (2004) argued that technology makes it possible to separate various organizational activities across geographic space. Therefore globalization coupled with technology advancement has made it possible to obtain human capital anywhere and anytime thereby facilitating offshoring activities (Lewin, 2005). Even the cultural and geographical challenges are easily overcome through technology. This has encouraged many businesses to disintegrate their functions and increasingly adopt outsourcing (McLaren, 2000).

Major economic changes or reform were also evident in emerging countries such India, China, Russia, Hungary, Middle East, etc, who willingly opened their markets to more established countries (Kedia, Lahiri, & Mukherjee, 2006). These emerging markets have abundant human capital which are untapped and can be leveraged to gain huge competitive advantages in terms of cost, skill, labour, knowledge, etc. Many literatures have supported this and one of the most recent one being B.L. Kedia, D. Mukherjee (2009) who identified four external drivers of outsourcing which are globalization, technological advancement, liberalization of economies and hypercompetition. They concluded that these macro-environmental drivers led to changes in a firm’s strategy and thus resulting in the disintegration and unbundling of value chain activities that promotes offshoring.

Another related study by Mudambi (1995) identified infrastructure, location-specific risk and government policy as crucial factors that facilitate outsourcing. K. Bunyaratavej et al (2008) found that infrastructure (which includes physical infrastructure and human capital) and location specific factors are more crucial drivers to any outsourcing initiatives compared to government or legally related policies. The study argued that while government policies and legal barriers may pose a challenge to outsourcing initiatives, it is more relevant to attracting foreign direct investment (FDI) rather than being an actual barrier to outsourcing decisions by business across the globe. Hence the primary drivers that spur outsourcing are infrastructure and location as these are tied closely to the business objectives and motivations which are the internal drivers at a micro level. However the importance of political-legal conditions cannot be undermined as they do have some influence over outsourcing decisions to an extent. Labour concerns, taxation, competition laws (Hitt et al., 2002), trade barriers and quotas (Stack and Downing, 2005) does play a role to encourage and promote offshore outsourcing as cross-border activities are made much easier.

Socio-demographic factors such as age structure, population size, educational level and workforce motivation are also seen as the driving factors (C. Jahns et al., 2006). The workforce in the emerging markets has higher education level with good language command and skills (Thondavadi and Albert, 2004) which make it easier for cross-border knowledge transfer. In fact, businesses in the developed markets (i.e. the Clients) are able to leverage on the knowledge and skills of the workforce in the emerging markets and thus capitalising on process innovations which they lack in the host country (Kotabe, 1990). Even the population in emerging markets are driving more and more businesses to adopt outsourcing for sustainability as they have a growing number in young workforce compared to the increase in ageing population in developed countries (Robinson and Kalakota, 2004).

2.4 Efficiencies derived from outsourcing

The focus of many literatures in the past has been to answer the primary question of "why businesses embark on outsourcing?" Many of these literatures relate the decision to outsource to internal (Fisher et al., 1999; Heikkila and Cordon, 2002) and external drivers (B.L. Kedia, D. Mukherjee, 2009) as well as efficiencies gained from outsourcing (J.R. Kroes, S. Ghosh, 2010). There is a very thin line separating the drivers and efficiencies derived from outsourcing. In fact, both these terms have often been confused to mean the same. While drivers are often the motivating factors which influences businesses to embark on outsourcing, efficiencies are the advantages that are derived by adopting outsourcing strategies. It has been established earlier that drivers are factors such as the objectives, motivation and goals of an organization to gain these efficiencies through outsourcing efforts related to its supply chain processes and activities (Fisher et al., 1999; Heikkila and Cordon, 2002).

Efficiencies or advantages of outsourcing is a widely researched area and has many facets to it. Past literatures have looked at the efficiencies from many different perspectives such as the economic and organizational theories (C. Jahns et al., 2006; Dibbern et al. 2001), DLE aspects consisting of disintegration-location-externalization advantages (B.L.

Kedia, D. Mukherjee, 2009) and the congruence between outsourcing drivers and competitive priorities (J.R. Kroes, S. Ghosh, 2010) among others.

While there are many theories which can be related to outsourcing efficiencies, based on the existing literates the most prominent ones are the transaction cost economics, the resource based view and knowledge based view theories.

