

## **SERVICE PROVIDER AND SERVICE RECIPIENT PERSPECTIVES TO MITIGATING RISKS IN OFFSHORE INFORMATION TECHNOLOGY OUTSOURCING RELATIONSHIPS**

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### **Abstract**

This paper seeks to find evidence that the risks of offshore outsourcing are determined by the several variables inherent to the Information Technology (IT) service provider and their counterpart in host nation known as the service recipient. These variables include the IT service provider's IT capabilities and their cultural climate. The aim of this research is to expose determinants of the offshore outsourcing risks inherent in any offshore outsourcing relationships. Through review of the literature, several determinants were found that exist from both the perspective of the IT service provider and service recipient regarding their risk mitigation strategies. Through a better understanding of the determinants, service provider and service recipients can further secure their offshore outsourcing partnerships against risk.

**Keywords:** service recipient, service provider, offshore IT outsourcing relationships, IT capabilities, collectivism, risk mitigation strategies

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## **RESEARCH BACKGROUND**

Business Process Outsourcing (BPO) is generally viewed as the contracting of a specific business task, such as payroll, to a third-party service provider. BPO can be defined as “any contribution to a client organization by one or more external vendors with a different country of origin in tangible, intangible, human and/or nonhuman resources to the IT infrastructure” according to Kumar and Palvia (1998). Usually, BPO is implemented as a cost-saving measure for tasks that a company requires but does not depend upon to maintain their position in the marketplace. BPO is often divided into two categories: back office outsourcing which includes internal business functions such as billing or purchasing, and front office outsourcing which includes customer-related services such as marketing or technological support.

These IT enabled services also known as offshore IT outsourcing delegates one or a number of business processes to a company (3rd party) that administrates and manages the selected process. In which typically, the 3rd party BOP provider is given specific guidelines based upon definition and measurable performance metrics. As noted by Welsh (2014), companies usually tend to outsource specifically non-core functions such as human resources, finance and payroll, customer relationship management and IT services. This have made outsourcing overseas (offshoring) as a global strategy to concentrate on core business and improve efficiencies of multinational companies (Juma'h, 2007). Welsh (2014) also claimed that this is done so the company itself could focus on its core activities, reducing operational costs in the process.

History suggested that BPO has only seemed to reach prominence over the last 5 years but has existed in principal for decades with companies processing everything from medical claims and contracts. However, in the late 1970s the BPO focus was aimed at shoes, cheap electronics and toys manufactured in China, Taiwan and South Korea. The 1980s and 1990s brought with it

the first wave of computers and recruiting software developers in India and Ireland etc. In relation with this, Kumar & Palvia (1998) claimed that since the dawn of the new millennium, the proliferation of the internet has greatly expanded the field of IT enabled services.

By 2010, US corporations are estimated to have saved \$390 billion through offshore IT outsourcing to countries such as Indonesia, India, South Africa, and the former Soviet Union where skilled IT workers are plentiful and inexpensive (Fitzgerald, 2003). Most of these outsourcing service providers produce software services, such as debugging existing code, and perform low-level software development tasks (Heeks, 1999). Current TechNavio's analysts forecast the global and particularly offshore IT outsourcing market to grow at a CAGR of 5.71 percent over the period 2013-2018 (Infinity Research Limited, 2014). And along with this growth, a drive to achieve cost-effective operations to tackle high attrition rate remains as the company tries to expand their business around the world.

While most of these activities would fall under the category of “support” functions, with low strategic impact, there are several firms who are more closely enmeshed with their outsourcing service provider, and whose relationship with said service provider has a high impact on the success of the service recipient firm itself (Kishore, Rao et al. 2003). This access to skilled labor forces, coupled with the cost savings promised by service providers in developing countries, makes offshore outsourcing very attractive to US corporations. Particularly due to the recent recession, corporations are attempting to cut costs wherever they can, with IT spending being near the top of the list.

There already exists a wide body of literature analyzing factors that influence a company's decision to outsource (Ang & Straub, 1998; Heeks, 1999; Kern, 1997), factors that affect success in outsourcing (Cavaye, 1997; Lacity & Willcocks, 1998; Swinarski & Kishore, 2001), as well as

issues of trust between service providers and service recipients in outsourcing (Sabherwal, 1999). However, the existing body of literature fails to address the unique aspects of offshore IT outsourcing that make its needs different from other types of outsourcing relationships.

