Risk Identification in Offshore Outsourcing of Services in Small and Medium sized Enterprises

Master of Science in Business Administration
Strategy and Management in International Organizations

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Abstract

Title: Risk Identification in Offshore Outsourcing of Services in Small and Medium sized Enterprises

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Background: Development of technologies and worldwide reductions of trade barriers during the last decades increased competition and the need to offer high-quality products and services for a reasonable price. Particularly, the service sector increased in size and variety of outputs. The development of the information technology segment has determined the market environment. To be able to compete in this global market offshore outsourcing of IT functions can be a valuable tool if handled in the right way. Small and medium sized enterprises can profit from service offshore outsourcing although studies show that this type of organizations fail in their outsourcing initiatives in an above average rate as a result of deficits in risk management, precisely in risk identification.

Aim: The aim of this Master Thesis is to analyse the specific characteristics of small and medium sized enterprises in order to find out how they impact the different stages of the service offshore outsourcing process. Theory and empirical data helps to spot strengths and weaknesses of these organizations in order to find a solution to a better risk identification process which then might lead to increased success in offshore outsourcing of services.

Definitions: Service offshore outsourcing refers to the purchase of a service (which may have been produced in-house before) by a firm from a supplier located in a different country while the supplier and buyer keep their respective initial locations. Risk is the potential that a chosen action or activity leads to an undesirable outcome. Risk identification, the first part of risk management (followed by risk assessment and prioritization), is defined as an analysis of potential risk factors to the success of an endeavour.

Completion and results: Specific characteristics of small and medium sized enterprises play a significant role in the risk identification process of service offshore outsourcing. By being aware of these risks and acting according to minimize them, harm can be prevented. Especially, a well-designed service offshore outsourcing contract, regular communication and personal relationships could be an advantage to overcome the drawbacks of small size, high dependency, need for flexibility and lack of resources.

Search Terms: risk management, risk identification, risk, offshoring, outsourcing, service, small and medium sized enterprises.
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Writing a Master Thesis was very different from everything we did before. This has been a challenge… Research poses many problems and questions, which we believe, have given us the chance to extend our horizons and learn.

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Christian and Oleksandra
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List of Abbreviations

Offshore outsourcing = O/O
Service offshore outsourcing = SOO
Small and medium sized companies = SME
Research question = RQ
Information technology = IT
Service transition, delivery and post-transition management stage = execution stage
1. Background

With the modern development of technology everything seems like it is located “around the corner”. It is no longer surprising to call a US company for technical support and be redirected to an office somewhere in Mumbai for the service. Borders have become so irrelevant that it does not surprise or ruin expectations when, for example, a product of an Italian company, headquarter in Dubai may be manufactured in a plant in China or India. (Mayrhofer, 2004) Even in the case of physical products everything looks confusing, when it comes to services situation can be even more complicated (Bahli and Rivard, 2003).

Increasing competition and accessibility of foreign markets led companies to start looking for business partners globally (Grant, 2010). The fall of the Berlin Wall and the inclusion of Eastern European and Asian countries in the World Trade Organization marked milestones towards a globalized world (Friedman, 2005). Companies are now able to benefit from this new economic environment by moving production units to countries with low labor costs in order to experience decrease in overall expenses or to expand their markets. Besides producing goods globally, many companies also hand over parts of their production and operating units to third parties which perform these tasks in low wage countries (Stare and Rubalcaba, 2009). For enterprises from developed countries this usually results in lower production costs. However, the offshore outsourcing (O/O) of physical goods commonly also results in increased transportation costs if not sold in vendor’s home country and automation in production and decreases cost savings in O/O of products (Weber, 2006).

A different situation is present in O/O of services. Due to the technological development, transportation costs for services are marginally low or even zero but they are usually personnel-intensive (Moeller, 2010). Service offshore outsourcing (SOO) offers a possibility for companies to drastically reduce costs. Therefore, it had an enormous growth within the last decade and it is expected to continue in the future (Hahn et al, 2009). Many multinational organizations are already active in SOO but also increasing number of small and medium sized enterprises (SMEs) are realizing this opportunity (Stuart, 2011).

