

Chapter 6

Offshoring and Outsourcing of Customer-Oriented Business Processes: An International Transaction Value Model

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Abstract Business processes that involve information processing and human interaction raise unique issues of geography and governance. To explain outsourcing and offshoring decisions by firms, we develop a model of international transaction value that integrates resource-based theory, location economics, and transaction costs theory. This firm-level model provides a strong theoretical foundation for understanding and testing the conditions for effective outsourcing and offshoring of customer-oriented business processes (COBP). In addition to establishing static conditions that should favor greater or lesser degrees of outsourcing and offshoring, the model also provides pathways to suggest how preferences will change under alternative circumstances.

Keywords Offshoring • Outsourcing • Transaction value • Business processes • Resource-based view • Transaction costs theory • Geography and governance

6.1 Introduction

Firms have sought competitive advantage by offshoring and/or outsourcing parts of their operations for years. Offshore production often is tied to comparative advantage on the part of foreign sites of production due to relative factor

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endowments, competitive advantage on the part of firms in one location (Porter 1990), or product life-cycle conditions (Vernon 1966). Internalization theory (Buckley and Casson 1976; Dunning 1988) ties the choice of external or internal control of offshore production to transactional conditions that either support or do not support efficient markets for components made in foreign locations. Venkatesan (1992) describes the advantages of outsourcing manufacturing as permitting the firm to focus on making critical components at which it is distinctively skilled, offering lower costs by using suppliers with distinct advantages in making other components and providing incentives to in-house production employees. However, these models have all focused on manufacturing activities. In today's information-intensive global markets, the focus is shifting to business processes, and the service activities provided to customers both inside and outside the firm by companies in many sectors. This situation motivates the development of a geography and governance model to better understand firm sourcing of customer-oriented business processes (COBP).

Business process outsourcing and offshoring (BPO/O) have become increasingly widespread—and have had profound effects on how companies and their customers interact.¹ There is a long history, in both manufacturing and services, of outsourcing noncore activities to suppliers, in the ongoing search for a competitive edge (Quinn and Hilmer 1994). Service firms have long contracted with overseas firms to provide some part of the overall service value-added process (Erramilli 1990; Kotabe et al. 1998; Richardson and Marshall 1999). Services are now the largest component of both developed and developing country economies. They account for more than one-quarter of total world trade and are increasing in importance (World Bank 2005). Both service and non-service firms offshore and outsource business processes, especially those involving information technology (Barclay and Gray 2001). Information management through technology and standardized systems has made outsourcing of business processes much more feasible. These systems and the increasing sophistication of relatively low-cost workers in emerging markets have vastly increased the potential for also offshoring a wide range of business processes. As a consequence, BPO/O is a rapidly growing phenomenon attracting increasing attention from business, policy makers, and scholars.

A large part of the business process story relates to back-office business services such as audit, payroll, personnel, and processes that serve internal customers. These technical services are largely cost centers and have no direct impact on company outputs, revenues, or customers, even if they are sometimes disconcerting to public policy makers. However, according to the research firm IDC, customer service, sales, and marketing comprised 45 % of the total worldwide BPO/O market of \$382.5 billion, as far back as 2004. The bulk of some firms'

¹ In this context, outsourcing refers to the contracting of a previously internal business process to unaffiliated parties outside the firm, while offshoring, often of the same knowledge-based activities, refers to locating activities in a foreign country, whether through an affiliated (captive) supplier or through an unaffiliated supplier or outsourcer (Murtha 2004).

customer-oriented operations in sales and service became managed offshore by outsourced suppliers (Gibson 2006).

COBP can be defined as firm activities that involve direct interaction between the firm and its customers and that provide the basis for customer relationships. The rise in the outsourcing and/or offshoring of these processes challenges notions of how customer relationships are formed and maintained and of the value proposition inherent in them. Marketing and strategic management scholars have emphasized the importance of customer focus and customer relationships, suggesting that customer-focused activities are critical to firm-specific advantage (e.g., Kohli and Jaworski 1990; Jaworski and Kohli 1993; Sheth and Parvatiyar 1995). However, in many cases, COBP are not unique firm-specific capabilities, and outside suppliers or offshore facilities, or both, might be of value. We provide a conceptual geography and governance model that clarifies the governance decision of whether and when to manage COBP in-house or through outsourcing, the location decision of whether to provide COBP activities onshore or offshore, the effect choices have on competitive advantage, and how factors may change in predictable patterns in a dynamic context.

Make/buy or outsourcing decisions are typically modeled by drawing on transaction cost economics (TCE) theory (Geyskens et al. 2006), although scholars also turn to the resource-based view (RBV) of the firm for explanations of outsourcing (Barthelemy and Quelin 2006) and related strategic moves, such as alliance strategies (Madhok and Tallman 1998). A consensus seems to be forming that in order to be fully applicable to complex decisions both TCE and RBV needs further development or evolution, with considerable potential for an integrated theoretical perspective (Madhok 1996; Rindfleisch and Heide 1997; Madhok and Tallman 1998; Foss and Knudsen 2003; Foss and Foss 2005; Jacobides and Winter 2005). The benefit of integrating TCE and RBV into an explanatory model has been persuasively argued, with the term “transactional value” used to describe models that integrate transaction costs and resource value perspectives to address alliance strategies (Zajac and Olsen 1993; Madhok 1997).

We integrate TCE and RBV considerations to explain firms’ governance choices for service activities. Further, we add explicit consideration of location factors in taking an “international transaction value” approach to the examination of the offshoring and outsourcing of COBP. By simultaneously applying theories of location-based advantage, transaction cost minimization and organizational capabilities as a system of interacting explanatory constructs, we offer a dynamic and integrative strategic management approach to finding competitive advantage through business services. This model is in some ways the application of Dunning’s Eclectic Model (1988) to services, providing a coherent analysis of the interaction of firm-specific assets, location issues, and internalization decisions in the service sector. A strategic management interpretation of the eclectic paradigm is well established in the international business strategy literature (Tallman 2004). However, where the Eclectic Model provides a sequential decision process, an international transaction value perspective recognizes that any decision on one

dimension may change the potential value proposition for the multinational enterprise (MNE) along with all dimensions and model this interaction explicitly.

