Offshore outsourcing: A dynamic, operation mode perspective

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Abstract

While the extant literature on offshore outsourcing at the firm level basically deals with this operation mode *in isolation*, in this paper we address the issue of outsourcing in the context of the broader question of how companies choose and use outsourcing as part of their operation mode development in foreign markets. Based on a case study of the Danish company SimCorp and the development of its operations in Kiev, Ukraine, we analyse offshore outsourcing in a broader, longitudinal foreign operation mode context, and how it may contribute to mode change in the host country over a certain span of time. The case study approach allowed us to explore the dynamic processes in depth. The study shows that involvement in the foreign market generates learning in various forms that provide a foundation for eventual mode development or change – beyond outsourcing specific learning. At the same time, restrictions on 3rd parties', that is, independent vendors' access to confidential client data, as well as protection of specific investments in human assets, may eventually become a driver for mode change, as in the SimCorp case, to ensure more effective control of the foreign operation. Finally, the case study shows how outsourcing can be used proactively as a springboard to deeper and changed operation mode activities in a foreign market.

Keywords: Outsourcing, offshoring, foreign operation mode dynamics, case study.

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1. Introduction

Offshore outsourcing – the delegation of specified value chain activities to one or more foreign provider(s) – has, for good reasons, received considerable attention from international business and management researchers over the last decade.[1] Outsourcing was the focus of a recent special issue of *Industrial Marketing Management* in which its impact on business-to-business marketing was examined. In the introduction to the special issue Ahearne and Kothandaraman (2009, 376) maintain: 'Increasing globalization has made companies focus more on their outsourcing decisions. Moving beyond the tactical companies have begun to incorporate outsourcing as a strategic weapon in their armory'. Recently, attention has been drawn to the growing importance of offshore outsourcing in the services sector (Bunyaratavej et al., 2008; Griffith et al., 2009). Given the size of the services sector in advanced economies, this latter trend is of particular significance (UNCTAD, 2004). The ability to utilize offshore outsourcing has been facilitated by the development of large multinational companies providing outsourced production and other services on a global scale (Welch, Benito and Petersen, 2007). Intermediaries like the Hong Kong-based company Li and Fung have emerged as specialists in handling the various steps in offshore outsourcing for their client firms – allowing companies effectively to outsource the outsourcing problem (Economist 2001; Einhorn 2009; Welch, Benito and Petersen, 2007). In this article we focus on services and take the treatment of outsourcing, in offshore form, down a different strategic path by asking the questions: what follows, and what should follow, *after* offshore outsourcing?

Most of the research on offshore outsourcing examines the phenomenon at a certain point in time (see e.g. Bunyaratavej, Hahn and Doh, 2007), whereas fewer studies apply a dynamic perspective (for an exception, see Lewin, Massini and Peeters, 2009). As examples of dynamic issues, Dossani and Kenney (2004) and Manning, Massini and

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[1] This has been reflected in recent special issues on offshore outsourcing (as well as captive offshoring) in *International Business Review* (2011), *Journal of International Business Studies* (2009), *Journal of International Management* (2007) and *Journal of Management Studies* (2005).

Lewin (2008) point to evidence of a change in outsourcing motives from basically being cost-focused towards a broader palette of strategic drivers. From substantial survey work, involving a full size range of European and US companies, Manning, Massini and Lewin (2008, 35) argue, that "reducing labor costs is no longer the only strategic driver behind offshoring decisions. Accessing pools of highly skilled talent around the world [...] has emerged as a new key strategic driver".

Further, Maskell et al. (2004) find evidence of offshore outsourcing as a gradually expanding process in which companies initially outsource limited tasks, but – as outsourcing experience is accumulated – broaden the range of business functions being outsourced to foreign providers. Outsourcing of manufacturing and IT tasks seems to lead to the addition of other value added activities to be outsourced, such as human resource management, finance and accounting, and research and development. Put together, these dynamic perspectives suggest that offshore outsourcing is a phenomenon that fits with conventional internationalization process theory in which firms' foreign engagements evolve as an incremental learning process (Johanson and Vahlne, 1977/2006; Johanson and Wiedersheim-Paul, 1975; Welch and Luostarinen, 1988); though with the important caveat that firms' offshore outsourcing location decisions may be less susceptible to a psychic distance logic (Hatönen and Eriksson, 2009) to the extent that the outsourcing location first of all is determined by countries' factor endowment and not local demand. However, physical and cultural distance cannot be dismissed as location decision factors when outsourcing operations imply learning and close interaction between the contractee and the outsourcing firm and/or its clients. Stringfellow et al. (2008) stress that interaction intensity and interaction distance (including language distance) have an impact on the extent of invisible costs in offshoring service work, and therefore its viability.

Although both static and dynamic studies have informed us about the offshore outsourcing phenomenon of the 1990s and 2000s, there is relatively little known about how this foreign operation mode intertwines with a firm's other modes of operation in the host country, and whether and how it might be used to develop foreign operation modes in the host market, or other markets including the home market, as part of firm internationalization. The extant literature on offshore outsourcing at the firm level

basically deals with this operation mode *in isolation*, addressing questions like: what are the motives for offshore outsourcing and what are its managerial and operational challenges?

Therefore, in this paper we address the issue of outsourcing as part of the broader question of how companies choose and use outsourcing in foreign operation mode development in foreign markets. To our knowledge this is the first attempt to do so. We analyse offshore outsourcing in a broader, longitudinal foreign operation mode context (Benito, Petersen and Welch, 2009). Our unit of analysis is not just the offshore outsourcing operation, but includes the type of changes associated with its use that lead to operation mode alteration in the host country over a certain span of time, including within mode change. Given the lack of previous research on these issues, our study is exploratory, both conceptually and empirically. The focus on a single case, the Danish company SimCorp's development of operations in Kiev, allowed us to explore the dynamic processes in depth.

