Building service provider capabilities: The impact of clients and service types in service offshore outsourcing

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Abstract

In this paper we study whether and how the interaction between clients and service providers contribute to the development of service provider firm capabilities. Where such a contribution occurs, we analyze how different types of service activities in the production process of the services, i.e. if the services follow sequential or reciprocal task activities influence the development of different types of capabilities. We study five cases of offshore-outsourced knowledge-intensive business services that are distinguished according to their reciprocal or sequential production processes. We find that clients influence the development of human capital capabilities and management capabilities in reciprocally produced services. While in sequentially produced services clients influence the development of organizational capital capabilities and management capital capabilities. We contribute to organizational capability theory and offshoring literature.

Keywords: Offshore outsourcing; offshoring; services; resource-based theory; capabilities; organizational learning.
INTRODUCTION

When Texas Instruments established a research and development facility in India in 1985 to develop software for the company, in retrospect it was an event that marked the start of a new phase in the globalization of services and business activities. From this point onwards the continuing global integration of firms and markets has included a wide and steadily growing range of services of a technical and administrative nature as well as knowledge-intensive and professional business services. While Texas Instruments incorporated its activities in India within its own global organization, a whole industry of service providers has appeared, especially in developing countries, to serve clients across the world in the provision of various kinds of services. Interestingly, studies from the Offshoring Research Network indicate that due to the co-evolution of a range of enabling factors offshore outsourcing, as opposed to in-house or “captive” offshoring is increasing (Lewin and Volberda, 2011). These include improvements in the institutional framework in the host countries, commoditization, advances in IT and communication technology, growing client firm operational experience, and the building of host firm capabilities to cater to the needs of international clients. In this study, the latter aspect concerning the development of capabilities in the service provider firm forms the topic of our inquiry.

While the strategy and practice of firms regarding the global sourcing of services has attracted significant interest from the academic community since the turn of the new millennium, the resulting research has predominantly focused on client firms. Various aspects pertaining to service provider firms remain understudied topics of research (Jensen, 2012; Lahiri and Kedia, 2011). From a corporate strategy perspective, notably in the literature on the resource-based view of the firm, the building of firm resources and capabilities is central for the future competitiveness of the firm. Whether and how the firm is able to build resources and capabilities over time, either internally (Dierickx and Cool, 1989; Helfat and Peteraf, 2003), or in inter-firm relationships (Dyer and Singh,
1998; Jensen, 2012; Johanson and Vahlne, 2009; Kedia and Mukherjee, 2009; Maritan and Peteraf, 2011), is a critical determinant of the firm’s competitive situation.

Based on a multiple case sample, i.e. five cases of offshore outsourcing relationships between client firms from developed countries and service provider firms from India, we investigate the relation between offshore outsourcing of knowledge-intensive business services and the outcome in terms of the development of capabilities in service provider firms. Our research question in this study is twofold. First, we analyze whether the interaction between the client and the service provider in fact does contribute to the building of capabilities in service provider firms. Second, in situations where such a contribution occurs, we further analyze how different types of activities in the production process of the services, and the related processes for execution of activities, influence the development of different types of capabilities. We take an activity-based perspective on the analysis (Johnson et al., 2003) to derive the strategic implications for the service provider firms, and our capability construct is based on the work by Lahiri and Kedia (2009). Thus, we distinguish organizational capacities into organizational capital capabilities, human capital capabilities, and management capabilities.

This study aims to make several theoretical contributions. First, we address a research gap regarding the impacts of offshore outsourcing on the competitiveness of service provider firms. This is an important contribution as previous research predominantly studied offshoring from the clients perspective in studying the benefits of offshoring for clients or reasons for clients to offshore. Second, we cater to a call for more activity-based studies in firm strategy (Johnson et al., 2003) with a combined theoretical perspective on resource-based theory (Dierickx and Cool, 1989; Maritan and Peteraf, 2011) and business network theory in international business (Forsgren, 2008; Johanson and Vahlne, 2009). Finally, we contribute the organizational capability theory with a set of propositions
concerning the determinants of capability development in service provider firms and the influence client firms and services have on the development.

The remainder of the paper is structured as follows. First, we discuss relevant literature on capability development and offshoring and design a theoretical framework. After explaining our research methods, we analyze the generated empirical data and conclude the paper with implications.

THEORETICAL FRAMEWORK

Capabilities in offshore outsourcing

The question concerning the capabilities and capability development of service provider firms is an emerging research theme and has been addressed by a range of scholars. Research on this question is rooted in earlier theoretical works on the resource-based view of the firm (Barney, 1991; Penrose, 1959), including research on the development of resources and capabilities (Dierickx and Cool, 1989; Eisenhardt and Martin, 2000; Teece et al, 1997). We follow Barney’s (1991) definition of capability as: “the ability of firms to use their resources to generate competitive advantages” (Barney, 1991: 647). It follows that this understanding of the capability construct denotes an organizational ability possessed by the firm to deploy its resources.

