

Cultural Risk versus Cost in IT Offshore Outsourcing

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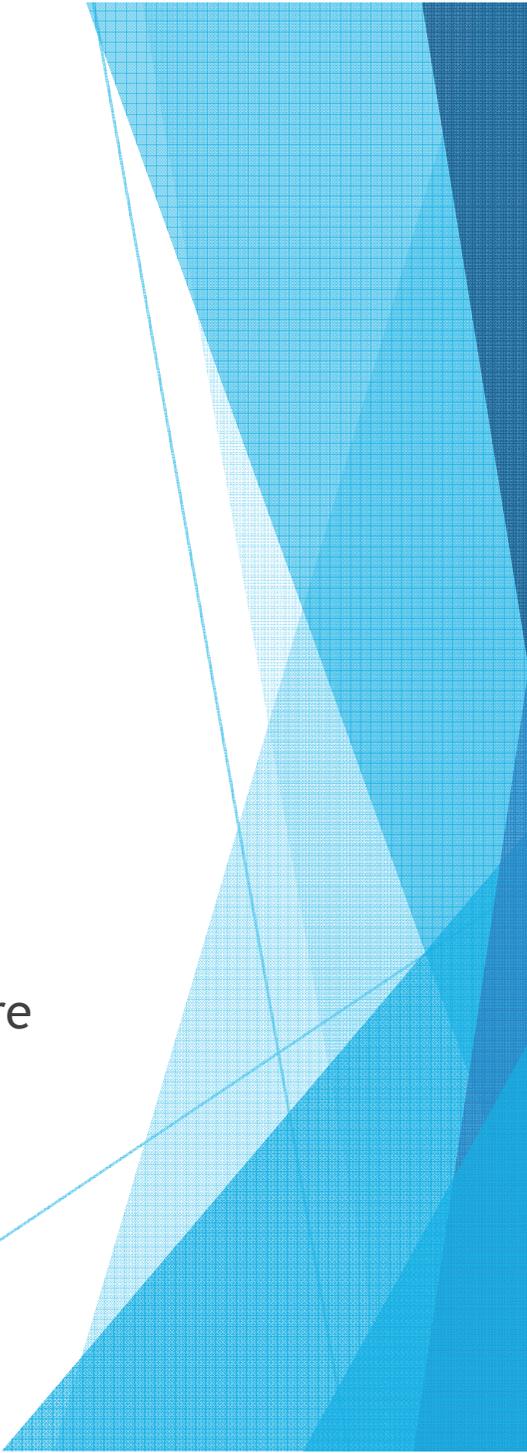
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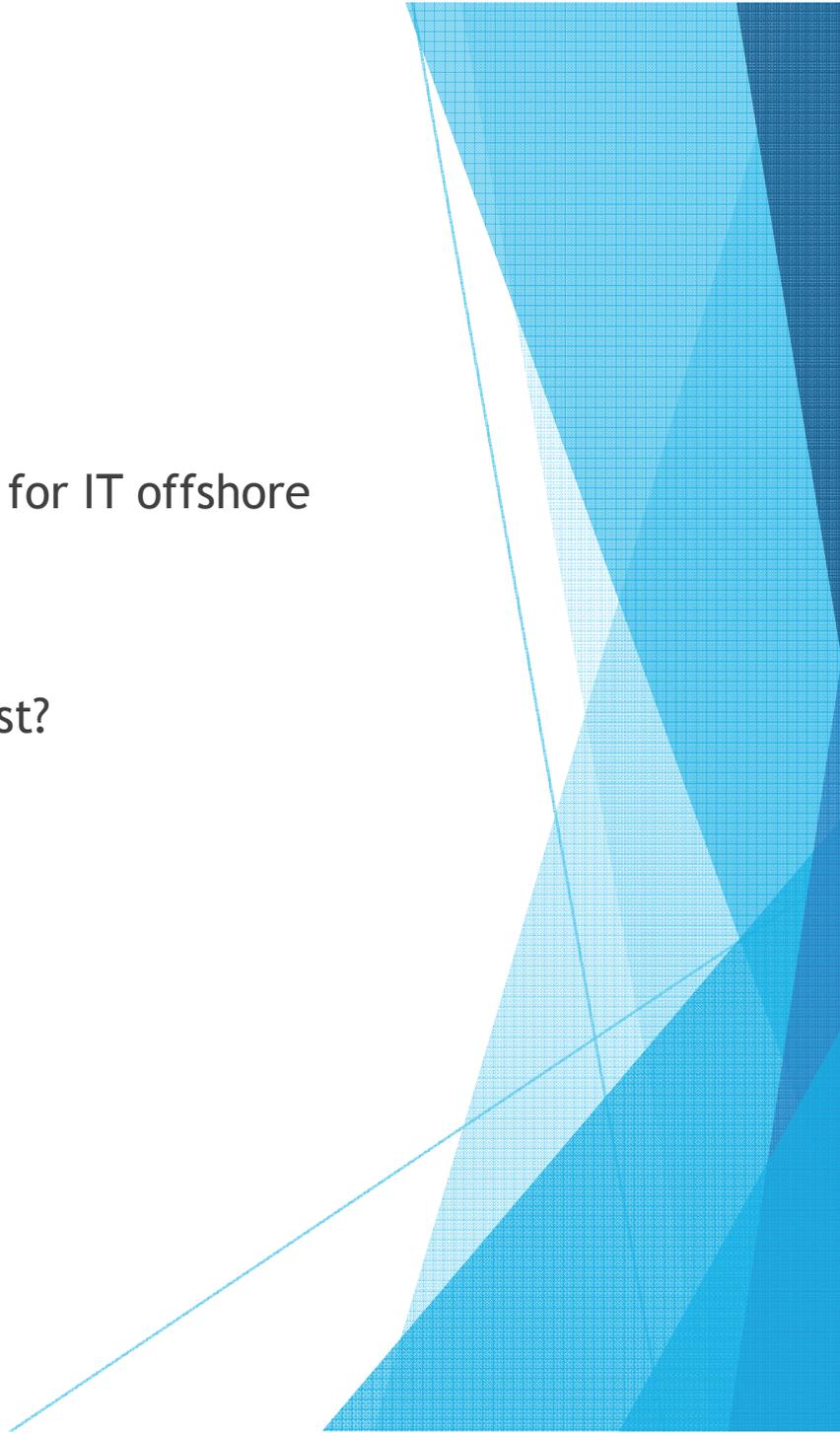
Introduction