Our article is organized as follows: we begin with a brief discussion of terminology and note the broadening of strategic roles for outsourcing in companies' international operations. We then set offshore outsourcing within the context of firm internationalization – both as an initial foreign market activity, and as a subsequent step. SimCorp's evolving operations in Kiev are described and analysed. We conclude with case findings and analysis, including the development of a conceptual framework, and outline managerial and research implications.

The key contribution of our analysis is to show the way in which offshore outsourcing may contribute to foreign operation mode development and extend the range of organizational learning that may be an outcome of outsourcing. In doing so, we change the focus away from cost reduction. Empirically, we contribute by providing an in-depth case investigation of outsourcing in the services area: bringing a unique insight into the process (from initial outsourcing idea to eventual subsidiary establishment) and the evolutionary factors that over time underpinned eventual mode change, considered from the perspectives of both contractees, the contractor (HQ and project management staff in Kiev), and the external consultant.

2. Definition

Various definitions and terms have been applied to the outsourcing activity in the research literature on the topic (Welch, Benito and Petersen, 2007; Hatönen and Eriksson, 2009). Indeed, outsourcing as a term has only come into vogue in recent times, even though the phenomenon itself is much older (Hatönen and Eriksson, 2009). However, terminology and definitional consistency seems to be emerging around what has been proposed by UNCTAD (2004). In simple terms, offshoring refers to the relocation of one or more processes or functions to a different (and usually lower cost) foreign location (Deloitte Consulting, 2008). This relocation can be carried out either in-house, as a tied or captive form of operations via the firm's own subsidiary, or through the use of an external supplier in the foreign market (what we refer to as outsourcing). Thus, in this article, we concentrate on the final category: offshore or international outsourcing (or outsourced offshoring). Kedia and Lahiri (2007, 23) refer to it as 'independent third-party offshore outsourcing'. Effectively, through outsourcing, a company is able to tap into another company's facilities and/or service provision capacities in a foreign location.

3. Changing focus in offshore outsourcing: from cost to competence

Much of the extant literature on offshore outsourcing traces its development and explains its rise, although recently going beyond explanations that concentrate on relevant cost differences between countries. For example, one study concluded that 'a country is more likely to be a destination of services offshoring as the average wage of a country increases' (Bunyaratavej, Hahn and Doh, 2007, 7). ORN (Offshoring Research Network) survey results also indicate that companies are thinking about outsourcing at a more general strategic level: 'more and more companies are formulating and disseminating corporate-wide strategies for guiding outsourcing and offshoring decisions …and are integrating offshoring decisions into the overall corporate strategy' (Manning, Massini and Lewin, 2008, 49). While governments in general have exhibited concern about, even attempting to restrain, the extent of outsourcing because of concerns about domestic job losses, at the same time there has been recognition of the need to use outsourcing as a

means of accessing the global pool of skilled talent in areas of domestic shortage – even by governments. In the case of the Danish company SimCorp (see below), the move to outsource part of their software development, while instigated internally, was *facilitated* by a government program called 'Mind Match' which actively promoted outsourcing possibilities for Danish firms. The company was invited to take part in Danish government organised seminars and to meet with potential partners in Saint Petersburg in 2002 as part of its investigation of outsourcing options.

From a company perspective, the appeal of outsourcing's potential to reduce costs is understandable – as is the more recent interest in outsourcing's capacity to relieve shortages of high level manpower (Manning, Massini and Lewin, 2008). The popularity of outsourcing solutions to such concerns, for example in the area of business process outsourcing (Kshetri 2007), has nevertheless led other researchers to raise questions about the possible impact on a company's basic competitive core competence. However, the role of outsourcing as a legitimate means of entering and servicing different markets in the longer term, as an alternative or complement to foreign direct investment, alliance arrangements, licensing and the like, and its role in operation mode development, has received far less attention (Welch, Benito and Petersen, 2007). Similarly, Johanson and Vahlne (2009, 1427) have commented that the 'dynamics of the internationalization of supply networks is an increasing problem in international business', but one which has received little treatment.

4. Outsourcing and internationalization

As a result, we focus on the way companies can use outsourcing to service foreign markets, on entry and beyond, and, through this, its impact on companies' internationalization. While going beyond the argument about cost reduction, we recognise that cost reduction may have some important flow-on implications for international expansion capacity and strategic options – for example through its impact on a company's international competitiveness(see eg Di Gregorio, Musteen and Thomas, 2009). Further, for many companies using outsourcing there is no interest in going beyond basic contractual arrangements. For example, large US retailers such as Toys 'R'

Us and Liz Claiborne, are not using outsourcing as a path to other forms of international operations (Einhorn 2009). There are many cases of foreign outsourcing of manufacturing or servicing where the outsourcer merely plugs the product or service back into one minor part of its overall domestic value chain and will never have the scope or interest to develop the operation as an end in itself – it has an insignificant place in overall operations. In such circumstances, it would be highly unlikely for offshore outsourcing to be used or even considered as a springboard to expanded international operations.

In much of the literature, offshore outsourcing tends to be treated as an act, rather than as part of an ongoing, evolving process. An exception is Manning, Massini and Lewin (2008, 49), who stress the way in which offshoring, including outsourcing, is evolving in response to the development of relevant outsourcing capabilities within companies; being exposed to various related challenges; and finding 'new opportunities, such as the rise of new locations in the offshoring space and the emergence of new specialized external service providers' (see also Kotabe, Mol and Ketkar, 2008). Similarly we emphasise the dynamics of offshore outsourcing: co-evolving with a company's internationalization strategy, both influencing and being influenced by this strategy; and as part of a company's set of evolving operation modes in different foreign markets. It should be noted that offshore outsourcing may not be operating as a sole mode, and as a separate activity, in a given foreign market, but may be in joint operation with other activities and modes – that is, as part of an integrated mode package (Benito, Petersen and Welch, 2009). For example, outsourcing could be tied to a licensing arrangement with the foreign contractee.