Few studies have explored the role of capabilities in the context of offshore outsourcing. One example is Ethiraj and colleagues (2005) who extend the current understanding of capability development from the service providers’ perspective. The authors examine two specific types of capabilities: client specific capabilities and project management capabilities. This finding is similar to the literature on the provider-client relationship arguing for the importance of clients in offshoring relationships. This literature has paid considerable attention to social exchanges between
the two parties, and the impact these have on the relationship and the combined creation of capabilities. Vivek and colleagues (Vivek et al, 2009) propagate the idea of relational capabilities. Similar to earlier works (e.g. Cohen and Bacdayan, 1994; Dyer and Singh, 1998), the authors argue that in dynamic relationships such as outsourcing relationships between the client and service provider, relational exchanges between the client and service provider foster the transfer of knowledge and intangible assets, and can lead to the development of joint capabilities.

Moreover, research in relationship governance shows relationship-specific capabilities that involve the ability to configure resources in order to meet client requirements, leading to enhanced exchanges, efficient use of resources and the development of trust and commitment between partners (Nooteboom, 2004). Clients benefit from improved performance and lower coordination costs, while the service provider benefits with an improved quality of relationship, the opportunity to develop in-house capabilities and engage in joint learning (Vivek et al., 2009).

Supplementing the relational view of capability development, research has also examined the joint development of knowledge and capabilities between clients and service providers. Two main arguments are presented: the first states that during the course of the relationship between the service provider and client, the service provider may develop knowledge and capabilities that are essential to the client (Barthélemy and Quélin, 2006). Additionally, the service provider can also adapt to the needs of the client, and develop capabilities that cater to a specific vendor’s requirements.

There are risks involved in the relocation of services, such as the clients’ potential loss of service quality, the loss of process knowledge, protection of intellectual property, and dependence upon the service provider (Lewin and Couto, 2007). A general solution to these potential problems would be to internalize operations and thus keep knowledge-intensive services in-house, as this could reduce such risks (Jensen and Petersen, 2013).
Knowledge-intensive business services are characterized as being complex, dependent on knowledgeable experts, tailored to specific clients, require fast turnarounds and precision in production and delivery with high levels of data (Bettencourt et al., 2002). Moreover, knowledge-intensive business services have high information processing requirements, are highly interdependent and require extensive coordination (Luo et al., 2012). These characteristics of the services, demonstrate that they are highly complex, idiosyncratic to the client, and require significant adjustments between the client and service provider in order to meet requirements, supporting arguments on the joint investment in relationships of clients and service providers.

**Human capital, organizational capital and management capabilities**

In this study we follow the definition of a capability construct developed by Lahiri and Kedia (2009). In their study, Lahiri and Kedia (2009) examined the significance of pre-existing capabilities possessed by the service provider and the impact they have on the performance of relocated services. For the purpose of this paper we use the terms *human capital capabilities, organizational capital capabilities* and *management capabilities* for the three types of capabilities. Compared with Lahiri and Kedia (2009), who looked at the role of these capabilities as pre-existing factors in the outsourcing relationship, we consider whether and how these capabilities are further developed in the service provider firms as a result of the outsourcing relationship and the exchange of activities with the client firm. Thus, our approach falls within the strand of literature that takes a dynamic view on the role of firm capabilities, studying the development from existing capabilities as mentioned above. From the resource-based theory perspective, the central assumption is that creating and retaining such capabilities directly influences the firm’s ability to create and sustain competitive advantage.
For service production, human capital capabilities are the capabilities of the individuals in the firm and closely related to the analytical, technical and quality related aspects of the services. Broadly speaking, the human capital capabilities of a firm rest on a foundation composed of, respectively, the formal education of individuals that build analytical, technical, and language skills, professional experiences, and firm- and activity-specific knowledge (Hatch and Dyer, 2004; Jensen, 2009; Lahiri and Kedia, 2009). Such capabilities are especially important in knowledge-intensive service production, and in related outsourcing arrangements, since they incorporate both explicit and tacit knowledge, and knowledge of routines, that are not easily substitutable and transferable (Almeida, Song and Grant, 2002; Starbuck, 1992; Szulanski, 1996) but are important for understanding the problem-specific needs of the client (Lahiri and Kedia, 2009; Stabell and Fjeldstad, 1998).

At the aggregate level of the firm, the organizational capital capabilities result in the collective behavior of employees, and their use of institutionalized knowledge and routines combined with input from the client in the production of offshored services. According to Lahiri and Kedia (2009) the possession of organizational capital capabilities is crucial for service providers since it enables them “to utilize their accumulated codified knowledge-base in better serving their clients’ sourcing needs through use of various project-related documents and manuals, learning obtained through feedback from clients on earlier projects, unique methodologies and adaptive technologies developed and found useful in prior contracts, organization wide norms that stresses efficient practices, processes and programs, and culture that promotes innovativeness in providing new and superior services” (Lahiri and Kedia, 2009: 213). The importance of such capabilities is broadly discussed in the literature on strategy and organization, which mentions the ability to combine capabilities at the organizational level as a foundation for the creation of new capabilities (Kogut and Zander, 1992), the importance of higher order capabilities as a foundation of value creation
(Henderson and Clark, 1990), and the possession of organizational capabilities as a source of innovation (Subramaniam and Youndt, 2005).

