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A multi-theory approach to understanding the business process outsourcing decision

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ABSTRACT

This paper proposes a framework for understanding location distance and governance model choice in the business process outsourcing (BPO) decision. Much of the current international business (IB) literature employs location-specific factors alone to explain the BPO decision, and this literature is dominated by studies of the offshore location option, with limited attention given to the local and nearshore location distance options as alternatives to offshoring. The framework proposed here was developed from integrating firm-level and process-level factors with location attractiveness factors, and undertaking in-depth case study analysis of a number of German companies. The findings highlight the value of integrating firm-level and process-level factors with location attractiveness factors to understand location distance and governance model choice in the BPO decision, and support those who have argued that existing frameworks in this area cannot fully explain the complexities of the BPO decision. Moreover, the findings provide important insights into how these factors interact to influence location distance and governance model choice. The proposed BPO framework also provides a useful basis for practical prescription.

1. Introduction

Outsourcing has become a strategic imperative as organisations seek to reduce costs and specialise in a limited number of core areas. Developments such as globalisation, more demanding consumers, corporate restructurings and advances in information and communication technologies (ICTs) have been important drivers of business process outsourcing (BPO) (McIvor, 2010). For example, ICTs have facilitated the dis-aggregation of business processes into smaller standardised tasks, which has facilitated outsourcing to lower cost vendors (Sako, 2009). BPO is an important aspect of information technology (IT) enabled processes such as human resource services, and involves the vendor taking responsibility for executing a process and delivering it to the client as a service (Mani, Barua, & Whinston, 2006).[1]

BPO has grown as organisations have been transferring responsibility for entire functions such as human resources, logistics, customer contact, and IT services to both local and foreign vendors (Sako, 2006). Organisations have been employing specialist vendors in distant locations such as India to reduce costs and improve performance (Lahiri & Kedia, 2011; Schmeisser, 2013). Whilst the first wave of outsourcing involved outsourcing labour-intensive manufacturing processes, the current wave of BPO has expanded to include knowledge-intensive professional services such as accounting and legal support (Blinder, 2006; Sako, 2009) – sometimes referred to as knowledge process outsourcing (Currie, Michell, & Abanishe, 2008).

Organisations have a range of location options to select from including local, nearshore, and offshore when outsourcing services. Local outsourcing involves outsourcing to a vendor located in the client's home nation, and offers the advantages of the same culture, language, time zone, and physical proximity (McIvor, 2008). Nearshore outsourcing allows an organisation to outsource to a location that is relatively close in distance, time zone, culture, or language, whilst at the same time offering the benefits of lower labour costs relative to the client's home nation (Rottman & Lacity, 2006). Although offshore outsourcing involves outsourcing to a distant country, where there are significant cultural or language differences, an organisation can benefit from significant lower labour costs (Aron & Singh, 2005).

Organisations have been pursuing a number of governance models to manage BPO arrangements. The captive model is a

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[1] Information technology outsourcing refers to the use of external vendors to deliver the IT-element of the business process, which includes programming, application services and infrastructure. It is often referred to as a subset of BPO (Lacity, Solomon, Yan, & Willcocks, 2011).

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common governance arrangement where the client builds, owns, staffs and operates the facility to avail of skills and lower labour costs (Aron & Singh, 2005). As a more flexible alternative to the captive model, organisations have been using independent vendors in foreign locations for outsourcing business processes, which is likely to involve adopting a collaborative relationship with the vendor where the requirements of the client are not standardised and frequent changes are required (Rottman & Lacity, 2006).

Although the BPO phenomenon has been attracting the attention of international business (IB) scholars (Doh, Bunyaratavej, & Hahn, 2009; Graf & Mudambi, 2005; Hätönen, 2009; Jensen & Pedersen, 2011; Kedia & Mukherjee, 2009; Schmeisser, 2013), the current literature has a number of limitations. Much of the literature is dominated by studies of the offshore location option (Kumar, van Fenema, & von Glinow, 2009; Lahiri & Kedia, 2011; Lampel & Bhalla, 2011), with limited attention given to the local and nearshore location distance options as alternatives to offshoring (Hahn, Bunyaratavej, & Doh, 2011; Schmeisser, 2013). A further limitation is that many of the studies in the IB literature use Dunning's (1977, 1988) eclectic paradigm alone to analyse how host country variables influence location choice in the BPO decision (Bunyaratavej et al., 2008; Graf & Mudambi, 2005; Kedia & Mukherjee, 2009).

It is increasingly recognised in the IB literature that location attractiveness factors alone cannot fully explain the BPO phenomenon (Doh et al., 2009; Hätönen, 2009; Hätönen & Eriksson, 2009; Jensen & Pedersen, 2011), and the analysis should be extended to include factors at the process- and firm-level to explain location distance and governance model choice (Hätönen, 2009; Jensen & Pedersen, 2011). Analysis at the process level is particularly important given that the unique features of services, such as the involvement of the customer in service delivery, and the intangible nature of services make BPO more complex than manufacturing outsourcing (Doh et al., 2009). Moreover, firm-level factors such as the level of outsourcing experience, relationship management capabilities with vendors, and corporate restructurings are also important influences (Hätönen, 2009; Jensen & Pedersen, 2011; Maskell, Pedersen, Petersen, & Dick-Nielsen, 2007).

This study seeks to address this gap in the literature by enhancing our understanding of how firms decide between the local, nearshore and offshore location distance options, and captive and independent vendor governance model options. Undertaking in-depth case study analysis of BPO arrangements by a number of German companies, and employing the eclectic paradigm, transaction cost economics (TCE) and the resource-based view (RBV) as a theoretical basis, the study integrates location attractiveness factors along with process- and firm-level factors to develop a framework for explaining the BPO decision in relation to location distance and governance model choice.

The research makes a number of important contributions. Firstly, integrating firm- and process-level factors with location attractiveness factors has allowed us to better understand location distance and governance choice. The findings have shown how firm-level factors are an important influence on the local, nearshore, and offshore location options. Firm-level factors such as the presence of in-house human resources with foreign language and culture skills act as an important influence on the offshore option. Employees with foreign language and culture skills can mitigate the negative effects of cultural distance in the offshore location option. Process-level factors were also important influences on location distance choice. The offshore location option was more likely to be chosen for processes that were highly standardised, and low requirements uncertainty. The findings have also highlighted how firm-level, process-level, and location attractiveness factors interact to influence location distance and governance model choice. For example, firm-level capabilities in process improvement techniques were employed to redesign and standardise processes, which allowed organisations to outsource processes to more distant locations.

Secondly, the research highlights the value of integrating TCE and the RBV with Dunning's eclectic framework to enhance our understanding of the BPO decision. The logic of each of these theories was present, as the organisations standardised and outsourced processes to vendors with lower production costs in lower labour cost locations, whilst at the same focused on core capabilities and accessed the specialist capabilities of vendors. However, the findings have revealed the contradictory nature of TCE and RBV in BPO decisions, which is identified as an important area for further research. Moreover, further research is required to enhance our understanding of how organisations develop firm-level capabilities to leverage the benefits BPO offers.

Thirdly, the research in this paper has addressed an important area for practitioners. As organisations increasingly outsource more critical business areas such as design and customer relationship management, they are seeking to leverage a greater level of value from BPO. Although cost concerns are still important motivations for BPO, the implications for the long-term capabilities of the organisation have to be considered. The BPO framework developed in this paper provides a valuable basis for practical prescription, which integrates firm, process and location attractiveness considerations. In particular, it provides a mechanism for understanding which processes should be internalised or outsourced, based on firm and process level considerations rather than on location attractiveness influences alone.

