

# IN THE SHADOW OF OFFSHORING: AN EXPLORATORY STUDY OF THE EXPECTATIONS OF PROVIDERS

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## **Abstract**

Offshoring strategies are an emerging trend in the context of global business. Although the literature on this subject is vast, very scarce research has been made to understand the providers' perspective of an offshoring relationship. The goal of our study is to fill this gap in the literature through an exploratory research based on grounded theory, enabling us to understand the expectations of providers when they started working with foreign firms and compare those expectations with their perceptions of reality. A purposive theoretical sampling technique was used to select 7 Portuguese offshoring providers, from different sectors, sizes and ages. Data collected was then coded and analysed using and three broad categories of expectations and perceptions of reality emerged: business-related, firm-related and client-related. Creation of business and acquisition of skills were the most referred categories, both as expectations and as perceptions of reality. However, several expectations don't match the providers' perceptions of reality, as well as some perceptions weren't part of the providers' initial expectations.

**Keywords:** *Offshoring, Offshore Outsourcing, Providers, Expectations*

## **Introduction**

Multinational organizations are continuously transforming themselves into nimble, global competitors, through a process that is enabled by the practice of outsourcing and offshoring strategies (Couto et al., 2008).

Offshoring refers to the completion of business tasks, functions or processes outside the firm's home country, but it is no longer just a labour arbitrage strategy. For more and more companies, offshoring is turning into a means to gain access to qualified personnel and to increase organizational flexibility and competitiveness (Farrell et al., 2006; Lewin and Peeters, 2006; Lewin and Couto, 2007; Bunyaratavej et al., 2007; Manning et al. 2008; Couto et al. 2008; Lahiri and Kedia, 2011).

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Despite the extant literature, to our best knowledge, the complex dynamics of this phenomenon is not well understood (Manning et al. 2008). Although providers play a crucial role determining the success of an offshoring partnership (Lahiri and Kedia, 2009; Lahiri et al., 2012), most of the published research is focused on the clients' perspective and unnoticed the dimension of the providers (Mao et al., 2008; Lahiri and Kedia, 2009; Aundhe and Mathew, 2009; Lahiri et al., 2012).

Considering this gap in the literature, the goal of our research is to analyse the context of the Portuguese providers, which is particularly pertinent after the identification of the country as one of the eleven developed countries better prepared to receive globally sourced services in the IT sector<sup>1</sup>. Particularly, we would like to analyse the expectations of these providers, when they engaged in offshoring activities.

Given the absence in the literature of formal theories addressing the particular case of the expectations of offshoring providers we propose an exploratory approach, based on Grounded Theory.

This paper is divided into five main sections. In Section 1 we introduce the research subject. In Section 2 we make a literature review on Offshoring: first by defining its key concepts (2.1), and then by analysing the main aspects framed in the literature (2.2). In Section 3 we present the methodological approach we propose to apply in our research; in Section 4 we describe our main findings; and in Section 5 we conclude.

## **Literature Review on Offshoring**

### **Definition of key concepts**

Globalization has been influencing the competitive behaviour of firms in their different aspects: supply chain, marketing, corporate strategy and organizational structure (Bunyaratavej et al., 2007). Particularly, the increasingly competitive global business environment led companies to focus on cost-cutting strategies, such as offshoring (Lewin and Peeters, 2006). However, nowadays reducing labour costs is no longer the single strategic driver behind offshoring implementations, and other factors like assessing pools of highly-skilled workforce, or increasing organizational flexibility are gaining importance (Farrell et al., 2006; Lewin and Peeters, 2006; Bunyaratavej et al., 2007; Lewin and Couto, 2007; Manning et al. 2008; Couto et al. 2008; Lahiri and Kedia, 2011).

Likewise, literature has revealed that companies are increasingly recurring to outsourced activities to create value and to fuel their accelerated innovation needs (Couto et al. 2008; Manning et al. 2011), and therefore outsourcing “has expanded rapidly in recent years, offering client firms the opportunity to select from a range of full-service and specialist providers for specific needs” (Manning et al., 2011, p. 382).

Thus, these two concepts, offshoring and outsourcing, are occasionally confused

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<sup>1</sup> Source: Gartner, Inc., Gartner's 30 Leading Locations for Offshore Services, 2012, Ian Marriot, January 16, 2012.