Finally, management capabilities assist in the assembly and deployment of resources to fulfill the contracts. In our definition of management capabilities we follow the definition of Lahiri and Kedia (2009) and Desarbo and colleagues (2005). The management capability construct refers to firm-level capabilities that integrate and support various capabilities related to logistic systems, cost control, financial and human resources, profitability and revenue forecasting, as well as marketing planning. The construct fulfills two central overall objective the serving client needs and generating new business. From a business development perspective it follows that service provider firms that possess strong management capabilities are able to generate business from new clients in international markets (Ethiraj et al., 2005). As Lahiri and Kedia (2009) point out: “higher management capability should enable providers to better manage i.e., bundle and leverage various firm-level resources and capabilities in attaining superior performance” (Kedia and Lahiri, 2009: 213).

In addition to these capabilities, the literature on emerging market firms has noted that these firms do not always possess capabilities from the outset. Thus, linkages with and spillovers from developed market firms (in many cases client firms) are crucial for the building of capabilities in emerging market firms (Matthews, 2002; 2006). However, such findings also underscore the importance of absorptive capacities service provider firms need to posses. These capacities are essential to explore and exploit knowledge from client firms, and to build capabilities. We view absorptive capacity as an antecedent to organizational learning, such that it facilitates the ability to acquire knowledge and learn from new sources (Reagans and McEvily, 2000; Sun and Anderson, 2010; Szulanski, 1996). Commonality or overlap of knowledge bases increases the propensity of learning for firms (in our case the service provider) to acquire and assimilate knowledge (Cohen
and Levinthal, 1990; Lane, Koka and Pathak, 2006). While this is important, our focus in this paper is primarily on the outcome of the process, which is the resultant capability development in service provider firms and to a lesser degree on the possession and quality of absorptive capacity of these firms. We consider these as firm-internal mechanisms by which capabilities are built.

These absorptive capacities might be challenged in an emerging market context, where firms often lack behind in technological and organizational capabilities. Even though firms from emerging markets are engaging in innovative activities, they still have not fully caught up with developed market firms (Brandl and Mudambi, 2014; Awate et al, 2014). In line, the global value chain literature proposes that the learning that is required to develop and enhance capabilities can be time consuming and challenging for a firm to achieve. Thus, learning from external sources potentially expedites this process and assists in upgrading the needed capabilities (Gereffi et al., 2005). By investing in close ties with developed market firms, developing market firms can enter relationships that have the potential to help with the development and upgrading of capabilities much faster, also potentially enabling to gain mature market standards through spillovers (Mudambi, 2008).

**The role of activities in offshore outsourcing**

Earlier reviews of the literature on the global sourcing of services observed that previous research focused on the aggregate level and discusses “services” in general terms without considering the specific nature of the service activities involved (Doh et al, 2009; Jensen, 2012; Jensen and Petersen, 2012). However, some works do focus on the specific value chain activities in question (Jensen, 2009, 2012; Kedia and Mukherjee, 2009; Kumar et al., 2009; Mudambi and Tallman, 2010; Stringfellow et al., 2008), and we position our study in this strand of research.
Furthermore, this positioning reflects a current discussion on micro-foundations in strategy research. A number of scholars of strategic management and organizations have argued for the need to move the level of analysis from the macro level to a micro level. The core argument in the discussion is that motives and behavior of individuals, and the nature and characteristics of activities need to be taken into account (Foss, 2009; Johnson et al., 2003; Priem and Butler, 2001; Rouse and Daellenbach, 1999).

The discussion concerning an activity-based perspective and micro-foundations may be extended to offshore outsourcing research. We argue that the characteristics of the services are important in an offshoring context and that these characteristics impact the activities and the development of capabilities. Especially the dependency on tasks within services and how these tasks and activities are designed is important. Various service researchers have studied the characteristics of services based on for example the contact with customers (Chase, 1981), the degree of customization of the services (Groenroos, 1978; Maister and Lovelock, 1982) or the knowledge intensity of the services (Alvesson, 2001). Based on the argument of slicing and relocating the services abroad, we argue for a characterization of services according to tasks and activities within the production process of the services. This argument goes in line with Thompson (1967) who distinguishes tasks according to the interdependence of activities, into reciprocal and sequential task interdependencies. In a service production process context, this distinction means that tasks within the production process are either reciprocally or sequentially executed.

In the context of offshore outsourcing, the nature of reciprocal task interdependence compared to sequential task interdependence creates two different types of work processes with implications for the interactions between onshore and offshore units. This includes fundamental differences in terms of coordination between the individuals involved, knowledge transfer and exchange, and requires different skill sets and roles in the execution of tasks.
Cases of reciprocal task interdependence are characterized by a high level of uncertainty about how best to deliver intended outcomes and a high interdependence among members of the workforce, regardless of their spatial location. The problem-solving process is iterative and cyclical, since the perception of the problem and adequate solutions may possibly change during the execution of the task. Examples include work done in hospitals, educational institutions and professional services firms in medicine, law, IT, architecture, and engineering. Thompson’s (1967) illustrative example of reciprocal task interdependence is a medical doctor treating a patient: in this scenario the diagnosis of the disease comes first, i.e. the problem definition, which is then followed by the treatment, i.e. the solution. However, if the treatment fails to cure the disease, then the diagnosis/problem definition must be revisited and revised in order to provide a new/revised solution. From an offshore outsourcing perspective, this means that task execution is a dynamic process with many feedback-loops between onshore and offshore units.