In the next section, we provide an overview of relevant past research in the context of the international trade in services. Next, we introduce an international transaction value model of the COBP sourcing decision, with suggestions about when and why offshoring and outsourcing would be most likely. The final section discusses the managerial and research implications of our geography and governance model.

6.2 COBP Sourcing: Geography and Governance

We focus on COBP because their explicit tie to business customers and consumers creates a need for both superior information transmission and superior customer interaction, as compared to information-focused back-office business processes. While back-office BPO/O can be seen as primarily a technical challenge with important cost control benefits, COBP outsourcing and offshoring raise broader interpersonal and revenue issues (Whitaker et al. 2007). COBP, encompassing marketing, sales, and consulting, have direct value-adding implications, suggesting that decisions about outsourcing and/or offshoring these activities have broad implications for the firm and its economic performance.

A key question is whether firms have the capabilities to leverage technological possibilities in the management of information, while retaining and enhancing the human interaction aspects of COBP that are so important to customer satisfaction (Aron and Singh 2005). All BPO/O involves some inherent “tech versus touch tradeoffs” (Graf and Mudambi 2005), but COBP emphasize these tradeoffs and dilemmas due to the customer contact involved. Firms can reduce overall costs by cutting labor costs through offshoring to lower cost locations, by substituting technology for labor or by outsourcing to specialists, but service quality and customer satisfaction may suffer as a consequence. The challenge for the firm is minimizing overall costs while providing superior customer value and maintaining high levels of customer retention.

The dynamics of COBP outsourcing and offshoring are complex, with actual business practice filled with changes in direction and apparent contradictions. For example, General Electric moved early to set up a captive call center in India, only to later spin off its various business process support activities into Genpact. In November 2003, Hewlett-Packard announced it would set up a customer contact center in India for its North American consumer market (Tata Telecom 10 Dec. 2003b). At about the same time, Dell announced it would stop routing corporate customer calls to a contact center in India, due to customer complaints (Frauenheim 2003). As the size of the BPO/O market grows, firms simultaneously use onshore and offshore providers, spin off or snap up offshore facilities, and sometimes bring processes back in-house at the home location. Given this turbulent environment, it

is instructive to turn to theory and to past research to better understand and explain COBP outsourcing and offshoring decisions as critical strategic decisions.

The following brief literature review begins by introducing customer-oriented business processes as a particular and important category of business processes and then focuses on relevant firm-level research on the international trade in services. To understand the outsourcing and offshoring of customer-oriented business processes, it is important to identify the unique nature of COBP as a set of business processes and to place them into the context of previous research on international trade in business services and sourcing decisions. COBP involve direct interpersonal or indirect technology-enabled interaction between the firm and its customers. Other administrative and technical business processes may involve both interpersonal interaction and interaction with technology, but not within the primary value-adding process. In “back office” business processes, employees largely interact with other employees or service providers, or rely on technology for information transfer between employees. For example, employees may hold face-to-face, telephone-based, or instant messaging discussions regarding expense reports, database maintenance, payroll changes, or accounts receivable. Employees may also obtain data directly from a proprietary website or an online database without any direct interpersonal contact.

Managing the flow of information and communication remains problematic within most firms and supply chains, yet it is the management of the customer experience (Meyer and Schwager 2007) that has been shown to pose special challenges and opportunities for a firm’s competitive strategy (Day 2003) and is the focus of our attention here. Direct customer contact, either with employees or through electronic interfaces, distinguishes COBP.

Customer relationship management coordinates and integrates what are commonly known as customer “touch points,” defined as the instances and locations of direct contact between the firm and the customer.² Although customers do not demand interpersonal interaction from the firm at every touch point, the interpersonal aspect (even via electronic means) is an important determinant of customer satisfaction. Offshoring the human touch aspects can create new management headaches. Firms increasingly recognize the importance of accent training and customer rapport skills to avoid “cross-cultural flashpoints” (Huff 2005), service failures that lead to customer dissatisfaction and negative word-of-mouth. With ever-improving information technology, customers increasingly expect technological interfaces with highly developed interactivity. Interactive multimedia, or rich media, can create knowledge and customer satisfaction, but are relatively more expensive than more static media forms.

The varied nature of COBP emphasizes relevant conceptual distinctions that have been made about service businesses. One key distinction is between core and

² The term “touch points” may be somewhat misleading, as touch points can involve a human touch (a telephone call from or to a sales representative), a technology-based touch (a mass-produced email or a customer visit to a website), or a media-based touch (exposure to an advertisement or direct mail piece).

supplementary services. Core services are the main activities that customers seek from a particular service firm, while supplementary services facilitate or complement core activities for any firm (Kotabe et al. 1998). While core services provide competitive advantage to the service firms that provide them, supplementary services also can be important sources of or supports for differentiation and competitive advantage (Anderson and Narus 1995; Kotabe et al. 1998). The further from the firm's core are supplemental COBP such as ordering or customer service operations, the more likely they are to be outsourced or offshored. However, specific processes can and do vary in their strategic centrality depending on the firm. Services that are supplementary to many manufacturers and service providers are core businesses to outsourcing specialists, for instance. By disaggregating the many activities involved in building competitive advantage, to include business processes in general and COBP specifically, firms can identify varying levels of internal competence and strategic importance among their many activities and may adjust over time their perception of what should be outsourced or offshored and what should not be (Venkatesan 1992).

Another conceptual issue is the separability of production and consumption of business services. According to Erramilli (1990), a hard service permits separation of production and consumption (in time and/or space), whereas a soft service requires physical proximity between the service provider and the service consumer and is both produced and consumed simultaneously. Offshoring has been assumed to be feasible in the case of hard services, while colocation has been assumed to be necessary for a soft service provider and customer. Affordable information and communication technology (ICT) has expanded the scope of services that do not require direct contact, by enabling interpersonal interaction without physical proximity through the use of the telephone, voice over internet protocol (VoIP), video conferencing, instant messaging, and other methods. These methods vary in degree of interpersonal interaction, yet each facilitates the separation of production and consumption and the potential for international trade in business processes. At the same time, this separation creates new governance problems to maintain the quality and consistency of customer experiences when a soft service is delivered electronically, possibly limiting the potential for outsourcing soft services.