Transaction cost economies (TCE) theory introduced by Coase (1937) and developed by Williamson (1975) assumes that transactions are determined by production economics and organizations are economic actors using the most efficient mechanism for transactions (Williamson, 1981). It fundamentally explains that organizations adopt governance structures to minimise transaction costs (Williamson, 1975, 1985). It predicts that when the size of the overall organization gets smaller due to outsourcing efforts, there will be an overall reduction in the required transaction costs (Holcomb and Hitt, 2007; Schniederjans et al., 2005). Therefore this theory suggests that cost efficiencies can be gained through appropriate governance structures for handling its transactions (Tsang, 2000).

The resource based view (RBV) theory focuses on gaining competitive advantage by acquiring, exploiting and developing strategic resources. These resources can be physical resources (such as plant, technology, equipment, access to raw materials, etc.), human resources (training, intelligence, judgment, insights, etc.) or organizational resources (administrative or management systems, planning processes, etc.) (Barney, 1991) and it enhances the value creation potential of a particular organization (Wernerfelt, 1984).

Knowledge based view, on the other hand focuses on the knowledge set as a core capability that differentiates one group from the other and thus providing a competitive advantage (Leonard-Barton, 1992). Knowledge set can comprise of employee knowledge or skills, technical or managerial systems, norms and values (J.R. Kroes, S. Ghosh, 2010) which an organization can capitalize to develop and sustain competitive advantage.

There are also other literatures which identified cost savings as the primary efficiency derived from outsourcing activities (Casale, 2004). Most often than not, the cost competitiveness can be improved by restructuring the supply chain activities where unproductive activities can be eliminated and therefore reducing costs. It also allows resources to be focused on core competencies and ultimately lowering the overall costs (Gottfredson et al. 2005; Leonard-Barton, 1992). Bozarth et al. (1998) and Min and Galle (1991) also argued that outsourcing increases economies of scale through new market penetration and thus lowering costs.

Another related study by Frohlich and Dixon (2001) focused on flexibility as one of the efficiencies derived from outsourcing. Changing customer requirements such as demand fluctuations or product characteristics (Schniederjans et al., 2005) require organizations to be responsive at all times (Narasimhan and Das, 1999; Choi and Hartley, 1996; Weber et al.1991). Loh and Venkatraman (1992) also stated that flexibility in an organization also increases the ability to change production volumes as per changing market demands while Lee (2004) advocated on the ability to change supply chain activities.

Innovativeness has also been most commonly identified as one of the advantages of outsourcing. Innovativeness is said to improve when businesses gain access to labour skills and expertise that are not readily available in house (Hoecht and Trott,2006) as well as new technologies (Bozarth et al., 1998; Loh and Venkatraman, 1992).

Quality is another facet which is closely linked to the efficiencies derived from outsourcing activities. The availability of superior expertise from the Vendor can improve the quality performance and/or conformance of an activity in an organization (Schniederjans et al., 2005). In addition to that, an organization may also have the luxury to reassign employees in roles which focuses on quality improvement (Gottfredson et al. 2005; Leonard-Barton, 1992).

Many existing literatures have identified time as one of the key advantages derived from outsourcing. When non-value adding activities are outsourced, an organization is able to focus on core competencies and thus saving considerable amount of time which could result in a more speedy or quick service and performance (Frohlich and Dixon, 2001). Organizations involved in service delivery could also provide speedy response and reduce cycle/turnaround times (Weber et. al.1991) thereby developing a competitive advantage for sustainability.