In reciprocal task interdependence the work process must therefore be carefully managed and continuously coordinated and integrated between the locations in order to be effective. This high degree of interconnectedness of tasks makes it difficult to distinguish clear interfaces and boundaries between tasks within the production process of the services. Moreover, reciprocal task interdependence reflects services that are strongly dependent on the judgment of individuals and on activities that need to be executed simultaneously. There is no clearly defined border as to when activities start and end. The service is fully produced when delivered to the client.

In contrast more modularized and clearly defined borders of tasks are evident in sequential task interdependent service production processes, where one task depends on the completion of the previous task in a sequence of tasks. Thompson’s (1967) illustration of this work process is the factory assembly line: “The original symbol of technical rationality, the mass production assembly line, is of this long-linked nature. It approaches instrumental perfection when it produces a single
kind of standard product, repetitively and at a constant rate” (Thompson, 1967, p. 15-16). While Thompson’s example describes a manufacturing scenario, the execution of many contemporary services follows the same principles as the assembly line work process (Karmarkar, 2004; Sako, 2006). Here, both the problem and the related solution are understood and clearly defined from the outset of the work process. Employees responsible for task execution must possess the necessary skills to complete the work process in a stable, reliable and transparent manner. They are required to comply with codified instructions, not to perform individual, case-by-case solutions. Table 1 summarizes the central features and differences between reciprocal and sequential task interdependence.

Analytical Model

We are now able to develop an analytical model (see Figure 1) that combines the above-discussed theoretical concepts and helps us in studying (1) whether the interaction between the client and the service provider contributes to the building of capabilities in service provider firms and (2) how different types of activities in the production process of the services influence the development of different types of capabilities. The first dependency in the model is based on the characteristics of the services. The activity types of the services (sequential or reciprocal) impact the production of the services and thus, are also expected to have an impact on the capabilities that are developed in the organization that produces the services. By offshoring these services to the service provider and through the requisite interaction to produce these services, the client is influencing the development
of capabilities by the provider. A moderating effect is also evident by the absorptive capacity of the provider to understand the requirements of the client and the service type.

As argued above, we contend for three capabilities in line with Lahiri and Kedia (2009); Human capital capabilities, Organizational capital capabilities and Management capabilities. More specifically, we examine the processes through which the sequential and reciprocal activities are produced and whether and how these processes lead to the development of the above mentioned capabilities.

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METHODOLOGY

Research Approach and Setting

As the aim of the paper is to extend existing literature on organizational capabilities, we apply a multiple case study approach (Eisenhardt, 1989). A qualitative multiple case study method allows gaining a detailed understanding of the development of capabilities as well as the factors, actors and processes that influence this development. In order to provide such a detailed perspective, we conduct a cross case analysis and apply an abductive research approach (Dubois and Gadden, 2002) that allows to use data and theory in an alternating manner.

The research is set in the Indian offshore outsourcing industry of knowledge-intensive business services (often referred to as the KPO industry). We study five such services that require knowledgeable and educated employees to produce the services; however these services are of
varying knowledge intensity and production characteristics. The unit of analysis is at the level of the service and its production by the offshore service provider. We focus on the subsequent capability development that takes place within the provider that is influenced by the client and the offshored services.

The five services are termed Measurement Sciences (Case A), Client Services (Case B), Market Research (Case C), Competitive Intelligence (Case D), and Intellectual Property and R&D Research (Case E) (see Table 2 for more information). Cases A, B and C are produced by an Indian multinational that offers business process and knowledge process services (BPO and KPO respectively). In this study, we focus on the KPO department of the firm, which has representative offices and production sites in India and around the world. For confidentiality reasons, we call this firm ServiceNow. Cases D and E are produced by a service provider that offers solely KPO services. The firm has sales representatives around the globe that travel to client locations and owns production sites in India, Chile and Romania. We call this firm COVALU.

All services represent highly knowledge-intensive and value adding services. In order to support this argument the authors carefully studied the service activities, the skills and roles of employees executing these services, the type of knowledge utilized, the degree of knowledge transfers required and the type of data and inputs that were required for the production of the services. Moreover, the authors identified the importance of the services to the clients and the significance of knowledge the clients provides in order to produce these services. All services contributed to the core operations and/or strategic decision making of the client firm. Services A, B and C contribute to a service the client firm is selling to an end-customer; services D and E are not distributed further and used by the client firm for operational and strategic decision making activities.
Data generation

Data was generated predominantly through primary data, such as semi-structured interviews with key personnel for the production of the services, including for example executing employees, team managers, trainers that educate the employees and knowledge managers. Each interview lasted on average 45 minutes ranging from 30 minutes to 1 ½ hours. In total 55 interviews were conducted between October and December 2011. All interviews were recorded, transcribed, and analyzed using NVivo 10. In addition to the interviews, secondary data in form of internal documents and publicly available information was used to triangulate information.