- ▶ A number of IT offshore outsourcing projects fall short of being successful (Davis et al., 2006).
 - ▶ Due to the frustration basically caused by the difference between the host and the home country's culture, some companies have brought back home their outsourced projects such as Dell and its customer support services.
 - ▶ Do managers know if or how well consulting firms consider the role of culture in IT offshore outsourcing?
 - ▶ Do people in IT offshore outsourcing consider the role of culture enough?
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Data Source

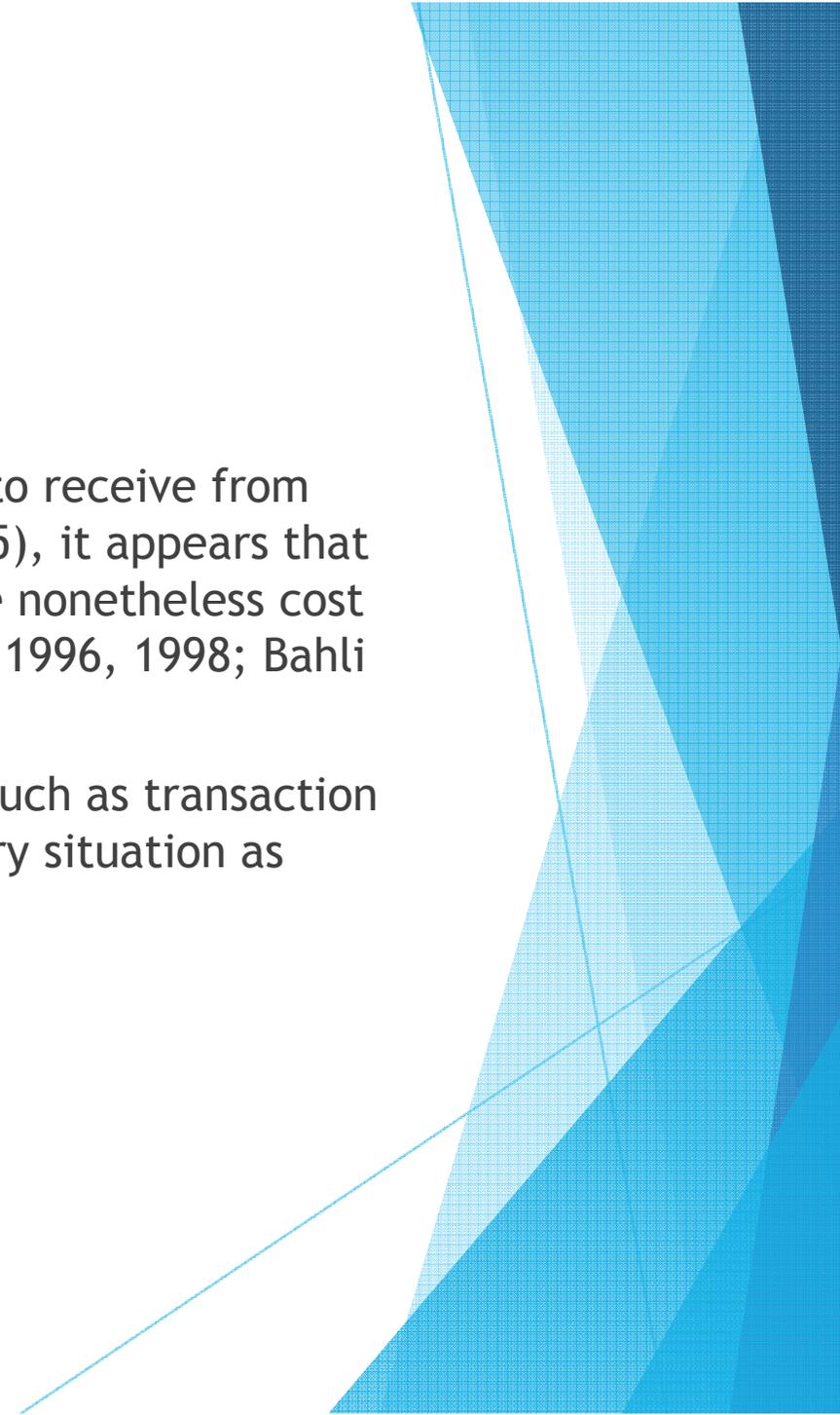
- ▶ This study uses the Global Outsourcing Index (GOI) data prepared by CIOInsight.com (by Minevich and Richter, 2005), in which information such as cost and risks of best countries recommended for IT outsourcing in 2005 was analyzed and used to rank the countries. The risk analyzed was broken into subcategories such as geopolitical, human capital, and cultural risk.
- ▶ Unfortunately, in generating the GOI, only 6% emphasis was given to cultural risk (and no more than 10% for each subset of risks), while 30% emphasis was solely to cost. While that method appears reasonable, recent academic literature seems to stress that *culture is not just a problem - but a leading problem in offshore outsourcing* and should be considered more seriously than previously thought (Beulen and Ribbers, 2003; Metters, 2008). We recognize the contribution of the original GOI study that provides managers a convenient list of best twenty countries for IT offshore outsourcing. However, we encourage the users of this type of reports to be vigilant and consider factors such as culture more seriously before making a decision to outsource IT functions or projects (Davis et al., 2006).
- ▶ Therefore, this study aims to examine the role of cultural risk versus cost in global IT outsourcing by analyzing secondary data from a well-known source that is likely to be used by many managers. Specifically, this paper empirically assesses whether cost to outsource and/or cultural risk are influential in determining which country is recommended best for IT outsourcing in the GOI study.