4.1 Offshore outsourcing as the first international step
For many companies the start of internationalization often occurs on the inward side, for example via licensing from a foreign provider (Welch and Luostarinen, 1993; Holmlund, Kock and Vanyushyn, 2007). A study of Finnish SMEs found that more than half of the surveyed companies began international activities as inward operations (Korhonen, Luostarinen and Welch, 1996). The global rise of offshore outsourcing has included many cases where it represents the starting point of international operations for the

companies concerned, often with an inward focus, such as importing back into the outsourcer's home market.

Despite its role as a common starting point in international operations, there has been surprisingly little research on offshore outsourcing as a mode of international entry, and of the longer-term international consequences of this establishment role. As a triggering factor in a company's international start, offshore outsourcing may have implications for later internationalization that go well beyond the act itself. The emerging research on inward-outward connections in internationalization is suggestive of the different ways in which offshore outsourcing might contribute to expanded forms of foreign operations (Karlsen, Silseth, Benito and Welch, 2003). It might involve contributions such as: basic international exposure to potential clients, on both inward and outward sides; network development in the foreign market; learning about, and developing skills in, various aspects of international operations that are transferable to other forms of international operations; and cross-cultural exposure. It is conceivable that a company starts with offshore outsourcing as an inward-oriented activity, but adds outward-oriented operations from its international outsourced base in the foreign market – servicing the contractee's market or third markets. However, research on inward-outward connections indicates that the connections may not be straightforward, often involving varied, indirect and opaque links over time (Welch and Luostarinen, 1993).

4.2 Offshore outsourcing as a later step

Contractual arrangements in various forms are often used as stepping stones to alternative mode arrangements in companies' international expansion processes (Welch, Benito and Petersen, 2007). Contractual arrangements can even include clauses which facilitate later takeover (Petersen, Welch and Welch, 2000). In some cases, offshore outsourcing may perform its most important role as a foundation for penetration of a given foreign market, rather than as a source of any short term cost advantages. For companies that are engaged in varied mode use in different parts of the value chain in a given foreign market, it may be relatively straightforward to move into, or out of, outsourcing with regard to one part of the value chain, especially if outsourcing experience and knowledge have already been acquired in other markets (Mudambi, 2008; Welch, Benito, and Petersen, 2007). Grote

and Täube (2007), focusing on financial research activities, concluded that ability to do so depended on the strength of ties to other parts and processes within a company.

Offshore outsourcing may be introduced into international operations at any stage in a company's foreign expansion beyond its starting point: the longer, deeper and more expansive a company's international involvement the more substantial the international experience base which a company can work from in establishing the outsourcing activity. There might be some cases where there is little value from past experience (as our case company SimCorp found; see also Karlsen et al. 2003), but others where the base is so long standing and substantial as to make for a relatively easy path into the new operation mode. The outsourcing could be fitted closely with preceding operations in a given foreign market, as part of a comprehensive mode package (Benito, Petersen and Welch, 2009) or the connections may range to the point of almost full independence or disconnection, thereby ensuring limited support from the pre-existing operation. For example, divisions of the Norwegian multinational Norsk Hydro developed operations in India independently of each other – with limited utilisation of the others' experiences (Tomassen, Welch and Benito, 1998). We now turn to the study of the Danish company SimCorp and its adoption of foreign outsourcing as a means of supporting its core software development activities.

5. The SimCorp case: Methodology

5.1. Research design and data collection

Given the paucity of prior research, we considered an exploratory study as the appropriate initial step in investigating the phenomenon of offshore outsourcing in a dynamic mode development perspective. Eisenhardt (1989, 548, 9) has argued that case study research is especially 'appropriate in the early stages of research on a topic…or research areas for which existing theory seems inadequate' (see also Patton, 1990). Case study approaches are also particularly useful when trying to follow longitudinal patterns and processes of some complexity (Eisenhardt, 1989; Patton, 1990), as in this study, in which we followed the outsourcing development over a number of years from its inception in SimCorp HQ in Copenhagen (2002) to ultimate subsidiary establishment in

Kiev (2007) and beyond. Case study research has long been regarded as a suitable research approach when the focus of research is on "how" and "why" questions (Yin, 2003; Ghauri, 2004), and these were critical questions for our study as we sought to understand how SimCorp came to be involved in and went about outsourcing, the driving forces behind this move, and the process that led it to eventually replace its independent suppliers with its own subsidiary.

The case company was chosen because of the in-depth access to those involved in the outsourcing decision-making in SimCorp and at the Ukrainian contractees – that is, purposeful sampling was undertaken. Patton (1990, 169) has argued that 'the logic and power of purposeful sampling lies in selecting *information-rich* cases for study in depth' (see also Eisenhardt, 1989 and Yin, 2003). A strength of the study was the access to key players in the outsourcing venture. The triangulation of informants was an important way of validating the case study data (Piekkari, Plakoyiannaki and Welch, 2010; Yin 2003). Those interviewed were:

- the head of the software development unit at SimCorp headquarters (until 2008);
- the outsourcing project manager (2005-2007) who re-located to Kiev after initially managing the project from Copenhagen;
- the managing directors of the two Ukrainian contractees Infopulse and ProFIX;
- four employees of SimCorp Ukraine who worked at the contractees on SimCorp projects and later shifted to SimCorp's subsidiary operation;
- the representative of the consulting firm who was involved in the original decision-making process that led to the selection of Ukraine and the contractees.