(Bunyatarajev et al., 2007; Manning et al. 2008). While offshoring denotes the performance of tasks and business functions across national borders (Manning et al., 2008); outsourcing consists on the delivery of products or services of the firm by a specialist third-party provider, within or outside of the firm's national border (Manning et al., 2008; Lahiri and Kedia, 2009).

In this work we propose to analyse providers whose foreign clients have outsourced their activities in Portugal. This means we will be dealing with the concept of offshore outsourcing, which according to Manning et al. (2011, pp. 382) "means that client companies choose to source functions and processes supporting domestic and global operations from outside their home countries, using third-party service providers".

Considering that the goal of our study is to gain further understanding of the offshoring phenomenon through assessing the expectations of the providers, the analysis of the concept of expectations is also of crucial importance.

The concept of expectations is greatly studied in the marketing literature about service quality, since service quality has been defined as the difference between the perceptions and the expectations of service level (Parasuraman et al., 1985; Parasuraman et al., 1988; Brown and Swartz, 1989; Carman, 1990; Teas, 1993; Parasuraman et al., 1994; Donthu and Yoo, 1998). Considering the gap in the offshoring literature with regards to the conceptualization of expectations, we analysed the service quality literature, aiming to find a definition of expectations to be used in the context of our study.

If we analyse the service quality conceptualization of expectations under the light of the thematic of our study, we reach our own definition of providers' expectations. Thus, providers' expectations may be defined as believes, predictions, desires or wants of providers, i.e., what they feel an offshore outsourcing relationship should offer them or what are the desired attributes of that relationship. These expectations function as standards or reference points against which performance is judged. Plus, providers may form their expectations either on the basis of their own past experience, or by observing or being informed about other provider's experience in offshoring.

The definition of these two key concepts, offshoring and expectations, play a very important role in the subsequent sections of our study. First, because we limit our concept of offshoring to offshore outsourcing, that is, to the performance of outsourced activities by a third-party supplier located outside the home country. Second, because from now on we bear in mind that the expectations of the providers are believes, desires and standards that emerge both from the provider experience and also from observation and exchange of experiences with other providers. We should take this into account in our following literature review.

### **Main aspects framed in the literature**

This section continues our literature review, by analyzing the main aspects framed in the offshoring literature. Our goal is first to investigate the generic literature about offshoring, identifying the seminal aspects and the more recent trends; and then to give a special attention

on the scarce literature focusing on the dimension of the providers.

Offshoring research has given place to extent literature (Lahiri and Kedia, 2009). Farrell et al. (2006) point out that this subject causes controversy among policy makers, business executives and thought leaders. Much has been said, for instance, about the past, the present and possible future of offshoring and the drivers behind its decisions (Lewin and Peeters, 2006). Lewin is also the lead principle investigator at Offshoring Research Network (ORN), an annual survey conducted since 2004, that collects firm-level data on the offshoring experiences of companies across industries, aiming to track: the drivers behind offshoring decisions, the impact on employment, the drivers behind location choices and the risks firms perceive before and during their engagement in offshoring activities (Lewin and Couto, 2007).

But the scope of literature is wide. Other questions, like the factors that contribute to the location choices (Bunyatarajev et al., 2007); the unbalanced dynamics for supply and demand for offshore service talent (Farrell et al., 2006); the use of offshoring to globally source Science and Engineering talent (Manning et al., 2008); the stability of offshoring relationships (Manning et al., 2011); or the impact of trust (Lee and Choi, 2011) and control (Mao et al., 2008) in offshore outsourcing relationships, have also been deeply analyzed. Although these studies have dealt with relevant aspects of offshoring, Manning et al. (2008) claim that the complex dynamics of this phenomenon is not well understood. A fact that stands out is that most of the published research has focused on the clients' perspective and unnoticed the dimension of the providers (Mao et al., 2008; Aundhe and Mathew, 2009; Lahiri and Kedia, 2009; Lahiri et al., 2012). Table 2, gives us an overview of the reviewed literature about offshoring.

From Table 1, we understand that the offshoring literature focusing on the providers is not only scarce, but it is also somehow disintegrated, making it difficult to find connections between researchers.

For instance, some authors (Lahiri and Kedia, 2011; Lee and Choi, 2011; Manning et al., 2011) chose to analyse both the dimensions of the client and the provider to understand the offshoring phenomenon. While Lahiri and Kedia (2011) developed a framework to explain the co-evolution of institutional and organizational factors in offshoring, Lee and Choi (2011) focused on the impact of trust in IT outsourcing relationships, and Manning et al. (2011) analysed the role of relation specificity and client control.