Research Questions

- ▶ What treatment yields the lowest GOI (i.e. the best scenario for IT offshore outsourcing)?
 - ▶ Is cost important in determining the GOI?
 - ▶ Is the best treatment significantly better than the second best?
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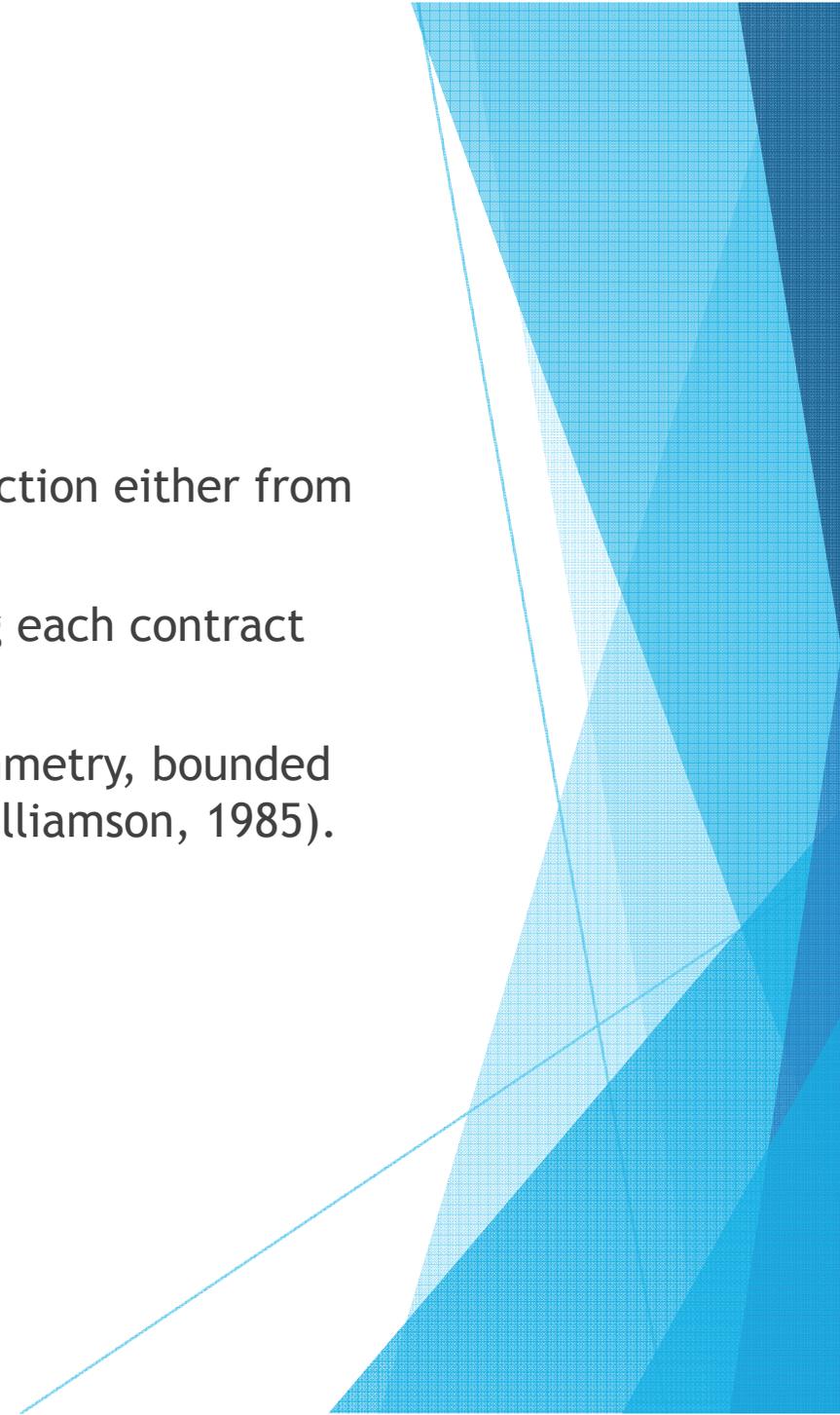
Cost