Research Process

In order to study the development of organizational capabilities of the service provider and the impact of client firms in this development, we study the production of the services at the offshore location. The services were grouped according to similar characteristics in line with their activity types, and distinguished into sequential and reciprocal services. Then a cross-case analysis was conducted in order to identify changes in the chosen cases and common patterns within and across the activity types. The services are presented according to their activities; first sequential services (cases A and B) and then reciprocal services (cases C, D, and E) are discussed. The investigation was informed by earlier outlined theoretically derived models based on three identified capabilities, Human capital capabilities, Organizational capital capabilities, and Management capabilities (Lahiri and Kedia, 2009).
Validity (construct/credibility, internal/integrity and external/transferability) was secured through the following measures. The generation and analysis of various data sources allowed the authors to gain vast insights into various organizational levels, i.e. via interviews with top-level managers, trainers and knowledge platform managers but also executing employees. It also allowed gaining insights on various organizational topics with regards to knowledge platforms, management, training and service production, i.e. production processes, challenges, employee activities, offshoring process. The data across all cases was purposefully collected and represents reciprocal and sequential services, with common patterns with each service type. Although only one researcher conducted the interviews, the transcribed interviews were shared, collectively coded, discussed, and analyzed by all authors.

**DATA ANALYSIS**

**The development of capabilities in sequential services**

*Human capital capabilities.* In Case A and B, young and newly hired statisticians, media experts, or commerce graduates produce the services. The highly educated background is needed to apply and use statistical analysis or to project the development of industries as done in both services. Data to evaluate the progress and development of the industry is largely provided to the analysts. The analysts need to have statistical skills, skills in excel or similar data software programs that allow a data analysis, but also industry related or country related information. The individual analysts use their own knowledge and critical thinking when analyzing the results of their applied statistical analysis in order to project the development of the media industry in relation to the end-customer as in Case B, thus, the end-customers industries and products need to be known as well as the market conditions, which includes country specificity.
As a consequence of the case characteristics, employees argue that the services are not challenging, which resulted in lower work motivation due to the limitation of personal progress and individual learning. As a consequence, the mostly young, often newly hired and highly motivated employees frequently leave the company after a short period to progress in more challenging positions or in other firms; “we have a lot of attrition because of people that loose interest [...] generally people get better in a problem or bored and then some of them move on” (Training Manager, Case A).

These employee turnovers cause instable working environments and changing team dynamics. In both cases, it is challenging for ServiceNow to retain a constant employee base. Thus, in order to secure efficient and undisturbed communication with the client, only the management or team leader communicates with the client. Executing employees/analysts seldom have direct contact with the client. Due to the characteristics of the services, further development of resources is restricted. The sequential services do not require developments and learning by the executing employees, nonetheless, ServiceNow tries to make the services more attractive to its employees through internal re-allocations or position improvements in order to reduce the mentioned high attrition rate.

Organizational capital capabilities. The production of the services in Cases A and B is very sequential with data input by the client. In Case A, employees use electronically collected data for statistical analysis in order to show trends and developments of the purchasing behavior of global customers (end-customers of the client). To analyze this data, statistical methods that allow projections of industry developments are used. The client produced the service initially onshore and had a set analysis approach before offshoring the activities to ServiceNow. As a consequence, various documents and standard operating procedures (SOPs) existed and were transferred from the client to the service provider at the initiation of the collaboration. These production activities and set procedures were not changed in ServiceNow and the services are produced as initially.
Similarly in Case B, activities were offshored that were produced internally before offshore outsourcing took place. Data is provided by the client and complemented by own data that allow (statistical) well-informed projections of industry and product developments for the end-customer of the client firm. In both cases, ServiceNow took over the activities without changing the production of the services and integrated these activities into own organizational contexts.

Moreover, the intention in both services is to document (new) processes in order to overcome knowledge loss, for example through a high attrition rate. The Client Head of Case B outlined this aim for documentation with “at the end of the day, will we get 100% of the information documented? Probably not. Can we get 80% to 85% documented? Yes, the endeavor is to try to get 100%. Every individual at the end of the day is going to have something in their mind, which they know and need to share.” This documentation of activities is central for the services that are based on statistical models, which might do not change for the production of the services.

In order to share these documents and production processes, ServiceNow uses an online operating platform: “We have a knowledge management system and team sharing sessions. So anybody who learns something new shares it with the team, it’s documented and kept in our knowledge management system, which can be accessed by anybody. Then meetings and line sessions are organized to have those cross learning [...] that we are not too much dependent on one person “ (Regional Delivery Head, Case B). The platform allows an easier and more efficient transfer of documents. In line with the integration of services into the organizational context, ServiceNow uses the provided SOPs and documents by the client and inherits procedures into firm processes that can be transferred to other contexts and clients.
Management capabilities. In Cases A and B, the management within the services is mainly based on managing the staffing of resources to tasks. Due to the relatively high attrition rate of both cases, staffing activity and the constant hiring and training is the prevailing management activity. Although, the client has no influence in the staffing and management of employees, which is managed by ServiceNow, their training is done with some recognition and involvement of the client. The Head Trainer of Case A explained the training as: “the [client] has gathered this fantastic knowledge for 20 years, so to compress that and give it to one new hire who’s probably a fresh graduate or with only a couple of years of experience is not likely to happen in a classroom training. So the objective here really is to introduce them to the concepts, make sure they get familiarized. We aim that about 20% of the knowledge transfer is done during that [first] stage. […] That will give you an overview of the company, so this is a one-week session. […] Then you take them a level down and here we would get into the mitigation, what exactly the team would be doing.”