The expanding scope of services calls into question some assumptions of past research on the differences between services and tangible goods (Zeithaml et al. 1985; Lovelock 1996) and the implications for international services trade (Ekeledo and Sivakumar 1998). Just as manufacturing processes have been de-integrated and contracted out or moved offshore (Kedia and Mukherjee 2009), as firms apply ICT processes and analyze the content of services more closely the information-processing aspects of services are separated more easily from the physical aspects of COBP and from each other. Reducing the scope of direct interpersonal, interactive services enhances the potential of outsourcing and offshoring aspects of COBP. The "hard" versus "soft" designation is less critical than the differences between information or technology-intensive processes and

interaction or touch-intensive processes. Information-intensive processes are primarily focused on providing explicit knowledge to the customer, who must then absorb the information. Interaction-intensiveness implies the development of understanding, of tacit knowledge, through mutual interactions in which knowledge absorption is assisted by the provider, whether face-to-face or at a distance. ICT developments mean that information is more easily delivered across separations in time and space, but meaningful human interactions can take place (depending on the exact nature of the business process) via electronic means as well, though tacit knowledge is more easily transmitted directly (Brown and Duguid 2001).

Past research reveals a need for further conceptual development in how and where to source services and business processes (Kotabe and Murray 2004; Doh 2005). This is especially true for COBP involving direct interaction between the customer and the firm. As a result, past research provides limited guidelines on COBP outsourcing or offshoring. In the next section, we develop a theoretical framework to provide a systematic analysis of the factors affecting the COBP outsourcing/offshoring decisions. The emphasis is on the firm and its strategy, rather than macroeconomic exogenous factors that constrain or drive the firm.

6.3 Application of International Transaction Value to COBP

A starting point for theory building about any business process management is examining the concurrent decisions that firm managers make about the governance (in-house or outsourced) of the process and about the location (onshore or offshore) of the process provider. Nearly all outsourced services, including COBP, are performed off-site from the perspective of the focal firm, whether in the same country or in a foreign location. Although any off-site activity entails some external transactional governance costs to minimize any drop in service quality, we assume that legal and customary demands and expectations will limit difficulties with the service itself if it is provided in the home market by a domestic outsourcer. However, the various geographical and institutional aspects of distance provide a qualitatively different service experience for customers when provided from a foreign site, particularly for interaction-intensive aspects of COBP, and even if the offshore provider is a wholly owned subsidiary (Ghemawat 2001). COBP offshoring is qualitatively different from COBP outsourcing.

At the same time, the transactional or governance risks entailed by outsourcing are likely to be enhanced by distance and boundaries. Offshoring and outsourcing decisions are interactive processes. In parallel with both the governance and the location decisions, the relative importance of COBP-related activities to the firm

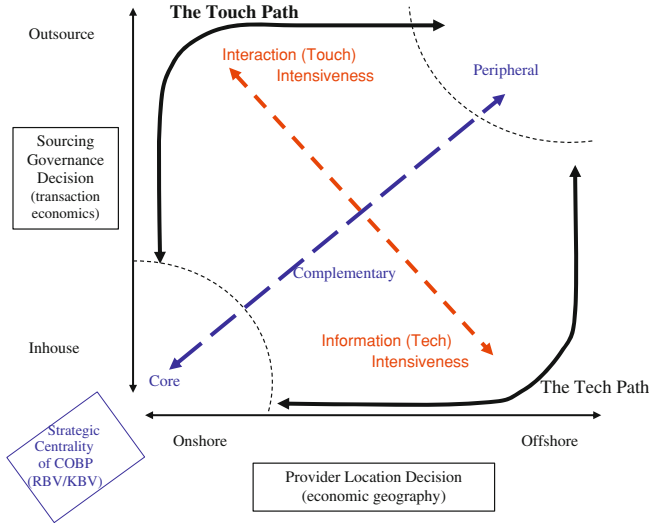


Fig. 6.1 International transactional value model of customer-oriented business process geography and governance

must also impact the “where/how” decision of COBP provision.³ All three aspects of the international transaction value construct—strategic centrality, transactional governance, and location effects—come to play with both direct and integrated effects on the outsourcing/offshoring decision.

Figure 6.1 provides an illustration of considerations and trade-offs in international transactional value considerations for COBP sourcing. The COBP provision decision is shown on the two primary dimensions: sourcing governance and provider location. Governance can be either internal (in-house) or external (outsourced), and providers can be located either in the home country (onshore) or in a foreign country (offshore). Note that this two-dimensional formulation has become widely accepted among scholars of offshoring, whether of manufacturing or of services (Kedia and Mukherjee 2009). The strategic centrality of a COBP process is equally important to the sourcing decision process (Quinn and Hilmer 1994), moderating the effects of location and transactional conditions on offshoring and outsourcing decisions, and is indicated along the main diagonal, running from core, nearest the origin, through complementary, to peripheral.

³ We use the terms capabilities and competencies as defined in Tallman (2003). A capability is an intangible firm-specific resource composed of a complex set of interacting assets and processes. These may be more or less central to the competitive advantage of a firm. A core competency is a unique organizational capability that can be shared across units of a corporation to generate competitive advantage in a variety of settings, and that tends to characterize the firm. The range of COBP in an industry may involve a variety of capabilities, some core, others less so for any particular firm. However, COBP are likely to be core competencies only for firms actually involved in providing these services as their primary business.

The dashed curves in Fig 6.1 approximate the conceptual boundaries of the centrality levels. These suggest that at the extremes of strategic centrality, firms will tend either to provide COBP in-house and onshore, for maximum control of core processes, or to contract for the service in an offshore market, in order to minimize related costs of peripheral processes. In intermediate cases, when COBP are shown as complementary activities, important but not core to the firm, another factor comes into strong consideration. The off-diagonal capabilities dimension suggests that the sourcing location and governance decisions will depend on the relative importance of informational (tech) capabilities and interpersonal (touch) capabilities to the firm and its customers when a COBP directly supports the competitive advantage of the firm, but is not at the core of its strategic success. Finally, the two “paths” indicated by heavy curved arrows suggest dynamic aspects of the model to be discussed below.

Figure 6.1 suggests that every solution involves a decision about both governance and location, conditioned by strategic centrality and the perceived importance of tech and touch capabilities. These are dynamic considerations, in that changes in strategic centrality of an activity will impact both location and governance decisions. Although Fig. 6.1 may imply mutually exclusive corner solutions, in the next section we will develop the likelihoods of each outcome in any given sourcing decision.