- ▶ While the key benefit an organization immediately expects to receive from outsourcing is reduced costs (Susarla et al., 2003; Tafti, 2005), it appears that some of the prominent negative consequences over time are nonetheless cost escalation and even service debasement (e.g. Aubert et al., 1996, 1998; Bahli and Rivard, 2003).
- ▶ Researchers have attempted to draw from several theories such as transaction cost theory and agency theory to explain such a contradictory situation as follows.



Transaction cost theory

- ▶ Why an organization performs a business activity or a transaction either from the market or within the firm.
- ▶ Transaction is not free of charge, but entails costs of making each contract (Coase, 1937).
- ▶ Overall cost is still likely to rise due to the information asymmetry, bounded rationality and opportunism intrinsic to each transaction (Williamson, 1985).



Agency theory

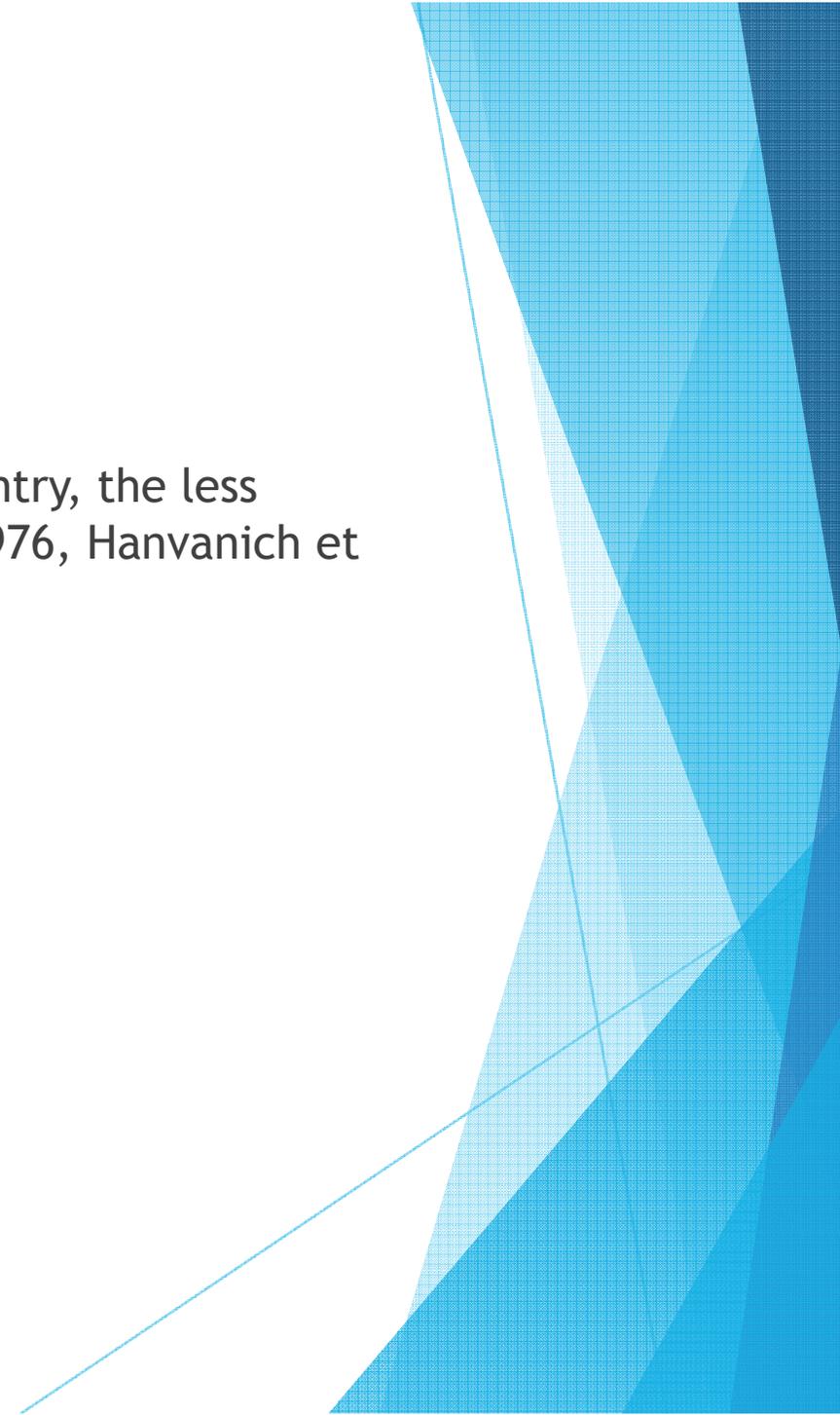
- ▶ Cost is a crucial determinant in identifying the interaction between an agent and a principal. (Eisenhardt, 1989)
- ▶ Agency theory assumes that either the agent or the principal has its own self-interest or motive for participating business activities.
- ▶ Principal must coordinate, monitor, and control the agent's activities to ensure that the agent pursues the principal's goals.
- ▶ This indicates, in the case of IT outsourcing project, that it will cost the principal (outsourcer) to coordinate and monitor the agent (outsourcee)'s activities.