In the same vein, Mao et al. (2008) had already focused on the impact of trust and control in offshore outsourcing, but in this case the authors analysed only the vendor's perspective. Also, the remaining authors who focused only on the perspective of the providers, analysed unrelated subjects: while Lahiri and Kedia (2009) investigated the impact of resources and partnership quality on the provider's performance, Aundhe and Mathew

(2009) shed light on the risks in offshore IT outsourcing, and Lahiri et al. (2012) assessed the impact of management capability on the performance of offshoring providers.

This disintegration and shortage of literature about offshoring focusing on the dimension of the providers increases the relevance of our study, and supports the conduction of an exploratory approach.

However, to refute this tendency in the literature, in 2008 the Offshoring Research Network launched a report based on a survey conducted in the previous year to offshoring service providers. It was “the first comprehensive examination of offshoring from the service provider perspective” (Couto et al. 2008).

Following the same line of thought, Lahiri and Kedia (2011) also suggest that more than simply analysing the drivers behind offshoring, it is of crucial importance to study the factors that are present both on the client and on the provider side, that together explain the decisions to engage and continue offshore outsourcing activities. Therefore they developed a framework based on the coevolution perspective aiming to explain how institutional and organizational factors coevolve and contribute to the engagement in offshore outsourcing (both for clients and providers).

Their position is that clients and providers are interdependent actors and their behaviour influences and is influenced by the interaction of environmental determinism resulting from institutional and organizational factors.

If we use these insights of Lahiri and Kedia (2011) to shed light on the focus of our study that is analyzing the perspective of the providers, we recognize that providers must continuously evaluate their client’s environment to track changes, specific requirements and needs. This allows them to improve its own resources and capabilities and to take corrective actions, based on the feedback and on the knowledge transferred through client interactions, in the constant attempt to be the clients’ dependable business partner.

**Table 1: Overview of the empiric literature about offshoring.**

<i>Reference</i>	<i>Topic</i>	<i>Year</i>	<i>Thematic</i>	<i>Unit of analysis</i>	<i>Methodology</i>
<i>Lewin, A. Y., and Couto, V.</i>	<i>Drivers of offshoring decisions and location choices, impact on employment and risks perceived by firms (ORN Survey Report)</i>	<i>2007</i>	<i>Drivers, Location, Impacts</i>	<i>Client firms in the U.S., U.K., Germany, Netherlands and Spain</i>	<i>Quantitative - Exploratory</i>
<i>Couto, V., Mani, M., Sehgal, V., Lewin, A. Y., Manning, S., and Russel, J. W.</i>	<i>Examination of offshoring service providers (ORN Service Providers Survey Report)</i>	<i>2008</i>	<i>General Overview of providers</i>	<i>Service Providers in the U.S., Europe, India, China, Brazil and other countries</i>	<i>Quantitative - Exploratory</i>
<i>Bunyaratavej, K., Hahn, E. D., and Doh, J. P.</i>	<i>Drivers of location choices of service offshoring</i>	<i>2007</i>	<i>Drivers, Location</i>	<i>Client firms in the U.S.</i>	<i>Quantitative - Causal</i>
<i>Lee, J. N., and Choi,</i>	<i>Bilateral perspective on the</i>			<i>Service receivers and</i>	<i>Quantitative –</i>