Interviews were conducted over a three month period in 2009 by one of the authors. Each interview lasted about an hour, and was recorded and transcribed. Interviews were conducted in the local language (Danish and Ukrainian), then translated into English by one of the authors. Prior to the interviews each informant was sent a list of guideline questions and themes to be covered in the interview. In addition, documentary secondary data were provided by SimCorp – including administrative records, internal memos and reports and contractual agreements.

In methodological terms the company and the situation surrounding the use of outsourcing and the eventual move to subsidiary establishment can be seen as representing a "critical" case dealing with the phenomenon under investigation – the role of outsourcing in foreign operation development (Eisenhardt, 1989; Patton, 1990).1[2] The benefit of such a single case investigation was the opportunity to delve more deeply into processual aspects of SimCorp's Ukrainian venture. Single cases trade such an in-depth approach for the comparative insights of a multiple case study (Dyer and Wilkins, 1991). A study of the use of cases in Industrial Marketing Management between 1997 and 2006 found that almost half were single case investigations (Piekkari, Plakoyiannaki and Welch, 2010). The authors note that for processual investigations, in-depth case studies are particularly useful in exposing dynamic influences (see also Piekkari, Welch and Paavilainen, 2009). Single cases are also useful for in-depth, exploratory investigations with the aim of theoretical extension (Ghauri, 2004).

5.2 The company

SimCorp is a Danish company, specialising in financial services software. Its revenue in 2010 was EUR 185.4 million. In 2010 it had nineteen foreign subsidiaries and branches, including the one in Ukraine. In 2001, when the company first began to exploring outsourcing as an option it already had established subsidiaries in nine countries. Revenue is derived from three main forms: sales of software licences, maintenance income and fees from professional services. SimCorp's main product – SimCorp Dimension – is a comprehensive system solution for professional investment managers that supports all the elements of the investment management process. It accounted for approximately 95% of the Group's business. Table 1 below summarises the evolution in

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[2] We also took an abductive inferential approach to the use of this case (Alvesson and Kärreman, 2007; Dubois and Gadde, 2002; Van Maanen, Sørensen and Mitchell, 2007). Dubois and Gadde (2002, p. 554) use the term "systematic combining", wherein "research issues and the analytical framework are successively reoriented when they are confronted with the empirical world", as an example of so-called "abductive" logic in research. For example, the empirical investigation led to a stronger focus on the nature of the learning processes taking place through outsourcing activities, bearing in mind that, for the company under investigation, this was a step into the unknown at two levels: the type of market (former Communist state) and the mode (offshore outsourcing).

SimCorp's operations in the Ukraine: from offshore outsourcing to the establishment of its own subsidiary, although the initial idea occurred far earlier.

Table 1: *Key Phases in the Development of SimCorp's Ukrainian Operation*

Phases / Duration	Context of the Relationship	Contracts and Provisions	Use of Options
Pilot project: Offshore outsourcing March - August 2005	*Probation period* To test the parties' compatibility on a small scale project	*Memorandum of Understanding* Pilot project terms and conditions. Draft version of the contract	*Inherent options:* Option to abandon the project if deemed un-successful (not exercised); Option to expand the project if deemed successful (exercised)
Full cooperation: Offshore outsourcing August 2005 – September 2007	*Outsourcing cooperation* Service providers acting as subcontractors. Search for and selection of qualified personnel. Idiosyncratic Investments by SimCorp – training and education. Increasing asset specificity	*Cooperation Agreement* Legal framework for outsourcing cooperation. Terms and conditions of each party's responsibilities. Option for future cooperation – JV option.	*JV option* in the contract: SimCorp 51% of shares; appoint managing director and chairman of the board (the option was not not exercised). *Implicit options:* staff motivation, retention and integration into SimCorp (partly exercised)
Wholly owned subsidiary establishment; operations and staff transfer Autumn 2007 – May 2009 (including future HR cooperation)	*Integration of human resources.* Taking over the service providers' personnel on a legal basis after establishment of own subsidiary. Option of further transfers after reaching 18 month experience threshold.	*Addendum to Cooperation Agreement* Extension of the contract to operationalise staff transfer. Option of future cooperation – future HR services.	*Future cooperation option* Option to transfer, on a selective basis, project staff members to own subsidiary (exercised). Option to use the service providers' assistance in search for, and selection of, new staff candidates (partly exercised).

6. The outsourcing decision and implementation

6.1 Initial considerations

During winter 2001/2002, SimCorp's management for the first time considered the idea of outsourcing. It was initiated in the software development department (IMS Development) primarily because the market for good IT software developers and engineers had become tighter in Denmark. Consequently, it seemed reasonable to consider moving the future growth of development capacity to a place with lower costs. The cost factor was quite important as, at that time, SimCorp was struggling to match revenues and rapidly growing expenses. SimCorp's senior management team decided to investigate the general prospects of offshore outsourcing, and to establish a profile of an appropriate offshore outsourcing partner in the near geographical area. It was decided that a potential partner should be located within 2-3 hours flight distance from Copenhagen in order to be able to maintain close contact without being constrained by the long travelling hours.