6.3.1 Theory and the COBP Outsourcing and Offshoring Decisions

Most models of BPO/O have been built around the ideas of TCE as they relate to the make or buy decision (Williamson 1975; Murray and Kotabe 1999). As we consider the concurrent decisions of process sourcing governance, whether internal or external, and location, whether domestic or international, we develop an international transaction value perspective to consider the endogenous effects of resource-based strategy, transaction governance characteristics, and location economics on the locational and governance decisions of COBP sourcing and on each other.

This integrated approach is necessary to understand and explain decisions about outsourcing and offshoring of firm activities that involve direct interaction between the firm and its customers and that provide the basis for customer relationships. However, this complex integrated model requires step-by-step development. The following sections will specifically discuss the costs of transactional uncertainty and the role of location-based advantage in governance and locational decisions about sourcing. Then, we consider the moderating influence of strategic centrality of assets and capabilities on these decisions. Finally, we consider how the specific concerns for information-intensive COBP and interaction-intensive COBP will influence the transactional value of a specific outsourcing/offshoring decision and how these effects may develop over time.

6.3.1.1 Uncertainty Costs, Governance, and the Location Decision

As previously established, the make or buy decision is at the heart of any outsourcing discussion. Transaction cost and internalization models (Coase 1937; Williamson 1975; Buckley and Casson 1976) assume that under efficient market conditions, firms should normally contract for any needed assets or activities in a market transaction. However, under certain conditions—uncertainty, bounded rationality, small numbers bargaining, and asset specificity—market failure in transactions is probable, and the transaction will be internalized (Williamson 1975). COBP were long seen as unique to the firm and internalized, but developing technologies, specialization of practices, and the rise of emerging markets have resulted in increased outsourcing of business processes, primarily relying on alliances (extended contracts or joint ventures) rather than arm's length market transactions.

As these processes have been constantly more finely divided, first into information and interaction-intensive services and then into ever-finer segments of information-intensiveness, the real transaction costs of providing information-intensive services are being consistently more sharply defined on a disaggregated basis. Their information-intensive nature has been greatly affected by improvements in ICT that have made the creation, storage, and transmission of high volumes of information faster, more accurate, and less expensive. This increased bandwidth in ICT and improvements in education and skill levels in emerging economies allow increasingly effective interaction-intensive services to be delivered at a distance. Real transaction costs for outsourced business processes fall with improvements in ICT. Actually, moving customer-related information from one place to another or one organization to another is becoming much more feasible and much less expensive, so that questions of internalization of COBP transactions are dependent on the uncertainties of these transactions.

Transaction costs are higher under conditions of greater uncertainty, and sufficiently high costs may offset any production or skill advantages held by external sources of business services. Transactional uncertainty takes two major forms—environmental uncertainty and behavioral uncertainty, and the costs of making, monitoring, and enforcing market transactions are higher in both cases. While transaction cost models focus on sourcing governance or the make or buy decision, these same costs are critical to the internalization of foreign markets in the eclectic paradigm, so that they are affected by offshoring. Environmental uncertainty costs result from unfamiliar international business environmental issues such as differences in political, economic, legal, social, and technological institutions and are reflected in search and negotiation costs, and the dynamism of ICT and labor markets. Uncertainty is relevant to both onshore and offshore outsourcing, but is likely to be exacerbated in unfamiliar contexts, as explained by the liabilities of foreignness (Zaheer 1995). At the same time, firms are building their levels of international experience, more reliable information on locations is available, and experienced agents and intermediaries can provide investment advice, suggesting that overall levels of environmental uncertainty are falling.

Behavioral uncertainty costs also affect the outsourcing decision. The higher the behavioral uncertainty of potential partners, the higher the expected transaction costs, and the less outsourcing is expected. Any partner can be opportunistic, but the added geographical, cultural, developmental, legal, or regulatory distances of international outsourcing exacerbate any uncertainties about the possibility for opportunistic behavior. Unfamiliarity reduces trust, and distance blunts the effects of reputation, suggesting that behavioral uncertainty is likely to be higher when dealing with potential foreign outsourcers than with domestic providers, at least until the focal firm gains considerable international experience. However, as in the case of environmental uncertainty, exposure to international markets is growing, and reliable information is more available, for specific partners as well as nations. Executives interview prospective partners, intermediaries exist to offer introductions to suppliers, and the increasing concentration of offshore operations make the reputations of suppliers more transparent and more important to maintain. Of course, as quality problems in the manufacture of toys, pet foods, and pharmaceutical precursors in China have shown, supply systems are still often less than transparent. Thus, we expect that in general, uncertainty-related transaction costs are higher for offshore COBP production, but are falling over time.

6.3.1.2 Production Costs, Governance, and the Location Decision

As the real transactional costs decline due to enhanced ICT and as uncertainty about foreign locations declines due to experience (both direct and vicarious), the cost of service provision comes into focus (Walker and Weber 1984). Labor mobility and better information and communication technologies have improved the tradability of services. Several studies have examined the complexity of the location decision of where to site business services (Graf and Mudambi 2005; Bunyaratavej et al. 2007; Doh et al. 2008), with offshoring case studies revealing a diversity of management practices (Pyndt and Pedersen 2006). Where the traditional TCE model assumes production processes and costs to be identical and focuses its arguments on the costs of transactional governance, our international transaction value perspective explicitly incorporates the costs of providing services. A meta-analysis by Geyskens et al. (2006) found that only a few studies in the transaction cost literature have compared in-house and supplier production costs, despite calls by Rindfleisch and Heide (1997) and others for explicit consideration of differential production costs in transaction cost models. Ignoring this is no longer realistic—a firm must compare its internal service provision costs to the equivalent costs of alternative providers and alternative locations. If the cost differential of providing business processes is much lower offsite, home country outsourcing may be a way to lower costs with little added uncertainty about quality.

However, with the rapid development of emerging market economies, home country-based, or onshore, operations may be replaced by offshore providers because of perceived location-based production advantages, even in the face of

some continuing transactional uncertainties (Mudambi 2007). Research suggests that low costs alone are not as important to foreign services provision as is net productivity. Jensen and Pedersen (2008) and Doh et al. (2008) show that when business processes are offshored, the most favored locations are not the least expensive, but those with evidence of more skilled labor and infrastructural development—superior quality as well as lower costs.