2. Literature review

Much has been written in the IB literature on the motives for the offshore outsourcing of business processes, and the associated benefits and risks for firms and nations outsourcing to offshore locations (Jensen, 2012). Location choice in the BPO decision has become an important strand of the IB literature with a number of scholars examining the influence of host country variables such as human capital, infrastructure, country risk and government factors (Bunyaratavej et al., 2008; Graf & Mudambi, 2005; Kedia & Mukherjee, 2009). For example, Bunyaratavej et al. (2008) analysed host country attractiveness in the context of BPO, and found that countries are more attractive where they offer efficiencies in wages, infrastructure, and education. Similarly, Bunyaratavej, Hahn, and Doh (2007), using a parity perspective of home versus host country factors, found that firms are more likely to offshore processes to locations with lower but increasing wages towards home country parity and to those with a similar culture and education level.

Governance model choice is another element of the BPO decision, and this area has also been attracting the attention of a number of IB scholars (Demirbag & Glaister, 2010; Hutzschenreuter, Lewin, & Ressler, 2011). Demirbag and Glaister (2010) have found that home and host country factors determine the location choice for the captive offshoring governance model in the case of research and development services. Moreover, Hutzschenreuter et al. (2011) examined the factors that influence a firm's governance model for offshoring business processes, and found that it was influenced by the institutional environment, firm-specific characteristics, and the individual settings of a particular implementation.

Although research in location and governance model choice has been increasing, the current IB literature has a number of shortcomings. Much of the literature is dominated by studies of the offshore location option (Kumar et al., 2009; Lahiri & Kedia, 2011; Lampel & Bhalla, 2011), and insufficient attention has been given to the local and nearshore location distance options as

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alternatives to offshoring (Hahn et al., 2011; Schmeisser, 2013). Indeed, there are few studies currently in the IB literature that analyse the factors that influence the choice between the local, nearshore, and offshore options. Moreover, little attention has been given to understanding the factors that influence the nearshore location option in the IB literature (Lewin & Volberda, 2011). A further shortcoming is that many of the studies in the IB literature use Dunning's (1977, 1988) eclectic paradigm alone to analyse how host country variables influence location choice in the BPO decision (Bunyaratavej et al., 2008; Graf & Mudambi, 2005; Kedia & Mukherjee, 2009). It is increasingly recognised in the IB literature that location attractiveness factors alone cannot fully explain the BPO phenomenon (Doh et al., 2009; Hätönen, 2009; Hätönen & Eriksson, 2009; Jensen & Pedersen, 2011), and that multiple theoretical perspectives are required (Hutzschenreuter et al., 2011).

A number of authors have argued that location distance and governance model choice depends on the fit between location factors and the characteristics of the outsourced processes (Hätönen, 2009; Jensen & Pedersen, 2011). Process characteristics such as the level of customer contact, process complexity, and process customisation are also important influences on the decision (Jensen & Pedersen, 2011). As firms outsource more complex processes over greater distances, the need for additional coordination mechanisms increases, which in turn increases costs. The difficulties of transferring processes to vendors in distant locations are further increased where the process involved is highly customised and has complex interdependencies with other processes (Stringfellow, Teagarden, & Nie, 2008).

The dominance of the eclectic paradigm has also led to insufficient consideration being given to how firm-level factors influence the BPO decision (Hätönen, 2009). Some authors have argued that factors at the firm level such as the level of outsourcing experience, relationship management capabilities with vendors, and corporate restructurings are also important influences (Hätönen, 2009; Jensen & Pedersen, 2011; Maskell et al., 2007). It is likely that more experienced firms will differ from less experienced firms in their evaluation and approach to managing the governance model chosen (Martínez-Noya, García-Canal, & Guillén, 2012). Moreover, firms view BPO as a way of supplementing core capabilities by accessing the specialist capabilities of vendors in areas such as process design and continuous improvement (Shi, 2007). Corporate restructuring efforts are important influences on outsourcing as organisations focus on core areas that are critical to competitive advantage, and outsource back-office functions such as human resource, and finance and accounting that are resource intensive, and have little impact on competitive advantage (McIvor, 2010; Sako, 2009).

This study seeks to address this gap in the literature by enhancing our understanding of how firms decide between the local, nearshore and offshore location distance options, and captive and independent vendor governance model options. The study integrates location attractiveness factors along with process- and firm-level factors to develop a framework for explaining the BPO decision in relation to location distance and governance model choice. Following this logic, the research question of this study can be formulated as follows:

> RQ. How do location attractiveness, process-level, and firm-level factors influence location distance and governance model choice in the BPO decision?

2.1. Conceptual framework

The conceptual framework was developed to address the research question. This involved reviewing the literature to identify a number of suitable theories that could be used as a theoretical basis to examine how location attractiveness, process-level and firm-level factors influence location distance and governance model choice in the BPO decision. The research focused on the local, nearshore and offshore location distance options, and captive and independent vendor governance model options. Dunning's eclectic paradigm was chosen to understand the location attractiveness influences on location and governance model choice (1998, 1988). Dunning's eclectic theory proposed three determinants of international production: ownership advantages, internalisation advantages, and location advantages to explain the location of international production. Dunning (1988) identified three categories of factors that affect location advantages including infrastructure (physical and digital capabilities related to communication, production and transportation), country risk (economic and political risk factors), and government policy (costs and location incentives). The value of applying the location advantages determinant of the eclectic paradigm to the BPO location decision has been well acknowledged in the IB literature (Graf & Mudambi, 2005; Kedia & Mukherjee, 2009; Schmeisser, 2013).

Although the eclectic paradigm can explain the influence of location attractiveness factors, it cannot fully explain the complexities of location and governance model choice in the BPO decision. The location, ownership and internalisation advantages determinants of the eclectic paradigm have been applied widely in the IB literature in an attempt to explain the origin, level, pattern, and growth of MNEs' offshore activities (Eden & Dai, 2010) including international production and foreign owned activities including FDI (Dunning, 1988, 2001; Stoian and Filippaios, 2008). However, a number of authors have argued that the eclectic paradigm cannot fully explain the complexities of the BPO decision (Graf & Mudambi, 2005; Hätönen, 2009; Jensen & Pedersen, 2011; Martínez-Noya et al., 2012). Critical aspects of location distance and governance model choice in the BPO decision such as strategic importance, process standardisation and the level of vendor dependency are not fully considered in the eclectic paradigm (Hätönen, 2009). Moreover, additional theoretical perspectives are required to allow a more fine-grained analysis of the influence of process- and firm-level factors (Jensen & Pedersen, 2011).

TCE and the RBV were employed to analyse the influence of process-level and firm-level factors. TCE specifies the conditions under which an organisation should manage an economic exchange internally within its boundaries (hierarchies) and the conditions suitable for managing an economic exchange externally (markets) (Williamson, 1975). Hierarchies involve performing processes inside the firm, whilst markets involve relatively short-term, bargaining relationships between independent buyers and suppliers. Production costs are the direct costs in creating a product and include labour and infrastructure costs. Transaction costs involve the costs of monitoring, controlling, and managing the contract with the vendor. Influences on transaction costs include the level of specific investments involved, uncertainty, and performance measurement difficulties, and the number of suppliers (Williamson, 1985). These influences on transaction costs are closely related to process-level factors in the BPO decision. For example, the presence of investments in physical or human assets specific to a particular BPO arrangement will create switching costs for the client. Moreover, difficulties with measuring process performance can create difficulties in the outsourcing relationship, as the client has to expend additional resource on monitoring performance (Williamson, 1985).