2.5 Why outsourcing fails?

While the phenomenal growth and success of outsourcing as well as its advantages cannot be disputed, there are growing concerns on the failure to realize these benefits in some organizations. In fact there are literatures and anecdotal reports indicating the failure rates of outsourcing practices. In a study by Deloitte Consulting (Landis et al. 2005), 64% of the respondents stated that they had to bring back in-house the services which they outsourced whereas 44% did not realize the targeted cost-savings. In a related study by Dunn and Bradstreet, approximately 20%–25% outsourcing relationships fail within the first 2 years and approximately 50% fail within 5 years (Doig et al., 2001). In a more recent survey conducted by Deloitte Consulting, 300 business executives felt that there is a need to improve outsourcing practices. There were only a small percentage of these executives who were satisfied with the provider's innovation and this only accounted to 34% of the total respondents. 61% of the respondents indicated that they encountered situation where problems had to be escalated to senior management within the first year (Robinson et al., 2008). In addition to this, 75% of the service providers expressed that their clients were not prepared for the outsourcing strategy and thus often lacked a clear strategy or understanding. Studies have also proven that outsourcing compares poorly when compared to other methods of cost saving such as re-engineering of processes which can generate cost savings over 50% as opposed to outsourcing savings that generally averages between 10% to 15% (Bryce & Useem,1998). Although the study by Bryce and Useem (1998) focused mainly in human resource (HR) functions that were outsourced, the results are nevertheless alarming. In fact more than 30% of HR outsourcing arrangements were not renewed mainly due to the cost savings not being achieved (Geary & Coffey-Lewis, 2002). These findings raises concerns and queries if there is indeed a gap between the expectations and reality of how outsourcing work and its benefits.

Given the fact that outsourcing has emerged as a prevalent business practice it is quite surprising to note that there are failures. Several of the existing literatures have focused on the reasons for the failures of outsourcing as well as the subsequent operational impact. A study by Insinga and Werle (2000) and Quinn and Hilmer (1994) suggests that every organization must develop a thorough understanding of their core competencies and how each of their business activity is related to the overall objectives before they even decide to embark on outsourcing. They further suggest that a thorough evaluation of an organization's current and potential strategic value of their capabilities is an extremely critical aspect of the overall strategic evaluation. In fact a capability evaluation to perform a certain function or activity must be carried out before any organizations decide to outsource (Barney,1991; Dierickx and Cool, 1989; Wernerfelt, 1984).

Quinn and Hilmer (1994) believe that organizations must focus on developing a few of their core competencies internally while the rest could be outsourced. This will in fact free up resources which can be channelled to concentrate in areas that could provide a competitive advantage. In addition to that, capability evaluation must also take into consideration which skills and capabilities could be critical in the near future in order to equip the businesses to be competitive (Eisenhardt and Martin, 2000; Holweg and Pil, 2008). In fact, with the markets being constantly volatile coupled with the ever changing environment as well as the evolution of the global markets, capabilities that are currently non-core could become core in the future (Helper et al., 2000). Therefore the failure of organizations to carry out strategic and capability evaluation has resulted in many incorrect and inefficient decisions relating to outsourcing strategies. Hence many of the benefits have not been realised and some outsourcing efforts have even failed at the very beginning.

Strategic risk assessment is another area where most organizations have failed to a large extent. Strategic risks are risks associated with outsourcing of a business activity. One of the key risks which must be assessed is related to making proprietary information available to external organizations (Kogut and Zander, 1992). An organization must carefully consider the impact of making such information available to external parties as it may have serious repercussion if they were misused for personal gains or not handled in a proper manner. Walker (1988) has termed this as ‘diffusion risk’ while Aron et al. (2005) has called it as ‘poaching’. Another type is risk that could potentially impact any outsourcing initiative is supplier ‘shirking’ or ‘moral hazard’ (Eisenhardt, 1989). This is mainly related to the misalignment of goals between the Client and Vendor as well as the imperfect ability of the Client to observe the actions of the Vendor (Alchian and Demsetz,1972; Aron et al., 2005). The third type of risk primarily borders on the possibility of the service provider behaving in an opportunistic manner due to the absence of a complete contract (Klein et al., 1978; Williamson, 1979). Opportunistic behaviour may include any act which takes advantage of the client or any particular situation for self-benefit not withholding what is stated in the contract. This type of risk is commonly known as the ‘hold-up’ problem (Holmstrom and Roberts, 1998).