Our international transaction value approach explicitly considers the relative costs and quality of service provision. Offshoring traditionally has been seen as a way to reduce costs, but productivity also requires adequate quality of service. ICT-enabled business processes are very dependent on the quality and availability of telecommunication infrastructure and the cost of telecommunications. For example, Calliano and Carpano (2000) concluded that Ireland's telecommunication infrastructure contributed much to its success in attracting investment, and others point to the importance of a well-educated, English-speaking population in Ireland. Technology-intensive services were in the past considered to be in the natural sphere of industrialized economies due to better infrastructure and superior labor skills. However, the trend toward offshoring business processes, plus an overwhelming literature, demonstrates that ICT infrastructure and workers are available in many locations that are both less expensive and appropriately high quality for virtually any information-intensive task (Doh 2005). This explains IBM's India-based staff increase from 9,000 to 43,000 in less than 3 years, its China-based staff growth from 4,200 to 7,200 and the doubling of its staff in Brazil and Eastern Europe (Hamm 2006). At the same time, Indian providers of business process services grew, consolidated, and invested in market countries (Couto and Divakaran 2006). From an international transaction value perspective, we find that the greater the relative increase in ICT and labor productivity of offshore COBP provision sites, the more likely a firm is to offshore its COBP provision.

6.3.2 Offshore and Outsourced: The Importance of Moderating Factors

We have suggested that location productivity may favor offshore production of COBP, while lingering transactional uncertainties may favor either home-based, onshore providers or internal control of offshore provision. Yet, we see the use of outsourcers in foreign locations as the most rapidly growing means of providing COBP. Two fundamental aspects of COBP explain why provision of these services is shifting in this radical, even counter-intuitive direction. One relates to the relative strategic importance of COBP to a particular focal firm to the technology of COBP and the other to the relative importance of information- and interaction-intensiveness of a particular service.

6.3.2.1 COBP Strategic Centrality as a Moderating Factor

The RBV of the firm (Barney 1991; Peteraf 1993) emphasizes the importance to the firm of protecting, exploiting, and enhancing the core strategic assets and capabilities of the firm through its choices of strategies and governance mechanisms. Value is tied to the potential for maximizing economic quasi-rents to the firm's unique assets and capabilities through the transaction (Peteraf 1993). Thus, the decision to make or buy inputs to a transaction depends on whether these inputs are key sources of competitive advantage to the firm and, if not, on whether the greatest value enhancement comes from outsourcing to a more competent (and possibly foreign) supplier or from developing these skills in-house. Similarly, the locational choice of offshore or not also should be aligned with the nature of the firm's management resources. In short, according to RBV tenets, the outsourcing and offshoring decisions should be based on the strategic centrality of these capabilities to the focal firm and its competency in comparison with potential suppliers.

Previous research has shown that COBP-oriented resources and capabilities may or may not be central to the firm's competitive advantage. We categorize the possible strategic roles of COBP-oriented capabilities as core, complementary, or peripheral by extending the Kotabe and Murray (2004) typology of core and supplemental. If supplemental, COBP may be relatively important, playing a complementary role (Kotabe et al. 1998), or they may be peripheral—necessary to the business without a direct impact on strategic, rent-generating activities. If COBP are core strategic competencies of the firm, they are likely to stay in-house and under close supervision, no matter the marginal transactional or locational effects, while if COBP are complementary or peripheral aspects of the firm's strategy, they are increasingly likely to be considered ripe for outsourcing and/or offshoring. Consideration of the three specific situations of core, complementary, and peripheral CRM resource centrality merit further explication.

COBP at the strategic core. Not all customers are equally important, and not all customer processes are equally important. For customized luxury goods and for corporate key accounts, the direct relationship between employee and customer is critical to overall strategy. For example, the sophisticated help desk of Rolls-Royce's commercial jet engine division was credited with increasing Rolls-Royce's competitive edge over rival GE (Reed et al. 2005). Some firms in consumer markets also seek to differentiate themselves from competitors on the basis of their relationship strategy. For example, Commerce Bank in the U.S. promised that its phones would be answered by "a real person" not a machine and kept its incoming call center function in-house and onshore. Commerce's customer-centric approach captured market share and positive attention (Bernstel 2006). The niche website www.gethuman.com rated Commerce Bank as an "A" on its "humans first" standard, where several key rivals rated an "F." When COBP are highly central to the firm's strategy, they should be closely controlled by the firm to maximize economic rents to these firm-specific assets. High strategic centrality suggests that firms are unlikely to weight either transactional or

locational factors heavily in deciding to keep these activities in-house and at home. The more a particular COBP is seen as core to the firm's strategy, the more likely it will be sourced in-house from home country locations, no matter the production cost consequences.

COBP on the strategic periphery. On the other extreme, supplemental COBP may be perceived as peripheral to a firm's strategy. Few firms are willing or able to bear the costs, both financial and managerial, of internalizing peripheral activities. Peripheral business processes can be described as those with low operational and structural risk (Aron and Singh 2005). From a resource-based perspective, the focal firm would be expected to have no unique skills and little investment in these activities. Managing a peripheral activity in-house takes managerial time and effort and generally involves opportunity costs of not managing core processes more closely. At the same time, the likely transactional risk of contracting for peripheral activities is minimal—even if a provider is opportunistic, the resulting costs are low. If COBP are seen as peripheral, they will be located wherever they can be provided at the lowest cost, even if this may degrade the capability—the loss of customer value is minimal. In firms with a low degree of firm-specific knowledge or where customer inputs are less immediate to the value-adding process, capabilities in COBP will remain peripheral to the firm's strategy. In addition, other firms that do see COBP as at least part of their core business are likely to be more efficient at delivering COBP. In a globally interconnected world, when COBP are seen as peripheral to the firm's strategy, they are more likely to be provided from offshore locations and to be outsourced to specialists, no matter the risk of uncertainty-related transaction costs.

