Managing Performance of the Offshored Services

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Executive summary: this paper will provide a short summary of a bigger research work that was performed to: 1. to develop a management tool that would enable the management of offshore operations to increase the efficiency and effectiveness of the offshored services, 2. to test this tool empirically. The research was started as a result of real-life observations that pointed out high management dissatisfaction with offshore counterparty performance, especially where it concerned less structured activities. This paper, therefore, will address the current flaws in the observed performance management framework, and it will propose a new approach that will address observed inconsistencies in current approach.

For the full text of this master thesis refer to the following webpage: http://hdl.handle.net/2105/4969.

1. Introduction

The topic for this paper was formed as a result of real-life observations at a big financial organization that had offshoring practices in different areas of operations, from IT to Financial and Management Accounting. The first observations pointed out that the less structured and organized the offshored activities are, the less satisfied is the onshore party with offshore counterparty's performance. Furthermore, this dissatisfaction was not expressed in formal evaluations, which implied that the daily work was performed satisfactorily by offshore counterparty. The main problem seemed to be the discrepancy between what was measured and evaluated and what management expected from offshore counterparty.

The existing literature on the management of the offshore services at the time was also confirming the initial findings by citing the following statistics. The actual savings on labour costs for financial firms in 2008 could range from 20% to 70%, depending on the effectiveness of the management of the offshore services (knowledge@emory, 2008). Another citation from sandhill.com (2007) states "many sourcing deals that underperformed have been effectively diagnosed to have had weak and ineffective governance processes and structures". Unfortunately, the remedies that the articles provided were mostly based on "best practices" and not on a rigorous scientific research.

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Another problem was that very often different parts of the overall offshoring strategy would be addressed without explaining how a remedy for that particular part would fit in the overall offshoring strategy of the firm. For example, one frequently cited tool that would help to manage offshore services better was “more communication”. However, more communication also means more costs and more effort and, therefore, it does not necessarily fit in the overall approach of a firm. Therefore, the all-inclusive guidance was required for the management of the offshored services to address challenges in this area.

The all-inclusive approach that will be analyzed in this paper is referred to as “performance management framework (or PMS)”. The main research question that is to be answered at the end of this paper is “How performance management system for offshore operations should be structured in order to increase efficiency and effectiveness of offshore operations?” To answer this question the following steps will be performed next.

In part one a theoretical research will be done to explore the previous works in this area and to see how other works can contribute to the topic of this paper. This research will de done for different part of the performance management system and it will address the following questions: 1. Overall offshoring strategy, 2. What to offshore? 3. How to control offshore activities? 4. Offshoring approach in time perspective. All questions will be consistently approached from 3 different perspectives: transaction-based economics (TCT), resource-based view (RBV), and trust-based view. All three views try to explain how to minimize the threats of opportunistic behaviour, information asymmetries, and uncertainty while planning and executing on offshoring strategy.

The end-result of theoretical research will be a development of a management tool, performance management system for the offshored services. This system will integrate different parts of PMS that are described in part one. Next, PMS framework will be tested high-level using the financial firm where the initial real-life observations were done. The overall approach to this test as well as sample choice and research design will be elaborately discussed in part two of this paper. The goal of this qualitative test is to get the first impression on how real-life cases are reflected in the created framework, and what type of analysis can be performed based on this framework.

The results of the empirical research will be presented in part three, and part four will follow with a detailed analysis of the results. The results will be compared with the initial expectations that are documented in the developed PMS framework. Any deviations from this framework will be highlighted and elaborately discussed. Finally, in section five of the paper conclusions and recommendations will be made. Conclusions and recommendations will be addressed to the financial firm that is subject to the case study.

Next, a theoretical research on performance management system for the offshored services is presented.

2. Prior literature

The research in offshoring area in prior literature concentrates around three main perspectives: transaction cost theory (TCT), resource-based view (RBV), and trust-based view. The research in these areas will be used in this section to analyze how it impacts different components of performance management framework for offshore services: overall strategy, activities, governance structure and controls. Next, conclusions will be drawn on how this research can be used to create a cohesive performance management tool for offshore services. Finally, a performance management framework for offshore services will be developed at the end of this section based on prior research.

2.1 Offshoring strategy

Offshoring strategy sets the overall direction regarding offshoring practices and provides an overall guidance for a firm on how these practices should be managed, measured, and evaluated. Operational objectives, performance measures, and control mechanisms should all be traceable back to the overall strategy and business objectives. This section will describe what basic offshoring options are available to firms and what trade offs, in terms of risks and benefits, are considered when setting the overall offshoring strategy.