<i>B</i>	<i>impact of trust in IT outsourcing</i>	2011	<i>Trust</i>	<i>service providers</i>	<i>Causal</i>
<i>Manning, S.; Lewin, A.Y.; Schuerch, M.</i>	<i>The role of relation specificity and client control on the stability of offshore outsourcing relationships</i>	2011	<i>Relationship and Control</i>	<i>Service Providers in the U.S., Europe, India, China, Latin America and other regions</i>	<i>Quantitative – Causal</i>
<i>Mao, J. Y., Lee, J. N., and Deng, C. P.</i>	<i>The impact of vendor's trust and client's control on the vendor's performance</i>	2008	<i>Trust and Control</i>	<i>Offshored Information System Projects in China (from Japanese clients)</i>	<i>Quantitative – Causal</i>
<i>Lahiri, S., and Kedia, B. A.</i>	<i>The impact of internal resources and partnership quality on the performance of offshoring providers</i>	2009	<i>Resources, Partnership</i>	<i>Indian Business Process Outsourcing Providers</i>	<i>Quantitative – Causal</i>
<i>Lahiri, S., Kedia, B. A., and Mukherjee, D.</i>	<i>The impact of management capability on the performance of offshoring providers</i>	2012	<i>Management Capability</i>	<i>Indian Business Process Outsourcing Providers</i>	<i>Quantitative – Causal</i>
<i>Lahiri, S., and Kedia, B. A.</i>	<i>Co-evolution of institutional and organizational factors in explaining offshore outsourcing (both for clients and providers)</i>	2011	<i>Institutional and Organizational factors in the Relationship</i>	<i>Indian Business Process Outsourcing Providers</i>	<i>Quantitative – Causal</i>
<i>Aundhe, M. D., and Mathew, S. K.</i>	<i>Risks in offshore IT outsourcing from the perspective of service providers</i>	2009	<i>Risks</i>	<i>IT Service Providers</i>	<i>Qualitative – Case Study</i>

**Source: own elaboration**

Nonetheless, in 2012, Lahiri et al. still argue that “very little attention, however, has been accorded to understand the context of offshore service providers” (Lahiri et al., 2012, pp. 1). In the same vein, we can argue that very little attention has been accorded to understand the context of offshore providers in general, which further enhances the relevance of our study.

To fill this gap in the literature, Lahiri and Kedia (2009) and later Lahiri et al. (2012), intended to broaden the understanding of offshoring, through analyzing the factors that allowed providers to better respond to their client’s needs.

It is their belief that offshore providers contribute to the value creation mechanism of their clients and that the success of offshoring relies on their performance. Particularly, they analyzed the effects of internal resources of the company, such as human capital, organizational capital and management capability, and its interaction with partnership quality (between client and provider) and measured their impact in the performance of the company (Lahiri and Kedia, 2009; Lahiri et al., 2012).

Thus, we may conclude that, first Lahiri and Kedia (2009), and then Lahiri et al. (2012), considered that it was important to fill the gap in the literature about the offshoring providers, through assessing the factors that affect the provider's performance.

Previously, Mao et al. (2008) had already analyzed the impact of the vendors' trust in their client and the client's control over the vendor affecting the vendor's performance, in a study conducted with Chinese outsourcers working for clients in Japan. They claim that the interactions between clients and providers are of crucial importance to determine the success of an offshore outsourcing relationship. Likewise, we can argue that the expectations of the providers may impact their performance.

Mao et al. (2008) researched the practices and behaviours that influenced a vendor's perception of trust and identified a number of trust building mechanisms: information sharing, communication quality and inter-firm adaptation. They argue that the client's willingness to be open in sharing domain and process information (information sharing); the importance the client's personnel attach to the communication with the vendor (communication quality); and the efforts of the client in adapting to the vendor's constraints (inter-firm adaptation) influence the vendor's perception of the relationship and have a positive impact on the vendor's trust in the client.

The findings of Mao et al. (2008), about the impact of trust and control on the performance of the suppliers, make us believe that to fully understand the complexity of the offshoring phenomenon, multiple dimensions should be looked at, which enhances the relevance of studying the expectations of providers and the role they play.

Another of these dimensions framed in the offshore outsourcing literature is the risk involved in offshoring partnerships. Given our focus on the providers, the work of Aundhe and Mathew (2009) about the risks in offshore IT outsourcing on a provider perspective is particularly relevant.

Aundhe and Mathew (2009) believe that "outsourcing partnerships carry risks as evidenced by reported failures of such engagements" (p. 419). These risks are mostly caused by the assumptions (or expectations) taken into account in the definition of outsourcing contracts, that carry a limited understanding about the future. Therefore, the success of offshoring engagements will depend on the understanding of the risks involved in the partnership and on the strategies to attenuate those risks.

To prove this belief, Aundhe and Mathew (2009) collected data from five Indian providers, which allowed them to identify three categories of risk faced by the offshore service providers: project specific, relationship specific and macroeconomic risks.

Aundhe and Mathew (2009) argue that it is important to understand the categories and contents of risk involved in offshoring, because only through that comprehension it is possible to draw the above mentioned risk mitigation strategies, with significant managerial implications. We may argue that the importance of studying the expectations of providers in offshoring is based on the same belief.