COBP as a strategic complement. Having addressed the extremes of strategic centrality for COBP, we now turn to the intermediate and likely most common case: that of COBP as a complementary capability, that is, one which does not generate economic rents but is directly tied to other capabilities that do. Customer service, call centers, help desks, complaints, returns, and inquiries are relevant to the mission of satisfying customer needs, but are generally seen as outside the firm's core activities. For example, in 2004, SprintNextel outsourced its call center customer support to IBM. This resulted in a transfer of 4,500 call center positions to IBM as part of larger deal involving the outsourcing of a range of IT services (Datamonitor 2006). In this situation, the firm is likely to consider outsourcing based on the expected transactional value of managing COBP through market or alliance relationships as opposed to handling COBP in-house. Likewise, the cost differences of providing COBP from foreign locations versus from the home market will be important, but the quality of service will still be relevant.

For many companies using COBP, customers interact with company websites and with company employees during the ordering and delivery process and for after-sales service. A technical customer service representative needs to have both general knowledge of computing hardware and software, specific knowledge of the firm's products, operating systems, and business practices, and be able to build trust and rapport with novice and expert customers. Unlike situations when COBP are core competencies, complementary COBP do not generate rents, but unlike

peripheral services, they may well be critical to retaining customers and perceived value. Such services may need to be finely sliced to determine value. For computer help desk support, routine and basic informational questions from consumers are routinely offshored, while highly complex inquiries and questions from key corporate clients may be better handled onshore, even in person. Thus, by the end of 2007, IBM was estimated to have more than 70,000 service employees in India, and Accenture India is expected to employ more than 15,000 professionals (SiliconIndia 2007).

Overall, the net value of the location and governance of transactions will be critical—and interactive. Firms calculate net transactional value when they estimate the rents less costs of the COBP sourcing decision, taking into account the transactional costs of the governance decision of outsource or not, and the locational costs or advantages of the local market or lower cost foreign market. Thus, when COBP are seen as complementary to the firm's strategy, COBP will be governed and located in order to maximize net transaction value for the focal firm.

6.3.2.2 Process Characteristics, Location, and Governance: The Tech versus Touch Tradeoff

We have described COBP as involving both information processing and human interaction, both of which are affected by environmental and behavioral uncertainties in COBP. This distinction is particularly relevant to governance and location choices in the case of complementary COBP. As we have seen, the information-intensive aspects can more easily be delivered via technology at a distance in time or space from the customer, while the human interaction-intensive aspects are more likely to be successful if delivered directly and concurrently to the customer (Mithas and Whitaker 2007). The rapid development of ICT and increases in available bandwidth have improved the speed, quality, and capacity of technology-intensive services greatly, thereby reducing the costs of transmitting information relating to business processes. As a result, firms constantly reanalyze their service activities to isolate informational aspects that can be transferred to technological media from interactional aspects that continue to require the human touch, separating hard from soft aspects and emphasizing the time/space separability of hard services. As the service value chain is de-integrated, and new ICT is applied to information processing, the information creation and analysis portion of the service often can be performed at a distance, both in time and space, while the interaction aspect of the service, the actual delivery, can continue to be delivered directly (Johnson et al. 2005).

More information-intensive processes tend primarily to require superior data transmission and technically skilled workers. We anticipate that in the case of information-intensive COBP, environmental uncertainties can be resolved by understanding macro-conditions—thus, Bangalore, Singapore, or Shanghai can be observed to have a relatively developed ICT infrastructure and technically skilled ICT workers. In addition, the quality of information-intensive services can be

observed, compared to standards, and corrected relatively easily and with fewer time constraints than can human interactions. However, behavioral uncertainty on the part of potential COBP suppliers may be made riskier by their skills. Technology-intensive COBP can involve highly customized ICT systems, which must be exposed to outsourcing partners if they are to be used effectively. The absorptive capacities of such outsourcing specialists for knowledge overflows from a client are relatively high, and the potential to combine such learning with internal skills to benefit the competitors of the original client, or to become competitors with that client, as has happened in the case of manufacturing outsourcing, is apparent. While onshore COBP suppliers can also be opportunistic, closer observation and a common legal and regulatory system should reduce risks, while working in multiple legal jurisdictions internationally reduces protection from such opportunism. Thus, we would expect that in the case of information-intensive COBP, environmental uncertainties are relatively easily resolved, shifting the location choice focus toward production costs, while behavioral uncertainties are exacerbated, encouraging the use of in-house, or captive, suppliers in international markets.

Despite the focus on the face-to-face aspect of human interaction in COBP, increasing bandwidth for ICT allows highly interactive processes to take place indirectly (that is, not face-to-face, as in the case of a help desk with a live operator), typically using telephone or other live voice and/or image transmission technology. While simultaneity of production and consumption is still necessary for interactive services, distance is becoming less of an issue—in some cases. Firms that have strong and unique organizational cultures with specific norms for customer service and a specified approach to customer interaction can provide “that human touch,” even indirectly. Their customers may expect to reach a customer service representative who goes the extra mile to serve them and may be dissatisfied with service from a firm that does not have a similar culture, and whose employees go strictly by the book. Customer service may be delivered via electronic communication media and can be highly scripted, but the human interaction aspect of the transaction remains critical. For business processes involving telephone or email contact, language skills are critical (Read 2001), as are quality voice transmission and interpersonal skills. The sales or service representative must be able to “give good phone” (Cool 1988) and develop rapport and trust with customers (Davis and Landaker 2000). Employee attitudes toward technology, interpersonal contact, and their perception of empowerment also play a role.

In the case of interaction-intensive COBP, the costs of uncertainties and consequences of location and governance effects are reversed from the information-intensive context. The quality of the human interaction has been found to be more important to service encounter satisfaction and future business than the quality of the technology interaction or the quality of the information, even among young, tech-savvy customers who had a simple information request (Makarem et al. 2009). Quality and directness of human interaction are tied to location—specifically to cultural and psychic distance from the customer’s location. High-interaction services require physical collocation, discounting foreign (or any offsite) production

completely. However, many seemingly informational COBP encounters have relatively high interaction needs—even such an apparently information-focused activity as a computer help desk can become an intensely interpersonal encounter for a novice user with some fear of technology. Thus, environmental uncertainty becomes a greater concern for interaction-intensive COBP.