Despite the advantages, O/O activities expose companies to a range of risks, which means that for gaining maximum benefits, organizations should navigate between the advantages and disadvantages of this process (Gonzalez et al, 2010). Especially in SOO the risks can have more serious consequences than in O/O of manufacturing due to service specific characteristics that are explained in Chapter 2. An international study conducted by Pallatto (2005) shows that SMEs disproportionately face negative outcomes of O/O activities even though they account for most of the outsourcing contracts. More
than 36 percent of them were not satisfied with the results of SOO which differed dramatically from the expectations (Pallatto, 2005). This often led to a termination of the SOO contract before its expiration date and to a surrender of the O/O initiative. (Deloitte, 2008) Keller (2008) states in his article that the main reasons for failure in SOO activities are caused by insufficient risk identification and risk management of the outsourcing company. A study conducted by ESI International (2010) confirms this argument by stating that more than half of the questioned companies stated that risk management especially in service outsourcing is their main challenge.

In this research we analyze SOO from the perspective of SMEs-outsourcers in order to find out why these companies fail disproportionately in their SOO activities. Specific interest is put on risk identification which is the first step of risk management (before risk assessment and prioritization) (Burtonshaw-Gunn, 2008). Special focus of our work on SMEs can be explained by their significant role in world economy, innovation processes and employment contribution. At the same time there is lack of research in this area, especially in terms of risk management, and consequently risk identification process as its part (Henschel, 2008).

The aim of this thesis is to find out what kinds of specific risks exist in SOO and how they are taken into consideration by SMEs. Having based our findings on a thorough analysis of the SMEs’ characteristics, we have discovered which features of such companies can be beneficial or detrimental in the O/O process. This should result in guidelines for SMEs on how to handle their risk identification for SOO based on their specific characteristics. This paper is written from an outsourcing company’s perspective and covers only marginally the view of the vendor. Besides a theoretical analysis of the currently most used SOO frameworks, we also collected empirical data from primary and secondary sources to prove, or to refute the validity of the models.

1.1. Trends and Definitions

With the ongoing globalization and constant technological evolution, every company, regardless of its size and field of business seeks opportunities to establish its market position, maintain competitive advantage and maximize profits (BHP Information Solutions, 2010). Driven by these goals, companies in pursuit of lower expenses, technological improvement or industrial strategy often turn to outsourcing (Gonzalez, et al, 2010).

Multinational corporations began to use outsourcing as a business opportunity as early as 1970s (Amiti and Wei, 2004). As manifested in the words of Dus and coworkers “outsourcing refers to the contracting with an independent service provider to handle services previously performed within the organization” (Dus, et.al., 2009, p. 3f); a trend
started with manufacturing companies and later supported by representatives of the service sector on the international outsourcing arena in the early 1990s (Bryson and Daniels, 2007). Events later compelled small and medium enterprises (due to limited financial as well as human resources) to adopt outsourcing albeit more cautiously as it is seeing as an opportunistic strategic tool rather than a tactical solution (Mac and Bhaird, 2010).

“Offshoring refers to the delocalization of [business] activities into a foreign country” (Dus et al, 2009, p. 3). This may be done within an organization (regular offshoring), or through a third party (offshore outsourcing). Reasons for relocation are usually connected with financial benefits due to lower labor cost in other countries, differences in taxation system; growth strategy and/or competitive pressure (Jabbour, 2010). In turn, offshore outsourcing represents relocation of specific area or particular function of business abroad with full responsibility and execution as a third party (OECD, 2004). In addition to the aforementioned benefits, offshoring adds value to organizations by providing the opportunities to reduce and control operating costs, focus on core competences and access to scarce resources (Mei and Th, 2009; Bryson and Daniels, 2007; Sichtmann and Von Selasinsky, 2010). O/O as any other business activity requires cooperation of at least two sides. In this case the party that provides the outsourcing company with supporting activities is referred to as a “vendor” (OECD, 2004). Having existed for quite some time, O/O attracted much attention and numerous researches over the years (Tate, 2009; Mei and Th, 2009; Tafti, 2005) what provides a good basis for our research.