The RBV is regarded as a valuable theoretical framework for analysing the influence of both firm- and process-level factors such as internal capabilities in BPO and the strategic importance of the process on the BPO decision (Ceci & Prencipe, 2013; Lewin & Peeters, 2006; Martínez-Noya et al., 2012). The RBV views the firm

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as a bundle of assets and resources that if employed in distinctive ways can create competitive advantage (Barney, 1991; Peteraf, 1993). Proponents of the RBV argue that heterogeneity in an organisation's knowledge-based resources and capabilities explain differences in performance and the sustainability of a competitive advantage (Barney, 1991). The RBV is important to the study of outsourcing, as superior performance achieved in organisational processes relative to competitors would explain why such processes are performed internally (McIvor, 2009; Peng, 2001; Warner & Carrick, 2011). Adhering to the logic of the RBV, the BPO decision is influenced by the ability of an organisation to invest in developing a capability and sustaining a superior performance position in the capability relative to competitors. Processes in which the organisation lacks the necessary resources or capabilities internally can be outsourced (Barney, 1999).

3. Research methods

A case study approach was chosen to undertake this research, allowing for richness in both the quality and quantity of data obtained (Gummesson, 1991). Case studies allowed for analysis of the complex relationships and social processes involved in BPO activity not possible via a quantitative approach (Miles & Huberman, 1994). In addition, a case approach allowed for the use of multiple sources of data, including secondary data to enhance the validity of the enquiry. This research strategy allowed for an inductive, in-depth investigation of the topic, analysis of the phenomenon in its contextual setting, and a more holistic investigation of the companies and their BPO decisions (Ghauri, 2004).

In-depth case study research was conducted with five German companies, which for purposes of confidentiality, are referred to as Cases 1, 2, 3, 4, and 5.

Case 1 – a leading provider of a web-based business-to-business platform for supply chain management integration in the areas of sourcing, logistics, finance, engineering, and quality management;
Case 2 – a global chemical company operating in the fields of health care, nutrition, and high-tech materials;
Case 3 – a multinational company operating in the areas of electronics and electrical engineering, energy, and healthcare;
Case 4 – a subsidiary of a multinational chemicals company;
Case 5 – a leading provider of customisable messaging and Internet security software.

German companies were identified as research subjects, as given Germany's geographical size and location, it was likely that the research team would find companies that had selected the range of location distance and governance models under investigation in this study. The cases for this research were purposefully selected and case selection involved Internet pre-screening of German owned and headquartered companies who were actively outsourcing business processes. Cases were identified and selected to encompass the full range of BPO sourcing options. These included the governance choice (captive, independent and vendor), and location distance choice (local, nearshore, offshore, and/or a combination). A number of the companies had outsourced processes to local vendors, as well as to vendors in nearshore locations such as Hungary, and to vendors in offshore locations such as Malaysia. Some had established wholly owned captive operations in foreign locations. This allowed the researchers to analyse the full range of factors that influence each of these BPO options. In addition, the investigated companies had been involved in BPO for between three and twelve years.

3.1. Data collection

The conceptual framework, based on concepts drawn from TCE, the RBV, and the eclectic paradigm, was used to inform the development of a detailed research protocol for undertaking data collection. The unit of the analysis was the BPO decision, and how location attractiveness, process-, and firm-level factors influenced location distance and governance model choice. Fig. 1 provides a summary of the BPO decisions studied along with the case labels.

The first stage of the data collection phase focused on the background and overall strategy of the companies. This involved gathering data on influences from the industry environment such as customer demands, competitor actions, technology changes and government. Primary data collection was via semi-structured interviews. An interview guide was developed from the conceptual framework to carry out the interviews. Four in-depth interviews were conducted with each case company making twenty formal interviews in total. In addition a number of less formal telephone interviews were carried out. Thirty-two interviews in total were conducted with these case firms. The respondents chosen were both senior managers who were involved in making the BPO decision, and personnel from a range of functions at lower levels in the companies, who were implementing the BPO arrangement (Huber & Power, 1985). Full access was granted to these personnel, which facilitated the collection of data at the level of quantity and quality required. The interviews normally lasted from one to three hours. All interviews were audio-recorded for later analysis and a

	Local	Nearshore	Offshore
Independent vendor	*Case 5 Sales Local* A sales process outsourced to a local vendor in Germany.	*Case 1 SWDevelopment Nearshore* Software development process outsourcing to a vendor located nearshore in Byelorussia.	*Case 4 Infrastructure Offshore* An IT infrastructure operation outsourced to a vendor located offshore in Malaysia.
Captive	*Case 2 BPO Local* A BPO captive operation established by *Case 2* in Germany.	*Case 3 SWDevelopment Nearshore* A software development captive operation located nearshore in Hungary.	*Case 2 Infrastructure Offshore* An IT infrastructure captive operation located offshore in India.

Fig. 1. Summary of BPO decisions.

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transcription of each interview was created within 48 hours after its occurrence in order to control bias and increase data reliability (Saunders, Lewis, & Thornhill, 2009).

Secondly, data was also collected from a number of other sources including a range of documented material detailing the rationale for the BPO decision after an approach used by Loane, Bell, and McNaughton (2006). Information on case companies was collected from sources, such as company websites, the business press, industry journals and partner websites. This secondary data gave an overview of the case companies and enabled the research team be more informed interviewers. A further benefit was that displaying a sound knowledge of the case companies facilitated deeper access and rapport with respondents.

3.2. Data analysis and validation

All the textual data was transferred into the NVivo software, which was used to manage and organise the data systematically in the coding process. This involved matrix coding and analysing text queries in the software to allow the research team to determine the interviewees' views on the factors that influenced the BPO decision. Case study narratives were then developed from both interviews undertaken with personnel involved in the BPO decision and implementation, and from the archival data collected. The research team then reviewed the conceptual framework, and undertook cross-case analysis to develop a preliminary understanding of location attractiveness, process-level, and firm-level factors that influenced location distance and governance model choice. An understanding of these factors emerged iteratively from an analysis of the underpinning theories in the conceptual framework and analysis of the empirical data. As part of this analysis, the follow-up telephone interviews were undertaken to discuss both earlier responses and those of other informants. These interviews involved additional questions based on information obtained from earlier interviews. Once this analysis was complete a further degree of iteration took place to further refine the factors for use in the BPO framework. In adopting this approach the recommendations of Eisenhardt and Graebner's (2007) for in-depth case study research were followed.

Tests of construct validity, internal validity, external validity and reliability were employed to validate the research findings (Stake, 1995; Yin, 2009). To ensure construct validity, multiple sources of evidence including the interviews and archival data were used to triangulate data. Internal validity was ensured by using within-case analysis and then through cross-case analysis, to develop the influencing location attractiveness, process-level, and firm-level factors on the BPO decision. The final follow-up interviews with the case companies reviewed our findings. To ensure external validity, the study used replication logic to conduct and analyse each of the case studies. To increase reliability, all procedures were applied consistently across all cases, including the preparation of interviews and questionnaires, and data collection and analysis.

The following sections present the findings from this analysis including the case companies and their BPO decisions which provides an overview of the BPO decisions studied. Additionally, an overview of the factors that influence the BPO decision is presented; and a prescriptive framework for the BPO decision which provides a overview of the framework, along with the key factors that influence location distance and governance model choice is developed.

4. Background to the BPO decisions

4.1. *Local outsourcing to an independent vendor:* Case 5 Sales Local

Case 5 developed a new product that was targeted towards both distributors and directly to customers. The company had neither the skills internally, nor the infrastructure to serve a growing customer base and thus decided to outsource to a local independent vendor. This was viewed as a flexible way of reacting quickly to market changes, and avoid employing people in-house. One of the main concerns was the inflexible German labour and taxation laws in case of employee redundancies in the future. *Case 5* opted for a German vendor as most parts of the sales process included direct customer contact with its customers in Germany, Austria, and Switzerland, and the importance of native speakers was considered as crucial. Outsourcing to this vendor meant that *Case 5* was avoiding employing staff directly, and thus avoiding inflexible German labour and taxation law. Moreover, the vendor had sufficient area in this area as it was already offering similar services to a range of other customers. The physical proximity of the German vendor was important due to frequent coordination and communication during the management of the outsourcing relationship as the outsourced sales process had close linkages with other internal processes.