The importance of identification between the customer and worker is apparent in practice. Up to 50 % of the training in India of business process center employees—who already speak English—is spent on accent neutralization, listening comprehension, and other communication skills. Outsourcers are rated on the basis of their call-handling abilities which include empathy, listening skills, voice, accent, and clarity (Tata Telecom 25 July 2003a). Further, we see rising concern about identity deception in offshore call centers. Many firms require service representatives to conceal the calling location and to use pseudonyms common in the customer's home country (Taylor and Bain 2005; Poster 2007). These practices may be reassuring to some customers, but often increase tension in the service encounter by creating extra pressure on employees and potentially generating customer distrust or anger (Taylor and Bain 2005). Yet, it remains difficult to distinguish whether some communication problems are due to customer unfamiliarity with foreign accents or due to the lack of language proficiency of the outsourcer employees (Yeung 2005). While ICT can offer call clarity, it cannot eliminate foreign accents and attitudes completely and may not be able to avoid such technical nuances as satellite delays that “give away” foreign location. The interpersonal interaction between employee and customer is intended to build rapport and trust and encourage future business, so a tense service encounter can be counterproductive to firm objectives, especially since some disgruntled customers are likely to switch service providers.

Uncertainty about these areas of concern in interaction-intensive COBP is exacerbated for foreign locations, as a priori knowledge of both technical and human capabilities in the host environment is likely to be lower than in the home environment, and potential individual providers will be more difficult to evaluate. Since the monitoring of services providers may require visits of managers from the home country to an offshore location, distances associated with foreign locations also play a potentially important role (Ghemawat 2001). For these reasons, provision of interaction-intensive COBP from the same national culture as the likely customers may be preferred but more costly, particularly if the market in question is in an industrial nation.

We expect that firms are likely to consider reducing costs by outsourcing to specialist providers in the target market or nearby countries with similar attributes—so-called near-shoring. The employees of such firms can be expected to have native cultural attributes, and specific technical training can be provided. To prevent cultural and communication problems, European firms can afford to take a more hands-on approach to training and monitoring the labor force if the service provider is in Hungary than if the service provider is in the Philippines (Beasty 2006). Such specialist suppliers, even in a more expensive location, at least offer economies of scale and scope and superior quality due to their specialized focus,

plus a common legal and regulatory regime offers greater protection from the potential consequences of behavioral uncertainty. Therefore, we suggest that in the case of interaction-intensive COBP, environmental uncertainties are relatively difficult to resolve, shifting the location choice to focus on quality of service and onshore (or perhaps near-shore) locations, where behavioral uncertainties involved in outsourcing are lower, and sourcing can focus on direct cost minimization.

6.3.2.3 The Dynamics of Outsourcing and Offshoring COBP

Finally, the strategic centrality and associated relative pressures toward specific location and governance choices for COBP are dynamic processes, changing with time, competition, and innovation. Specific COBP activities may transition from being core resources, sources of economic rents and sustained competitive advantage, to complementary or peripheral roles as they are finely subdivided and competitors begin to apply similar processes. Help desks were a real advantage to consumer-oriented personal computer companies such as Dell and Gateway at a time when larger firms focused on business customers and could provide on-site support and so saw little value in phone support. Over time, though, help desks became ubiquitous and are now more necessity for participation in the industry than a source of competitive advantage. Similarly, a firm may decide to take a more “customer-friendly” approach, moving its COBP into more strategically relevant locations.

In other cases, what were seen as monolithic services have become separable with improvements in ICT and innovative approaches to service provision. Tax consultants based on the United States can now visit key clients armed with analyses developed in India—the high-priced consultant can see more clients in a given amount of time, and the cost of the data analysis is lowered through offshoring. Of course, the consultant herself may be contracted to the nominal service provider, not an employee, and the India data-cruncher may also be contractor. Such developments in providing COBP seem to be increasing as economic pressures motivate more firms to consider experimenting with different combinations of outsourcing and offshoring and to also reconsider just exactly *what* their firm-specific sources of competitive advantage really are.

Outsourcing and offshoring decisions also are dynamic. Investments in some in-house offshore locations have increased the range of customer services that can be competently handled offshore, capabilities increase with time, and suppliers (particularly foreign suppliers) of services build reputations as they perform. As we have seen, firms have spun off offshore activities, while others have internalized previously contracted services. In the mortgage banking industry, some mortgage lenders have reversed earlier offshoring practices, especially those involving customer-facing processes, due to customer concerns, but have increased the offshoring of back-office and technology-based processes (Masood 2007). When COBP are perceived as supplemental, either marginally complementary or peripheral, firms

sometimes take a trial-and-error approach to offshoring decisions, with considerable learning by doing.

We illustrate the possibilities of changing assessments of international transaction value with the “Tech Path” and “Touch Path” arrows in Fig. 6.1. Each of these is intended to suggest that location and governance decisions can migrate as strategic, transactional, and locational benefits and costs are assessed and reassessed over time. Two paths are selected, as we expect that the relative information-intensiveness or interaction-intensiveness of any particular service will have a significant impact on the choices made, in keeping with the previous section. Consider the dynamics of an information-intensive process, the “Tech Path.” As a particular process is seen as less than core to the firm’s competitive advantage—possibly due to reassessment of some customer-oriented service, possibly because new technologies have developed, possibly due to a new separation of previously integrated processes—and slips into the range of complementary capabilities, it becomes first more likely to be offshored and only to be outsourced to a partner in the foreign location as its centrality falls further. Upgrading the strategic status of a peripheral information-intensive service would reverse this path by first bringing it in-house then possibly bringing it to the home market only if it is eventually seen as a major source of competitive advantage. This path suggests that retaining control of important complementary assets to avoid behavioral opportunism, even while cutting costs by sending responsibility for providing the service to a foreign location, is the key to managing information-intensive processes.

The “Touch Path” would then be followed in the case of downgraded interaction-intensive processes. We suggest here that, in accordance with the previous section, as an interaction-intensive process moves from core to complementary in its strategic centrality, it is most likely to be outsourced to an onshore provider. This will protect the cultural integrity of the interactions related to the process, while reducing costs by using a specialist provider. As suggested above, behavioral opportunism risks should be minimal in the same jurisdiction and in a relatively small and specialized market. If the process continues to lose importance to the focal firm, we would expect that, as a peripheral capability, it would eventually be moved offshore to a foreign outsourcer, possibly by the focal firm or possibly by the domestic outsourcer via a subcontract. Likewise, a developing realization that an offshored and outsourced interaction-intensive service needed to be upgraded, possibly due to a renewed consumer service emphasis, should lead to first bringing the service closer to the customer, either onshore or at least to a “near-shore” location, and only later to bring it in-house.