A choice for a certain mode of operation depends on management perceptions regarding the following offshoring benefits (Kedia & Mukherjee, 2008)

- ***Disintegration advantages***, which are achieved by unbundling of activities from the value chain vis-à-vis integrated firms serving in the same industry.
  These advantages include reduced coordinating costs; better focus on core capabilities; increased flexibility, speed, and responsiveness due to modular structure
- ***Location***. Assuming condition one is satisfied, it must be more advantageous for a firm to procure resources from outside the country to perform certain functions then executing the same in the country.
  The advantages include labour, time, and knowledge arbitrage; country level advantages in terms of, for example, economic deregulation and liberalization
- ***Externalization.*** Assuming condition two is satisfied, it must be more advantageous for a firm to externalize those functions to foreign providers or internalize those functions to be performed in-house in the foreign land by setting up centre.
  The advantages include co-specialization and organizational learning and reduced costs by tapping into specialized supplier capabilities

Offshoring risks relate to foreign country risks and to the flaws of imperfect markets that give rise to adverse selection and moral hazard within offshore transactions.

- ***Adverse selection*** refers to the situations where bad offshore agent is selected by accepting lower fees in the markets where perfect information about agents and agent pricing is not available to the principals
- ***Moral hazard*** refers to the situations where offshore agent has more information about actions and the results of those actions than the principal. This can lead to opportunistic behaviour from agent side when the interests of principal and agent

are not perfectly aligned and agents' actions cannot be perfectly monitored by the principal

Finally, the operational risks also increase when operating from offshore location. Operational risks arise when tasks are achieved with less efficiency and quality than onshore. This can be due to either transitional phase in offshoring strategy execution or the limitations of communication transmission system, presence of cultural gap, or geographical separation.

Kedia and Mukherjee (2008) use the following framework to show and describe how firms make a decision with regards to offshoring strategy and a mode of operations based on above described considerations.

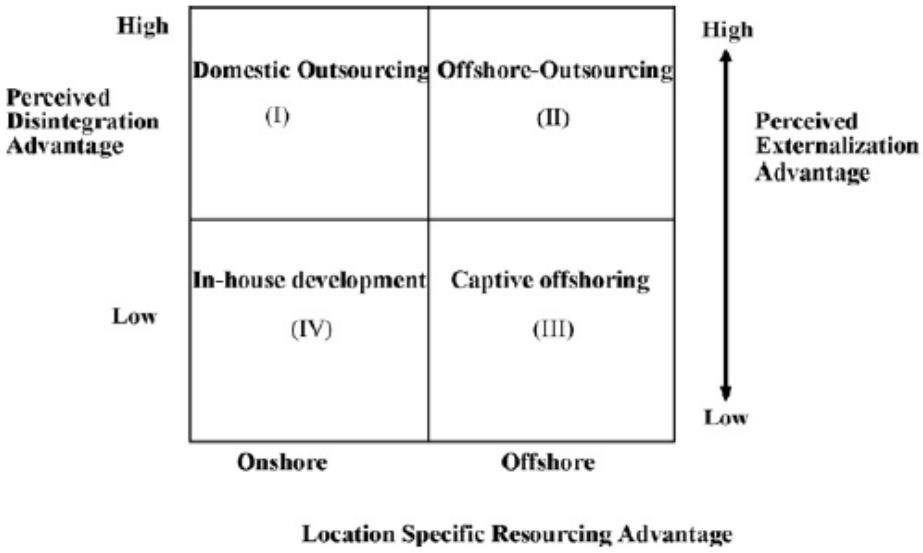

Fig. 2. A DLE explanation of different sourcing models.

Firms that strive for offshoring advantages in terms of co-specialization and organizational learning and that are less concerned with loss of control or operational inefficiencies will chose for either domestic (I) or offshore outsourcing (II). It will give these firms the possibility to focus on their core capabilities and to increase their competitiveness through increased service and/or product quality, and decreased time to market for their products or services. Firms that go for domestic option (I) in this case will consider the risks of having operations in foreign country higher that the advantages that foreign location has to offer.

Quadrant I and IV represent offshore bystanders that can either have domestic mindsets or lack of experience in managing from distance (Carmel & Agarwal, 2006). Some other reasons could be that these firms do not have a more demanding skills challenge at home, or they operate in an industry that is characterized by non-differentiated products (Boyer, 2007). It can provide firms with sustainable competitive advantage and remove the incentive to gain this advantage by tapping into global opportunities.

Finally, quadrant III, which refers to the case study in this research, represents firms that are willing to take advantage in terms of labour, time, and knowledge arbitrage that offshore locations present. However, these firms are either restricted in their activities by rules and regulations, or they consider the risks in terms of loss of control or operational failures to be very high. Therefore, they try to internalize location advantages and to manage it within the existing hierarchy through captive offshoring. This mode of operations requires availability of strong management skills and tools to be able to manage internal operations from a long distance and to ensure a similar level of control.

Strategic decision gives a direction to further definition of activities and processes that can be considered for offshoring. The higher are the risks and uncertainty perceived by a firm with regards to offshoring, the more conservative it will be regarding what activities to offshore. Next section will discuss the main determinants behind the decision what functions and what activities to offshore while bearing in mind the strategic requirements for captive offshoring.

