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Risks and governance modes in offshoring decisions: linking supply chain management and international business perspectives

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ABSTRACT

Governing offshoring has become a major challenge for firms that run operations outside the home country. International business (IB) and supply chain management (SCM) literature offer different insights on the topic, focusing especially on possible governance modes and the drivers of this choice, with different perspectives. Grounding the discussion at the intersection between these two research fields, the present study first proposes a taxonomy of offshoring risks (i.e. *tasks*, *operational*, *reputational* and *institutional*), with corresponding risk factors in each category; then, a set of research propositions are formulated, in order to link these categories to the governance-mode choice. Furthermore, we argue that the risk–governance link is moderated by two relevant factors, that is, the offshoring firm *size* and the *strategic relevance* of the outsourced activity. As a result, we elaborate on the interrelation between IB and SCM theories, emphasising the impact of risk management and contingent factors in offshoring governance modes configurations.

KEYWORDS

Offshoring strategy; offshoring risks; governance mode; theoretical model

Introduction

Offshoring can be conceptualised as sourcing of activities outside a firm's home country to fulfil domestic or global operational requirements (Lewin, Massini, and Peeters 2009). Offshoring trends have accelerated in the last decade, firstly concerning manufacturing activities, but then extending to administrative and technical services as well as high-value services (e.g. Doh 2005; Kotabe, Mol, and Murray 2009; Lewin and Volberda 2011).

Much of the traditional supply chain management (SCM) literature on offshoring has emphasised the cost-saving motivations (Kumar and Sosnoski 2009), while recent discussions have highlighted more articulated motivations driving firms' offshoring decisions, including the access to human resources and talent, knowledge and new technologies (Kedia and Lahiri 2007; Lewin, Massini, and Peeters 2009). Moreover, firms that decide to buy or relocate activities in a foreign country always deal with risks originating – e.g. – from cultural distance, foreign legal environment, market competition and political instability (Lampel and Bhalla 2008). As risk factors are associated to potential costs, they strictly interact with the governance mode adopted in determining the performance of the offshoring project, and many international business (IB) articles analyse how the strategic choice of the governance mode offers different options to hedge against offshoring risks and reduce transaction costs (e.g. Kotabe, Mol, and Murray 2009; Leiblein and

Miller 2003). However, the literature is unclear on how the different types of risks may influence the governance-mode decisions and what factors may affect the link between risks and governance mode.

With these premises, the present work positions itself at the intersection between SCM and IB literature, by discussing the relation between risks and governance mode in offshoring decisions. While the two streams of literature have provided several theoretical contributions and empirical evidence on the offshoring strategies, the current discussion lacks in presenting an integrated framework where the two perspectives harmoniously converge. In doing so, we first propose an integrated taxonomy of the different types of offshoring risks (explaining how each type may influence the governance-mode choice). Further, as the literature recognises potential moderators in the risk–governance-mode relation, we focus the discussion on the impact of two variables at task and firm level, that is, the strategic importance of the offshored activity and the offshoring firm size, which have been widely used in the literature to explain governance-mode choices (Zhao, Luo, and Suh 2004), but to a lesser extent associated with the (offshoring) risk-management literature.

On the one hand, this work proposes a multidimensional risks classification that can be considered original as it integrates country-, firm-, and project-level perspectives; on the other hand, we contribute to the offshoring debate by discussing the different

origins and the heterogenous impact risks may have on the governance choices integrating both SCM and IB theories.

Managing offshoring: the IB and the SCM perspective

In recent years the offshoring trend (i.e. the decision whether and how relocating some of the business activities) has been integrated in managerial practices (e.g. Lewin and Peeters 2006; Manning, Lewin, and Massini 2008), and the increasing relevance of the phenomenon has linked practitioners (e.g. Aron and Singh 2005) and policymakers (e.g. UNCTAD 2010) to the academic community.

In particular, the topic has been traditionally analysed by two different points of view, deriving, respectively, from the SCM (e.g. Ellram, Tate, and Billington 2008) and the IB literature (e.g. Lewin and Peeters 2006). Table 1 provides an overview of main topics discussed by the two streams, with evidences on potential points of connection. In fact, even though the research fields provide complementary perspectives on offshoring decisions, there have been only few attempts to link these existing contributions and propose a cross-fertilised research setting (e.g. Caniato et al. 2015).

IB literature recognises offshoring as a specific manifestation of firm internationalisation and first looks at this choice by evaluating costs and benefits associated to these decisions (Dunning 1998). So, a large number of studies are focused on exploring drivers of offshoring phenomenon and firms' decisions to engage in offshoring. Among these drivers, cost reduction motivations (Bunyaratavej, Hahn, and Doh 2007; Stratman 2008), market expansion, human capital acquisition (Lewin, Massini, and Peeters 2009), innovation and growth (Lewin and Peeters 2006) are recognised as the most relevant factors. Another subset of studies focuses on the implications offshoring has within the IB context, both at macro – development of knowledge

service clusters (Manning, Lewin, and Massini 2008) – and micro level – change in the relationship between the offshoring firm and its business partners (Gopal et al. 2003). Other studies argue on the consequences that the engagement in offshoring practices has on the organisation's economic performance, for example, profit (Hutzschenreuter, Lewin, and Dresel 2011) and/or resource and capability (Kotabe, Mol, and Ketkar 2008; Jensen, 2009).