Specifically, offshore outsourcing has several characteristics that impact the risks of these transactions. Offshore IT outsourcing involves corporations whose IT capabilities differ vastly from those normally present in the United States, as well as employees whose culture and value systems may be quite dissimilar to those held by employees in the United States (Khan & Currie, 2003). The costs involved in counteracting these issues through methods such as strong contracts and pre-emptive intelligence gathering need to be taken into account, since cost may prove to be a prohibitive factor for effective IT outsourcing (Ang & Straub, 1998).

The purpose of this paper is to bring together outsourcing variables from the literature in the context of outsourcing risk. The risks inherent in these variables are outlined and analyzed using resource-based theory, culture theory, and IT capabilities literature. The determinants discussed here include characteristics of the service provider organization.

The comprehensive research construct and proposition on offshore outsourcing put forth in this paper should serve as a reference point for analysis of current offshore IT outsourcing efforts, as well as a basis for planning future offshore IT outsourcing efforts. The following sections outline the research construct and proposition and describe the constructs involved and the relationships they form. Finally, the last section offers some concluding remarks and directions for future research.

## **RESEARCH CONSTRUCT AND PROPOSITION**

This research discusses some major contributors to offshore IT outsourcing risks and examines some key risk mitigation strategies. Offshore IT outsourcing risks emanating from

service provider IT capabilities in terms of their communication networks and human resource assets quality and cultural climate are examined using literature drawn from the areas of resource-based theory and culture theory particularly the transaction cost economies.

The role of service recipient risk mitigation strategies including strong contract construction and intelligence gathering in moderating the impact of risk drivers on offshore outsourcing risks is discussed. The role of some key service provider policies and practices including policies regarding employees' acceptable use of client information, practices that seek to increase employee retention, and policies that do not allow employees to work on projects for multiple corporations that are competitors with each other in reducing offshore outsourcing risk is also examined.

This section defines and ties to literature the constructs involved in the proposed research model. The constructs included in this research model are Offshore Outsourcing Risk, Service Provider IT Capabilities, Service Provider Culture Climate, existing Service Recipient Risk Mitigation Strategies, and existing Service Provider risk mitigation strategies.

### **Offshore Outsourcing Risk**

There are several possible conceptualizations and definitions of the notion of risk. (Aubert & Rivard, 2001) explains risk as a function of the expected loss from undertaking a certain venture and the probability that said loss will occur. (Jia & Dyer, 1996) furthers this notion of risk by adding an actor's expected utility from undertaking a venture to the risk equation. Thus, risk here is measured not only by the probability and value of loss, but by the value of what is to be gained. In this case, however, we define offshore outsourcing risk as an expected loss in offshore outsourcing contracts, following the perspective used in the context of IT outsourcing in (Aubert & Rivard, 2001); that is, taking into consideration the magnitude of loss from an undesirable

situation and the probability of occurrence of such loss. In the diagram above, two types of offshore outsourcing risk are mentioned. “Non-delivery of product to specifications” refers to a product that does not meet the specifications of the original contract, is flawed, or otherwise unacceptable to the service recipient (Aubert & Rivard, 2001). “Loss of IP” includes the sharing of a service recipient’s intellectual property, such as source code and personal company information, with other entities that do not have the right to access it (Aubert & Rivard, 2001).

Figure 1 shows a brief graphical overview of which types of risk correspond to which risk determinants. The following sections identify several determinants and moderators of risk in offshore outsourcing and their relationship to the risk inherent in offshore outsourcing.

|      |  |   |  |
|------|--|---|--|
|      |  | Level of IT Capabilities  |  |
|      |  | Low   | High   |
| High |  | <p><b>Outsource at your own Risk</b></p> <ul style="list-style-type: none"> <li>- High Risk for Loss of IP due to high Collectivism</li> <li>- High Risk for non-delivery of product to specifications and Loss of IP due to low IT Capabilities</li> </ul> | <p><b>Quality without Safety</b></p> <ul style="list-style-type: none"> <li>- Low risk for non-delivery of product to specifications and Loss of IP due to high IT Capabilities</li> <li>- High risk for Loss of IP due to high Collectivism</li> </ul>      |
| Low  |  | <p><b>Safety without Quality</b></p> <ul style="list-style-type: none"> <li>- High risk for non-delivery of product to specifications and Loss of IP due to low IT Capabilities</li> <li>- Low risk for Loss of IP due to low Collectivism</li> </ul>       | <p><b>Ideal Outsourcing Environment</b></p> <ul style="list-style-type: none"> <li>- Low risk for non-delivery of product to specifications and Loss of IP due to high IT Capabilities</li> <li>- Low risk for Loss of IP due to low Collectivism</li> </ul> |
|      |  | Level of Collectivism   |  |