In 2002 Russia was investigated. However, suitable candidates were not found in terms of data security, available infrastructure, educational level, managerial competencies, price level, and communication capacity (eg English skills). Furthermore, the company's management realised that SimCorp was not ready to deal with all the challenges of an offshore outsourcing venture. As a result, SimCorp turned its attention back to the domestic market, looking for possible qualified partners among Danish firms in order to try out outsourcing possibilities without the perceived major challenges and risks stemming from offshore outsourcing. This did not work out either, as SimCorp was again unable to find suitable partners

Thus, after some consideration, SimCorp's senior management team (SMT) decided to postpone the decision about any form of outsourcing. An internal evaluation at that point in time showed the company was not fully ready to carry out an outsourcing project. However, during the period up to autumn 2004 it became even harder to find qualified IT programmers in Denmark, which brought the outsourcing discussion back on the table. SimCorp's management decided to start a new investigation of offshore outsourcing opportunities. For this purpose, it hired a consultancy firm, Developmate,

which specialised in IT offshore outsourcing, to conduct a thorough examination of outsourcing possibilities in cooperation with SimCorp management. After initial screening and a thorough country investigation by Developmate, SimCorp's management decided to proceed with Ukraine, which resulted in further screening of the market for potential suitable partners[3]. Following the partner screening process, the representatives from SimCorp's senior management group and IMS Development department paid a number of visits to three Ukrainian companies of interest in February 2005. In the decision process, SimCorp always wanted to have more than one cooperation partner in the same area. This was considered crucial in order to be able to balance and compare service providers against each other in terms of price and quality of work, as well as stimulate a continuous positive rivalry among the partners. Another aspect equally important for SimCorp in this regard was to diversify the risk of becoming too dependent on one particular partner.

6.2 The pilot project

The selection process led to the choice of two companies, Infopulse and ProFIX. SimCorp started carrying through pilot projects with them on a probationary basis. The parties signed a Memorandum of Understanding (MoU), which outlined the terms and conditions of the projects and probation period. The MoU outlined also the initial framework for future potential cooperation between SimCorp and the Ukrainian service providers. This included three phases: 1) the pilot project phase; if successful this would lead to 2) a long-term cooperation phase; potentially followed by 3) the exercise of a joint venture option with the service provider. The pilot project set-up had the following conditions: A duration period of approximately three months; involvement of 4-5 full-time software engineers who would receive extensive training at SimCorp premises in Copenhagen. Upon completion of the pilot project, results would be evaluated by SimCorp's senior management and benchmarked against the standards of newly employed Danish candidates as well as against other external consultants used by SimCorp. SimCorp additionally secured the intellectual property rights on all material

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[3] In SimCorp terminology, the word "partner" was very often used when referring to service providers/vendors.

conceived, discovered or produced in connection with the pilot project. If the arrangement did not work out, each party was to cover their own part of the costs and cease cooperation.

6.3 Long-term cooperation

After both pilot projects produced satisfactory results, during the autumn of 2005 SimCorp and both service providers had a number of negotiations over entering the next phase of long-term cooperation - in essence continuing the outsourcing cooperation between SimCorp and Infopulse and ProFIX. The partner firms were to provide the services of searching, selecting and recruiting new, qualified candidates for the SimCorp development teams, and to provide the physical environment, technical support and infrastructure. As successful completion of the pilot project was a precondition for further cooperation, a number of terms and conditions were not finalised in the initial MoU, which required further negotiations after completion of the pilot project phase. The legal contract signed between the parties was an extended version of the original MoU. The Cooperation Agreement outlined the important conditions for long-term outsourcing cooperation and the rights and responsibilities of each party. Accordingly, the service providers were obliged to commit named and specified resources to the SimCorp development team based on SimCorp's specifications. In its turn, SimCorp was responsible for providing the necessary training and education of the vendors' personnel.

In November 2005 SimCorp expatriated its outsourcing project manager to Kiev in order to better coordinate and control the offshore development. It had become more and more difficult to manage the operation from Copenhagen. A person was needed in Kiev who could ensure SimCorp control, help Ukrainian project staff understand "the SimCorp way" of doing things, and ensure good communication flow between Kiev and Copenhagen. Two more employees from SimCorp Denmark were expatriated to Kiev during 2006. SimCorp had attempted to head off potential control problems through the terms of its partner (contractee) contracts. For example, the service providers were obliged to commit named and specified resources to the SimCorp development team based on SimCorp's specifications. However, SimCorp was not able to anticipate the full gamut of issues that emerged, and some were not directly controllable because it was

dealing with independent entities. Establishment of its training facility (SimCorp Academy) in Kiev in 2006 allowed the company to achieve a measure of control over the training and development of local staff.

6.4 Subsidiary establishment

SimCorp established a wholly-owned subsidiary in Ukraine in 2007. After deciding to do so, it negotiated an agreement that would allow the company to "acquire" the service providers' personnel and transfer them to the newly established entity. As SimCorp did not have a clause in the Cooperation Agreement that would specify the terms for establishment of a wholly-owned subsidiary and transfer of resources, an addendum to the original cooperation contract was negotiated and put in place. Further a clause was inserted in the addendum to cover future HR cooperation – specifically concerning help in finding suitable staff.

7. Case analysis and findings

7.1 Sequential internationalization

In one sense SimCorp's foray into Ukraine via offshore outsourcing proceeded like a classical case of sequential internationalization, despite its preceding range of international experience (Johanson and Vahlne, 1977; Welch and Luostarinen, 1988). The company was unsure about what it should do, even whether the step was appropriate or not, with considerable internal debate. Uncertainty was strongly felt by management. This was illustrated by the decision in 2002 to go back to the Danish market to seek local contractees rather than pursue the offshore path once difficulties were exposed. It only re-launched its offshore search when it became evident that a Danish solution would not be forthcoming. Thus, the process of adopting offshore outsourcing, the country of choice and the choice of eventual contractees was marked by a high level of caution and concern, and of attempts to limit the extent of commitment. Having decided on Ukraine, with external consulting help, it started with two pilot outsourcing arrangements – thereby limiting its commitment, taking an experimental approach to its initial

involvement, enabling withdrawal with limited costs if the outcome was deemed unsatisfactory. This is despite the fact that the company already had considerable experience in the international arena, although not in outsourcing. It clearly viewed much of its knowledge base as not being readily adaptable to its Ukrainian venture. Nevertheless, it had built up sufficient internal commitment to the new strategy such that it was prepared to declare a serious long term interest in the initial agreement with the Ukrainian contractees – including the possibility of a change to a JV. Such internal commitment development can be as important as the market commitment which is the primary focus of internationalization models. From the outset, there was a recognition that if relations and performance evolved as hoped, the initial outsourcing operation might develop into something more substantial: outsourcing was not necessarily the finishing point. The head of SimCorp's software development unit referred to the company's strategy in Ukraine in terms of "*building up the development capacity offshore at low cost*".

