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Strategic Off-shore Business Process Outsourcing and Competitive Advantage: The Role of Strategic Intent and Absorptive Capacity

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ABSTRACT

While off-shore business process outsourcing (off-shoring) is fast becoming a mega-trend, little is known about the strategic implications of such efforts. In this research we build and test a conceptual model of strategic off-shoring. The model draws from the contingency theory and dynamic capabilities streams of research and posits strategic intent and absorptive capacities as antecedents of competitive advantage derived from business process off-shoring arrangements. The model is currently being tested with the help of interview data collected from a number of providers of business process outsourcing in India.

KEYWORDS

Off-shore Business Process Outsourcing, Strategic Intent, Absorptive Capacity, Competitive Advantage

INTRODUCTION

Off-shore Business Process Outsourcing (off-shoring) – the process of aggregating value-chain activities or business processes and moving them to firms in other countries (McFarlan & DeLacey, 2004) – has increased in scale and intensity within the last ten years (Illie & Parikh, 2004). With the increasing globalization of markets, spurred by heightened competition and advances in information and communication technologies, among other things, firms in Western countries are increasingly experiencing intense pressures to reduce cost and to increase product/service quality, innovation, and customer responsiveness. To achieve and sustain competitive advantage in the global market place, firms can no longer strictly go it alone: they must enter into and cultivate value-enhancing relationships with providers of off-shoring services, domiciled in low-cost, developing countries, such as India, China, and the Philippines. Although off-shoring can deliver strategic benefits, in the form of lower costs and higher quality of product or service offerings to users of off-shoring services, the opportunity (or “hidden”) costs of off-shoring can also be quite high.

Thus, the purpose of our research is to develop a grounded theory-based model of *strategic off-shoring*. Based on the premise of *strategic fit, alignment or configuration* rooted in the contingency theory literature, as well as recent work in the dynamic capabilities-based view of strategic management, we identify two key antecedents of strategic off-shoring – *strategic intent* and *absorptive capacity* and discuss their roles in fostering dynamic capabilities, leading to *competitive advantage*. The overarching premise of our model is that in order to more fully capitalize on the benefits of off-shoring, both Off-shoring *providers* (local firms in developing countries that specialize in providing customized off-shoring services) and Off-shoring *clients* (i.e., foreign firms that use off-shoring services) must assess the extent to which their strategic priorities (or intents), as well as their absorptive capacities are well aligned. In turn, such an alignment will likely foster knowledge development and use, leading to a sustainable competitive advantage. Figure 1 provides the conceptual model that we develop subsequently. Initial empirical corroboration of this conceptual model is provided using interview data collected from various Off-shoring providers in India. India, currently the global leader in providing BPO services to a wide range of firms in western countries (McFarlan & DeLacey, 2004), provides a natural context for testing our conceptual model of strategic

business

process

off-shoring.