### Research Method

To the best of our knowledge, not only has very few attention been drawn to understanding the provider's perspective in offshoring, but also their expectations when engaging this type of partnerships haven't been analysed at all. For this reason, we conducted an exploratory approach based on Grounded Theory (GT), which is "used to generate theory where little is already known or to provide a fresh slant on existing knowledge" (Goulding, 1998, p. 51).

A purposive sampling technique was applied to select the firms to be approached and finally seven were interviewed. This selection aimed to include companies from different sectors, from different sizes and from different ages. One of the interviewed firms had already ceased its activity. Two of the interviewed firms were also producing for their own brands, while the others devoted all their production to outsourcing clients. Since our goal was to study the Portuguese providers, we restricted our analysis to companies totally owned by Portuguese capital, who had been providing offshore outsourcing activities for foreign clients for at least 3 years, which was the period used by Aundhe and Mathew (2009).

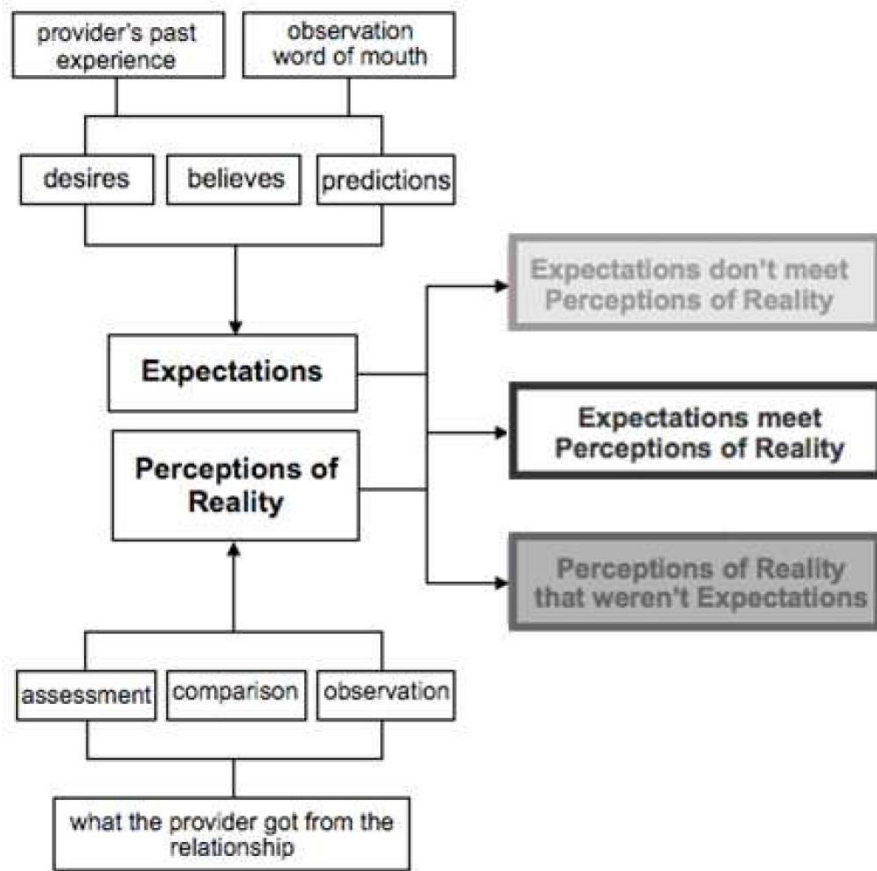
Data was collected via unstructured interviews to the managers of each firm. However, a protocol was employed to ensure the same themes were covered on each interview. The aim was to assess what were their previous expectations and their perceptions of the current reality of their firms. After seven interviews, theoretical saturation was reached: no new or relevant categories of data emerged from the final interview. For triangulation purposes additional information was collected via alternative sources, such as news in the press. The characteristics of the firms are presented in Table 2.