Despite the flagging of potential future mode development, how the outsourcing operation unfolded was crucial to further commitment, and in the end the path chosen, was not as originally anticipated. In this respect, it was evident that a range of evolving, interacting factors, such as those illustrated in Figure 1 below (including a reduction in perceived risk and uncertainty of the venture), explain the eventual switch to a subsidiary-based outsourcing operation. The nature and extent of direct involvement in a foreign market by the outsourcer inevitably affects the likelihood and form of any future commitments. Exploitable, new market opportunities beyond the confines of the initial contractual relationship may emerge, within the foreign market and/or beyond (Hatönen and Eriksson, 2009). Activities could be as basic as visits by the outsourcer's staff to liaise with the contractee, but could go further and involve market research, market scanning, and contact with different market players. In SimCorp's case, although heavily involved in the Ukrainian operation, this was relatively narrowly confined so that, for example, learning benefits centred around outsourcing and related activities, rather than being market related.

7.2 Learning

A key factor in mode change was learning. The learning that occurs through offshoring, enhancing the knowledge and capabilities of offshoring companies, for example through various interactions within the foreign market, has been stressed by Kenney, Massini and Murtha (2009; see also Johanson and Vahlne, 1977 and 2006 for a consideration of more general effects of learning on internationalization). Because SimCorp lacked previous experience in outsourcing, in Ukraine and with the partners (contractees) chosen, the unfolding learning process was critical to subsequent mode development. The pilot project was critical: it was viewed by SimCorp management as a way of allowing experimentation without long-term commitment. It provided a platform for learning about the practicalities and demands of outsourcing, as well as the potential for a more substantial, long-term commitment. One key aspect was for SimCorp to be assured that it could effectively teach Ukrainian staff to work with SimCorp's software development platform. The project manager commented: "*It is a quite special system and a programming language [APL] that is not so well-known, which needed to be learnt first*". There were unintended learning benefits from the first project (with Infopulse) to the second (with ProFix) because of a delay in starting the latter. Feedback from running the first project ensured that SimCorp was more prepared to start the second project, as well as equipping the company with a concrete assessment tool that had already been proven to work. A high level of interaction between the parties, and movement between Copenhagen and Kiev, as cooperation developed over time facilitated the learning process on both sides, and in both locations.

7.3 Partner relationships, trust and mutual adaptation

Communication between the parties intensified as the operation moved beyond the initial pilot project activities. To some extent this was a by-product of the type of activity being outsourced – software development – which ensured that there had to be a high level of personal interaction between HQ development teams and those in Kiev. In addition, HQ management was actively involved in managing activities and relationships in Kiev. Initially this was accomplished through travelling staff, then through expatriate

appointments. SimCorp consciously sought to drive this process of interaction through different integrative steps, structural and social, with the aim of fostering communication. Development staff in Ukraine was divided into groups according to the organization structure in SimCorp and had direct communication with their respective teams in Copenhagen. Thus, despite being an outsourcing project, close day-to-day interaction and involvement between the offshore operation and SimCorp developed.

The strength of relational development with its two Ukrainian partners was critical in enabling SimCorp to enact so many of its policies including some that were not covered under the terms of the Cooperation Agreement. However, the positive communication and staff interaction that took place did not occur in a vacuum: they evolved and depended on a supportive relational context between the parties. Over time, this became characterised by trust, to an extent that it was a facilitator of the move to a fully-owned subsidiary and supported a continuation of cooperation between the parties in the area of staffing even after the subsidiary was established and many of the activities internalized. There was a process of mutual adaptation between the parties as relations developed. This was most evident in the key area of training and staff deployment – in Kiev and Copenhagen. Cooperation between the SimCorp development teams in Kiev and IMS Development in Denmark increased gradually as training of the people in Kiev progressed and they started to become more competent and specialised in working for SimCorp. Such adaptations increase commitment on both sides and can become part of a base for extended collaboration (Madhok, 1995).

Language was a further aspect of adaptation. Ukrainian staff in general did not speak English fluently, but SimCorp required English proficiency for every member of the development teams. This was somewhat atypical for ProFIX, which used to work with projects where only a couple of people were required to speak the language and they served as a communication channel for the rest of the group. Nevertheless, because SimCorp was offering interesting and challenging work, people were motivated to invest time to improve their English proficiency. Infopulse management offered English courses at the company's expense for upgrading language skills if SimCorp found technically appropriate candidates among Infopulse staff who lacked English communication skills.