In the manufacturing sector for instance, O/O began significantly earlier compared to the service sector. Yet, research in the latter still lacks and has not been given the necessary awareness. La and others could not have echoed this better when they stated that “little research attention has been given to the performance of the service firms in the international context” (La et al, 2005, p. 379). This is the sad case even though the number of companies involved is large and the potential of the market base supports and necessitates taking closer look into this subject (Mei and Th, 2009; Bebko, 2000).

Service in general terms can be defined as “a way of delivering value to a customer by facilitating the expected outcome” (Hurwitz J. et al., 2009, p. 7). With emphasis on immaterial expression, customer relationships and marketing activities, service by nature is hard and difficult to hand over and delegate to a third party especially, in another country and culture (Sichtmann and Von Selasinsky, 2010) and that in our opinion, is why it should be treated differently than regular O/O.

Due to its characteristics, the quality of services performance even within the same company requires tremendous efforts; yet the organization is in absolute control of its workers and their training, and of creating a general corporate culture that should pro-
vide or develop understanding among employees of what quality service is (Stare and Rubalcaba, 2009). Risks increase once a company decides to outsource; it loses the opportunity for tight control. It especially becomes pronounced when going abroad. The company encounters not only different management systems and employees (who they did not select), but cultural, political and economic differences that affects the behavior of staff towards customers (Kelly, 2011; Mei and Th., 2009).

The lack of research in this area can also be attributed to the fact that O/O is relatively a recent phenomenon which owes its rapid development to the fast improvement and the increased use of information technology (Amiti and Wei, 2004). Even fewer researches are done regarding risk identification of SOO in small and medium sized enterprises in the service industry. However, it gains currency following the prediction that O/O by SMEs is to be one of the most promising in the next decades as the amount spent on outsourcing continued to grow rapidly. It is reported that “more than 80% of new and small businesses are outsourcing or considering outsourcing parts of their business functions to gain skills and cut costs” (Holland, 2010, p. 1).

1.2. Research Motivation

Offshore outsourcing is a common trend that offers benefits for companies; these are cost reduction, service quality improvements, flexibility, less capital employed, concentration on core activities, access to technology and greater staff variability (Gonzalez et al., 2010). Treating outsourcing as an important strategic tool, more and more SMEs began relocating activities abroad and responsibility for implementation given to third parties, often on short notice (Mag, 2010).

O/O equally has drawbacks which can seriously harm companies if not properly identified and treated effectively (Tafti, 2005). Issues such as difficulty in communicating with vendors, lack of trust, extensive dependence on service provider and cultural differences have negative consequences (Zechnich and Lee, 2009) which every company should seek for ways to minimize. The foundation of risk management is the proper identification of potential risks and threats and the further development of scenarios in order to find solutions by preventing and mitigating these risks (Datta, 2010).

Despite the difficulties connected with offshore outsourcing, companies all over the world still undertake it and are planning to invest even more in the future (Ketter, 2008). Specific frameworks, theories and models are developed for O/O in the manufacturing sector compared to the service sector; therefore, researchers unanimously conclude that more investigation in this area is of uttermost importance. Tafti for example, dedicated his work to risk management in the IT outsourcing, highlighting the importance of enhancing existing theory with empirical evidence. He stated that “available literature on
outsourcing risks is mainly prescriptive and, while mostly based on expert opinions, not adequately backed by empirical studies” (Tafti, 2005, p. 558). Other authors also recognize the lack of analysis in both theory and practice. Tate expresses his view in a way that “there is much to learn about the emerging patterns in offshore outsourcing from both theoretical and practical standpoints” (Tate, 2009, p. 512). Such statements presented in literature (Mei and Th, 2009; Sichtmann and Von Selasinsky, 2010; Tate, 2009), gave the opportunity and allowed us to narrow and actually direct our research to specific types of outsourced services. Moreover, works that contain both the theoretical and empirical elements usually focus on analysis of large enterprises. There is lack of information regarding small and medium enterprises despite the fact that these companies have the major impact on the world economy (Lukacs, 2005).