Finally, many IB authors provide insights on the implementation of the offshoring decisions, mainly focusing on the offshoring governance-mode choice (e.g. Gray, Roth, and Leiblein 2011; Elia et al. 2014). In particular, firms need to decide either to manage their offshored activities internally (Bunyaratavej et al., 2008; Hutzschenreuter, Lewin, and Dresel 2011), or to rely on an independent (foreign) provider (Kedia and Mukherjee 2009). In the first case, the selected governance mode is called *captive offshoring* and the firm can put it into action in two ways: by creating its fully owned subsidiary through a greenfield investment in the foreign country, or by acquiring an existing foreign company through equity investments (Anderson and Gatignon 1986; Chang and Rosenzweig 2001). In the second case, the firm chooses an external governance mode (i.e. *offshore outsourcing*), which is a contract-based arrangement with an external service provider (Hahn, Doh, and Bunyaratavej 2009). Finally, there is a third and particularly rare offshoring governance mode, that is, the *joint-venture*, which allows to share risk (and benefits) with another partner (Lewin and Couto, 2007).

Captive offshoring is the preferred governance mode in case the firm has capital and resources availability for a foreign direct investment, or it is particularly critical to establish long-term relationships in the host country by relocating abroad the ownership of a particular process, together with its operations (Medcof 2001). With captive offshoring, firms can replicate the existing organisational structure in the host country, with limited adaptations and by exerting a full control and avoiding the relational

Table 1. Offshoring literature from the IB and SCM perspectives.

| Topic | Stream of literature and most relevant contributions | |
|----------------------------|--|--|
| | IB | SCM |
| Offshoring drivers | Lewin and Peeters (2006); Bunyaratavej, Hahn and Doh (2007); Stratman (2008); Lewin, Massini and Peeters (2009); Roza, van den Bosch and Volberda (2011) | Kinkel and Maloca (2009); Stentoft, Mikkelsen and Johnsen (2015) |
| Offshoring governance mode | Hahn, Doh, and Bunyaratavej (2009); Kedia and Lahiri (2007); Hutzschenreuter, Lewin and Dresel (2011); Roza, van den Bosch and Volberda (2011); Elia et al. (2014) | Quinn (1999); Stratman (2008); Caniato et al. (2015) |
| Offshoring implications | Gopal et al. (2003); Jensen (2009); Larsen, Manning, and Pedersen (2013); Hutzschenreuter, Lewin and Dresel (2011) | Logan (2000); Bhalla, Sodhi and Son (2008); Tate et al. (2009); Kroes and Ghosh (2010) |
| Offshoring risks | Meldrum (2000); Hahn, Doh and Bunyaratavej (2009); Larsen, Manning and Pedersen (2013) | Venkatraman (2004); Kumar and Eickhoff (2005); Jahns, Hartmann and Bals (2006); Ellram, Tate and Billington (2008); Lockamy III and McCormack (2009); Kumar and Sosnoski (2009); Gray, Roth and Leiblein (2011); Holweg, Reichhart and Hong (2011) |

The table does not provide an exhaustive classification of academic production of the offshoring research, but it is intended to give a clear and synthetic evidence of the relationship between IB and SCM literature across the main offshoring-related topics.

IB: International business; SCM: supply chain management.

risks with an external provider (e.g. quality issues, service level, capacity problem). Captive offshoring certainly poses several challenges, including the lack of local-market knowledge, and the heavy investments in financial, human as well as capital assets to establish and run the wholly owned offshore entity (Hutzschenreuter, Lewin, and Dresel 2011).

In case of offshore outsourcing, firms can transfer some of their internal processes to a service provider, thus freeing limited resources for other business activities. Specialised suppliers can provide host country-specific knowledge and expertise in a given area, and they can count on larger scale and volume, with cost advantages for both parties (Luo et al. 2012). To work effectively, offshore outsourcing needs great efforts in terms of information exchange and coordination with the external partner, which can counterbalance the benefits deriving from supplier efficiency (Schilling and Steensma 2002; Rasheed and Gilley 2005). Moreover, firms might be exposed to the risk of knowledge spillover as a consequence of information sharing, especially when considering the offshoring of product engineering and R&D activities (Leiblein, Reuer, and Dalsace 2002).

Discussion on governance-mode configuration represents the point of connection with the SCM stream of research addressing offshoring, which is mainly oriented on shaping the optimal strategy for the offshoring organisation's value chain, and on make-or-buy decision applied to the offshoring case (e.g. Nayyar and Bantel, 1994; Quinn, 1999). SCM literature argues that, although governance modes can offer specific benefits, they also imply potential risks, which need to be properly integrated in the offshoring decision as they may ultimately jeopardise firm and project performance (Logan 2000;

Kumar and Eickhoff 2005; Kroes and Ghosh 2010; Holweg, Reichhart, and Hong 2011). Prevalent SCM perspective on offshoring offers evidences that decision-makers must perform a careful assessment and evaluation of offshoring risks, in order to strategically configure the offshoring organisation's value chain, by choosing the most appropriate form of governance and mitigate their incidence (Ellram et al. 2008; Caniato et al. 2015).