2.2 What to offshore?

The question what activities to offshore will be answered in this section using prior research in three different areas, transaction cost theory, resource-based view, and trust-based view and a captive offshoring as a mode of operations. The examples that will be used for illustrational purposes all come from financial industry because offshoring practices in this industry are already at a very advanced stage, these practices are very diverse in nature, and the case study in this article also concerns a big financial institution.

Transaction costs theory. Williamson (1975, 1986) defined transaction costs as those associated with an economic exchange that vary independently of the competitive market prices of the goods or services exchange. A simpler definition for it is “a cost incurred in making an economic exchange” (answers.com). In the context of this research transaction costs will concern the costs of monitoring and managing activities.

According to Nicholson et al. (2006) these costs differ per activity depending on the following characteristics:

- Uncertainty or the degree of specifiability of intended performance. The more uncertainty is involved in a certain transaction, the more will be the need to extensively monitor and manage this activity from a long distance
- Asset specificity or the degree of customization required to perform a certain task. Customization refers to a specific knowledge or skills that are required to perform a certain transaction. High degree of customization can give rise to opportunistic behaviour from offshore agent. Extensive monitoring will be required to prevent it
- Frequency of the transaction. This factor in combination with highly uncertain and highly customized transactions can increase the costs of transactions dramatically

Nicholson (2006) argues further that the financial activities higher in the organizational hierarchy (e.g. management accounting) are characterized by high uncertainty and high asset specificity. These activities are highly customized to business' internal and external environments, are prone to frequent adjustments, and produce highly sensitive data. They are, therefore, less suitable for offshoring because they will create a prohibitive level of transaction costs in terms of extensive management and monitoring of these activities.

Youngdahl and Ramaswamy (2008) support this view by introducing the "knowledge embeddedness" factor in process description. Processes with higher level of information embeddedness will contain a higher amount of tacit knowledge, which refers to "the elements that cannot be captured in repeatable routines that can be codified and transferred." As the level of knowledge embeddedness increases, operations progress from performing simple transactional services to providing more complex solutions. This also means that the complexity of managing the process of offshoring such delivery increases.

Kehal and Singh (2006), also argue that processes with a fairly high degree of codifiablity and, therefore, low uncertainty, are suited for offshoring the best. Another variable they introduce is the degree of interconnectedness of offshore processes with core processes. The preferable candidates for offshoring are processes with low to medium degree of interconnectedness with core processes. Offshore operations then will require less communication and coordination efforts. In addition, core processes will be less subject to stoppages in processing pipeline due to infrastructural or communicational failures.

Finally, the processes to be offshored should also be labour intensive (Stratman, 2008) or, in other words, they should require a fair amount of manual processing in order for offshoring case to make commercial sense.

To conclude, TCT and its proponents concentrate on minimizing the costs that are required to conduct offshore transaction. Therefore, the processes that should be brought offshore are the ones that not only minimize the costs of direct labour, but also require minimum effort in terms of monitoring and managing it. These activities are characterized by low knowledge embeddedness, low interconnectedness with core processes, high codifiability, high labour intensity, low uncertainty, low asset specificity, and high frequency of transaction. However, captive offshoring is not only done to capture cost and time arbitrage but also knowledge differential advantages. Next section will explore this topic further.

Resource-based view. While TCT concentrates mostly on negative market conditions and structures to eliminate those, RBV builds on the notion of a bounded level of trust in every market: "the expectation that the partners will not always be opportunistic even if they have the opportunity and the incentives for it" (Vivek, et al., 2009). This view concentrates more on a value creation through proper resource management and firm's ability to create unique and non-transferable core competencies. The competencies will then constitute firm's sustainable competitive advantage.

The proponents of RBV argue that firms can create sustainable competitive advantages through collective learning because collective learning in the organization eventually results in process optimization and technology integration. To build collective learning firms need to increase the knowledge intensity of offshore processes. That requires shift from transaction specific investments, which aim to minimize coordination and monitoring costs, to core specific investments, which increase onshore party involvement in process flow (Vivek, et al., 2009).

Offshoring processes with high knowledge embeddedness, medium/high uncertainty, high asset specificity, and high interconnectedness with core processes gives both parties a chance to collectively learn more about process flow and to add value to it through smooth migration, improvement initiatives, and redesign. Besides, it gives resources the opportunity to improve their coordinating and integrating skills, which makes resource pool unique and non-transferable. Talent-based advantage will also compensate for reduced labour arbitrage due to wage inflations, currency fluctuations, and offshore government initiatives.