7.4 Staff retention and confidentiality requirements

Staff retention and confidentiality requirements stand out as the dynamic influences that emerged most strongly from the case data. Given the service business that SimCorp was involved in, people were key, and they could leave at any time, so the need to control the HR levers was recognised very early. The move to a subsidiary operation was almost an inevitable end point once this was clearly recognized and commitment to the Ukrainian operation firmly established within the company. The SimCorp project manager stressed the challenge of retention: *"One of our biggest problems in cooperation with partners was the fact that we did not have control over the employee salary. The partners did. And it was sometimes difficult, as there were cases, where we would like to retain [people] also on higher salary, but because partners did not want to give the salary increase, we would lose those people, and it was too bad"*. Similarly, the head of the SimCorp development unit related: *"the whole establishment of own subsidiary ... would give us opportunities to make certain things (happen), which we could not do because we worked with partners i.e. differentiate people's salary, retain and motivate people"*.

Even more important for the decision to move to a captive operation were the restrictions on using 3rd party development resources for client support. As a result of their surprisingly quick upgrading the time arrived when it would be natural to let the teams of the two partner firms collaborate directly with SimCorp's clients around customizing their software. However, given the confidentiality of the information held by the clients only SimCorp's own developers were allowed access to the client systems. SimCorp's head of the software development unit expressed the pressing need for employing the Ukrainian system developers in the following way: *"We could not take Ukrainian people and send them to work on projects in Scandinavia, England or other places, as they were not directly employed by SimCorp. This is prohibited according to the contracts we have with our clients. So, we wanted to open up for this possibility [...] to be able to have a resource pool in Ukraine, whose people could be sent for 3-6 months projects to different places. This would be possible without any problems, if they would be employed by SimCorp."*

7.5 Mode change

The various dynamic, interactive factors examined above are illustrated in Fig 1.
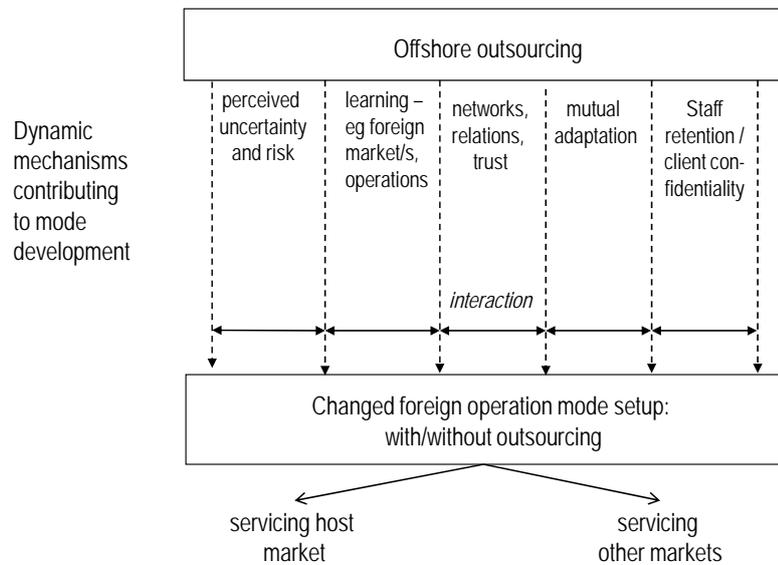

Figure 1: *Offshore outsourcing as a springboard*

Their combined, evolving influence was important in moving the company to a stage where mode change was almost a natural next step. Substantial *within mode change* (Benito, Petersen and Welch, 2009) acted as a lead into, and stimulus for, eventual mode change. This took various forms: through various HR activities, including personnel visits, both ways; expatriation of HQ staff members to Kiev; training; and language policies, all of which had the effect of gradually integrating the Ukrainian operations into SimCorp, even though the services were notionally provided by independent Ukrainian companies.

The evolution of trust was critical to the process. There is evidence that even with shorter term single contract arrangements, outsourcers prefer to develop these deals with trusted suppliers, that is, within the context of longer term relationships (Kakabadse and

Kakabadse, 2005). The process of establishing a contractual relationship and of enacting the relationship may open up different possibilities for further forms of cooperation that lead to mode change. These might include, for example, joint activities with the contractee's staff or training and technological exchanges as in the SimCorp case. Such collaborative activities allow for the evolution of knowledge and understanding between the two parties, of adaptations to each other, and the development of trust (Young and Wilkinson, 1989). Kedia and Lahiri (2007) point to the contribution of trustworthiness to the development of long term cooperation in outsourcing relationships. As Gainey and Klaas (2003, 209) stress, 'while an outsourcing arrangement may begin as an arm's-length relationship, disciplined only through market-based mechanisms, over time it may be transformed through a social exchange process'. In their study, they found a positive connection between trust and outsourcer satisfaction with outsourcing, while trust was positively related with relationship tenure and communication behaviour. In the case of Simcorp and its Ukrainian partners, although they began with a long term perspective, the development of trust was critical to subsequent commitments.

The development of trust between parties encourages disclosure and sharing of knowledge, particularly when it involves access to and use of personal networks, thus supporting the learning process (McEvily, Perrone, and Zaheer, 2003; Michailova and Husted, 2003; Welch and Welch, 2008). This contributes to the development of social capital. Thus, as a positive relationship between the outsourcer and foreign contractee develops, embedded within growing social capital, it provides a foundation that supports any consideration of extension of the core outsourcing operation into other arrangements, including more formal types of integration. Ultimately, from this process there might be a substantial foundation for a move to a stronger link. Relationships may develop to such an extent that quasi-integration takes place, facilitating formal internalization steps by the outsourcer (Morgan and Hunt, 1994; Petersen, Welch and Benito 2010). A Ukrainian employee at one of SimCorp's contractees commented that: *"All this together [bonuses, social events, trips to Copenhagen]... contradicted strongly with the thesis that being an outsourced part we were not a part of the company. This was not the case. We felt ourselves almost equal to SimCorp employees"*.