Offshoring risks: a comprehensive taxonomy from the IB and SCM perspectives

Past studies offer some insights about single types of offshoring risks (e.g. Ellram, Tate, and Billington 2008; Hahn, Doh, and Bunyaratavej 2009; Lockamy III and McCormack 2009; Thun and Hoenig 2011; Casson 2013). However, to the best of our knowledge, a comprehensive and multilevel taxonomy, considering risks classification from both the IB and SCM perspectives, does not exist. So, grounding on previous studies, we aim at filling this gap by proposing an exhaustive classification of offshoring risks, integrating groups discussed in the existing literature (i.e. *task-related* risks – typical of SCM field – and *institutional* risks – typical of IB field), with additional offshoring risks categories. Figure 1 presents the categorisation and summarises the main offshoring risk factors taken into consideration, presenting a pyramidal structure highlighting the multilevel approach adopted. For each risk category, examples are provided in order to link their theoretical definition to practical representation.

We disentangled risks directly related to the offshoring projects into two more fine-grained categories, that is, *task-related* and *operational* risks. While the first type

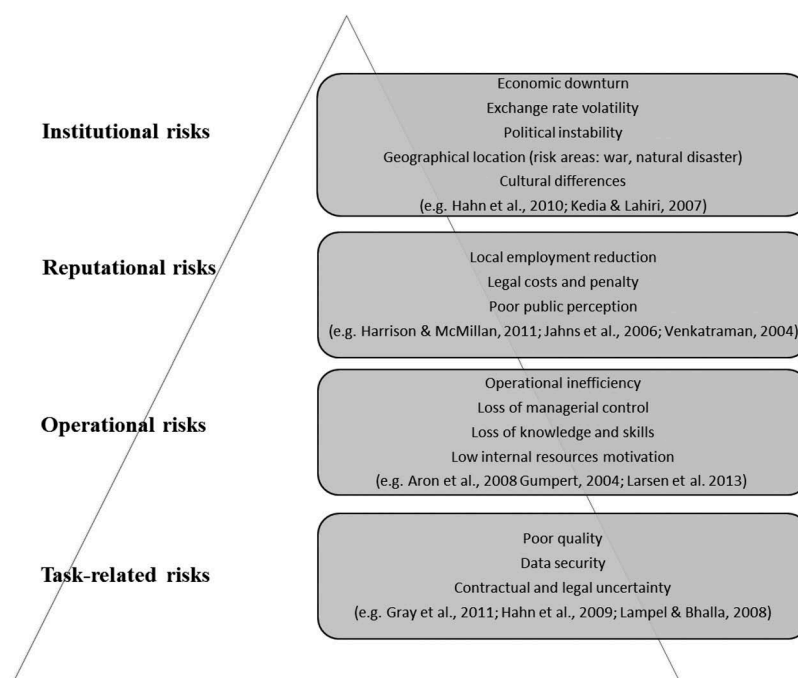


Figure 1. Offshoring risks categories and examples.

of risk refers to issues or uncertainties stemming from the actuation of the specific offshored tasks, the second relates to the consequences on internal processes of relocating activities in a country that can be very different from the domestic one. On the one hand, *task-related* risks include all potential risk factors to be considered when choosing a specific service provider for the offshoring task and may originate from the final quality of the service (which can be lower than expected; Gray, Roth, and Leiblein 2011), data security (Bhalla, Sodhi, and Son 2008; Lampel and Bhalla 2008) or by the impossibility to identify all possible contractual/legal provisions (Hahn, Doh, and Bunyaratavej 2009). On the other hand, inefficiency due to hidden costs or higher use of resources (Kumar and Sosnoski 2009; Larsen, Manning, and Pedersen 2013), loss of operational and managerial control (Aron et al. 2008) and decrease of internal knowledge and skills (Kumar and Eickhoff 2005) are all examples of risk factors of this type.

Reputational risks relate to the decision of offshoring specific activities, thus affecting the image and the reputation of the organisation (Venkatraman 2004; Jahns, Hartmann, and Bals 2006). Offshoring decisions often imply loss of jobs at city/region level, closures of local businesses owned by local suppliers, delocalisation of competences, arising severe critics of local labour unions or local governmental institutions (Harrison and McMillan 2011). These events can generate negative externalities and reputation issues, not directly connected to the company's core business operations, but to its image and local social responsibility.

Finally, *institutional-level* risks, the higher level of our taxonomy, relate to the characteristics of host country in which the firm decides to offshore its activities and the differences with the home country. Entering a foreign country generally means facing a range of economic, financial, governmental and political factors characterising different environments around the world (Kobrin 1979; Brouthers and Brouthers 2000; Meldrum 2000; Van Wyk and Baerwaldt 2005; Hahn and Bunyaratavej 2010). These can include country risks such as macro-economic and other financial shocks, as well as political, market, legal and cultural factors, that can weaken the stability of the firm operations in the host country (Gatignon, and Anderson, 1988).