The absence of a complete contract has also contributed to the failure in realising the outsourcing benefits. A complete contract normally specifies the promises, obligations and process for dispute resolution (Poppo and Zenger; 2002) while an effective contract will clearly state the expected and agreed Service Level Agreement and Performance as well as penalty and reward structures or benefits which could improve goal alignment between the Client and Vendor, and reduce strategic risks (Alexander and Young, 1996; Barthe´ lemy, 2001, 2003; Lacity and Hirschheim, 1993). An effective contract must also outline coordinating provisions that includes mutual expectations, delineate roles, rules, programs and procedures which will enable both parties to accomplish their collective goals (Mayer and Argyres, 2004; Mellewigt et al., 2007; Reuer and Arin˜ o, 2007). There must also be control provisions which mainly serve to determine and influence what each parties will do (Das and Teng, 1998). It is also intended to make outcomes more predictable (Das and Teng, 1998; Poppo and Zenger, 2002) as well as mitigate the possibility of relational risk associated with an inter-organizational arrangement (Das and Teng, 1998; Mellewigt et al., 2007). Therefore a complete and effective contract is normally aimed to serve two fundamental purposes; which are coordination and control (Mellewigt et al., 2007). In the absence of such a contract to govern the relationship and performance of the service provider, it is unseemly that the benefits of outsourcing can be realized nor the venture to be a successful one.

Commitment and cooperation are two key words which are essential to make or break an outsourcing relationship. For any outsourcing attempts to be successful, strong commitment from both the Client and Vendor is extremely crucial (Anderson and Weitz, 1992; Boyle and Dwyer, 1992; Dwyer et al., 1987). Long term relationship has proven to be beneficial to both parties in many ways. However it must be accepted that the journey will not always be a smooth one. It is important for both parties to be willing to value the strategic relationship and expand resources to make the venture a successful one (Morgan and Hunt, 1994). It is also important to have leadership commitment both at the top and middle level management as their involvement is essential to make the strategic venture work (Kakabadse and Kakabadse,2003; Quinn, 1999). Many outsourcing partnerships have failed mainly due to the failure of both parties to view the strategic venture as partnership rather than just a strategic engagement. Organization must view the engagement as a partnership (Dwyer et al.,1987; Mohr and Spekman, 1994; Prahinski and Benton,2004) and their goal should be to find ways on how to maximise the total system value rather than looking at just maximising their individual portion of the pie at the expense of either the Service Provider or Client (S.M. Handley, W.C. Benton Jr., 2009) Unless this is maintained, there will be more and more businesses experiencing failures in their outsourcing ventures.

From the perspective of resource dependency theory (RDT), it is believed that all organizations are interactive with the external environment mainly due to the fact that these organizations are dependent on resources such as labour, skills, technology, etc (Cheon et al., 1995; Aldrich, 1976) to sustain. There are two reasons which determine the extent of the dependency of one organization to another. The first reason would depend on the strategic importance of certain resources for the survival of an organization or the criticality of these resources to function in an unpredictable and highly competitive market (Pfeffer and Salancik, 1978). The second reason depends on the extent to which another organizations control the required resources (Pfeffer and Salancik, 1978; Shanikat, 2007). Most businesses embark on outsourcing practices to obtain cost and time efficiency, performance improvement in terms of quality and service level, innovativeness, flexibility as well as to leverage on human capital advantages. However, the selection of the Vendor is extremely crucial to ensure that we find the correct provider who is able to provide the level of performance and efficiency which a Client requires. The dependency on resources also placed many businesses, especially the Clients on a tough spot as the dependency would be subject to the extent to which another organization controls these resources as well as the criticality of these resources for the survival of the organizations. Therefore, it is highly questionable if the Client could actually have sufficient control over the performance level by the selected Vendors as well as the extent to which they would be able to meet the efficiency level targeted prior to outsourcing. The dependency theory proves that there is an imbalanced control and power held by one party compared to the other which could lead to the failure of outsourcing or at the very least, resulting in a situation where the efficiencies cannot be fully realized.

2.6 Outsourcing: A double edged sword?

Having looked at various benefits and efficiencies derived from outsourcing as well as the reasons that could potentially contribute to its failure, it is interesting to see if there is more to outsourcing than what meets the eye. The journey to success is definitely not a walk in the park. Hence as much as outsourcing has proven to be beneficial, is there a flip side to the coin where the same advantages could also backfire and prove to be a disadvantage or at the very least pose a challenge to various businesses across the globe.