Another management activity is the input and delivery of the services. ServiceNow receives the input of data from the client and is strongly dependent on this interaction with the client. The input is predominantly done on the management level and only occasionally requires a more intense communication between the two parties. Once the service is produced, the delivery requires similar interaction with the client. The analyzed data is documented and distributed to the client. This delivery is usually followed by a discussion between the two parties on the findings.

The development of capabilities in reciprocal services

Human capital capabilities. All three reciprocal services, i.e. Case C, D and E, require individual experts for the production process. These experts use their skills, educational background and
capabilities to critically analyze the business environment in the respective field and produce the service delivery, which is often in form of reports or presentation slides. All information needs to be gathered by the analysts; and they have to judge information according to the relevance and importance to the services as no preexisting data is provided by the client. For further developments and the necessary knowledge for a qualitative high service production the client communicates and builds a personal relationship with the service providers’ executing employees/analysts. For example in Case C, onshore and offshore employees have weekly phone calls to strengthen the relationship and enable a higher service quality: “there are three weekly calls; one is for project discussion, one is for industry discussion, and one is for getting to know each other [...] for the industry discussion, basically every day I need to present a topic like what is happening in the music industry, what are the latest challenges and issues being faced [...] the project discussion is about all things I have done, how much I have completed, what challenges I am facing, is there any other kind of report which could help me to furnish better information and insights. Third, is to get to know each other, how I can accommodate her, how she can accommodate me, it’s on the personal level. So these are the ways in how I developed a relationship with her and I was able to develop much better insights and every feedback she gave helped me to improve and turnaround time substantially has gone down.” (Analyst, Case C).

Similarly, in Case D, the responsible client manager travels regularly to the offshore location, while an offshore employee travels to the client at least once a year, which is argued to enhance the relationships and enable a better understanding between clients and service providers. In all cases, the management as well as executing employees emphasize the need for regular and personal contact between the client and offshoring employees in the production process of the services and allow for personal progress of the employees. This personal contact also motivates the employees to be involved with the team, thereby securing or even improving service quality. The feeling of
belonging and integration in the team is enhanced where the client integrates the service provider in their own organizational context and provides access to their internal databases.

Organizational capabilities. As the services are comparably unique and strongly context dependent, standardization of service deliveries only exists in the form of delivery formats such as delivery design and approach, content and production processes are not standardizable in all three cases. The service providers develop their own unique approach to the service production. This development approach is limited and not transferrable to other contexts across ServiceNow and COVALU. Thus, offshored services are based on the specialized context of client firms and strongly dependent on the judgment of experts producing the service. Only generic and process related information is transferred and documented and shared through firm internal knowledge sharing platforms.

Management capabilities. Reciprocal services are dependent on individual employees that produce the services. Consequently, the assembly and development of human resources is important. Employees are hired based on their educational background, experience and industry or service related knowledge. In all three cases, the employees are trained in order to ensure the equally important aspects of service production and client context. Consequently, the client supports the training and resulting development of service provider employees. For example, in Case C service provider employees of ServiceNow are trained at the client side and spend several weeks shadowing the client employees to understand the firm’s specific requirements, context and service related execution processes, a Team Manager of Case C explained: “we’re sending the associates to the US or other geographies that he or she knows the client better and can understand the customer better.”
Due to the regular contact between the client and the service provider, the deliverables are more tailored to the client’s needs and the feedback loop is faster and more efficient. An Analyst of Case C argues that: “there will be a draft before final deliverable, I will send her my deck, so that she can review it. She would come up with feedback and I will incorporate that. Then, with the final deliverable, I need to walk her through the entire presentation. So this is how the entire transition happened and now I am able to handle all this individually.” These meetings are used to improve service quality, but also enable insights for potential new service offerings and are thus, attended by onside sales representatives.

**DISCUSSION**

After outlining the two service types separately, we are now able to compare sequential and reciprocal services and study whether and how the interaction between the client and the service provider contribute to the building of capabilities in service provider firms and more specifically, which types of capabilities result from these interactions (see Table 3 for a summary).

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Human capital capabilities are a composite of individual knowledge, experiences, skills and abilities within a firm, and are therefore tacit in nature (Lahiri and Kedia, 2009). In cases with reciprocal activities, the service providers were responsible for the performance of core activities; therefore to ensure a high standard of performance and high level of risk for the client there were weekly feedback meetings with the client. These meetings included discussions of a very practical nature
and performance reviews of the output delivered by the service provider. This frequent and intense interaction not only allowed the service provider to develop and extend their knowledge base, but also led to the opportunity to assimilate past experiences with the current task and extend their value offering to the client. The frequent interaction and feedback with the clients led to the recombination of past knowledge to create new offerings for the client leading to the development of in-house capabilities for the service provider. This supports the findings by Vivek and colleagues (2009) on the importance of relationships in the development of capabilities.