Linking the governance mode to risk factors: theoretical model and propositions

Several authors explicitly recognise that risk factors drive governance decisions (e.g. Kim and Hwang 1992). Other authors implicitly embed the different risk categories described into aggregated factors. For example, Griffith, Harmancioglu and Droge (2009) argue that the

governance-mode design depends upon four driving factors dealing with institutional-, population-, firm- and implementation-specific variables.

This is consistent with transaction cost economics (TCE; Williamson 1985), which is commonly adopted in both IB and SCM literature, regarding both manufacturing (Qu and Brocklehurst 2003) and services (Murray and Kotabe 1999). According to TCE, firms choose the appropriate governance mode for their foreign operations by balancing the transaction costs associated to integrating operations within the firm boundaries and the costs associated to outsourcing (Brouthers 1995; Slangen and Hennart 2008).

In the offshoring context, the most simplistic view is that firms will offshore if savings due to this decision exceed the additional transaction costs associated with offshoring. However, as higher risks imply also higher costs (Venkatraman 2004), incoherent decisions with the offshoring project may lead to higher costs due to unforeseen risks the company was not prepared to face. Existing research has shown that institutional- and task-related risks increase transaction costs and cause firms to avoid some entry modes (Delios and Henisz 2003; Henisz and Macher 2004). Even though not all risks affect firms in the same way, overall operational risks also appear to be an important consideration in offshoring investment (Oetzel 2005), as well as reputation-level risks, rarely taken into consideration (but included in this discussion).

Managers can implement a different array of strategies to mitigate large transaction costs associated with offshoring implementation (e.g. Carmel and Nicholson 2005), with the common objective of risk (and related cost) minimisation. Among these, the choice of the optimal governance mode is one of the most effective, as it can smooth the issues associated with bounded rationalities and opportunist behaviours of the project partners (Malhotra and Gaur 2013). According to TCE, firms will deploy their offshoring strategy in order to minimise, as much as possible, the source of risks of the decision. As risks can be of different nature (institutional-, reputational-, operational- and task related), some of them can be managed effectively with a higher control of activities (i.e. *captive offshoring*), while others can be mitigated through the support of external partners (i.e. *outsourced offshoring*).

Thus we suggest the following proposition:

Proposition 1 (P1): *The type of risk faced during offshoring projects drives the choice of a specific governance mode*

We can then discuss the governance-mode decision, by presenting a more detailed risk-governance-mode analysis, according to the classification of risks provided.

Institutional risks

If a firm chooses to offshore to a country where institutional risks are very high (due e.g. to political instability, cultural or institutional differences), a local partner can help mitigating such risks and their impact acting as a bridge between the offshoring company and the local institutional environment. As a matter of fact, despite the interaction with a host-country provider might increase buyer–supplier transaction costs, these are normally compensated by the reduction of transaction costs due to the interaction with all the local stakeholders as well as the opportunity costs due to the lack of awareness or the underestimation of risk factors connected to the regulatory, political and cultural context. For this reason, the offshore outsourcing governance mode is a good option. This is especially true for some types of institutional risks, such as the socio-economic ones (Bühler and Haucap 2006). In this case, firms should invest in building a partnership with the selected provider, as the sustainability of the offshore outsourcing mode critically depends on the ability to satisfy the needs of the stakeholders, from the dual perspectives of the offshorer and the offshoree. More, grounding on the distinction between efficiency-seeking versus resource-seeking strategies (Mazzola and Perrone 2013), we can also recognise efficiency and market motivations (local presence and sales opportunity) as the main drivers for implementing offshoring strategies through offshore outsourcing, in presence of institutional risks. Suppliers specialisation, economies of scale and learning, as well as the possibility to transform fixed into variable costs (thus managing demand uncertainty), can support the risk reduction efficiency-seeking strategy (Aron et al. 2008; Ellram, Tate, and Billington 2008).

These considerations bring us to formulate the following sub-proposition:

Proposition 1.1 (P1.1): *Firms more likely will choose the offshore outsourcing mode in order to mitigate the institutional risks*

Reputational risks

Reputational risks arise when the public image of the company may be affected by the offshoring decision, which could be seen negatively, as it may result in loss of jobs for the company and suppliers (Levine 2012). Governments, in fact, put considerable pressure to keep jobs in within the country generally reporting the number of workers who have lost their jobs as a result of offshoring. When companies are located in countries particularly sensitive about this aspect (e.g. the United States), they can opt for captive offshoring in order to limit the negative impact on the job market without jeopardising the offshoring needs. Indeed, through

captive offshoring, the total number of company employees might stay the same or even increase thanks to the hiring of new employees in the host country. In some situations, companies can also offer the opportunity of relocation to the current employees willing to transfer to the foreign location. As such, organisations can show their commitment in safeguarding – at least partially – the workers' employment. This decision can be made also considering the degree of offshorability of the activity and the ease of employees' relocation: if the majority of jobs offshored are 'low attractive jobs' (e.g. call centres, low-wage technology jobs), more attractive jobs should be created in their place (Blinder 2009).