Of course, these are projected tendencies, and many COBP mix information and interaction-intensiveness. In addition, firms often do not have a solid perception of just how central a process may be to their strategies, and these strategies may change. Further, COBP that are seen initially as information-intensive may turn out to have greater than expected interaction issues attributed to them by customers and may need to switch from one path to the other (or at least from an inclination in one direction to an inclination in the other). This may be, for

instance, the key to Dell bringing some of its help desk activities back onshore. Dell thought that the help desk existed to provide information to users, while Dell's business customers expected not just information, but customized information and customized interpersonal interaction guided by a deeper understanding of business needs and business culture—a difficult role to send offshore.

6.4 Conclusions and Implications

The growth of COBP outsourcing and offshoring as a key strategic decision reflects the overall rise of the global service economy. The growing occurrence of BPO/O reflects the integration of the powerful forces of the service economy, the increasing role of information technology, and globalization. For competitive reasons, firms want their business processes to be high tech, with low labor costs and high service quality, and are turning to a globally dispersed value chain strategy to make this possible. Customer-oriented, but offshored, business processes remain highly telephone or voice-based while becoming sufficiently sophisticated as to be referred to as “knowledge process outsourcing” or “judgment-based outsourcing” (Anonymous 2006).⁴ We have focused on customer-oriented services common to most consumers and firms, yet the next generation of offshoring is likely to encompass a wide range of innovation and knowledge creation activities (Lewin and Couto 2007). Firms are rethinking their strategies and structures in order to cut costs, but also to better serve their customers and seize new opportunities. The conceptual model offered in this chapter is intended to shed light on these decision making challenges.

Overall, our model of COBP outsourcing and offshoring decisions builds on the solid theoretical framework of transactional value theory, as a combination of resource and capability theory and transaction cost theory, and also applies theories of location-based advantage. In doing so, the model takes a strategic management approach to Dunning's (1988) eclectic paradigm and applies it to service activities. This can be considered a geography and governance model. The model incorporates concepts of asset specificity and production costs into the model, and it uses multiple measures of environmental uncertainty and behavioral uncertainty to describe potential transaction-related costs. The model also includes the moderating factors of COBP resource centrality and the relative importance of tech versus touch and is one of the first to incorporate the role of both human touch and information technology. In this way, it reflects much of the complexity of the COBP outsourcing decision in a global business environment characterized by rising utilization of ICT, but also one with rising customer expectations for expert

⁴ Note that popular parlance still frequently fails to differentiate outsourcing and offshoring. Popular concerns are primarily with offshore value production, but popular terminology describes the governance decision. As scholars make the distinction found in Fig. 6.1, perhaps this will change in the wider parlance.

and personalized service. Of particular note is that not all “human interaction” transactions require actual face-to-face interaction. The “touch” may be electronic in many cases, so long as a sense of human caring is transmitted.

Our international transaction value model is potentially generalizable to other forms of outsourcing and offshoring. If we focus on customer preferences in goods versus productivity and efficiency, we see many of the same influences—which is of course the driving force behind models of strategic outsourcing (Quinn and Hilmer 1994) and of international production (Dunning 1988) of goods—although the real costs of moving goods long distances make “real transaction costs” much more important to manufacturing than to technology-assisted information flows. Likewise, although many of the insights that we have provided on COBP can be applied to other forms of BPO/O, the lack of customer and revenue focus of back-office processes make the concern for customer satisfaction and quality interactions much less salient. Payroll operations will be offshored to a less expensive provider, even if the home country personnel office might be forced to adapt—paying customers will demand more consideration when they are part of the transaction. Thus, while the international transaction value model can undoubtedly be used more generally, it seems to provide the greatest clarity in the case of customer-oriented business processes.

The international transaction value model and our interacting considerations lend themselves to future empirical testing. Testing will provide additional insights and specific managerial guidance. To test the framework empirically, our model will need further refinement, with measures developed for each construct. Although the empirical research can utilize existing scales to some degree, the areas of new theory development will require new constructs and measures. Empirical testing also raises a number of data questions. Data on business process outsourcing are becoming more available, yet a number of data collection issues remain, especially for cross-country research. Given adequate data, future research could also examine the moderating effects of the firm’s network of organizational relationships, as suggested by Geyskens et al. (2006).

The governance question raised at the outset of the paper was when, why, and how are companies shifting COBP to outsourced and/or offshore providers? Part of the answer to this question is that customer relationships are not a key source of competitive advantage to all firms. A greater part of the answer is tied to expected value. McKinsey and Company calculated that every dollar’s worth of business offshored from the United States and United Kingdom creates between \$1.45 and \$1.47 of value, with at least \$1.12 being reinvested back to the United States or United Kingdom and the rest going to the recipient country (Yeung 2005). Our international transaction value model provides an in-depth, theoretically grounded answer to this question. Firms calculate net transactional value by estimating the rents less costs of the COBP sourcing decision, taking into account the transactional costs of the governance decision to outsource or not, and the locational costs of the siting decision between a local or lower cost foreign market. In addition, the resulting levels of customer satisfaction, process improvement, capability enhancement, and firm learning should also be considered in the net value calculation.

Companies are rethinking their strategies and crossing international boundaries in order to better serve their customers, seize new opportunities, and cut costs. As firms seek ways to better manage COBP for their continued competitive advantage, firms consider a range of inter-organizational governance structures (Heide 1994). This may mean managing processes in-house or by outsourcing, onshore or offshore. For many firms, outsourcing options are likely to remain attractive, either in offshore or onshore locations. Our research illustrates that the factors underlying outsourcing and offshoring are not the same—but they are related. As long as environmental and behavioral uncertainty costs continue to decrease due to IT advances and globalization, and outsourcer cost advantages remain significant, outsourcing and offshoring COBP will continue to grow. Growth may be limited by firm recognition of the strategic importance of customer relationships in some markets and by customer demands for higher levels of interpersonal competence from their service providers. Even in a high tech, global world, human touch still matters.

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