4.2. *Nearshore outsourcing to an independent vendor:* Case 1 SWDevelopment Nearshore

As a result of rapid growth *Case 1* outsourced all its software development processes to two independent vendors located in Germany and in the nearshore location Belarus. Prior to nearshore outsourcing *Case 1* had no international outsourcing experience and all software development processes were provided in Germany. *Case 1* decided to outsource to the Byelorussian vendor as a shareholder of *Case 1* had successfully employed this vendor in the past. Moreover, many of the management team in the vendor spoke German. The nearshore vendor was chosen for all software projects that could be clearly specified, and had limited interdependencies with internal processes. The main motive for outsourcing software development to an independent vendor was demand flexibility when more or less programming resources were needed. The key motive for nearshore outsourcing was cost. Significant cost savings could be achieved with daily rates of software programmers in Belarus being proximately 25% of comparable German programmer's rates.

4.3. *Offshore outsourcing to an independent vendor:* Case 4 Infrastructure Offshore

Case 4 was under pressure to reduce costs and improve service levels in IT services, whilst at the same time remain flexible in meeting business growth. These IT services included infrastructure, data processing centres, networks, servers, and applications. The company decided to outsource a range of these services to a German vendor that would deliver these services from its offshore site in Malaysia. Rather than using the vendor's local operations sourcing these services from the offshore site would allow the company to enjoy considerable cost savings. The company had extensive international outsourcing experience and believed it had the necessary skills to manage this offshore arrangement. The company already had built a strong relationship with the vendor in its Germany sites, and was confident that it could establish a relationship with the vendor in the offshore site. This was seen as a better alternative to a captive model in an offshore location as the company lacked the management resource to establish and mange such an arrangement. Moreover, prior to outsourcing the company embarked on a continuous improvement initiative to consolidate and standardise much of its IT service requirements, which in turn would reduce the risks of outsourcing offshore.

4.4. *Local captive model:* Case 2 BPO Local

Case 2 embarked on a corporate restructuring programme, which involved consolidating a number of functions from different

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locations in Germany into an internal shared services operation. These services included procurement and logistics, HR services, in-house consulting, finance and accounting, and IT. A key objective of this shared services operation involved redesigning and, where possible, standardising many of the services so that they could be delivered from a single services centre. The company considered outsourcing some of these services to local vendors. However, they opted to retain these services internally for a number of reasons. The majority of its core production and research and development (R&D) facilities were located in Germany, and the company wanted to retain close control of the support functions to these core operations. The company believed there was important knowledge sharing and development between its core operations and support functions, which might have been lost through outsourcing. Moreover, many of the internal functions had been providing customised services to the rest of organisation, and external vendors might not have taken too long to replicate these services. Finally, by retaining the services internally the company was obtaining the benefits of consolidation and standardisation rather than sharing these with a vendor.

4.5. *Nearshore captive model:* Case 3 SWDevelopment Nearshore

Case 3 had offshored manufacturing and service processes for a number of years primarily as a result of high labour rates in Germany. As a result of a number of bad experiences with offshore outsourcing of IT services to India it decided to outsource to use nearshore locations in Eastern Europe for IT services. One such operation involved the establishment of a captive arrangement for software development services in Hungary. Establishing a captive operation in Hungary would allow the company to take advantage of more favourable tax rates relative to Germany. Much of the Hungarian population speak fluent German and there was an adequate supply of low cost, suitably qualified labour in the software development field. Hungary shares a land border with Germany, thus facilitating frequent face-to-face communications, which was an important aspect of coordinating and developing software processes. Finally, the captive operation would allow the company to maintain greater control of important knowledge and data, which would not have been possible with an independent vendor.

4.6. *Offshore captive model:* Case 2 Infrastructure Offshore

Case 2 established a captive model in India for its IT infrastructure services with the primary goal of cost reduction. The captive was established in India to represent the growing importance of customers in the Asia-Pacific region for the corporation. By selecting India the company was also benefiting from more favourable employment legislation than in Germany, and this would allow it to be more flexible when demand changed. The company consolidated and standardised many of the processes involved from various geographical locations prior to establishing the captive operation. The highly standardised nature of the services involved meant that they could be easily transferred to an offshore location.

5. Factors that influence the decision

5.1. *Process-level factors*

Using TCE and the RBV as a theoretical basis and analysis of the case study findings, this section introduces the key process-level factors that were important influences on location distance and governance model choice. These factors are summarised in Table 1.

5.1.1. *Complex interdependencies*

Complex interdependencies refer to the inter-connections between processes, business units and tasks, and had an important influence on the sourcing option chosen. The presence of interdependencies means that the performance in one process is dependent upon the execution of other processes, which can have a negative impact upon performance. High levels of interdependencies between processes increase the need for co-ordination, joint problem solving and mutual adjustment, which in turn increase transaction costs (Bahli & Rivard, 2005). Where a process is performed internally, interdependencies can be more straightforward to manage because business units are located on the same site, and an understanding of the interdependencies has built up over time. For example, analysis of back-office processes such as HR, procurement, and finance and accounting by *Case 2* had revealed there were important interdependencies with R&D that facilitated knowledge sharing. *Case 2* decided not to outsource the back-office processes as these important interdependencies would have been at risk through outsourcing.

In the case of outsourced processes the level of interdependencies certainly influenced the location of the vendor. When *Case 5* outsourced part of the sales function it opted for a local vendor due to important interdependencies with internal sales processes. Selecting a local vendor ensured frequent interpersonal communication through visits and face-to-face meetings, as evidenced by a comment from a manager involved: '... *continuous personal contact is extremely important. This is why it is also very important for us that there is physical proximity to our vendor to have this personal contact* ...'

However, when selecting the nearshore or offshore locations the organisations studied were more likely to select processes with a low level of interdependencies due to communication and coordination difficulties across geographic distances. Indeed, the companies pursued strategies to reduce the level of interdependencies prior to outsourcing. For example, *Case 3* when transferring software development to a nearshore location was careful to define clear specifications and interfaces between tasks involved to reduce the interdependencies involved, as evidenced by a comment from a manager involved: '... *When I work nearshore, I need more detailed specifications ... when I have all the employees at the same location, then a lot of things are done by informal communication. This does not work with nearshore* ...'

An increase in the importance of reducing complex interdependencies was influenced by an increase in location distance, i.e. nearshore to offshore outsourcing. The case evidence suggests that reducing complex interdependencies are necessary preconditions especially, for offshore outsourcing.

5.1.2. *Uncertainty*

Uncertainty can occur in outsourcing arrangements as result of factors such as changing client requirements for the vendor, and create difficulties as the client and vendor have to adapt to unexpected changes. The presence of uncertainty means that it is not possible to write complete contracts and renegotiation and frequent amendments are required as circumstances change (Williamson, 1975). Uncertainty was an important influence on the choice of sourcing options for the organisations studied. In the face of high uncertainty the organisations were more likely to retain the process internally or outsource to local vendors. However, the findings have shown that in some cases organisations were likely to outsource in the presence of uncertainty. Although there were some process changes associated with the sales function that could not be fully specified in the contract, *Case 5* believed these could be managed via relational contracting with a local vendor. However, the organisations were unlikely to outsource to foreign locations in the presence of high uncertainty

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Table 1
Process-level influences on location distance and governance model choice in the BPO decision.