**Table 2. Firms' characteristics \*887 in Portugal + 2793 worldwide**

	<i>Sector</i>	<i>Year of Establishment</i>	<i>No. of workers</i>
<i>Alpha</i>	<i>Plastic Injection</i>	<i>1993</i>	<i>60</i>
<i>Beta</i>	<i>Textile</i>	<i>1972</i>	<i>250</i>
<i>Gamma</i>	<i>Footwear</i>	<i>1947</i>	<i>108</i>
<i>Delta</i>	<i>Pharmaceutical</i>	<i>2001</i>	<i>180</i>
<i>Epsilon</i>	<i>Textile</i>	<i>1997 (ceased activity)</i>	<i>30</i>
<i>Zeta</i>	<i>Textile</i>	<i>1984</i>	<i>490</i>
<i>Eta</i>	<i>Health &amp; Beauty car and packaging</i>	<i>1965</i>	<i>3680*</i>

Our analysis procedure consisted on the content analysis of the transcription of each interview, using QSR NVivo9 software. Initially, data was classified into nodes, corresponding to categories of expectations and perceptions of reality. The categories resulting from this initial coding were then grouped into broader categories: business-related, firm-related and client-related.



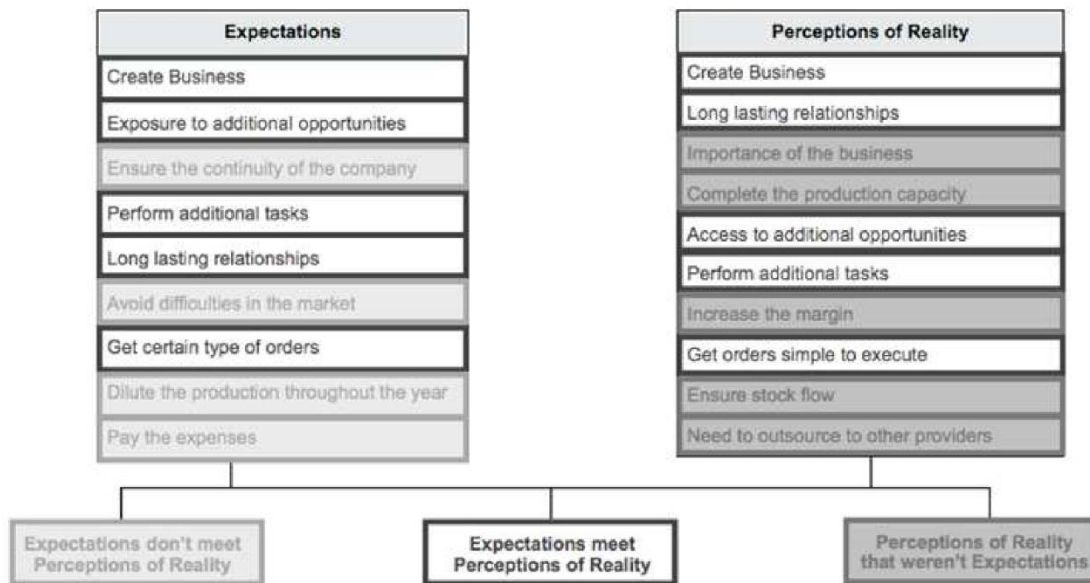


*Figure 1. Framework for comparison between expectations and perceptions of reality*

Following these coding, we then compared the expectations and perceptions of reality of each category, to assess which ones matched or not, but also to identify the perceptions of reality that the providers didn't have as initial expectations. Figure 1 represents the framework used for this comparison. This framework was then applied to the three categories of expectations and perceptions of reality.

### **Research Findings**

The major expectation revealed by the firms we interviewed was to they most expected when starting an offshoring relationship with comparison framework applied to the business-related categories.