Trust-based view. Vivek et al. (2009) refers to it as a view that "blurs the firm boundaries opening the door for evolutionary and ever changing organizational form." Joint value maximization takes precedence over single firm cost maximization and activities that are transferred offshore focus on continued association between onshore and offshore partners (Vivek et al., 2009). These activities can include sharing of strategic planning and knowledge at this stage. Transaction costs mediating mechanisms are partially or completely replaced by a notion of trust in offshore party gained through partner experience (Dekker).

To conclude this section, the processes that firms offshore will depend on: strategic focus in terms of costs, time, and knowledge arbitrage; onshore experience in managing offshore activities; offshore partner experience. The next step in performance management framework is to determine what controls to apply to monitor and manage offshore activities. This topic is analyzed in the next section.

2.3 How to control offshore activities?

TCT. Management accounting scholars have been using transaction cost theory to analyze current offshore governance and control practices and to explain it from the perspective of transaction costs control for different service exchange events. Spekle (2001), for example, argues that control suitability for a certain transaction is a function of the following three characteristics (Nicholson, 2006):

- the ease of ex ante programmability (or predictability) of the outcomes
- the degree of asset specificity
- the extent of information impactedness

Based on these characteristics a choice can be made between five categories of controls: market controls, arm's length controls, machine controls, exploratory controls and boundary controls.

Machine control is a preferable option for activities with high degree of ex ante programmability of outcomes. It means that for these activities it will be fairly easy to associate required actions with desired outcomes and controls, therefore, can be defined in terms of desired outcomes or required actions. Result-driven controls will involve clearly pre-defined performance targets and performance-linked rewards system. Action-driven controls will involve standardization of behaviour, the setting of codified norms and rules, close monitoring, rewards for obedience, and punishment for disobedience.

Another proponent of TCE view, Stratman (2008), suggests enterprise resource planning as control mechanism for offshore activities where the main goal is cost reduction. ERP is an example of advanced machine control. It deploys common data structures that facilitate communication between corporate management and sub-units. It allows for easier monitoring and reduces coordination costs and transaction risk by limiting the potential for opportunism and eliminating information asymmetry.

Arm's length controls will be used for activities with moderate level of ex ante programmability (moderate uncertainty). They are articulated in terms of market-based performance benchmarks and ex-ante contractual provisions. Performance is assured by enforcing the adherence to contractual arrangements, and arbitration is stipulated in contracts to resolve conflicts.

Exploratory or boundary controls are applied to transactions with low levels of ex ante programmability and high level of uncertainty. Exploratory controls are defined as very informal arrangements with very little explicit guidance. The focus is mainly on peer pressure within the group that results from high interconnectedness of activities. Boundary controls intend to prevent cases of irremediable and "incorrigibly high levels of" information impactedness. They focus on prescriptive code of conduct, ethical behaviour and activities that are off limits for the prevention of a limited set of undesired outcomes and unwanted behaviour that can be anticipated ex ante. Boundary controls are stated in negative terms as minimum standards (Nicholson, 2001)

All above-described controls refer to transactions with moderate to high levels of asset specificity or transaction customization to customer needs. Spekle (2001) argues that transactions with low asset specificity, irrespective of their level of uncertainty, can be handled the best by market forces as market pressures are relatively high on the providers of these services (Nicholson, 2001).

RBV. RBV adopts a more dynamic view on a firm as opposed to a static TCT view. While TCE focuses on discrete transactions and decisions related to it at a certain point in time, relational view concentrates on continuity of association or social exchange between onshore and offshore parties in the future. This has its major implications on control objectives and mechanisms.

While TCE proponents focus on outcome controls and strive to ensure deliverability against the lowest costs possible, RBV proponents argue that firms should manage for development

of core specific assets in order to create competitive advantage. Core specific assets are expressed in terms of "the extent to which resources contribute to the competitive advantage of the firm" (Vivek, et al., 2008). These core competencies must be unique and non-transferable in order to contribute to firm's competitive advantage.

In order to develop core competencies management should switch its control focus from deliverability and time management to management for quality, knowledge development, and process improvement. Control focus shifts from outcome control to process monitoring and development of complimentary capabilities. Deliverability becomes a hygiene factor. Technology and training drive quality of the process (Vivek, et al., 2008). This shift reinforces the learning curve within offshore entity.

Next, control mechanisms such as machine controls and highly specified service level agreements will be replaced by a more extensive use of exploratory and boundary controls. These controls set a minimum process requirement and behavioural expectations but they also stimulate cooperation and knowledge sharing between onshore and offshore party.

Trust-based view. Trust based view goes even further than RBV and argues that as time passes managerial control from onshore site decreases in its importance and mutual strategic planning and cooperation emerge. Onshore party increases its relation-specific investments in mutual strategic planning and cooperation, managerial control, bilateral governance, and knowledge intensity of the processes. These investments in offshore partner development increase mutual dependence (Vivek, et al., 2008), which constitutes a very strong control mechanism.