Process-level factors	Local outsourcing to an independent vendor *Case 5 Sales Local*	Nearshore outsourcing to an independent vendor *Case 1 SWDevelopment Nearshore*	Offshore outsourcing to an independent vendor *Case 4 Infrastructure Offshore*	Local captive model *Case 2 BPO Local*	Nearshore captive model *Case 3 SWDevelopment Nearshore*	Offshore captive model *Case 2 Infrastructure Offshore*
Complex inter-dependencies	Sales process closely linked with other internal marketing processes	Software development processes separated from other processes due to modular approach	Processes clearly separated due to application of process improvement techniques	Processes closely linked with core production and R&D operations	High degree of iteration and linkages with internal company processes	Processes inter-linked with other internal processes
Uncertainty	Moderate uncertainty regarding capacity needed	Relatively low uncertainty regarding capacity needed	Low process uncertainty	Some degree of uncertainty regarding capacity needed	Relatively low uncertainty regarding capacity requirements	Low process uncertainty
Performance management difficulties	Some degree of difficulty with establishing performance measures for sales leads	Relatively easy to measure performance due to modular approach	Easy to measure performance due to standardisation of processes	Difficult to measure performance of processes involved	Relatively easy to measure performance	Relatively easy to measure performance
Knowledge loss	Potential for loss of sales data and know-how mitigated by employing local vendor and detailed, formal contract	Retained software development processes with sensitive data to reduce potential for data loss	Potential for data loss limited by robust formal contract and retention of critical data internally	Extremely high potential for knowledge loss	Some potential for data loss but captive model would allow greater control to reduce this risk	Some potential risk of knowledge loss
Strategic value	Relatively high strategic value due to direct customer contact	Some degree of strategic value but strong quality systems in place	Some degree of strategic value but detailed, formal contract in place	Very high strategic value.	Some degree of strategic value.	Small degree of strategic value.

with the nearshore and offshore location options more likely to be chosen where there was low uncertainty. Nearshore and offshore outsourcing are less likely to be chosen as the need for frequent communication and adaptation associated with changing requirements would have to take place over greater physical distances, therefore making it more challenging to manage. *Case 3* highlighted that changing process requirements could best be dealt with by the centralisation of locations in Germany, as evidenced by a comment from a senior manager involved: '... *When there are quick cycles and the reaction has to be flexible, distance can be an obstacle. Because everything has to be specified very thoroughly and all changes have to be communicated* ...'

5.1.3. Performance measurement difficulties

Difficulties with measuring the contribution and performance of the vendor in the process can also create transaction costs, as the vendor might renege on their requirements (Williamson, 1975). The presence of performance measurement difficulties means the client must expend additional resource on monitoring performance. For example, the client will have to include clauses to allow third-party performance monitoring and benchmarks to assess performance. Moreover, differences in relation to the interpretation of performance can create difficulties in the outsourcing relationship (Bahli & Rivard, 2005). The importance of defining precisely measurable service levels was important in all of the processes externalised. The organisations placed considerable emphasis on specifying performance measures prior to moving the processes, and measuring performance during the arrangement.

The importance of performance measurement been has highlighted as particularly important in the case of outsourcing to independent vendors in foreign locations (Aron & Singh, 2005), and this was certainly evident in the companies studied. Effective performance measurement is especially important for nearshore and offshore arrangements. Investing resource in performance measurement allowed the case organisations to assess whether the vendors were delivering the processes at the required quality. For example, *Case 4 Infrastructure Offshore* placed particular emphasis on developing effective performance measures for use in the contract, and this was perceived as contributing to the success of the offshore outsourcing arrangement, as evidenced by a comment from a senior manager involved in managing the contract: '... *Prior to the signature of the contract, we developed a comprehensive matrix to evaluate the providers according to measurable service levels* ...'

It is important to stress that the companies expended considerable efforts on performance measurement in the case of captive models. Although the organisations had greater control via the captive model than with using an independent vendor they were still careful to develop performance measures prior to transferring the processes to the captive centres.

5.1.4. Knowledge loss

An important transaction attribute emphasised in transaction cost theory is knowledge loss (Argyres & Mayer, 2007; Williamson, 1991). In outsourcing arrangements where property is created or exchanged that cannot be well protected by legal mechanisms such as patents, additional contractual safeguards will be required. Planning for future contingencies and including provisions for dispute resolution can help serve as safeguards (Argyres & Mayer, 2007). This was an important issue for the companies studied, and the companies were particularly concerned with data protection between foreign locations and local operations. When outsourcing to an independent vendor offshore, *Case 4* was careful to incorporate additional clauses into the contract to safeguard against data loss in the vendors operations. Of course the dangers of knowledge loss also had an important influence on organisations that maintained control of the process internally – either via

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performing the process internally locally or opting for the captive model in the foreign location. *Case 3* and *Case 2* opted for the captive model as result of the need to protect against knowledge loss. In both cases the captives provided processes that were highly knowledge intensive and close to its research and development activities.

5.1.5. Strategic value of the process

Resource-based theorists argue that organisations will attain competitive advantage by building superior performance positions in processes that are valued by customers (Barney, 1991; Peteraf, 1993). This logic was clearly evident in the actions of the case organisations, as the strategic value of the process to the firm had an influence on whether process were retained internally or externalised. Processes that had a high level of strategic value to the firm were likely to be retained internally, as they had an important impact on competitive advantage and the organisation had a superior performance position relative to external vendors. For example, *Case 2* believed that retaining the functions internally would protect the firm's competencies. Alternatively, processes with a lower level of strategic value were more likely to be externalised as they had a limited impact on the competitive position of the organisations. Although these processes have to be performed well, any performance improvements achieved in such processes are unlikely to be a source of competitive advantage for the firm. The logic of the RBV is that such processes are of limited value, readily accessible in the supply market and easy for competitors or suppliers to imitate. The case of *Case 1 SWDevelopment Nearshore* and *Case 4 Infrastructure Offshore* followed this logic. Capabilities in these processes were readily accessible in the supply market, and provided no basis for competitive differentiation if performed internally by *Case 1* and *Case 4*.

5.2. Firm-level factors

Using the RBV as a theoretical basis and analysis of the case study findings, this section introduces the key firm-level factors that were important influences on location distance and governance model choice. These factors are summarised in Table 2.

5.2.1. Internal resource availability

The availability of internal resources was an important influence on the BPO decision. Resource-based theorists argue that organisations should focus scarce resource on processes that are valuable, rare and difficult to imitate, and therefore should allocate scarce internal resource to these processes (Barney, 1991). *Case 2* believed that allocating internal resources to the area of BPO would strengthen its core competencies internally. However, it is not possible for organisations to invest scarce resource in all internal processes, and organisations have to prioritise resource in processes that have high strategic value, and outsource processes that have lower strategic value. Moreover, there are risks in focusing scarce resource on processes that have lower strategic value, as this will divert resource from areas which have a higher level of strategic value. Processes that have a high level of strategic value are limited in number and require considerable resource and management attention to maintain and develop strong performance positions. A key principle of the RBV is that processes in which an organisation lacks the necessary resource can be outsourced to specialist vendors. The actions of the case organisations clearly support this logic with one of the key motivations for outsourcing being the lack of available internal resources for performing processes internally. The presence of local and foreign vendors with the necessary skills and lower cost base was an important driver for the outsourcing for the case organisations.

Table 2
Firm-level influences on location distance and governance model choice in the BPO decision.