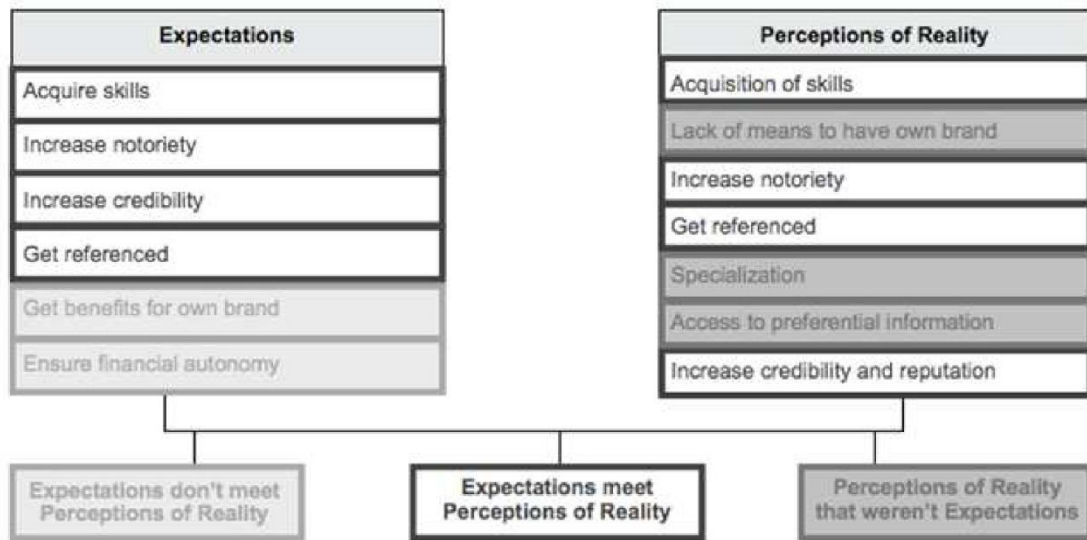
**Figure 2.**

***Comparison between business-related expectations and perceptions of reality***

Other significant nodes emerging as business-related expectations are the exposure to additional opportunities, the performance of additional tasks and to have long lasting relationships. These expectations, along with getting certain types of orders, are the ones that meet the perceptions of reality.

Although the expectations to avoid difficulties in the market and to dilute the production throughout the year don't meet the perceptions of reality, these nodes have only few references. We stress the fact that only one firm identified the insurance of the continuity of the company and the payment of expenses as expectations for new offshoring relationships. This was firm Epsilon that eventually ceased activity, and these expectations didn't meet any perception of reality.

The creation of business is also the more relevant perception of reality from all three categories. Besides, firms reveal that the offshoring relationships have allowed them to have important business, to complete their production capacity, to increase their margin, to ensure stock flow and to outsource their production to other suppliers. These were aspects that they didn't initially expect.