These considerations bring us to formulate the following sub-proposition:

Proposition 1.2 (P1.2): *Firms more likely will choose the captive offshoring mode in order to mitigate the reputational risks*

Operational and task-related risks

Operational and task-related risks essentially deal with possible internal inefficiencies of service provider quality level. When these sources of risk are present, the captive offshoring solution may support effectively the offshoring strategy, as it avoids high transaction costs related to potential asset specificity, hold-up problems and uncertainty. By adopting a captive form of offshoring, firms can – at the same time – keep control over the offshored process, protect their operational knowledge and task-related competences and fully exploit the benefits arisen from the relocation of firm' activities to a foreign location. More specifically, under these circumstances the offshoring firm is able to (1) secure the rent deriving from competitive advantage (also relating to growth in new markets, innovation and differentiation) and (2) avoid risks such as decay in service quality, poor responsiveness, uncertain relationship investments. Captive offshoring enables also to minimise the risks associated with the choice of a wrong offshoring partner (Aron and Singh 2005).

These considerations bring us to formulate the following sub-proposition:

Proposition 1.3 (P1.3): *Firms more likely will choose the captive offshoring mode in order to mitigate the operational and task-related risks*

Possible risks' combinations and the optimal governance modes

In order to analyse the relationship between offshoring risks and governance mode by combining the IB and SCM perspectives, considering the different risk

categories separately is not enough to get the real complexity of the relationship, as each offshoring project may contemporarily imply more than one typology of risk. Thus, with the aim to deepen our understanding of the different sources of risks and their potential impact on the optimal governance modes, we decide to relate the typical combinations of offshoring risks, with the possible governance-mode choices (Figure 2; for a similar approach in the IB field, see Slovic et al. 2004).

Coherently with the IB theory (Brouthers 1995; Schwens, Eiche, and Kabst 2011), we argue that institutional risks push firms to adopt a *third-made* governance mode, mainly based on an offshore outsourcing partnership configuration. On the contrary, typical SCM risks (reputational, operational and task-related) drive firms towards a *host-made* governance mode, based on captive offshoring.

When different sources of risks are present, firms should question their offshoring strategy, as real costs can overcome the potential benefits of relocating activities in a foreign country, independently from the governance mode. Saving costs, opening up new markets, accessing foreign distribution channels, accessing materials and goods and securing knowledge are among the most important motivations for offshoring (e.g. Kinkel and Maloca 2009), but without a clear knowledge and control of the foreign environment, host service providers and internal factors, the potential benefits can rapidly evolve in more organisational complexity, lack of capital and financing requirements, bureaucracy, as well as lack of know-how, capacity and competent personnel for

cross-border management. The growing transaction and coordination costs related to risk factors are two of the strongest arguments for explaining the recent reconcentrating trend via insourcing and backshoring activities. Once firms realise that internationalisation obstacles cannot be easily overcome (e.g. problems of transferring knowledge on how to run reliable production processes efficiently to the foreign location), they try to correct misjudgments of previous offshoring decisions, by opting for an *home-made* execution of the activity.

Finally, in the (rare) cases in which risk factors are restrained at all levels, firms can choose the governance mode only according to the offshoring strategy (Venkatraman 2004), with the choice driven by other factors, such as cost of labour, resource availability, cultural proximity, business environment and local networks. In particular, with efficiency-seeking reasons (where cost of labour and resource availability represent main drivers), firms are motivated by the possibility to reduce wages and other operational costs and/or to access specialised resources, so the outsourcing mode seems more suitable (Premus and Sanders 2002; with resource-seeking goals (where local networks and market competences represent the main drivers), firms are motivated by the possibility to gain sources of new knowledge abroad, which have a potential for contributing to the international competitiveness of the firm, so a captive mode is more appropriate Dutta and Roy (2005).

In its simplicity, the matrix is able to give an immediate view of how IB and SCM arguments can be used to interpret a key offshoring decision (i.e. governance