The dynamic mechanisms shown in Figure 1 are indicative rather than exhaustive, especially in relationship terms. From a theoretical perspective, co-evolution theory appears to be an appropriate framework for setting mode change in the wake of offshore outsourcing, given its focus on process, and interacting factors in development (see e.g. Cantwell, Dunning and Lundan, 2010; Lewin and Volberda, 1999). Pajunen and Maunula (2008, 249) argue that 'for a co-evolutionary relation to occur it is necessary that two or more processes must have a noticeable influence on each other's evolution'. They apply co-evolution theory to internationalization in general, but the ideas are equally applicable to mode development dynamics. Lewin, Massini and Peeters (2009, 921) have used a co-evolutionary framework, with managerial intentionality, in empirically examining the rise of offshoring in innovation projects. From their empirical data they found support for 'the idea of cumulative experience building' and an important role for managerial intentionality in explaining the development of offshoring.

8. Conclusion

The SimCorp case demonstrates that offshore outsourcing may involve much more than the outsourcing act. This 'more' can be quite substantial, depending on how much the outsourcer becomes involved in the foreign market and with its foreign partner. This is perhaps even more the case with services outsourcing, where there is often considerable focus on training and interaction of staff on both sides to ensure the quality of what is ultimately supplied – with cost implications. Whether it is a starting intention or not, involvement in the foreign market inexorably generates learning in various forms which may build a foundation for eventual mode development or change. Such mode-related learning goes beyond the outsourcing-focused organizational learning noted in other studies (Manning, Massini and Lewin, 2008). At the same time the inevitable concern about retention of key personnel at the outsourcing partners (representing significant, sunk investments in training and education), problems of contractual restrictions on the use of 3rd party development resources for client support, aligned with the outsourcer's internal learning processes, eventually became a driver for mode change, as in the SimCorp case, to ensure more effective control of the foreign operation.

Our study reveals how outsourcing can be used as a springboard to changed foreign operation mode activity in the host foreign market. Although the shift to captive outsourcing via subsidiary establishment entailed a substantial change in commitment, it could be argued that it was a sequential change: in various ways SimCorp had sought to internalize and control the activities of its contractees – including what might be called 'soft' control measures, such as in the emphasis on implanting its 'performance culture'. These actions prepared SimCorp in such a way that the subsidiary step was not viewed as a major one for the company.

SimCorp's Ukrainian experience exposed a number of change influences that emerged, and evolved, in an interactive way, driving its developing responses through the independent outsourcing stage. For example, feedback and learning from experience heightened control concerns. A high level of interaction and communication between the parties facilitated evolving trust, lowering perceived risk and uncertainty, supporting the transition to a subsidiary, and continued cooperation. As the company's first step into outsourcing, it was perhaps inevitable that the type of learning would be a key factor in how it reacted and built the Ukrainian operation. Nevertheless, SimCorp began with a perspective that signalled and perhaps coloured the nature of its perception of, and responses to, the Ukrainian experience - as indicated by its insertion of a foreshadowed JV option even at the pilot project stage. Thus, the outcome showed strong evidence of both co-evolution and managerial intentionality (Lewin, Massini and Peeters, 2009).

The SimCorp experience shows clearly that offshore outsourcing can play an important developmental role in a company's penetration of foreign markets. It also demonstrates that offshore outsourcing should be considered alongside other foreign operation modes not merely as a way of lowering costs but potentially as part of a strategic pathway or bridge to extended and deepened internationalization. While cost advantages were not stressed as the key factor in the outsourcing move, they were a continuing underlying consideration for SimCorp: the shortage of software development talent in Denmark pushed up remuneration rates, and made Ukraine more attractive. Countering this effect, though, SimCorp experienced a range of costs associated with establishing and running its Ukrainian venture. Some of these costs were associated with ensuring control, such as the expatriation of its project manager to Kiev.

9. Managerial implications and research issues

Offshore outsourcing is an important part of the international business operations picture that is here to stay, and likely to grow rather than diminish, so that it needs to be considered as an integral part of the internationalization strategies of companies. This means placing greater emphasis on both inward and outward sides of international activities and their connections. Wherever the drive for offshore outsourcing comes from, its future market development potential needs to be considered at the outset. If deeper future commitment is a possibility, a range of steps need to be taken – including the content of contractual arrangements, a more comprehensive assessment of potential contractees and market options, and possible links to the use of other modes as part of a more substantial mode packaging arrangement for the market in question. Our analysis has shown that companies can use offshore outsourcing in a proactive way in fostering internationalization. It might be feasible for the next step to be set up as an option in the initial contract with the foreign contractee, as SimCorp did, and many companies have done with joint ventures, licensing deals, and intermediary arrangements (Petersen, Welch and Welch, 2000). Importantly though, it requires a change in strategic thinking, to pursue its potential beyond cost reduction, particularly in the area of services. Internalization via equity or other forms of foreign involvement can be facilitated by contractual arrangements that include internalization options. To include mode switching options up front, though, requires a deliberate, planned approach to foreign operation development whereas emergent approaches tend to be more typical. In a study of contracting within the personal computer industry, it was found that contracts evolved over time as relationships between the parties developed and that they exhibited the impact of incremental, experiential learning. In particular, they observed that 'rather than anticipating … problems and contingencies, the parties had to actually experience an adverse situation before addressing it in new contracts' (Mayer and Argyres, 2004, 395).

In this article we have focused on one company's experience, with the limitations this approach entails, and it was its first foray into outsourcing, in a relatively unknown market area. There is obvious need for this account to be supplemented by others,

including those where companies have used outsourcing in different places in their patterns of internationalization. As well, there is a need for examples of companies that have gone on to other mode forms than wholly-owned subsidiary establishment, such as to JVs or a broader mixed mode approach (Benito, Petersen and Welch, 2009).

Acknowledgements

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