Firm-level factors	Local outsourcing to an independent vendor	Nearshore outsourcing to an independent vendor	Offshore outsourcing to an independent vendor	Local captive model	Nearshore captive model	Offshore captive model
	Case 5 Sales Local	*Case 1 SWDevelopment Nearshore*	*Case 4 Infrastructure Offshore*	*Case 2 BPO Local*	*Case 3 SWDevelopment Nearshore*	*Case 2 Infrastructure Offshore*
Internal resource availability	Lack of internal resources to deliver sales process	Low availability of internal resources in software development area	Low availability of internal resources including management resource	Internal resources for service provision available	Lack of internal resource at required cost	Some degree of availability of internal resources
Client outsourcing capability	Some prior outsourcing experience in other parts of the business	Limited outsourcing experience	Extensive local and international outsourcing experience prior to offshore outsourcing	Some local and international outsourcing experience	Local and international outsourcing experience in manufacturing and services	Extensive local and international outsourcing experience prior to offshore outsourcing

5.2.2. Client outsourcing capability

Client outsourcing capability encompasses the client's prior experience with outsourcing and the skills required for effectively managing outsourcing arrangements. Clients with greater outsourcing experience are likely to have a greater ability to specify contracts more precisely, and develop organisational routines that allow collaboration with vendors (Bahli & Rivard, 2005; Boyson, Corsi, Dresner, & Rabinovich, 1999; Gopal, Konduru, Krishnan, & Mukhopadhyay, 2003). Prior experience of outsourcing is acknowledged in the literature as an important influence on outsourcing (Hätönen, 2009), and is particularly important with regard to offshore outsourcing (Ørberg Jensen & Pedersen, 2007). The findings here certainly support this view. A project manager in *Case 4 Infrastructure Offshore* explained how their previous experiences with outsourcing had helped them better prepare and implement an offshore outsourcing arrangement, '*... I think it was good for us to have experience so that we knew what would happen. Our experiences were not purely positive, but we also saw where things didn't work as well. Now we prepare things in a very different way ...*'

The companies with a relatively low level of prior international outsourcing experience were more likely to opt for local or nearshore outsourcing. The findings here found that foreign language and cultural management skills were important for dealing with an independent vendor or captive model abroad. The case companies that selected offshore locations had employees with extensive foreign language and cultural management skills. *Case 4 Infrastructure Offshore* possessed people with the necessary cultural and language skills and thus chose to offshore outsource IT infrastructure and helpdesk processes, as evidenced by a comment from a manager involved: '*... Cultural and language factors are extremely important. To reduce these different cultures to a common denominator is extremely difficult and a challenge ...*'

The findings revealed that in-house human resources with foreign language and culture skills had different importance levels for nearshore and offshore outsourcing. For offshore outsourcing these skills were regarded as crucial. However, nearshore outsourcing was chosen as an alternative to offshore outsourcing when the case companies did not have the necessary in-house human resources with foreign language and culture skills. *Case 3 SWDevelopment Nearshore* decided to choose nearshore as opposed to offshore outsourcing due to a lack of in-house employees with foreign language and culture skills, as evidenced by a comment from a senior manager involved: '*If you have outsourced work for example to India you have to handle it differently. But to this date, we would not have the right people for that ...*'

5.2.3. Location attractiveness factors

Using the location advantages determinant of the eclectic paradigm as a theoretical basis and analysis of the case study findings, this section introduces a number of key location attractiveness factors that were important influences on location distance and governance model choice. These factors are summarised in Table 3.

5.2.4. Location distance

Similar to the concept of psychic distance in IB (Child, Rodrigues, & George Frynas, 2009), location distance refers to the culture, language and geographic differences between the organisations local site and outsourced operations. Culture has long been viewed as an important influence on international business decisions, and cultural differences have been considered as a barrier to BPO in foreign locations (Brouthers & Brouthers, 2001; Graf & Mudambi, 2005). Similarly, language differences can be a significant barrier to coordinating service work in remote locations. Geographic differences in the form of travel and time

Table 3
Location attractiveness influences on location distance and governance model choice in the BPO decision.

Location attractiveness factors	Local outsourcing to an independent vendor *Case 5 Sales Local*	Nearshore outsourcing to an independent vendor *Case 1 SWDevelopment Nearshore*	Offshore outsourcing to an independent vendor *Case 4 Infrastructure Offshore*	Local captive model *Case 2 BPO Local*	Nearshore captive model *Case 3 SWDevelopment Nearshore*	Offshore captive model *Case 2 Infrastructure Offshore*
Location distance	Extremely high importance of cultural and language closeness as process contains direct customer contact; physical proximity important due to frequent meetings	Cultural closeness important; language closeness less important as software programming in English; physical proximity important due to frequent meetings	Cultural and language closeness less important as English is common business language; physical distance less important due to coordination via media technology	Cultural and language closeness very important; physical proximity very important due to integration of processes into corporation	Cultural and language closeness important; physical proximity important due to frequent meetings to integrate processes	Cultural and language closeness less important; physical distance less important due to coordination via media technology
Human capital	Quality concerns more important than cost; process contains direct customer contact	Lower labour costs were motive for nearshore outsourcing; relatively high importance of qualified personnel	Lower labour costs were main motive for offshore outsourcing; cost concerns more important than quality concerns	Quality concerns much more important than cost; quality concerns are main motive	Lower labour costs were motive for nearshore outsourcing; and relatively high importance of qualified personnel	Lower labour costs were motive for offshore outsourcing; quality concerns less relevant
Government policy	Government policy of limited importance	More flexible employment legislation and stable infrastructure in nearshore location	More flexible employment legislation and stable infrastructure in offshore location	Government policy of limited importance	More flexible employment legislation, better tax rates, generous government incentives, and stable infrastructure in nearshore location	More flexible employment legislation, better tax rates and, stable infrastructure in offshore location

zone differences can also be major inhibitors to BPO that require intensive and instant communication between the client and the vendor (McIvor, 2010). Location distance was a significant influence on location choice for the companies studied. *Case 5* was not willing to outsource to a foreign location and opted for a local vendor because of the need for physical proximity and frequent face-to-face communication. In particular, the vendor had to share the same language as there was direct contact with customers of the client.

Location distance was an important influence on the choice between nearshore and offshore options. The nearshore option allowed the companies to reduce the barriers associated with distance, whilst at the same time achieving the benefits of lower labour costs. Although the offshore location option would have offered lower labour costs, *Case 1* and *Case 3* opted for the nearshore option primarily as a result of location distance issues. Cultural, language, and time zone closeness were important because of the iterative nature of the software development process and the need for coordination and regular communication. Although much of this communication was via electronic media the physical proximity of the nearshore location made regular face-to-face meetings possible. In contrast, *Case 4* and *Case 2* opted for the offshore location because of the characteristics of these processes allowed it to be managed over a longer distance. Cultural, language, and time zone closeness were not necessary because of low interdependencies and limited coordination between the local and offshore operations.

5.2.5. Human capital

There were a number of aspects of the human capital dimension for the companies studied including labour costs and labour quality. Lower labour costs have been recognised as a dominant motive for many companies in their global outsourcing strategies in the IB literature (Graf & Mudambi, 2005; Kedia & Mukherjee, 2009). The case study findings support this view, and in particular that the nearshore and offshore choices were driven by labour cost advantages in these locations. For example, *Case 1 SWDevelopment Nearshore* reported that by using a vendor in Byelorussia allowed it to achieve a cost saving of about 50%. The companies also considered a number of important influences on labour costs including the dynamics of the labour pool in the location, which included labour availability and labour inflation trends. Labour quality was also an important consideration, and refers to factors such as education levels, skills levels, technical expertise, and previous job experience. For example, in the cases of *Case 1 SWDevelopment Nearshore* and *Case 3 SWDevelopment Nearshore* educational levels and job experience were important considerations due to the complex and technical nature of the software development process.