For instance, the practice of outsourcing to a different location or country in a different time zone is definitely beneficial as the workforce could be useful to run a 24 hr business and thus achieve cost efficiency. Call centres in Asia Pacific countries are ahead of the United States (U.S.) time zones between 8 – 12 hours. Even information technology (IT) development can be accommodated and performed at an accelerated pace in U.S. while the coding being carried out in the outsourced country in a different time zone (Fitzsimmons and Fitzsimmons, 2004). Therefore in order to be cost effective, many of these businesses can work around the clock and thus providing better service and turnaround time to meet the agreed Service Level Agreement with the Client (Rao, 2004; Sheu et al., 2004). However the challenge lies in communicating with the personnel in the other time zone as even a conference meeting may prove to be difficult. Although this has given rise to remote or 'faceless' management where the personnel in the Client and Service Provider's office may not even know how one another looks like, it is always effective to know whom we are dealing with as it fosters closer relationship between all parties. This is even more crucial for outsourcing as relationship management has been cited to be one of the essential criteria which enable the success of outsourcing through trust, commitment and cooperation (Prahinski and Benton, 2004). If at all face to face meetings are desired, this could be done through time consuming travels or video conferencing facility, both of which could significantly raise the operational costs.

Language is definitely one of the key challenges to any business processes involved in outsourcing. Therefore this explains why some countries are more prominent as offshore locations compared to the rest as they have an edge in terms of English-speaking workforce. Some of these locations are also more costly, such as Ireland and Canada compared to the Middle East or Asian countries primarily due to the dominance of English speaking capabilities (Robinson and Kalakota, 2005).

Culture on the other hand has considerable impact in many aspects such as their beliefs, values, local norms and behaviour which relates to their work culture. In fact culture also plays a crucial role in the level of quality delivered as well as the ease with which the work is done. There are also instances where countries that share a common language may have difficulties communicating service or process related issues due to differing business cultures. Most customers are also willing to participate in the service delivery process across cultures and this considerably eases the burden of training foreign service providers (Youngdahl et al., 2003). To increase the level of service delivery, some of the call centre employees are routinely trained to speak in western accents and most of them are usually found willing to adopt a western name especially those dealing with service counters (Davies, 2004). As much as culture facilitates improvement in service delivery, it has also proven to be a significant barrier to outsourcing. Business culture, practices and regulations in some Asian counterparts poses to be a challenge to the Western partners as countries like China and India are very famous for their bureaucracies. Many other countries which has significant advantage to be an attractive outsourcing hub lack middle management talents which makes it a real challenge to venture into these specific locations and has proven to be a deterrent factor (Davies, 2004; Robinson and Kalakota, 2005). As a counter measure, middle management talents are often brought in from the parent companies to reduce the level of transaction risk as well as to enable better monitoring and control while most local employees play a significant role in managing the bureaucratic hassle (Preston, 2004). While there is a definite advantage to this arrangement where specific assets can be transferred to offshore locations while simultaneously retaining the institutional knowledge of the service process for the purpose of absorptive capacity (Cohen and Levinthal, 1990), there is also a disadvantage in terms of cost as this approach would definitely be more expensive. According to Davies (2004), India is a good example of an offshore location that rapidly develops middle management talent and the required quality standards to significantly reduce the coordination costs and transaction risks.

2.7 Risks in outsourcing: Is it worth the effort?

Most studies and existing literatures related to outsourcing would have definitely touched on the risks involved in any form of outsourcing initiatives, be it domestic or offshore outsourcing. Just like any other conventional businesses, outsourcing too has been proven to have its fair share of risks. The most common type of risk associated with outsourcing would be the risk of loss of control, innovation and organizational trust (Cecily A. Raiborn, Janet B. Butler, Marc F. Massoud, 2009), higher than anticipated transaction costs (Albertson, 2000), impact on employee morale and performance (Elmuti & Kathawala, 2000), service risks (Lily, Gray, & Virick, 2005), reduced value (Sullivan, 2002), diffusion risk (Aron et al. 2005), opportunism (Klein et al., 1978; Williamson, 1979) and last but not least goal misalignment (Alchian and Demsetz, 1972; Aron et al., 2005).