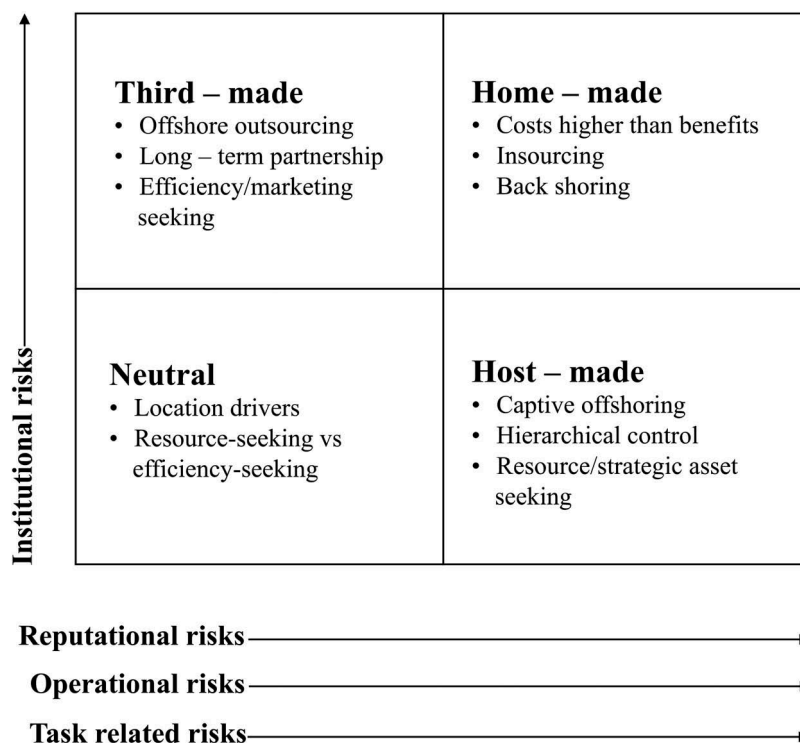


Figure 2. Combination of risks and entry mode choices of offshoring.

mode), giving also managers a starting point for positioning the offshoring decision-making process.

The moderating role of the offshored activity and firm size

Behind the comprehension of the different risks associated with offshoring projects, and their incidence on the governance-mode choice, firms then need to develop an appropriate strategy to mitigate these factors under certain contingences within the offshoring project.

Previous studies propose different approaches, depending on the structural characteristics of the organisation that cannot be modified in the short term (e.g. type of business model, internal organisational structure, key strategic priorities) and may affect the firms' perception and reaction to different risk factors (Aundhe and Mathew 2009; Kumar, Kwong, and Misra 2009).

As a matter of fact, the relationship between offshoring risks and governance mode may change considering that some firm- and task-specific characteristics can differently influence this relation. This is particularly relevant if we analyse some common traits of the so-called *next offshoring generation* (Massini, Perm-Ajcharyawong, and Lewin 2010). First, firms are increasingly relocating highly knowledge-intensive activities (Lewin and Peeters 2006; Manning, Lewin, and Massini 2008), reducing managerial complexity and tacit know-how accumulation (compared to more standardised and low-value-added activities): offshoring of R&D, innovation and other knowledge-intensive tasks differ from the more common offshoring of less advanced tasks and challenge the existing theoretical 'tool-box' in IB and SCM (Doh 2005). Therefore, more research is needed to understand how this tasks' heterogeneity relates to the offshoring decisions. Second, as argued by Roza, van den Bosch and Volberda (2011) 'offshoring opens new opportunities for firms of different sizes' (pp. 315), representing an internationalisation strategy used not only by large firms and multinational enterprises (MNEs), but also by small and medium enterprises (SMEs), which consider offshoring to more easily overcome resource constraints and cost barriers to global markets. However, there are evidences of organisational and behavioural differences between SMEs and MNEs that may differently influence offshoring decisions (Volberda, 1999).

For these reasons, the strategic relevance of the activities for the offshoring company and the size of the offshoring organisation emerge as two relevant contingencies, deserving to be included in the present discussion in order to contribute to the existing literature with theoretical arguments that can clear up their role in influencing offshoring decisions (and specifically the relationship between offshoring risks and governance mode).

The impact of the strategic relevance of the offshored activity

While there is a general understanding that organisations typically outsource noncore activities in order to gain from labour arbitrage, evidence from existing research suggests that it is often more profitable, from the client perspective, to outsource projects that are more complex and strategic in nature (Gopal et al. 2003).

Conventional wisdom and existing literature show that high-value-added activities (such as innovation, R&D, product development, engineering services) represent the core of the competitive advantage of the firm, which indeed should be able to keep them under control in order to build a sustainable advantage over time (Porter 1985). In general, a positive correlation between the complexity of a specific activity and its strategic relevance exists (Mudambi and Venzin 2010). An array of different characteristics can influence the strategic relevance and relative complexity of an offshore activity and its implementations, such as the amount of tacit knowledge underlying the task, or the interdependence with other tasks or sub-tasks (Campbell 1988). According to Larsen, Manning and Pedersen (2013), a higher degree of offshoring complexity is more likely to result in cost-estimation errors, being ultimately associated with a higher perception of risk; so, offshoring of activities that are more complex and strategic can alter how firms perceive the different source of risks surrounding the offshoring decision, and how they chose the optimal governance mode.

These circumstances may constrain the degree of freedom of the offshoring decision, especially in connection with the governance-mode choice. The strategic relevance of the offshored activity may limit the implementation of some governance modes, by amplifying the transaction costs associated with certain configurations (eventually calling into question the feasibility of the offshoring decision). Thus, we can recognise a moderating effect the strategic relevance of the offshored activity has on the relationship between each typology of risk factors and the governance mode, expressed by the following proposition:

Proposition 2 (P2): *The complexity and strategic relevance of the offshored activity moderate the relationship between the different risks factors and the governance mode*

When the offshoring process involves strategic and high-value-added activities, firms deal with a higher degree of uncertainty, if compared to the offshoring of standardised and low-value-added tasks. As such, the firm should carefully manage the high strategic relevance of such activities, as

these are key for firm's competitive advantage. The involvement of a strategic relevant activity increases the need of minimising offshoring costs (which arises from unforeseen risks), amplified by the complexity of the underlying offshored activity. Under these circumstances, the severe inability of estimating the costs of the offshoring project makes the choice of the optimal governance mode particularly crucial (Elia et al. 2014), giving preference to governance modes offering a high extent of integration or control (Anderson and Gatignon 1986; Williamson 1985).