**Figure 1.** Four Types of Risk Situations

**Service provider IT capabilities**

The Service Provider IT Capabilities are defined in this research as the quality of reliable, secure communications and quality of human resource assets to the offshore outsourcing service provider. Since infrastructure can vary from service provider to service provider, this variable

refers to infrastructure on a corporation level. According to Silverman (1999), an organization is comprised of its various tangible and intangible resources. The resource-based view suggests that the usefulness, quality, and uniqueness of these resources together make up the value of the corporation. This is not to say that any resource that the firm possesses automatically gives it a competitive advantage.

RBV describes competitive advantage-generating resources as those which are not easily immitatable, substituted for, or transferred to another party (Coff, 1999). In Wade (2004), we see that the resource -based theory, when taken in the context of information systems research, identifies infrastructure variables such as communications networks and human resource assets as resources important to the success of an information systems operation. (Swinarski & Kishore, 2002) states that firms with capabilities specifically in the IT area have an inherent advantage based on their ability to better acquire, develop, implement and manage IT resources.

Fitzgerald & Kaplan (2003) bases the success of an IT outsourcing relationship, particularly one that involves offshore service providers, partially on the development of both parties' telecommunications systems. (Dutta & Roy, 2001), in their study on Internet diffusion in India, point to infrastructure as an important variable in developing countries' economic relations with more developed western nations. They focus particularly on the infrastructure variables of telecommunication systems. (Bharadwaj, 2000) identifies IT infrastructure components that enable the sharing of information across products, business units and locations as assets that have the potential to generate much rent for the firm according to resource-based theory.

These communications systems move from being assets to capabilities depending on how they are leveraged and utilized to bring value to the firm and differentiate the service provider from other service providers in the context of lowering risk. Ross and Beath (1996) identifies the

technology asset as having several components that can be leveraged as capabilities. The first is a well-defined architecture, and the second is having standards that help the service provider achieve their architectural vision. Firms without this architectural vision will implement a particular communications technology first, and then try to integrate it into the existing systems and provide support for it later (Ross & Beath, 1996) This will invariably lead to breakdowns in communication between service provider and service recipient, which in turn raises the risk of a product being delivered that does not match the service recipient's specifications, or in the worst case no product being delivered at all.

From a resource-based perspective, these capabilities variables can be seen as providing value to the firm. IT capabilities resources (that is, resources that provide some competitive advantage to the firm) can be broken into three categories: those that aid in the basic functions of the firm, those that aid in dynamic improvement of the firm's processes, and metaphysical capabilities that allow firms to conceive and implement new strategies quicker than their competitors (Collis, 1994). Communication network infrastructure fits into this first category of capabilities-generating resources. The ability of the service provider to generate rent or "appropriability" from physical infrastructure resources such as network infrastructure is high especially if the service provider has the first-mover advantage on technological advances in these areas (Wade, 2004).

Wade (2004) also touches on the low-substitutability attribute of physical IT assets. Communication networks comprised of Internet access, computers and phone service have substitutes (i.e. standard mail), however this is not a practical long-term substitute for offshore outsourcing of IT processes. Thus, with the presence of high appropriability and the absence of

viable substitutes, IT infrastructure variables can provide a competitive advantage to the service provider.

Taking the above information concerning the resource-based theory and information systems capabilities into consideration, the conclusion can be made that the quality of infrastructure resources of the service recipient can either increase or decrease the propensity for loss on the side of the service provider. Since this will also mean a loss for the service recipient, any variables that may increase the chance for loss will increase risk as it is defined in (Aubert & Rivard, 2001). Thus, we arrive at the following:

*Proposition 1a: The quality of the service provider's physical IT capabilities, such as communication networks, contributes to the risk associated with an offshore outsourcing relationship.*

In the context of this research, the overall quality of human resource assets of the service provider are also being classified as service provider infrastructure variables. Human capital is important resources to the firm, as evidenced by Galunic (2000). The overall quality of human resource assets, for the purpose of this research, will consist of the knowledge and skills of the service provider IT staff, as well as the capability of the service provider to retain this knowledge and skill through employee retention.

