

ROTTERDAM SCHOOL OF MANAGEMENT, ERASMUS UNIVERSITY

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The business school that thinks
and lives in the future

Offshoring and firm innovation

by Justin Jansen

Offshoring has been one of the most enduring themes in the corporate world in recent times. It still splits the opinion of fans and opponents in a manner that is usually the preserve of obscure religious disputes.

Believers in offshoring will argue intensely that the only true corporates are those that embrace offshoring from here till eternity. Doubters will question the wisdom of transplanting activities to far-flung areas of the world. The cultural and physical distances involved will inevitably, they say, create at least as many new problems as they solve old ones.

introduction of new products and services, but the subject needs to be placed firmly in a longer-term context.

When the trend towards the outsourcing of low-value non-core activities to a specialist supplier first began to seize the imagination of the corporate world there was one key aim: to cut costs. A secondary benefit, almost an accidental by-product, was

- followed a similar trajectory, driven by similar ambitions. However, offshoring today has a look all of its own.

The international financial crisis that began unfolding in the summer of 2007 created a new environment, forcing companies of all sizes across the globe to find new ways to grow. The imperative is to find new ideas, establish a presence in new markets and create new products, while achieving operational excellence to increase efficiencies and cut costs still further.

Offshoring challenges

This in itself presents a new challenge: the balancing of exploration of the future through research and development with delivering enhanced performance in the present. The paradoxical choices involved make it difficult to do both at the same time. Innovation needs liberation and decentralisation. Efficiency needs tighter controls and greater centralisation. Combining the two requires a high level of corporate ambidexterity.

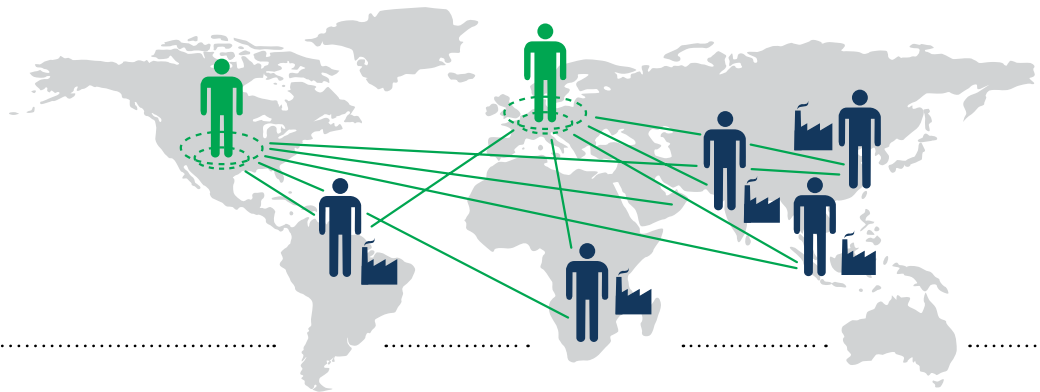
Some research suggests that offshoring to geographies such as India and China can be an important element in helping management to solve the apparently impossible equation, by helping to bring in new ideas and knowledge. Other research suggests the opposite, simply because it can be difficult to integrate such ideas and

“Innovation needs liberation and decentralisation. Efficiency needs tighter controls and greater centralisation. Combining the two requires a high level of corporate ambidexterity.”

As one of the authors of the paper entitled *Offshoring and Firm Innovation: the moderating role of top management team attributes*, I take a close interest in the subject. The prime goal of that study was to increase the understanding of how offshoring influences the

found to be the possibilities it offered to achieve increased operational efficiencies. As outsourcing became more established it began to be applied to higher-value activities.

Offshoring - the relocation of activities to another country or countries



knowledge into the parent company in its domestic market, partly because of the cultural and physical distances involved. Offshoring can be beneficial, yes, but it can be difficult to implement successfully.

Our paper takes a positive view: it shows that the offshoring of R&D and other knowledge-intensive functions can help a company renew and refresh itself to face the future. There is a clear caveat, however. Companies that offshore R&D must continue to conduct R&D in the home location in order to be able to integrate the results of the offshored R&D into the parent company.

We suggest that the extent to which organisations offshore primary functions enables them to unleash unrealised potential for firm innovativeness as they may leverage specialised knowledge sources from foreign locations and utilise wage-differentials. Yet, we argue that the relocation of primary functions to foreign countries will exhibit a pattern of diminishing returns, eventually reversing itself at high levels when organisations may become detached from most of their primary operations and, consequently, experience difficulty in recognising and responding to environmental changes.

Our study also contributes to establishing the link between upper echelon and innovation literatures by highlighting and clarifying the role of

top management teams in how firms may enhance innovativeness through international sourcing.

To advance a deeper understanding of the relationship between offshoring and innovation, we provide an upper echelon contingency perspective that analyses the strategic importance of attributes such as informational diversity and shared vision.

Key lessons

Stripped down to absolute basics, the study offers three key lessons on the offshoring of knowledge-intensive functions for senior managers to take from our research. One, take your time in the initial decision-making process. Think twice before you start. It might be a good idea for the company, in terms of reducing costs and increasing potential profits, but it can be difficult to manage.

Two, offshoring can undoubtedly be profitable, but not everything can, or should, be outsourced. You need to retain and grow an R&D capability in your established markets.

Three, you need the right management team. In particular, you need a balance of diversity in the team in order to understand and negotiate cultural differences. You can lower some costs somewhere, but you need to invest elsewhere to derive the maximum total benefit available to the company. ■

This article draws its inspiration from the paper *Offshoring and Firm Innovation: the moderating role of top management team attributes*, which was written by Oli R. Mihalache, Justin J.J.P. Jansen, Frans Van Den Bosch and Henk W. Volberda. The paper was published in *Strategic Management Journal*, Strat. Mgmt. J. (2012) DOI: 10.1002/smj.

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