In particular, we claim that the strategic relevance of the offshored activity negatively moderates the relationship between institutional risks and the choice of the offshore outsourcing mode. As a matter of fact, the possibility to lose competitive advantage by offshoring a strategic activity pushes firms to avoid offshoring (or nearshoring), as benefits of choosing a local partner to minimise the institutional risks may be lower than the costs of losing the control over key activity.

On the other hand, we argue that the strategic relevance of the offshored activity positively moderates the relationship between reputational, operational and task-related risks and the choice of a captive offshoring mode. Ownership-based modes are particularly suitable in presence of a high impact of reputational, operational and task-related risks, as they enable firm to ultimately maintain the control over strategic relevant offshored activities, preserving competences that can be still transferred and redeployed at home, also minimising costs and risks arisen from issues related to reputation, operations and implementation of the specific task.

The impact of firm size

Offshoring and internationalisation of activities represent a trend affecting firms of all sizes. Studies have shown that also SMEs, characterised by an entrepreneurial management and quick response to market changes, are important actors in international markets (e.g. Liesch and Knight 1999), as they can use offshoring of manufacturing activities and more complex business services as way to overcome resource constraints that would characterise their execution in the host country. According to Roza, van den Bosch and Volberda (2011), cost and entrepreneurial motivations seem to be the predominant part of an offshoring strategy as the size of the company increases, while resource drivers seem to affect more offshoring decisions of SMEs.

However, firm size appears to impact fundamentally when firms implement internationalisation strategies, and particularly offshoring decisions, that is, when choosing the entry mode in a foreign country (Samiee and

Walters 1990; Bonaccorsi 1992). In the IB literature, in fact, it has been argued that larger firms have greater (tangible and intangible) resources to be used for implementing wholly owned foreign direct investments, compared to smaller companies (Kogut and Singh 1988). SMEs, with limited financial resources, tend to privilege outsource offshoring, which represents the 'easiest' solution to be executed (Fagiolo and Luzzi 2006); large firms, instead, possess advantages coming from higher capitals, economies of scale and scope and a richer knowledge base, which enable the use of different governance mode for the same activity. Captive offshoring, in particular, represents a capital-intensive choice, and it is likely to be chosen by larger companies. By evidence, firm size represents a contingency also affecting the offshoring governance mode, representing an important moderating factor when analysing these risks and their potential impact. Based on our assumptions, we claim that – other things being equal – firms undertaking offshoring projects have a different perception of risks and a different ability to manage those risks considering their size. In particular, we can recognise the existence of a moderating effect of firm size on the relationship between risk factors and offshoring governance mode, bringing us to formulate the following proposition:

Proposition 3 (P3): *The size of the offshoring firm moderates the relationship between the different risks factors and the governance mode*

Companies of larger dimensions can rely on a set of intangible assets (i.e. competencies, resources and capital) that may help them to mitigate potential sources of uncertainty, and making the captive offshoring decision more feasible. In the perspective of our model, this means that we may expect a negative moderating effect of firm size on the relationship between institutional risks and the choice of the offshoring outsource mode, while a positive moderating effect on the relationship between reputational, operational and task-related risks and the choice of a captive offshoring mode.

In fact, the availability of resources due to the firm large size influences the ability to identify risks associated to an offshoring decision and manage those factors in a more effective and efficient way. Therefore, larger organisations are more capable to determine, quantify and tackle the possible risks of offshoring, reducing the risk perception associated to the relocation of a particular activity. Compared to larger firms, SMEs generally lack both financial and technical resources and tend to have a very limited international experience. This increases the transaction costs associated to the offshoring decision and magnifies the likelihood that the firms need to rely on a local partner in order to reduce uncertainties. Further, the potential for 'free-riding' by the local partner is lower when considering small companies, as brand name

capital and physical asset specificity is generally limited (Williamson 1985), favouring the choice of a shared ownership control or an outsourcing model.

Conclusions

This study aims at contributing to the debate about governance-mode decisions in offshoring activities by integrating two topics in connection with both IB and SCM literature: the offshoring governance-mode choice and the impact of risk sources. In order to explore their linkage within this double perspective, we first developed a detailed and original taxonomy of offshoring risks, using a multilevel approach (see Figure 1). Then, we elaborated a set of research propositions, linking each type of risk to a possible governance mode (see P1.1, P1.2 and P1.3). Finally, we identified two variables that may affect the link between risks and governance mode, that is, the offshoring firm size and the strategic relevance of the offshored activity, elaborating additional research propositions assuming these factors as moderators of the risk–governance-mode relationship (see P2 and P3, respectively).

As a result of this conceptual effort, we are able to summarise the content of the present study as in Figure 3.