Ross & Beath (1996) identifies the human asset (consisting of technical skill, business understanding and problem- solving attitudes) as a very powerful capability if it is leveraged properly to include the three aforementioned skills. Firms with skilled IT assets are able to communicate more effectively with business units (in the case of offshore outsourcing, with service recipients as well) and conceive and deliver IT solutions faster and with more quality than their competitors (Bharadwaj, 2000).

To Hall (1993), such intangible assets as knowledge (in this case knowledge of the inner workings of a competitor's business process and/or proprietary software programs) can provide a sustainable competitive advantage to whichever firm possesses them. As well as leveraging these skills and knowledge to have a lower risk of delivering a product that does not meet the service recipient's specifications, another method of leveraging these IT skills is to maintain high levels of employee retention.

These human assets are best utilized for the production of goods and services when their specialized knowledge can be integrated with that of other human assets of the firm - this requires relationships and common language that develop in firms over time (Kishore & Agrawal, 2004). The communication and business understanding aspects of human resource assets depend on interpersonal relationships and tacit understanding between staff members that takes years to develop (Bharadwaj, 2000; Mata & Fuerst, 1995). Service providers with low employee retention rates could be losing employees to local competitors; these competitors could in turn be gaining valuable intellectual property of service recipient corporations by hiring away outsourcers involved in the service recipient's projects (Gamble, 2003). Also, service providers may be involved in outsourcing contracts with several competing service recipients.

Dyer (1998) identifies knowledge-sharing relationships with other firms (such as the knowledge transferred in the duration of an outsourcing contract) as one of a firm's critical resources. While the knowledge possessed by human capital assets of the firm adds value to the service provider itself (Grant, 1996) as well as the service recipient (since, as they grow in their knowledge related to the service recipient's project they become more and more useful to the service recipient), this knowledge may also make them very valuable to competitors of the service provider and of the service recipient as well (Poppo, 1998). In this case, service provider

employees working on projects for competing service recipients may, intentionally or otherwise, reveal a competitor's trade secrets or other protected information (Fitzgerald, 2003).

As evidenced by the preceding resource-based and capabilities literature, these human resource variables of employee skills, knowledge and retention can have an impact on the possibility of loss in an offshore outsourcing relationship. If these assets are not present and are not leveraged to provide value to the firm, it increases the likelihood that the service provider will fail and a loss will occur, which increases the risk as defined in (Aubert & Rivard, 2001). This is the basis for Proposition 1b:

*Proposition 1b: The quality of a service provider's human resource assets, taken as a part of their overall IT capabilities, will impact the offshore outsourcing risk for that service provider.*

### **Service Provider Cultural Climate**

The service provider's cultural climate refers here to the cultural norms and social mores of service provider's nation and its employees, particularly collectivism and the ensuing level of respect for intellectual property ownership. Hofstede defines culture as "the collective programming of the mind which distinguishes members of one group from another" (Hofstede, 1991). Walsham (2002) furthers this vein of thought by postulating that culture is "shared norms, symbols and values in a social collectivity."

Although specific "cultures" can vary across organizations of individuals as small as teams within corporations (Lenartowicz, 1999), certain aspects of human behavior are apparent across most citizens in any particular nation (Doney, 1998). Culture variables which are similar across a national or ethnic level greatly impact the culture of a particular service provider, since the employee base of that service provider is primarily drawn from members of this particular national and/or ethnic culture. Although cultural differences among individuals exist at every possible level

of analysis (e.g. team, organization, region, nation), the scope of this research focuses on risk at a service provider level. Thus, we choose to analyze service provider cultural variables as they relate to offshore outsourcing risk.

Even in the case where the legal climate protects intellectual property rights, the shared norms and values of employees in a particular organization will drive their actions more than the laws that they operate under (Kumar & Palvia, 1998). Khan & Currie (2003) further identifies both organizational and national culture as driving factors for behavior within a service provider's organization.