In the performance of sequential tasks, we did not find any generation or development of human capital capabilities. This lack of development can be explained through the nature of the task. These types of tasks the routine was predominant, and employees were largely working with codified data. While the tasks were knowledge intensive, they did not require judgment calls or subjective decision-making by the employees, thereby limiting the risk to the client. The inputs and outputs were clearly defined and combine the existing knowledge bases in a novel or different manner for the required outcome to be achieved. Furthermore, the clients did not deem on-going interaction to be essential to the production of the sequential task activities. Therefore, the individual employees did not get opportunities to progress and develop their individual capabilities. The skills required to perform sequential tasks implying (statistical) data analysis skills, which the employees arguably possessed before they were hired. Thus, the only knowledge transfer and learning that took place was limited to knowledge about the client and relevant industry context. Inputs and outputs in the performance of these tasks were largely explicit. Employees only exercised this type of knowledge, limiting opportunities and requirements for the development of human capital capabilities. Thus we propose:
Proposition 1: Offshoring service providers develop human capital capabilities with the influence of clients when services are offshored that are based on a reciprocal service production process.

In contrast to human capital capabilities, we found that organizational capital capabilities were only developed through the execution of routinized and documented processes relying on codified and explicit activities, such as sequential task activities (cases A and B). If the client was able to clearly communicate and document the production process for example in SOPs and transfer the required knowledge, then service providers were able to develop organizational capital capabilities. The documents could then be efficiently shared and disseminated within the firm. As the processes were relatively standardized, they could be applied and transferred to other contexts as well and utilized in the execution of tasks with other clients. As the service provider performed tasks for a number of different clients, knowledge gained from clients could be accumulated, codified and utilized organization wide through the use of structures, systems and processes (Subramaniam and Youndt, 2005), thereby further developing organizational capital capabilities. Thus we propose:

Propositions 2: Offshoring service providers develop organizational capital capabilities with the influence of clients when services are offshored that are based on a sequential service production process.

We found evidence of management capabilities being developed through both sequential and reciprocal tasks, but via different mechanisms. In sequential tasks such as Cases A and B, the initial knowledge transfer, the selection of human resources, understanding the project requirements, and allocation of resources was crucial. Managerial judgment was applied to identify and to hire the
most appropriate resources. While the allocation of resources was frequent, due to the nature of the routinized tasks being performed, they were of less significance to the client. The limited use of personal judgment and skills while executing these activities meant that managers purely had to ensure that an adequate number of employees were assigned to the tasks. As there were higher attrition rates in the performance of sequential activities, managers had to frequently and on an ongoing basis engage in the allocation of resources, which led to the development of managerial capabilities specific to the identification and allocation of resources.

Similarly, in reciprocal service production processes such as in cases C, D and E, the assembly and allocation of resources was equally (or even more) important but less frequent, due to lower attrition rates. The employees needed to have the required expertise for the services and the ability to use their knowledge and abilities in the production of the services. Finding the employees with the required skill levels was more challenging than in sequential services, but the frequency of assembling and allocating these resources was also lower. Thus, management capabilities specific to human resources were also developed through reciprocal tasks, however, to a lesser degree.

Interaction between the clients and managers also differed in sequential and reciprocal tasks. For example, in sequential tasks the interaction related to the transfer of knowledge and codifying this knowledge for the further training and education of the staff. Due to high attrition rates, the quality of these documents needed to be high and processes needed to be effective. Therefore, managers became adept at training employees and acquired a high degree of autonomy in training their employees in-house.

In reciprocal services, the clients and managers had an interactive relationship and active participation in the development of employee skills. Clients approved employees working on their case to ensure that they had the required skills and understanding of the industry and market context. Due to the high degree of industry and market specific knowledge compulsory for the
performance of the reciprocal tasks, clients played a much larger role in monitoring performances, inputs and outputs. In the initial stages the clients also monitored the performance meticulously and through this increased interaction, the knowledge base of the managers and their employees was developed and nuanced. Consequently, this interaction allowed managers to provide value added output and propose new ideas to existing clients. Additionally, managers used the gained knowledge and experience in order to attract clients, show evidence of past success and suggest novel value propositions for new clients. Thus we propose:

Proposition 3A: Offshoring service providers develop managerial capabilities with the influence of clients when services are offshored that are based on a sequential and reciprocal service production process.

Proposition 3B: Sequential tasks lead to the development of managerial capital capabilities specific to the identification and allocation of human resources.

Proposition 3C: Reciprocal tasks lead to the development of managerial capital capabilities specific to enhancing the value proposition for the client.

From our findings we see that clients do not contribute to the development of human capital, organizational capital and management capabilities uniformly. Moreover, neither sequential nor reciprocal tasks contribute to the development of all three capabilities, which posses some potential managerial challenges.

While the enhancement of human capital through reciprocal activities is attractive for individual employees, these capabilities are not per se translated into and/or embedded at the organizational level, in a business unit or the firm as a whole. In view of the high attrition rates often observed among service providers in India, it is a challenge for the service providers to ensure that the
knowledge (resources) built at the individual level are transferred and scaled-up at a more aggregate level of the organization. If this doesn’t succeed, then the contribution to the human capital and competitive resources could be very limited, since it remains, and disappears, with the individual employee. Analogously for sequential service production, where we see a contribution to organizational capital capabilities, but not any development of new content knowledge or other forms of human capital capabilities. Organizational routines are built, but these are simply the execution of business processes as defined by the client, without any accompanying development of human capital capabilities. The value added to the service provider (in terms of building resources that may be used for further business development, or progressing to offer higher order types of service offerings) of only this type of organizational capital capability is consequently limited. While the development of organizational capital benefits the service provider by increasing their explicit knowledge stock, this can be a short-term strategy for the service provider. Industry trends show the relocation of R&D activities to India is increasingly common. These activities are largely reliant upon tacit knowledge and co-creation of new knowledge, therefore, the reliance on enhancing organizational capital capabilities may not lead to a long term competitively favorable position within the Indian or global outsourcing industry.