Mao et al. (2008) tested offshore vendor perceptions on trust and control. His findings show that clients' control over vendor, in terms of cultural blending and goal setting, had a significant impact on cost control but had no impact on project quality. On the other hand, trust building in terms of effort invested by onshore party in information sharing, quality of communication, and inter-firm adaptation had a significant impact on project quality as measured by client satisfaction, quality of results, and standards set. However, it did not have any significant impact on cost control.

To conclude, above research suggests that control objectives, focus, and mechanisms evolve together with the evolvement of onshore-offshore relationship. TCE and its principles play important role at the onset of the relationship where agent principle problems have to be mitigated by stringent control measures. As relationship develops, TCE controls will be gradually replaced by core- and relation-specific investments and trust will start to play an increasingly important role as control mechanism. Next section will discuss the evolution in onshore-offshore relationship and performance management framework in more detail.

2.4 Offshoring approach in time perspective

Different authors argue that offshoring event is not static but very dynamic in its nature. Research by Kehal and Singh (2006) shows that as time passes the focus of offshoring activities gradually shifts from simple repetitive tasks to more uncertain and complicated tasks.

Another research by Yuongdahl and Ramaswamy (2008) illustrated that offshoring expertise gradually grows from simple tasks processing in process centre to unique capability centre with knowledge intensive processes and core capabilities. The strategic focus in process solution centre shifts from executing certain services to transforming these services through increased knowledge-based capabilities.

As offshore activities evolve so should also the mechanisms that control these activities. Vivek et al (2009) explain in their research that as firm's strategy changes from reducing transaction costs to developing new competencies and resources, the focus of control mechanisms is also adjusted to reflect this shift. The primary goal of this adjustment is to add value to existing processes through bilateral governance and increased strategic cooperation.

Forrester Research in IT industry (2003) showed that offshoring follows four stages of development, from bystanders to experimenters, to committeds, to full exploiters. Governance mechanisms shift from establishing the overall offshoring strategy to encouragement to increase the use of offshore services (e.g. cultural blending). Finally, as full exploiter, client concentrates on upgrading offshore processes and methodologies using offshore expertise (advancement stage) and shares the risk/rewards resulting from it.

To conclude, offshoring cannot be researched as a static event as this strategy evolves over time. Therefore, the dynamics of offshoring will be taken into account in the next section, where the performance management framework for offshore services will be developed.

2.5 Performance Management Framework for offshore services

This section brings together the items discussed above in a coherent performance management framework for offshore services. Similar to the views presented above, different opinions exist on how performance management framework should be created and used.

One view represents a static approach where key objectives are defined first. They are then translated into strategies and plans, the performance targets are set and the reward/punishment system defined and implemented. Information flows are defined to accommodate "learning organization", employee empowerment, and emergent strategy (Otley, 1999).

On the other hand, the proponents of RBV propose a more dynamic approach to PMS. Henri (2006) argues that strategy should not be taken as a given to derive the rest of PMS from

it. Instead, performance management system should be designed to influence strategy via the development of distinctive and valuable capabilities: market orientation, entrepreneurship, innovativeness, and organizational learning. He proposes to combine the diagnostic use of PMS, which focuses on mistakes and negative variances, with the interactive use, which is used to expand opportunity seeking and learning throughout the organization. This combination creates tension which will lead to the development of organizational capabilities.

The PMS framework that is presented below integrates TCT, RBV and trust-based views to define characteristics for strategy, objectives, activities, and controls at different stages of offshoring. The model assumes that at the beginning of offshore relationship the offshore centre is mainly used for cost cutting purposes. This centre gradually develops into important contributor to global knowledge, skills, and core capabilities base as relationship evolves. Frequent evaluations should be done by onshore partner to determine at what stage of development the offshore relation is and how to manage it properly.

The first column in the below presented framework represents the initial stage in offshoring that is covered by TCT and its principles. Offshoring here is mainly done for cost cutting purposes and the objectives are to minimize direct and indirect transaction costs. To achieve that, manual, repetitive processes with little interaction requirements and low knowledge embeddedness are brought offshore. These activities are governed by result- or action-driven controls that focus primarily on timely and accurate delivery of pre-defined products.

The second column represents a more advanced stage in offshoring relationship governed by RBV and its principles. The shift to this column can be driven by internal and external factors. Internally onshore party gains more experience in managing global resources. Externally competitive pressures increase and offshoring for cost cutting objective does not constitute a sustainable competitive advantage any longer. Strategic shift is, therefore, required to capitalize on offshore location advantages in terms of knowledge differential to improve product or service quality and time to market.

When above-mentioned factors are present, the following changes will occur in PMS. Onshore involvement in offshore operations increases. The knowledge embeddedness of offshore processes and its interconnectedness with core onshore processes increase, and the processes become more business specific. Controls that will be applied at this stage are ex-ante contractual provisions and performance benchmarks. Gradually more use will be made of exploratory and boundary controls to stimulate information exchange. Controls will also have to be complemented by interactive use of PMS and social measures, that keep focus on collective goals and objectives. Control focus shifts from results deliverability to quality of delivered results, knowledge development, and process improvement.