Hofstede (1991) identifies four aspects of national culture that could have an effect on the way business is done for a service provider located in a particular geopolitical region. Collectivism in particular has an effect on the risks of offshore outsourcing. Collectivism concerns the degree that employees see themselves as part of a group or collective organization rather than as single independent entities. Collectivism places high emphasis on group welfare and harmony at the expense of personal gain, and believes that sharing and cooperation within the group is paramount (Morris & Davis, 1994).

In collectivist cultures, an individual's definition of self actually extends beyond their own physical person to include aspects of the group and similarities between him/her and other group members. Commonality with the group is stressed, along with an emotional attachment to their in-group and certain feelings of hostility and negativity toward other out-groups (Erez & Somech, 1996; Morris & Davis, 1994).

Because these members of collectivist cultures do not see themselves as completely individual, but as part of a larger social group, the concept of individual ownership and intellectual property is somewhat blurred (Erez & Somech, 1996). This poses a concern when a service

provider with a primarily collectivist employee culture is charged with keeping safe proprietary code and information about a service recipient.

The service recipient may see the code being generated, as well as any information used to generate said code or software, as belonging to the service recipient alone. However, sharing and group welfare are paramount in collectivist cultures. Also, collectivist believers do not see themselves as being totally individual; rather who they are is defined partially by the group they belong to. For these reasons, they may not see property (particularly intellectual property which has no physical, tangible form) as something that can belong to one person or entity alone. Individuals with a high level of collectivism may not see intellectual property as belonging to an individual, but to society as a whole; thus they would not necessarily see it as wrong to copy code blocks or data for distribution (Fitzgerald & Kaplan, 2003).

This level of collectivism, along with its ensuing level of respect for intellectual property ownership, will be studied as part of the cultural climate of the service provider. As the level of collectivism goes up, the chance that a service provider may not respect the intellectual property ownership rights of the service recipient may also increase, resulting in an increased chance for loss of intellectual property. Thus, risk as defined in (Aubert & Rivard, 2001) will also increase. This brings us to the following proposition:

*Proposition 2: The level of collectivism inherent in the service provider's culture, and the level of respect for intellectual property ownership inherent in that level of collectivism, will impact the offshore outsourcing risk for that service provider.*

### **Service Recipient Risk Mitigation Strategies**

Certain strategies that are put in place by the service recipient organization have the potential to moderate the impact of service provider's IT capabilities and cultural climate on

offshore outsourcing risk. These practices include any other corporate policies that, while not specifically aiming to protect assets, may be used for that purpose as well. Service recipient risk mitigation strategies that could moderate these impacts include establishing intelligence and strong contract construction. These strategies may moderate the service recipient's vulnerability to the affects of the capabilities and cultural variables of the service provider (Fitzgerald & Kaplan, 2003). Thus, with the probability of loss being reduced by the usage of these strategies, the overall risk would be lowered.

In the case of the service provider's cultural climate, a strong contract can control for many of the conditions that may allow these variables to negatively impact an offshore outsourcing relationship (Khan, Currie et al. 2003). The outsourcing contract is perhaps the most important and most functional control mechanism for offshore outsourcing. One reason corporations often cite for failure of IT outsourcing projects is "loose" contracts - that is, contracts that are not specific enough to the task being done and the environment and conditions under which it is to be done (Costa, 2001).

These loose contracts, in the case of outsourcing risk, could mean employees making copies of service recipients' code blocks or data, selling the information to competitors, or taking it home with them for their own personal use. Kern (1997) draws a direct relationship between contract strength, exchange theory, and the success of outsourcing relationships. Dyer (1998) furthers the argument for contracts as a form of relational governance, which when accomplished correctly can function as a rent-generating capability of the inter-firm relationship.

Serafino (2004) suggests that the social and cultural risks of international commerce (such as outsourcing) can be reduced if they are subject to "negotiated regulation" - i.e. the contract itself. The contract needs to specifically detail the exchange between the two partners exactly as it

is to take place, with clauses for inappropriate actions on the part of the service provider, along with corresponding penalties, which cover any gaps in the service provider's social climate, as well as provide the service provider with minimum requirements for human resource asset management. This contract must include enough specific text concerning the above situations to counteract any existing differences between the cultural climates of the service provider and service recipient that might otherwise negatively affect the risk level of the outsourcing transaction, and leave either party no avenue for recourse or retribution if said violations were to occur.