It is likely that continued engagement with the clients can lead to further functional and product upgrading, whereby the service providers can provide a broader range of more sophisticated solutions. There is however, a likely pitfall that the employees working with specific clients might accumulate idiosyncratic knowledge and develop human capital capabilities that are closely tied to particular clients. While the production of more sophisticated services may be beneficial for the clients, this may not translate into increased competitiveness for the service provider as a whole. Therefore, the relationship may become stronger and employees gain more experience, but the implications for the firm might not be significant.
Implications

These findings hold theoretical and managerial implications. First, the findings show the developments of capabilities for the service provider, increasing the competitiveness of the firms. Offshore outsourcing was predominantly studied from the client’s perspective neglecting the benefits of offshoring for the service providers. We are now able to argue for the development of capabilities influenced by offshoring clients that help develop the capabilities of service providers. As these service providers are geographically located in emerging markets, this finding has also implications for literature on emerging market firms and their catch-up processes. There is clearly a development towards the catch-up of these firms to mature market standards in line with Mudambi’s (2008) value chain argument and Brandl and Mudambi’s (2014) industry findings.

Moreover, the activity-based perspective, incorporating the production processes activities of the services allowed us to gain deep insights into the organizations and the management thereof. Thus, we can contribute to the resource-based theory with detail information on the capabilities related to the management of human capital and the generation of organizational capabilities related to their management. This contribution to organizational capability theory allows furthering our understanding on organizations especially from emerging market economies. Moreover, the activity-based perspective also enabled a study on the interaction of the client and service provider firm in line with network theory.

Managers from the client and service provider side can gain insights in the management of offshore outsourcing activities also related to the service type characteristics. Moreover, especially service providers gain insights in where capabilities are gained in an offshore outsourcing partnership and how capabilities can be gained. This finding allows to outline where firms do not gain any
CONCLUSION

We set out to analyze whether the client contributes to the building of capabilities in service provider firms and if so, how the different types of activities in the production process of the services influence the development of different types of capabilities. In conclusion we found that clients influence the development of capabilities in service providers depending on the service characteristics and the activity type in the production process of the services. Influenced by the client, service providers develop organizational capabilities in sequential and reciprocal services. More specific we found that when sequential knowledge-intensive business service are offshore outsourced that follow a set routine, clients influence the development of organizational capital and managerial capabilities but do not influence the development of human capital capabilities. When reciprocal knowledge-intensive business services are offshore outsourced, clients influence the development of human capital and managerial capabilities but do not support the development of organizational capital capabilities.

The paper has some limitations, especially related the chosen methods and research approach. The study holds limitations to generalizability commonly criticized in qualitative case study research. However, we believe that the research method is appropriate base on the aim to study two service types including their production activities.

Moreover, we acknowledge that each firm already has organizational capabilities to some extent, if no capabilities would be existing, firms would struggle with competitive advantages. Thus, the
developed capabilities we are studying are further evolved of existing capabilities not the development of new capabilities.
References


Table 1: Task features

<table>
<thead>
<tr>
<th>Central task features</th>
<th>Reciprocal task interdependence</th>
<th>Sequential task interdependence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relation between problem definition and solution definition</td>
<td>Iterative and mutually dependent development of problem and solution definition</td>
<td>Clearly defined problem and related solution</td>
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<tr>
<td>Coordination and communication needs between onshore and offshore units/workers</td>
<td>High and ongoing need for coordination and communication</td>
<td>Limited, aside from initial instructions or training</td>
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<tr>
<td>Possibility for replication</td>
<td>Individual, case-by-case solutions,</td>
<td>Replicable and scalable processes</td>
</tr>
<tr>
<td>Importance of individual judgment, combinative capabilities, and experience</td>
<td>High</td>
<td>Low</td>
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Source: Authors’ own

Table 2: Case descriptions

<table>
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<tr>
<th>Characteristic</th>
<th>Case A</th>
<th>Case B</th>
<th>Case C</th>
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<td>Competitive intelligence</td>
<td>Intellectual property and R&amp;D research</td>
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<td>business issues - client provides data</td>
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<td>global intellectual property and R&amp;D activities - data needs to be gathered</td>
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<td>- Business analyst</td>
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<td>- On-side representative</td>
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<td></td>
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<td>- Trainer</td>
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<td>- Trainer</td>
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<td><strong>Required skills</strong></td>
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<td>Commerce graduates, media experts, statisticians</td>
<td>Business analysts, economists</td>
<td>Chemical engineers, business analysts</td>
<td>Chemical engineers, lawyers</td>
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Table 3: Capability development of sequential and reciprocal services

<table>
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<th>Human capital capabilities</th>
<th>sequential services</th>
<th>reciprocal services</th>
<th>Propositions</th>
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