Cultural Risk

- ▶ As cultural differences refer to “*dissimilarity of partner nationality*” (Hanvanich et al., 2003, p. 1), cultural risk can be defined as the possibility of social, financial, and/or physical loss caused by cultural differences.
- ▶ Hofstede (2001) proposes that national cultural differences can affect organizational beliefs, norms, attitudes, decisions, and behaviors.
- ▶ Previous studies in various disciplines (e.g. International Business, Knowledge Management) suggest that as firms internationalize to acquire resources, they are more likely to face risks embedded within cultural differences (Daniels & Radebaugh, 1998).
- ▶ Cultural risk may be the culprit of miscommunication and mistrust which then result in reduced or disconnected information flow which in turn leads to poor performance (Buckley and Casson, 1996; Hanvanich et al., 2003).

Cultural Risk

- ▶ The stronger cultural similarity between host and home country, the less cultural risk, and the more benefits to both firms (Hymer, 1976, Hanvanich et al., 2003; Hahn and Bunyaratavej, 2010).



Methodology

Cultural Risk	Cost		Average
	High (H)	Low (L)	
High (1)	2.66 (2)	2.18 (2)	2.42 (4)
Medium (2)	2.35 (5)	2.45 (3)	2.40 (8)
Low (3)	2.60 (5)	2.29 (2)	2.45 (7)
Average	2.54 (12)	2.31 (7)	2.42 (19)

Findings

Questions	Findings	Implications
What treatment yields the lowest GOI (i.e. best for IT outsourcing)?	Low cost, high cultural risk.	In determining the GOI, cost is influential, while cultural risk is not.
Is cost important in determining GOI?	Yes, cost is important.	Such a finding is strongly confirmed when the treatment of low cost, low cultural risk (second best) is not even significantly better than the treatment of low cost, high cultural risk (best treatment).
Is the best treatment significantly better than the second best treatment (low cost, low cultural risk)?	Yes, the best treatment (low cost, high cultural risk) is significantly better than the second treatment.	

Limitations

- ▶ Limited amount of the data
- ▶ Design and coding scheme



Conclusion

- ▶ Be cautious when seeking out advice from consulting firms and making a decision to offshore outsource IT by considering culture factor more seriously.