A Model for Firm-Level Competitive Advantage via Off-shoring

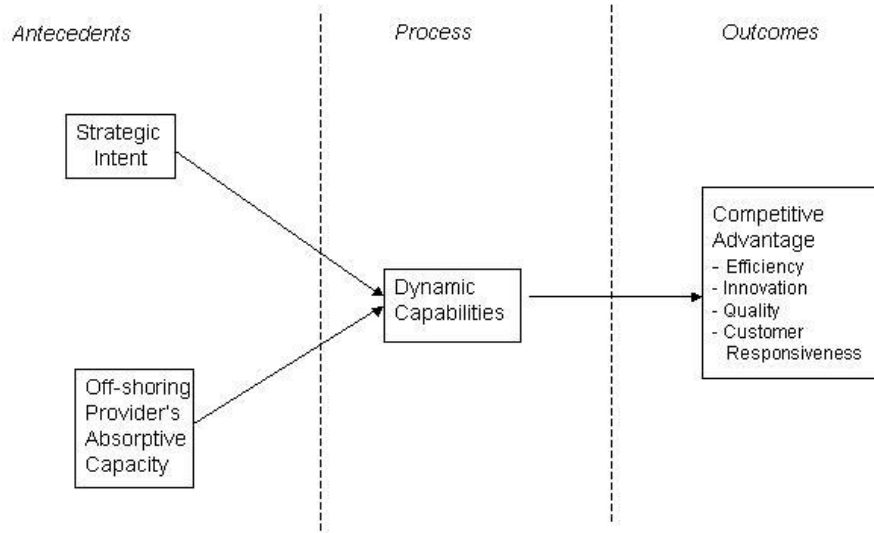


Figure 1. Conceptual Model of Strategic Business Process Off-Shoring

The conceptual model of strategic off-shoring integrates several recent research streams in strategic management, including literature in “core competence” (Hamel & Prahalad, 1989; Prahalad & Hamel, 1990), “dynamic capabilities” (Teece, Pisano, & Shuen, 1997), the “relational view” (Dyer & Singh, 1998) with ideas in traditional, contingency-based approaches in strategic management (e.g., Drazin & Van de Ven, 1985). Miller and Shamsie (1996) argued that it is necessary to systematically document the extent to which different types of firm resources and capabilities align with different contextual factors (such as environmental dynamism or organizational form) in order to develop a fine-grained, empirically testable resource-based theory. Building on this insight, we argue that in order for the research in business process outsourcing to move forward, it is important to systematically investigate a parsimonious set of antecedent factors (and alignment among them), and document their role in fostering the dynamic capabilities, leading to sustainable competitive advantage. Specifically, we argue that two such antecedent factors – the strategic intents of Off-shoring clients and providers and the requisite “absorptive capacity” of the Off-shoring providers – play a critical role in fostering dynamic capabilities, leading to the achievement and sustainability of strategic advantage (or win-win outcomes) for both parties. As strategy researchers have amply documented, firms that are able to develop and leverage “relational capabilities” through strategic collaboration are more likely to gain sustainable strategic advantages in an increasingly interdependent global market place (e.g., Dyer & Singh, 1998; Kale, Singh & Perlmutter, 2000; Lado, Boyd & Hanlon, 1997). Thus, an effective alignment of strategic intent and absorptive capacity can provide a stronger basis for building and sustaining “collaborative advantages” for both Off-shoring Client and Off-shoring Provider than a lack of strategic alignment.

ANTECEDENTS OF BUSINESS PROCESS OFF-SHORING

Strategic Intent. Hamel and Prahalad (1989) introduced the concept of strategic intent to describe an organization’s quest for leadership and success in the global market place. Characterizing “an obsession with winning at all levels of the organization” (Hamel & Prahalad, 1989: 64), strategic intent underscores the idea that in order to gain and sustain strategic advantage in the global market place, forward-looking strategic managers must articulate ambitious strategic goals that surpass the firm’s existing resource or capability base, and then actively mobilize the additional resources and capabilities necessary to accomplish the stated strategic goals (Hamel & Prahalad, 1994). Strategic intent also serves to infuse

organizational members with high levels of energy and enthusiasm, which can be effectively channeled to beneficial organizational ends. Thus, this concept reflects a sharp departure from tradition in strategic management that emphasizes establishing a “fit” between an organization’s existing stock of resources and capabilities on the one hand, and external environmental contingencies or imperatives, on the other (e.g., Lawrence & Lorsch, 1967). Instead, it places a premium on organizational actors’ volition and capacity to “enact” a beneficial environment through experimentation and improvisation (Weick, 1979).

In the context of off-shoring, the idea of strategic intent suggests the need for both Off-shoring clients and providers of off-shoring solutions assess the extent to which their strategic intents are compatible, as well as the extent to which such strategic intents provide an overarching basis for developing and deploying the core competencies needed to achieve positions of leadership and success in the global market place. Thus, for example, for an Off-shoring Client who exhibits a weak (or low) strategic intent, off-shoring might be considered merely as a “quick fix” to current operational pressures for cost reduction. Indeed, as DiRomualdo and Gurbaxani (1998) noted, cost reduction and efficiency enhancement have been the dimension of “strategic intent” most frequently mentioned in strategic decisions relating to the outsourcing of information technology. However, in the context of Off-shoring, a stronger (or higher) strategic intent might also encompass the quest for refining or “upgrading” of existing competencies, as well as searching for or developing new organizational competencies necessary for effectively achieving positions of competitive advantages in new markets in the future (Hamel & Prahalad, 1994). We argue that an off-shoring relationship characterized by a low strategic intent on the part of both the Off-shoring Client and Off-shoring Provider might at best yield short-term strategic or operational benefits, and thus, temporary strategic advantages. At worst, it might lead to the erosion of one partner’s competitive advantage through the skillful exploitation of its valuable resources and capabilities by the other party over time. Such an off-shoring relationship reflects a mismatch or misalignment of strategic intents, and is unlikely to produce win-win outcomes for the parties involved. In contrast, an off-shoring relationship characterized by high strategic intent on the part of both parties to the exchange is likely to produce the greatest “collaborative advantages” in the long run. Such a relationship reflects repeated interactions between the exchange parties, which form the basis for future interactions, and entails the exchange of relationship-specific resources and capabilities, thus facilitating the accomplishment of mutual strategic goals (Kishore et al., 2003). Additionally, the extent to which an off-shoring relationship can be the source of capability development and strategic advantage also depends on the relative absorptive capacities of the parties involved, which we discuss next.