Last column in PMS framework is covered by trust-based view and its principles. Earlier shifts make sure that the level of expertise by offshore party increases; offshore party is

more attached to a company and pursues collective goals; onshore trust in offshore partner increases. The next step in the relationship is to advance core capabilities that contribute to company's competitive advantage. Core capabilities represent not only executing but also managing functions at this stage. Managing global network of differing skills set becomes one of the most important contributors to company's competitive advantage.

At this stage offshore processes are not only transferred from onshore location but they are also developed offshore. Processes that are transferred from onshore refer to strategic decision making and business partnering. Trust and social controls become the most important governance mechanisms, and offshore partner is made co-responsible for company results. Social controls enable social interaction, cooperation, social attachment, information exchange and they stimulate discussion, which is necessary for company dynamics.

Above discussion is summarized in below PMS framework. This framework will be evaluated empirically in the next section using a real case example.

	Cost/Time arbitrage		Knowledge arbitrage
	Transaction costs theory	**Resource-based view**	**Trust-based view**
Assumptions	No previous experiences with offshoring	Offshore over-performance on key control metrics	Full trust in offshore party's capabilities
	Distrust of foreign operations & institutional framework	Positive personal experiences onshore about offshore party	Full trust in offshore party's work ethics
	High perceived macro- and micro risks	Competitive pressures to increase quality, time-to-market, flexibility	Integrated process execution & monitoring
	No managerial experience in global operations	Increased global management capabilities	Advanced global management capabilities
Strategy	Minimizing costs of non-core activities	Develop global operating base for non-core & core processes	Leverage global core capabilities to create competitive advantage
	Concentrating on & developing core activities onshore	Develop unique & non-transferable global core capabilities	Leverage global core capabilities to develop new opportunities
	Clearly defined and fixed	Frequent re-adjustments	Constantly evolving
Objectives	Reduce operating costs for non-core processes	Increase internal pressures for high performance	Reduce costs through better problem-solving skills
	Reduce management costs for non-core activities	Improve coordinating and integrating skills	Enhance cooperative and trusted environment
	Increase flexibility of non-core cost base	Streamline and optimize core processes	Leverage core processes to enhance competitive position
Activities	Processing jobs, highly predictable outcomes	Analytical work, hardly predictable outcomes	Strategic planning, unpredictable outcomes
	Transaction specific investments	High core asset specific investments	Relation specific investments
	Low interconnectedness with core onshore processes	High interconnectedness with core onshore processes	Integrated core processes
	Low knowledge embeddedness	High knowledge embeddedness	High strategic knowledge embeddedness
	High degree of codifiability	Low degree of codifiability	Uncodifiable activities
	Sequential or pooled order	Reciprocal execution order	Unstructured activities
	High frequency of operations	Regular frequency of operations	Periodical execution
Governance	Internal hierarchy	Sharing of managerial control	Bilateral governance
Control focus	Deliverability of process outcomes	Quality of processes and outcomes	Goal & planning achievability
	Standardization of processes & behaviour	Increasing knowledge-intensity of the processes	Increasing strategic knowledge-intensity of the processes
	Achievement of targets set, feedback function	Expanding opportunity-seeking & learning	Expanding organizational borders & possibilities
Control mechanisms	Mainly quantitative performance metrics	Quantitative & qualitative performance metrics	Increasing use of qualitative performance metrics
	Outcome-oriented	Process-oriented	Strategic target-oriented
	Result-driven machine controls	Exploratory and Boundary controls	Boundary controls
	Action-driven machine controls	Vertical integration	Social controls
	Punishment for underperformance	Non-monetary incentives	Trust & Cooperation
	ERP	Technological process improvements	Technology relates to seamless process integration

3. Methodology

The following factors had to be taken into account when considering different methods for empirical study on this topic. First, performance management framework in a random company will not be a result of elaborate scientific study but a result of direct and indirect interaction between a certain firm and its particular environment. A basic understanding of firm's context and environment is, therefore, required to draw conclusions. Second, this study involves personal interactions across firms, or inter-firm relationships, over time. A detailed analysis of individual firm's interactions over time is required to account for this factor.

Taking into account the above-mentioned factors and the novelty of the topic the research methodology chosen was, first, to perform a detailed case study of a single organization to appreciate the context in which it operates and the reciprocal impact of context and organization. Second, to perform a semi-structural survey within the case study to test the inductive generalizations made (Otley, 1999). As this study is not longitudinal, firm's archival data and records helped to understand the context in which a firm operates today. Survey was used to fill in the blanks in the model left out by archival analysis.