In particular, we are able to link typical IB topics (i.e. offshoring governance modes and drivers) to SCM-related topics (i.e. offshoring risks) overcoming the limited cross-fertilisation of extant literature (e.g. Caniato et al. 2015). In particular, the model supports both the TCE theory (often used in the SCM field to integrate the offshoring discussion and the crucial role of risks) and

the Internationalisation theory (addressed mainly by IB scholars when dealing with the governance-mode choices), thus reinforcing the link between the two fields. Within this study, we also present an integrated and up-to-date categorisation of the offshoring risks, which needs to be considered by managers when dealing with offshoring projects and related decisions. In particular, we go beyond the existing literature, and we show that risk management of offshoring decisions is a multidimensional framework, which therefore should be tackled considering a wide array of options to minimise the risk of failure and increase offshoring performance. Further, we contribute to the existing literature by analysing two of the most important contingency factors at firm and task level and relating them to the main relationship between offshoring risks and governance mode. In particular, relying on TCE, we identify two constructs, that is, firm size and task's strategic relevance, that have been widely used in the literature as TCE constructs to explain governance-mode choices (Zhao, Luo, and Suh 2004), but to a less extent associated with the (offshoring) risk-management literature.

Also, we deem our study to be relevant for practitioners who are engaged in an economy where the outsourcing and offshoring industry is at a turning point. As a result, offshore service providers are more and more proposing themselves as risk-mitigation providers, and firms that adopt offshoring tend to reduce the risks by implementing a portfolio approach (i.e. using different configurations, service providers and offshoring locations; Stentoft, Mikkelsen, and Johnsen 2015). So, by highlighting the role of some important contingent variables and discussing the impact of different risk factors, we can

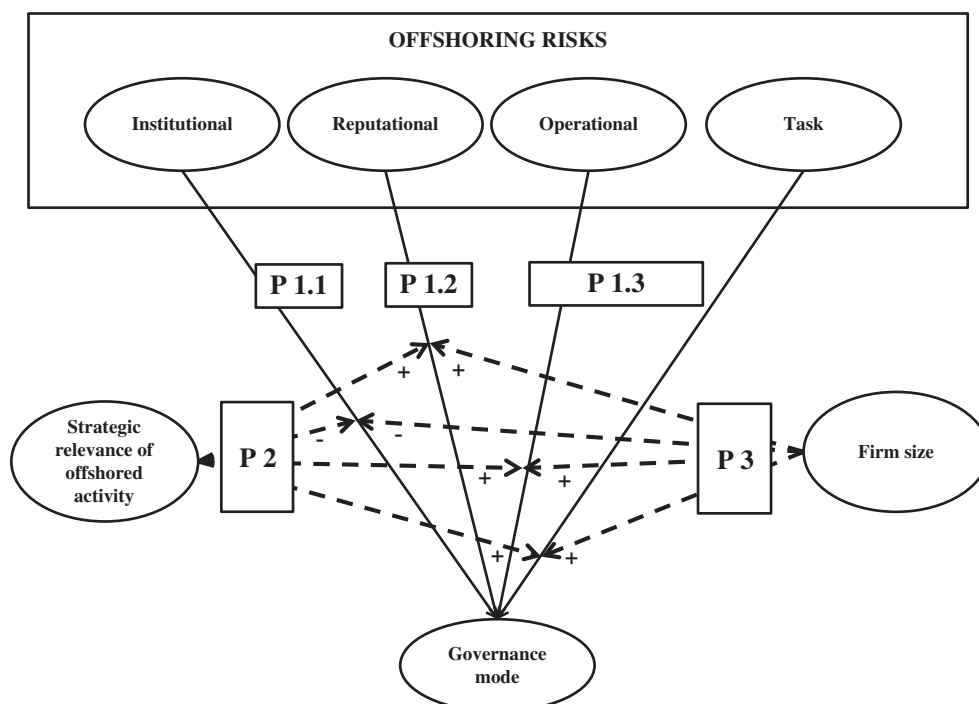


Figure 3. Overall conceptual model.

support practitioners in understanding which types of elements should be primarily considered when choosing the most appropriate governance mode.

We acknowledge that the present work has a number of limitations, which may provide avenues for future research. First, the conceptual nature of this study can represent a major limitation of the study, as we do not provide empirical evidence related to the validity of our arguments. However, we do offer an original perspective on the relationship between offshoring risks and governance mode, linking IB and SCM theoretical approaches and presenting practical tools and arguments useful for managers and practitioners dealing with offshoring decisions. This work can be source of inspiration for further research focused on its empirical validation. Second, we chose to focus our attention on two firm- and task-specific characteristics that might moderate the relationship between offshoring risks and governance mode, that is, firm size and task's strategic relevance. However, our literature review pointed out other possible moderators of the main relationship, such as country-level contingences as cultural, institutional or geographical distance between the home and the host countries. Finally, we call for studies that extend our theoretical framework beyond the offshoring decisions, by deeding the understating on how the relationship offshoring risk–governance mode may determine offshoring projects' performance.

Disclosure statement

No potential conflict of interest was reported by the authors.

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