Whang (1992) provides a comprehensive explanation of a contract that appropriately controls for intellectual property disputes which may arise between service provider and service recipient. Clauses regarding the actual ownership of the intellectual property being developed, as well as any trade secrets or programming methods that may pass from the service recipient to the service provider in the course of the transaction, are necessary to prevent any dispute over the service provider's acceptable use of the above mentioned information. This is imperative in dealings with service providers whose employees' cultural environments more collectivist in nature.

The contract can mitigate these factors by defining a single appropriate (as well as several inappropriate) course of behavior, thus ending any question as to what is the appropriate course of action with respect to the service recipient's intellectual property ownership. This contract also needs to be enforceable under both countries' legal systems, and needs to be strictly enforced from its inception. Specific penalty clauses for behavior deemed in the contract as inappropriate by either party need to be adhered to. A contract in itself is a good start toward mitigating risk; however without enforcement the activities deemed inappropriate by the service recipient will still

occur (Viscusi, 1986; Paternoster, 1989). By reducing the chance for collectivist behaviors that could be counter-beneficial to the service recipient, the strong contract can in turn reduce the chance for a loss to occur. Consequently, risk is reduced as it is defined in Aubert & Rivard (2001). This brings us to the following proposition:

*Proposition 3a: The contract put in place by an offshore outsourcing service recipient will moderate the impact of an offshore outsourcing service provider's cultural climate on the offshore outsourcing risk that may be attendant in dealing with this particular service provider.*

Culture-driven behavior, in an offshore outsourcing relationship, takes place after the relationship has already been established. Thus it is temporally possible to direct and/or change this risk factor. The service provider's IT capabilities, however, exist prior to the relationship formation. Although it is possible to change aspects of these capabilities through the updating of technology and addition or subtraction of employees, this would require significant time, effort and capital. Perhaps the most realistic control mechanism for the risks posed through the service provider's infrastructure is for the service recipient to thoroughly familiarize itself with the service provider's current capabilities climate before the relationship begins, so that it can prepare itself for any complications that may arise. This is known in the decision-making sciences as "intelligence" - the first step in the three-stage decision making model of intelligence, design and choice (Simon, 1978). Thorough, on-site investigation of the facilities where work is to be done and their surrounding area are necessary to counteract properties of the service recipient that the service provider has no control over, such as communication network structure (Fitzgerald & Kaplan, 2003).

This intelligence-gathering is an important first step to counteracting the threats of an underdeveloped or unfamiliar situation. In the context of this research, intelligence gathering refers

to the careful investigation of potential service providers on several variables that could have an impact on the risk situation, such as the capabilities variables described above. Physically inspecting the premises where work is to be completed is vital to ensuring levels of IT capabilities that are adequate for mitigating the outsourcing risk to the service recipient. This inquiry, although costly, will prove invaluable to the risk avoidance of an offshore outsourcing relationship (Fitzgerald, 2003).

The service recipient's use of intelligence gathering mitigates the probability that a loss will occur through selection of service providers with appropriate levels of IT capabilities needed for the task to be outsourced. Taking the above discussion into consideration, the following proposition is put forth:

*Proposition 3b: The pre-emptive investigation undertaken by an offshore outsourcing service recipient will moderate the impact of an offshore outsourcing service provider's capabilities on the offshore outsourcing risk that may be attendant in dealing with this particular service provider.*

### **Service Provider Risk Mitigation Strategies**

The existence of poorly developed infrastructures and cultural environments that do not protect the rights of intellectual property ownership can greatly impact the risks of an offshore outsourcing relationship. However, service providers may already possess risk mitigation strategies that counteract some of the affects that capabilities and social variables can have on the risks for offshore outsourcing relationships.