Sample. Finance department of a big financial firm was chosen for empirical testing of the presented PMS framework. This approach helps to concentrate on diverse processes that can be ranked according to their complexity within Finance organization and can then be placed in one of three PMS pillars for further research. Finance activities in this research include procure-to-pay (AP), management accounting, financial accounting, cost accounting, balance sheet, and product control processes.

Archival data analysis contains a thorough analysis of firm's initial offshoring strategy, objectives, control framework and mechanisms. Next, firm's top management evaluations of its offshore practices and regular operational reviews using key performance indicators are used to draw conclusions on different perceptions in the organization. Finally, a semi-structured survey is used to complement archival analysis. To prevent bias in response 5 employees from different departments and different hierarchical levels were interviewed. Departments interviewed were cost, revenue, balance sheet and intercompany accounting. Each interview took 1-1,5 hours on average.

Questionnaire. Different components of presented PMS model were operationalized using previous researches described above. Each model component was broken down into characteristics that the previous researches used to construct that component and to place it into TCT, RBV or trust-based perspective. As this research is highly qualitative in its nature, multiple-choice questions were used to determine component absence, presence, or relative stage in its evolution/growth. In addition, the respondents were asked to indicate if any other option was applicable in their situation.

Based on archival analysis and the results of questionnaire the following picture emerged for the offshoring practices of this firm.

4. Results

	Cost/Time arbitrage Transaction costs theory	Knowledge arbitrage Resource-based view
Assumptions	Simultaneous implementation of offshoring in multiple departments/no gradual approach	Onshore party is highly satisfied with offshore party's performance on current key performance indicators
	High perceived operational risks in terms of employee retention, key man exposure, loss of control over offshore activities, no process improvements offshore	Offshore parties are very consistent and consequent in their performance and task prioritization
	Limited managerial experience in global operations due to local "Netherlands" scope of operations	Competitive pressures exist onshore due to scarcity of qualified finance professionals
	Onshore reorganization and unstructured handover offshore activities	
	Onshore party is dissatisfied with overall offshore performance	
	Distrust in offshore party's capabilities to perform complex tasks	
Strategy	Cost reduction for finance activities, realization of targeted cost savings controlled by tight budgets	
	Concentrating on feasible opportunities for offshore operations based on already offshored operations	
	Strategic benefits in terms of scope enlargement of already offshored functions	
Objectives	Reduction of operating costs for administrative, back office tasks	Processes were described and codified by handover
	Reduction of management costs for administrative, back office tasks	
Activities	Management accounting (revenue management, product control), financial accounting (balance sheet), cost accounting, intercompany reconciliations	The actual outcomes of offshore processes depend on data/process quality and data/process knowledge
	Processing parts of multiple onshore activities are offshored/no end-to-end processes including responsibilities	Frequent and intensive communication between onshore and offshore parties is required to achieve acceptable process results
	Investments are done in handover of onshore transactions and training of offshore personnel to perform the highly defined tasks	Knowledge of business, processes, rules and regulations is required to be able to perform activities independently
	Knowledge of process steps is required to perform current offshore tasks	High key man exposure
	High degree of codifiability given current process description	High information impactedness as onshore party has a very limited knowledge of offshore operations
		Reciprocal execution order as onshore and offshore counterparties work in parallel
		Regular frequency of operations = monthly closing activities
Governance	Extended team model	Sharing of HR control
	Effective management control resides onshore Functional expertise is kept onshore	Effective operational control resides offshore
Control focus	Timely delivery of process outcomes	Quality of outcomes is also considered
	Enhancing predictability of outcomes	
	Achievement of targets set, feedback function	
Control mechanisms	Operational key performance indicators	G-SAT index
	Timeliness, turnaround time, documentation	Includes process, knowledge, quality, and proactive attitude orientation
	Punishment for underperformance = lower KPI scores/bonuses	

A detailed analysis of the above results follows in the next section.

5. Analysis

Archival analysis shows that offshoring practices in this organization started in 2004 with the clear goal to realize costs savings. To achieve that goal as many finance activities as possible had to be transferred from onshore to a captive offshoring centre in India. The only two other factors that had to be considered were the feasibility of the transfer, in terms of HR and regulatory restrictions, and a strategic fit within existing Finance organization.

The governance model chosen was that of an extended team per region per offshore function. Each onshore team was replicated at offshore location but control and expertise over deliverables were to be retained onshore. Cost control was achieved by setting clear targets and performing yearly budget evaluations. Operational control was achieved by defining and documenting key performance indicators in terms of timeliness, turnaround time, quality (accuracy), and documentation. Management control was achieved by introducing index that would determine management satisfaction scores using questions. These questions refer also to knowledge embededdness and process enhancement at offshore location.

Activities that were transferred offshore represent a mix from different functions, starting from accounts payable and intercompany reconciliations to cost, financial and management accounting. Furthermore, according to service level agreements, these activities represent steps in end-to-end reporting processes, with onshore party providing input and controlling output of the overall activity. Offshore activities belong to different levels in financial hierarchy and require different levels of expertise and interaction.