Absorptive capacity. According to Cohen and Levinthal (1990) absorptive capacity describes a firm’s ability to recognize the value of new, external information, assimilate it, and apply it to commercial ends. Such absorptive capacity is dependent on a firm’s prior knowledge, diversity of its background, extent of its communication systems and on the presence of “gate keepers” or “boundary spanners” in the firm. In the context of technology transfer, Kedia and Baghat (1988) used the concept of absorptive capacity to describe a recipient firm’s value orientation (i.e., local versus cosmopolitan), its possession of a sophisticated technological core as well as its strategic management process. Similarly, Zahra and George (2002) describe absorptive capacity in terms of organizational routines and processes, by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organizational capability.

This two-dimensional conceptualization of absorptive capacity provides a novel approach for understanding the capabilities of Off-shoring Providers and their potential to produce and deliver on their contractual commitments to their Off-shoring Clients. Thus, for example, an Off-shoring Provider whose absorptive capacity is characterized by low realized and low potential capabilities might only be considered for mundane, low-value-chain activities, the benefits of which might fall short of the total costs of their provision to the client. In this case, neither the Off-shoring Client nor the Off-shoring Provider stands to benefit from such a relationship. Any competitive advantages accruing from such an off-shoring relationship are at best fortuitous and short-lived. On the other hand, an Off-shoring Provider that exhibits high levels of both realized and potential absorptive capacity dimensions might be well positioned to implement and deliver Off-shoring solutions that would meet current as well as future needs of the client.

When joined with a high strategic intent (as discussed previously), such absorptive capacity might provide a robust basis for predicting the likelihood that an Off-shoring Provider endowed with such competencies will likely produce and deliver effective solutions to its client. In turn, this quality of service might translate into an “output-based competency” (Lado, Boyd & Wright, 1992) that signals to current and potential clients that the Off-shoring Provider is competent and trustworthy, thus bolstering its prospects of achieving a sustainable competitive advantage in the off-shoring industry. As noted by Lado et al. (1992:87), “a firm’s long-run survival and growth largely depends on how well value is delivered to its most important constituents – the customers.” In the context of the off-shoring relationship, such a competency, reflecting the extent to which an Off-shoring Provider delivers value to the Off-shoring Client via superior service, quality, reliability, etc. might enhance its reputation and image in the market for off-shoring services. Because such a reputation is developed over a long period of time and is hard to replicate, it can be the source of sustainable competitive advantage. In contrast, a low strategic intent,

coupled with a low absorptive capacity can be the source of competitive disadvantage, because such a strategic alignment reflects an orientation on the part of the off-shoring provider toward maintenance of the status quo, one characterized by low competitive “aspiration levels” (March & Shapira, 1987). By emphasizing quick “hits” (i.e., short-term benefits) from outsourcing contracts focusing on cost reduction, such a strategic orientation is unlikely to contribute to building a position of leadership and success in the global marketplace. Thus, an Off-shoring provider with such a strategic profile is unlikely to develop the output-competencies necessary for gaining and sustaining strategic advantage through superior customer (i.e., Off-shoring Client) responsiveness.

RESEARCH PLAN

The research plan is to follow the qualitative research method to provide corroboration with our conceptual model. We conducted a number of structured and semi-structured with executives from many Off-shoring Providers in India. Currently we are coding and analyzing our interview data.

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