5.2.6. Government policy

Government policy in the chosen location was found to be an important influence on location attractiveness including factors such as tax rates, employment legislation, and government investment in infrastructure, education, and general skills development. Employment and social regulation have often been used as important levers used by governments to enhance their attractiveness. One of the key reasons for the case companies outsourcing to nearshore and offshore locations was to benefit from more flexible employment legislation in terms of employee rights than that of Germany. The companies were achieving these benefits through using both independent vendors and captive arrangements. Moreover, the presence of more favourable tax rates in the host location was a further motive for establishing the captive arrangement. For example, one of the reasons why *Case 3* established a captive arrangement was the offer of a generous incentive package in the form of location grants and better tax rates by the Hungarian government.

6. A framework for the BPO decision

Using location attractiveness, process-, and firm-level factors developed from the case study analysis, this section provides an overview of the framework for explaining the BPO decision in relation to location distance and governance model choice. Fig. 2 summarises the key influences on these sourcing options, and these are now discussed.

Cell 1 – Local outsourcing to a vendor: this option should be chosen where there are internal resource constraints, and the process is not of high strategic value, as there are external vendors available with the required capabilities. Opting for a local vendor over a foreign vendor offers a number of advantages, particularly in managing transaction costs. There is less uncertainty in establishing a contract which is enforceable in the home nation than in a foreign location where for example, there may not be fully developed data protection laws. Selecting a local vendor allows an organisation to outsource processes with high transaction costs. Although influences on transaction costs such as complex interdependencies and performance measurement difficulties can exist, selecting a local vendor located in close proximity allows the organisation to mitigate these risks through adopting a relational contracting arrangement (Poppo & Zenger, 2002). A relational contracting arrangement allows the organisation to outsource processes that have a high level of strategic value, as it can establish and build a mutually beneficial relationship with the vendor. The focus in relational contracting is moving beyond a contractual mind set and developing a trust-based and mutually beneficial relationship.

Cell 2 – Nearshore outsourcing to a vendor: this sourcing option is appropriate in situations where an organisation is faced with resource constraints in areas that are not of high strategic value, and where there are significant pressures to reduce process costs. The nearshore location should deliver significant labour cost savings in comparison with performing the process internally or outsourcing to a local vendor. Moreover, outsourcing to an independent vendor rather than via a captive operation provides a flexible means of dealing with changes in demand. The potential for increased transaction costs arising from outsourcing to a nearshore location can be mitigated by outsourcing a process which is clearly specified, and has a low level of interdependencies with other internal processes. Opting for a nearshore location reduces the coordination and communication difficulties associated with offshore outsourcing through sharing language similarities, overlapping time zones, and relatively close geographic distance, thus making regular face-to-face meetings possible.

Cell 3 – Offshore outsourcing to a vendor: the dominant consideration when selecting this option is the need to reduce production costs, and the offshore location should offer this advantage. The offshore location should have significant labour cost savings over local or nearshore locations to compensate for the potential transaction costs that arise from using the offshore location. Offshore outsourcing is more likely to be successful where the client has extensive experience of outsourcing both locally and globally. Moreover, an additional motive for selecting an independent vendor rather than a captive model in the offshore location is having already prior relationships with the vendor. Careful attention should be given to managing the potential transaction costs associated an independent vendor in an offshore location. It is more prudent

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	Local	Nearshore	Offshore
Independent vendor	**Cell 1 – Local outsourcing to vendor** ***Process-level factors*** • Moderate levels of interdependencies with internal processes • Moderate uncertainty in requirements • Some difficulties with performance measurement • Some sensitive knowledge sharing • Process not of high strategic value to the firm ***Firm-level factors*** • Lack of resource internally to perform process • Low level of international BPO experience ***Location attractiveness factors*** • Same culture, language and time zone, close proximity required with vendor • High labour quality more critical than labour cost savings • Favourable government policy in terms of employment legislation and stable infrastructure	**Cell 2 – Nearshore outsourcing to vendor** ***Process-level factors*** • Low level of interdependencies with internal processes • Relatively stable requirements • Relatively straightforward to measure performance • Low potential for knowledge loss • Process not of high strategic value to the firm ***Firm-level factors*** • Lack of resource internally to perform process • Some previous firm international and local BPO experience ***Location attractiveness factors*** • Similar culture, language and time zone, relatively close proximity required with vendor • Need for labour cost savings and high labour quality • Favourable government policy in terms of employment legislation and stable infrastructure	**Cell 3 – Offshore outsourcing to vendor** ***Process-level factors*** • Clear specification of dependencies with internal processes • Low uncertainty in requirements • Very straightforward to measure performance • Low potential for knowledge loss • Process not of high strategic value to the firm ***Firm-level factors*** • Lack of resource internally to perform process • Extensive previous firm international and local BPO experience ***Location attractiveness factors*** • Similar culture, language and time zone, and close proximity not required • Dominant human capital motive is need for labour cost savings • Favourable government policy in terms of employment legislation and stable infrastructure
Captive	**Cell 4 – Captive model** ***Process-level factors*** • High level of interdependencies with internal processes • High uncertainty in requirements • Difficulties with performance measurement • Need to protect important knowledge • Process of high strategic value to the firm ***Firm-level factors*** • Resource available to perform process internally • Low level of international BPO experience ***Location attractiveness factors*** • Same culture, language and time zone , close proximity • High labour quality more critical than labour cost savings • Favourable government policy in terms of employment legislation and stable infrastructure	**Cell 5 – Nearshore captive model** ***Process-level factors*** • Low level of interdependencies with internal processes • Relatively stable requirements • Relatively straightforward to measure performance • Some potential for knowledge loss • Moderate levels of strategic value to the firm ***Firm-level factors*** • Lack of internal resource locally • Some previous firm international and local BPO experience ***Location attractiveness factors*** • Similar culture, language and time zone, relatively close proximity required with captive operation • Need for labour cost savings and high labour quality • Favourable government policy in terms of employment legislation tax rates, incentives and stable infrastructure	**Cell 6 – Offshore captive model** ***Process-level factors*** • Clear specification of dependencies with internal processes • Low uncertainty in requirements • Very straightforward to measure performance • Some potential for knowledge loss • Moderate levels of strategic value to the firm ***Firm-level factors*** • Lack of internal resource • Extensive previous firm international and local BPO experience ***Location attractiveness factors*** • Similar culture, language and time zone, and close proximity not required • Dominant human capital motive is need for labour cost savings • Favourable government policy in terms of employment legislation tax rates, incentives and stable infrastructure

Fig. 2. A framework for understanding location distance and governance model choice in the BPO decision.

to outsource a process with relatively standard requirements, low uncertainty, and low interdependencies.

Cell 4 – Local captive model: this option is appropriate where an organisation has to protect and build knowledge in a process that is of high strategic value. Retaining the process internally is also appropriate when the organisation has the resource and capabilities to build a strong performance. *Case 3* possessed the requisite skills in business process redesign to drive performance improvement in the processes retained internally. Moreover, close proximity and cultural closeness can facilitate continuous interaction and knowledge sharing between the functions involved, which can drive performance improvement. Even where there are local and global vendors available, high transaction costs in the form of complex interdependencies and uncertainty in requirements may make outsourcing inappropriate.