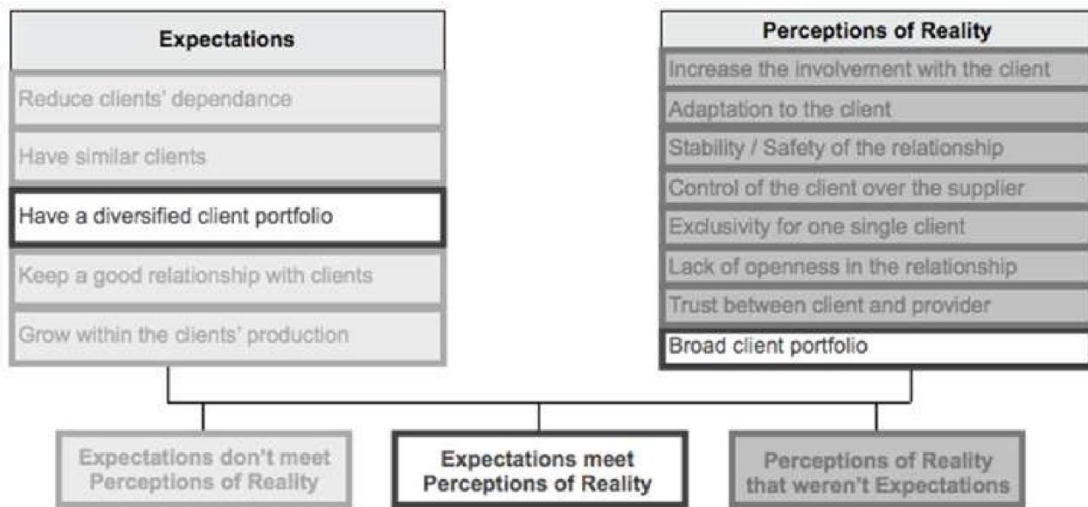


**Figure 3. Comparison between firm-related expectations and perceptions of reality**

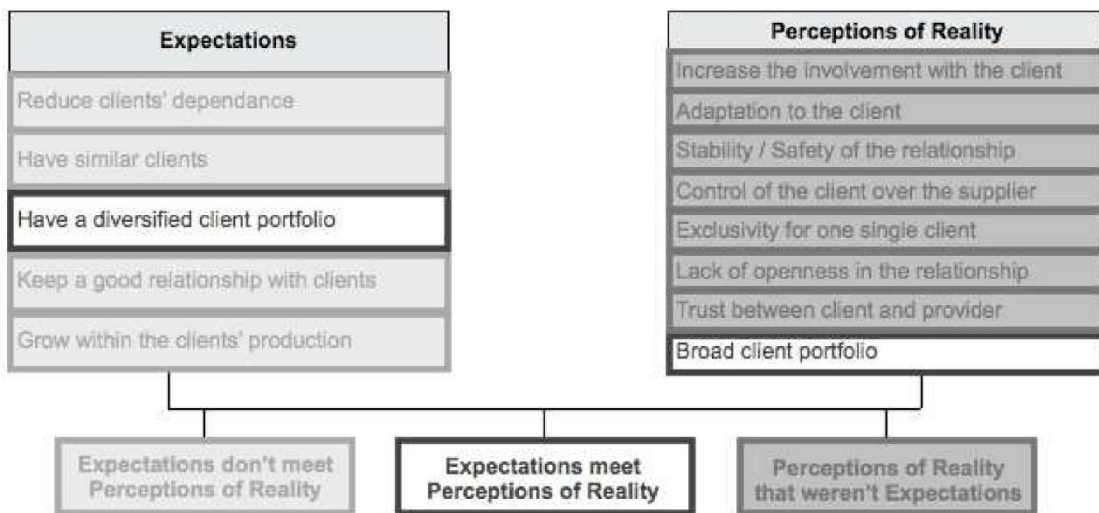
On the firm-related level (Figure 3), the acquisition of skills was the expectation and perception that was referred the most. Firms revealed the belief that they would become a more capable company if they worked as offshore outsourcing providers and, looking back, this is something they perceive as having achieved. This expectation, along with the notoriety and credibility increase, and the reference to other clients, are the ones that meet the perceptions of reality.

While the insurance of financial autonomy was an expectation that wasn't mentioned as a perception of reality, the hope for benefits for own brand, mentioned by the two firms that had own brands, might be indirectly represented in the perceptions of acquisition of skills, increased notoriety and credibility, get references and access to preferential information, that may benefit an own brand, although this wasn't directly mentioned as a perception of reality.

Plus, although a few firms revealed lack of means to have a brand, only firm Epsilon mentioned an increase in its degree of specialization.



**Figure 4. Comparison between client-related expectations and perceptions of reality**



The client-related (Figure 4) category is the one where there is less matching between expectations and perceptions of reality, only one category matches: having a diversified client portfolio.

Still, we believe that although the expectations of reducing clients' dependence, having similar clients, keeping a good relationship with clients and growing within the clients' production don't show up as perceptions of reality, this doesn't mean they didn't happen at all, but only that providers don't perceive them, or didn't mention them.

However, several perceptions of reality that weren't initial expectations emerge; most mentioned being the increased involvement with the client. Besides, some of the other perceptions that appear may be considered divergent: adaptation to the client, stability/safety of the relationship, control of the client over the supplier, exclusivity for one single client,

lack of openness in the relationship and trust between client and provider. This may happen because of the different typology of clients each case had.

### **Conclusions and Implications**

The goal of our research was to fill that gap in the literature regarding the impacts of offshoring in a provider-perspective. Specifically, we would like to assess the case of Portuguese providers, following Lahiri et al. (2012) suggestion of future research, in the form of a qualitative study.

Given the absence of formal theories in the literature regarding this subject, we carried out an exploratory approach on the expectations of providers and compared them with their perceptions of reality, aiming to extend the literature about this matter. We identified three broad categories of expectations and perceptions of reality: business-related, firm-related and client-related.

Our study revealed that both on the business-related and firm-related categories, there isn't a major gap between expectations and perceptions of reality, with a considerable number of matching categories. From these, we highlight the creation of business and the acquisition of new skills, as the more significant categories emerging in the data.

On the other hand, on the client-related categories, there is one single match, in an inexpressive category: diversified client portfolio. By contrast, the more significant category of expectations for providers starting new offshoring relationships was to reduce their dependence to their current clients. However, interviewees revealed an increased involvement with their clients as their main perception of reality in client-related category.

The implications of these findings are wide: offshoring providers may be a source of competitiveness for one economy, since they are bringing business and promoting the acquisition of skills in the country and so, Governments may want to stimulate this business model.

However, it would be interesting if further studies could research the reason why some expectations don't meet reality: are there gaps of communications between clients and providers? Or is it a matter of perception and management of expectations? We believe a clear empirical investigation of these aspects would give us an even broader understanding of the offshoring phenomenon in the provider-perspective.

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