When a process is outsourced, most often than not the Clients worry that there may be a possibility of losing control over their own process technologies or work standards. Although a complete and effective contract which outlines the Service Level Agreement (SLA), promises, obligations and process for dispute resolution (Poppo and Zenger, 2002) normally serves to control and coordinate the outsourcing agreements, inevitably the Client still loses some degree of control. No matter how complete and effective a contract is, there are always some forms of loopholes which can be manipulated by the Service Providers if they choose to. These normally take place when opportunistic behaviour is present supported by incorrect or inappropriate specifications on the contract.

Geographical distance also poses to be a challenge when monitoring performance and productivity. The management information (MI) produced by the Service Provider that details their performance standards and productivity level among others, could potentially be fabricated or manipulated to show a higher performance level and it would be very difficult for the Clients to authenticate the statistics unless stringent internal controls are in place. Most business also finds it a challenge to have real time meetings due to the different time zones each partners operate. This may also cause delays in discussing and addressing issues that may require quick resolution resulting in a sense of frustration on the part of the Client as they may feel less in control of the entire situation.

Innovation cannot take place unless an organization has the right type of human resources who may produce the required results. Business who intends to pursue innovation strategies must place great emphasis and care in their hiring decision in order to be able to recruit and retain these highly qualified personnel. These employees in return are able to produce high quality work and contribute great innovating ideas. However when a business or process is outsourced, it is undeniable that one of the primary drivers is the reduction in costs. Therefore the Service Providers themselves will be driven to provide those cost efficiencies to their Clients and at the same time increase their profits by reducing operational costs. Most often that not, this translates into hiring the incorrect labour force due to reduction in wages. Organizations tend to hire employees who are willing to accept the salary which is being offered rather than paying the right of amount of salary for the right type of employees which are required to add value to the business.

Hence this could potential reduce and even inhibit innovation goals that the organization may have wanted to pursue.

Many existing literatures have looked at various aspects of relationship management (Benton and Maloni, 2005; Prahinski and Benton, 2004) and commitment (Prahinski and Benton, 2004) in order to establish and maintain a mutually beneficial relationship between the Client and Vendor. The risk of loss of organizational trust can be applied at two different levels. The first level is the core relationship between the Client and Vendor that has gone sour which results in loss of trust. Opportunistic behaviour and self interest have often resulted in conflicts that can have functional and productive consequences (Frazier and Rody, 1991). The second level of loss of trust is more internal where there is a breach in the employer-employee relationship. When any outsourcing strategies are adopted, there will be a situation where staff headcounts will be reduced as certain job functions have been outsourced. Therefore, the employees tend to have fear of losing their jobs and most often that not, this translates into lack of commitment and engagement in their job tasks (Overby, 2005). This is a significant non-quantifiable risk and one that definitely could impact the performance of an organization.

The main drivers of outsourcing have always been to achieve cost reduction and efficiency. The decision to embark on outsourcing is only made after careful cost-benefit analysis. However some of the costs and benefits are easily identified while there are some which are not captured by the accounting system and these are normally not easily quantified. These types of costs and benefits require estimations to be done in order to obtain a good cost benefit analysis (Cecily A. Raiborn, Janet B. Butler, Marc F. Massoud, 2009. In addition to that, uncertain market conditions also make it difficult to determine the relevant costs and there is always a possibility of these costs changing over time which is inevitable. As such, the involved parties are not able to specify accurately the costs associated with the transactions and provisions are normally made for renegotiations subject to environmental changes which not only adds to the transaction costs but also pose a risk that the actual costs may be higher than the anticipated costs at the point when the decision to outsource was initially made (J.K. Stratman, 2008). Transaction costs comprise of coordination costs and transaction risks costs. Coordination costs is associated with the process of collecting and integrating information to be used in the decision making process while transaction risks costs is associated with the possibility that any of the parties involved in the contract may fail to meet their contractual obligations (Clemmons et al., 1993) and thus increasing the overall costs. This type of increase in cost is normally termed ‘hidden costs’ as it is not normally evident or easily anticipated prior to embarking on outsourcing.

Hence while outsourcing does have its benefits, it is certainly not risk free. Careful and calculated risk assessment must be done prior to making a decision to embark on any outsourcing initiative.