Although the social climate of the service provider may either not address or directly counteract the rights of intellectual property ownership (Khan & Currie, 2003; Medjaded, 2003),

certain service providers may have internal corporate regulations and practices which provide adequate protection for their outsourcing clients' corporate information and trade secrets. Such regulations and practices may include regulations regarding employees' acceptable use of client information (Barret & Sahay, 1997), practices that seek to increase employee retention (Ross, Beath *et al.*, 1996), and policies which do not allow employees to work on projects for multiple corporations that are competitors with each other (Fitzgerald & Kaplan, 2003). Knowledge is classified in resource-based literature as being a "rent-generating asset" (Coff, 1999). Silverman (1999) furthers this vein of research on rent-generating assets by proposing that human capital, being entrusted with the protection of this knowledge and other rent-generating assets, need incentives to prevent them from acting opportunistically (i.e., transferring the information to parties that do not have rightful ownership or use privileges.)

This importance of human resource practices and controls in order to safeguard service provider and service recipient assets is also supported in Youndt (1996) who postulate that service providers with human resource-based controls on their knowledge assets should be seen as lower-risk partners for potential service recipients. These regulations improve the standards practiced by the service recipient organization as far as respect for intellectual property ownership rights. If these regulations are already in place in the service provider organization, this will mitigate the probability that loss will occur due to these circumstances, thus mitigating the risk for the offshore outsourcing transaction.

These service provider policies can reduce the chance that the service recipient may experience a loss due to inadequacies in service provider capabilities, or due to cultural variables such as levels of collectivism inherent in the service provider organization. This leads to the fourth proposition in this research:

*Proposition 4: A service provider's risk mitigation strategies will moderate the impact of an offshore outsourcing service provider's cultural climate on the offshore outsourcing risk that may be attendant in dealing with this particular service provider.*

#### **CONCLUDING REMARKS AND DIRECTIONS FOR FUTURE RESEARCH**

Woon Tai Hai, an Executive Director & Head of KPMG's Business Performance Services said that *"One of the challenge for an outsourcing company is to endeavor to reach an Outsourcing Risk Equilibrium"*. His quote give remark to the context of this paper and what have been discussed in it particularly on the relationship between service provider and service recipient. The first step in mitigating any of the service provider risks associated with offshore outsourcing risk is to understand the risk inherent. Many of these risks are caused because the environment of the service provider, and thus the environment that the work will be taking place in, is vastly different from the environment of the service recipient. These differences need to be thoroughly investigated and understood prior to the selection of the service provider and the contracts being drawn up. This way, the service recipient will have a better understanding of the nature of the relationship they are about to enter, and thus will stand less of a chance for being blindsided by any potential hazards that they were unaware of.

Also, this understanding will allow for the service provider and service recipient to mitigate or reverse risk factors that they have control over. Understanding these service provider variables will also aid the service recipients in drawing up contracts and instituting other forms of controls (such as reward schedules, penalties, etc) that can mitigate some of the vendor risks that cannot be controlled by the service provider or service recipient. Cultural or social norms of the service provider's employee base that run counter to the values of the service recipient can be addressed through clauses in the contract dealing with legal vs. illegal sharing of corporate data, work being

done in the office only vs. being taken home, and other measures to combat cultural norms that may be hazardous to intellectual property rights.

This research also brings to light many areas for future study concerning the risks of offshore outsourcing relationships. While the cost of risk mitigation may in itself not be a determinant of the overall risk of a particular relationship, transaction cost can and does play a significant role in any risky situation, particularly one which has the potential to be as expensive as an offshore outsourcing partnership. The effects of transaction cost theories on offshore outsourcing risks offer a potentially interesting avenue of future research, especially considering the fact that many offshore outsourcing projects are undertaken specifically to reduce costs in the organization. It would be interesting to see if the costs saved by sending work overseas were proportionally larger than the costs involved in adequately mitigating the risks inherent in offshore outsourcing transactions.

Another area of research involves determinants of offshore outsourcing risks relative to the degree of cultural difference between nations. This research looks at the variables that determine risks to offshore outsourcing. However, it would be interesting to look at the degree of difference in each of these determinants for the service provider and service recipient as the true determinant of offshore outsourcing risk. For example, the difference in cultural environments between two developing countries, or two countries in the same geopolitical region of the world, might be very small if a difference even existed; for those countries, cultural climate may not be a determinant of offshore outsourcing risk because the difference in cultural climates was very small.

However, for a developing country such as Indonesia or Mexico, the difference in cultural system with that of a developed country such as US could make the cultural climate a determining

factor of offshore outsourcing risk. In researching this it may be found that the degree of difference in these variables is the true determinant, rather than the variables themselves.

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