Cell 5 – Nearshore captive model: there are a number of important motivations for opting for this sourcing option. The nearshore location should offer significant labour cost savings in comparison with labour costs in the home nation. The transaction costs associated with the nearshore location should be lower than any potential offshore locations as a result of similar language and culture, and shorter geographic distance. Although the captive model is more resource intensive and less flexible than using an independent vendor it offers a number of advantages. It allows a company to maintain control over processes that are of high strategic value, something which may not be possible with an independent vendor in a nearshore location. Moreover, it is possible to protect important internal company data which may not be possible through a contract with a vendor. Where an organisation has the necessary scale it can achieve significant cost reductions through establishing a captive model.

Cell 6 – Offshore captive model: this option is appropriate when there is considerable emphasis on the need to reduce labour costs in the process involved. In contrast to nearshore location choice, the offshore location should be chosen when the requirements are highly standardised and there is no need for cultural, language and time zone closeness. In terms of capabilities the organisation should normally have both local and global outsourcing experience. As with using the captive model in a nearshore location it offer advantages in the form of greater control over internal knowledge, and the potential to achieve all the cost savings internally rather than sharing these with a vendor.

7. Discussion

The findings in this paper have enhanced our understanding of the BPO decision, and support those who have argued that existing frameworks in this area are insufficient for understanding the complexities of the decision (Doh et al., 2009; Hätönen, 2009; Jensen & Pedersen, 2011; Schmeisser, 2013; Stringfellow et al., 2008). The findings have improved our understanding of location distance and governance model choice, and illustrated that, as well as location factors, process- and firm-level factors are required to understand the BPO decision. Drawing upon TCE, the RBV, and the eclectic paradigm and in-depth case study analysis enabled the development of a holistic framework that is grounded in both

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theory and practice. Location distance and governance model choice is the result of a complex set of interactions between a number of variables such as transaction costs, client outsourcing capability, government policy, and labour costs.

The findings have provided some valuable insights into how companies decide between the local, nearshore, and offshore location distance options in the BPO decision – an area largely ignored by IB researchers. Not surprisingly location factors such as lower labour and infrastructure costs, language, culture, and time zone differences are important considerations. However, the findings have provided important insights into the influence of firm-level factors on location distance choice. Firm capabilities such as the presence of in-house human resources with foreign language and culture skills act as an important influence on selecting the offshore option. It was found that employees with foreign language and culture skills mitigated the negative effects of cultural distance in the offshore location option. Moreover, a high degree of prior international outsourcing experience was found to be an important influence on the offshore option. Alternatively, companies were more likely opt for the local or nearshore locations where they have limited experience of offshore outsourcing. This supports the findings of those who have argued that experience is an important factor in companies' international BPO decisions (Jensen & Pedersen, 2011).

Process-level factors such as process interdependencies and the level of customer contact were also important influences on both location distance and governance model choice. One of the key reasons *Case 5* would only consider outsourcing sales to a local vendor was due to the vendor having direct contact with its customers in Germany. The offshore location option was more likely to be chosen for processes that were highly standardised, and at the same time there was low potential for knowledge loss. Process-level factors influenced governance model choice. The captive model was chosen as it offered greater control and protection of critical process knowledge, which would not have been possible through using an independent vendor in a location with underdeveloped legal institutions.

The findings have highlighted how firm-level, process-level, and location factors interact to influence location distance and governance model choice. Firm-level capabilities in process improvement techniques can be employed to redesign and standardise processes, which in turn can allow organisations to outsource the processes to more distant locations with lower labour costs. Internal capabilities in foreign language and cultural skills allowed organisations to mitigate the risks of outsourcing to locations with different language and cultures. Moreover, the lack of internal resources and scale was an impediment to organisations selecting the captive model. For example, the captive governance model was an option open to multinationals that had both the scale and experience to establish and manage such operations.

The findings have highlighted the value of employing TCE, the RBV and the eclectic paradigm to understand the complexities of the BPO decision. Reducing production costs through outsourcing to independent vendors or establishing captive operations in lower labour cost locations was a key motive for the companies studied. Transaction costs were important influences on the choice of location and governance model. As well making the BPO decision to reduce costs, the organisations were following closely the logic of the RBV, which involves developing internal capabilities in areas of high strategic value and externalising less critical processes. Location factors interacted closely with the logic of TCE and the RBV. The organisations were selecting different locations to access labour costs, whilst at the same accessing skilled labour areas such as software development. Linking location factors with transaction cost variables such as the level of process interdependencies, uncertainty, and performance measurement has enhanced our understanding of the influence of culture, language, and time zone on how companies make the BPO decision. In particular, these location factors help to explain some of the key influences on why companies select the local, nearshore or offshore location distance options.

Although the findings support the view that both TCE and RBV are required to fully explain the BPO decision (Combs & Ketchen, 1999; Jacobides & Winter, 2005; Madhok, 2002; Poppo & Zenger, 1998), the research has highlighted that both theories should be applied with caution. In particular, the contradictory nature of each theory is an important consideration. For example, in *Case 2* the company retained the process internally to develop internal capabilities in this area, even though there were a number of potential vendors available. The company's approach to the outsourcing process was influenced by the logic of the RBV. Although the company was aware of supplier capabilities, transaction cost considerations played no part in the decision to keep this design process internal. The decision to keep this design process internal was driven by the need to further invest in and develop an area that was of high strategic value. This is an important area for further research in enhancing our understanding of how organisations make BPO decisions, because in some instances the prescription of TCE and the RBV may be contradictory.

The findings have highlighted the important influence of firm-level capabilities on BPO. Although the RBV is a valuable theory for analysing capabilities, it is regarded as static in nature as it pays little attention to how resources or firm-level capabilities are developed (Bowman & Ambrosini, 2000; Kuivalainen, 2003). Further research is required to enhance our understanding of how firms develop and renew capabilities required for BPO. Little research has been carried out on how learning and knowledge, along with other resources, is combined, recombined and utilised to develop the capabilities required for BPO. Teece (2014) has argued that although the ownership determinant in the electric paradigm is accepted as a proxy for firm-level capabilities, there is still a dearth of theoretical structure and content around its nature, origins, orchestration, replicability, and imitability. The dynamic capabilities perspective, proposed by Teece, Pisano, and Shuen (1997), would be a useful framework for undertaking further research to understand how firm-level capabilities are developed and renewed for BPO.

8. Managerial relevance and conclusion

The research presented in this paper has important implications for practice. The BPO framework provides a useful basis for practical prescription, and encompasses a number of variables that capture the complexities of the BPO decision. The framework addresses a number of important questions for practitioners in the BPO decision: How can outsourcing be employed to achieve improvements in performance? Should an organisation maintain and build upon a superior performance position in a process, or outsource the process and leverage the capabilities of vendors? How can the choice of location distance option be used to create value and reduce transaction costs in BPO? What are the key factors that influence the choice of either an independent vendor or captive arrangement? What collaborative mechanisms can be developed between the client and vendor to deal with uncertainty and changing requirements? How do firm-level capabilities influence the choice of location distance and governance model?

There are a number of limitations with the research. Further research is required to explore more fully the linkage between the RBV, TCE and the eclectic paradigm in BPO practice. The findings have shown that the RBV and TCE should be applied with caution, due to contradictory prescriptions in some instances. Further

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insights are required into both the complementary and contradictory prescriptions of each theoretical perspective, and the implications for both management practice and theory development in the context of outsourcing. In considering only a limited number of case studies, there was no attempt to develop or test research hypotheses or propositions. Therefore, it is difficult to emphasise the significance of the research in relation to a wider organisational population. Also, as is often the case with case study research, when combining much data from a wide variety of sources, and over a long time period, the researchers' analysis of the findings is often a significant 'reality' filter (Gummesson, 1991). The main limitation of the outsourcing framework is that its applicability has only been assessed by one research group in a limited number of outsourcing instances. Therefore, the value of the framework will not be fully assessed until it is rigorously tested by other researchers and in other research settings.

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