Thus, archival analysis shows a mixed picture for offshore activities. On one hand, there is a clear cost cutting strategy and objectives, supported by the “extended team” governance model and clear operational KPIs with the focus on timely deliverability. On the other hand, some of the activities transferred require a lot of interaction with onshore team, subject expertise, and frequent adjustments. In addition, the index introduced for management control purposes includes items that question knowledge embededdness and process enhancement at offshore location, factors that clearly belong to RBV prospective.

Furthermore, management index shows highly unsatisfactory scores, whereas KPIs exhibit very high scores for offshore performance. Onshore party indicated during interviews that offshore performance is very low where it concerns process change management, process improvement, and proactive attitude with regards to task prioritization and problem resolution. One of the reasons is that offshore party tries to avoid “overt” conflicts and interruptions in the processes because it can potentially harm their KPI scores. Another reason is that onshore party avoids transferring additional knowledge or ad hoc requests due to high perceived risks and finance process complexities.

During interviews it also became clear that offshore party possesses more knowledge about offshore processes, which results in high information impactedness and high key man exposure offshore. In fact, the effective control over offshore operations resides with

offshore party. Next, offshore processes are subject to frequent adjustments in internal and external environments and they require frequent interaction with onshore party to enable process execution but, also, to guarantee proper process outcome. This frequent interaction does not support current cost cutting objective of the company.

In terms of management controls, it effectively resides with onshore party and offshore party involvement in overall decision making is very limited. Furthermore, onshore party uses scorecards to control offshore operations. Time aspect, responsiveness, and error limitation are indicators of performance that deserve a lot of attention in these cards. These indicators are well and narrowly defined in service level agreements. The narrow definition and a clear focus on deliverability of operational controls cause a big gap between KPIs and scorecards on one hand and a much broader defined index on the other hand. KPIs do not cover the full potential of current offshore processes.

The results of this analysis are summarized in PMS framework, presented in section three. They show a certain degree of incoherence in current approach. Even though the company tried to position itself entirely in TCT perspective, there are certain important elements that fall into RBV column based on performed analysis. This will be discussed in the next section, where conclusions and recommendations will be made.

6. Conclusions and recommendations

This research looked at offshoring practices from three different perspectives, transactions costs economics, resource-based view, and trust-based view. Based on prior research and taking into account the dynamics of inter-firm relationships, a performance measurement framework was created for offshore services. This framework included the following components: assumptions, strategy and objectives, activities, governance and controls, and it assumed that all components develop over time due to changes in internal and/or external environment. However, to achieve high performance in offshore services the PMS should retain a certain degree of coherence through all changes.

Using this framework the empirical study was performed within finance organization of a big financial firm. The initial results clearly showed that even though the offshore services scored high on daily operations, the management of the firm was not satisfied with the overall performance of offshore partner. Based on the analysis of archival records and semi-structured interviews with firm's employees the PMS framework was filled with data for this company. The conclusion was that this company's approach to its offshore operations shows a certain degree of incoherence that causes management dissatisfaction.

While the overall company strategy is to minimize costs by offshoring as many processes as possible, in reality most of the financial processes offshore do not support this objective due to high degree of uncertainty, information impactedness, knowledge embededdness, and high interaction requirements. These process characteristics are also not reflected in narrowly defined operational key performance indicators for offshore services. Thus, while offshoring strategy is focused on cost cutting and operational controls support it, the

processes exhibit more potential and cause high agency costs and management dissatisfaction.

To increase management satisfaction with offshore services, the overall approach should be re-evaluated and it should be determined if:

- cost cutting strategy is still relevant given internal and external developments
- offshore processes are fully exploited in terms of their contributed value to overall firm's performance

If based on above evaluation the company decides to move away from cost-arbitrage, current strategy, objectives, governance and operational controls should be moved more towards RBV driven approach. It will involve re-evaluating current offshore employees' capabilities and compensation packages; increased involvement of onshore party in offshore processes; increased transfer of managerial control to offshore location; introduction of qualitative, process-oriented performance metrics and cultural trainings.

When company decides to further pursue the cost-cutting strategy, current offshore processes should be re-evaluated and structured to minimize interaction requirements and information impactedness. In addition, different, more structured and standardized manual activities could be considered for offshoring for scale purposes. This will bring back the coherence in overall approach by placing it in TCT-driven column. As a result, management expectations regarding offshore services will decrease and satisfaction will increase.

Given these recommendations there are certain opportunities for future research. A more quantitative research can be performed to empirically test the relationship between PMS constructs (individual and combined), the degree of coherence between constructs, and the actual firm satisfaction with offshore performance. Larger and more diverse samples can be used by translating the semi-structured questionnaire into structured questionnaire using the insights gained in this research. Future empirical research can help to better quantify and generalize the results over multiple industries, companies, and functions.

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