Specific interest in SMEs is borne by the fact that even though they are not considered as main actors in the world economy, statistics shows that the most value adding activities as well as biggest contribution to economic development is performed by SMEs (for example, SMEs represented 99 percent of all businesses at one time in Europe) (Mulhern, 1995). SMEs are different from other organizations and should be treated as such in every aspect of management. Their characteristics such as limited resources, “dependence on limited number of people (e.g., lack of internationally experienced employees), small size, and simple structures” (Recklies, 2001, p. 2) affect O/O. Again, SMEs tend to put much emphasis not only on cost cutting factors but on the importance of trustworthy relationships with vendors (Sichtmann and Von Selasinsky, 2010).

Our research, despite the specific interest in SMEs, includes brief discussion on larger organizations and how they cope and manage offshore outsourcing in order to give a background for comparison and to highlight specific features of SMEs. Our focus solely on SMEs without referring to large companies is restricted to particular extent as most of the analyzed literature and secondary sources presenting the subject of O/O are based on the study of large enterprises. Therefore, the theory needs to be specifically adjusted for SMEs (Henschel, 2008). Hence, any research information used by us for literature review or further analysis relies as well directly or indirectly to the large organizations.

When it comes to the service industry research should become more precise as analysis of service specific characteristics together with particular features of SMEs can lead to valuable contribution regarding offshore outsourcing process. (Mulhern, 1995, p. 83). Global studies show that SMEs lack the capabilities for risk identification (ESI International, 2010). This may be due to, perhaps, one of two reasons: either the literature on theoretical framework of risk management in O/O is incomplete and does not offer guidelines for proper risk management or companies disregard these guidelines and use their own mechanisms (in case of the availability of sufficient theoretical frameworks). We were thus motivated to investigation the behaviour of SMEs on the stages of SOO.
We will present some recommendations for the consideration of SMEs and summarize the advantages and disadvantages these companies have during offshore outsourcing.

1.2.1. Research Questions

This research aims, through theoretical and practical analysis, to identify practices used by SMEs during SOO. We intend to highlight the important features considered by these companies in order to identify the main risks. We give an overview of the main risks SMEs encounter during SOO. The goal is to identify the features that can either overcome these challenges or aggravate the situation. Our findings are summarized in the form of guidelines on how SMEs should handle risks in service related O/O activities.

To achieve these goals, the following research questions (RQ) were formulated:

RQ1: What are the characteristic factors that influence service offshore outsourcing of small and medium sized enterprises?

RQ2: How do these factors affect the behavior in terms of risk identification and management during service offshore outsourcing lifecycle?

To answer the above questions, investigations are needed to be conducted, from both theoretical and practical perspectives of SMEs (as well as the service industry) regarding characteristic factors that ought to be considered for successful implementation of outsourcing by a company.

1.2.2. Research Objective

With services, factors such as difficult standardization, close ties with customers, repetition of activities leading to different outcomes affect quality, cost, control and credibility (of the products and company) (Anderson, 2010).

The objective of this research is to identify risks involving SMEs regarding SOO so as to create recommendations and guidelines for better engagement and improved risk identification. By this study, we envisage our contribution in two levels of academia; on the theoretical level, our findings should raise the debate on the relevance of risk identification and persuade researchers to develop further ideas and arguments there in. On the practical level, our results should raise the awareness of managers of SMEs and serve as guidelines to improve the risk identification in SOO.
1.3. Structure of the Thesis

The structure of the thesis is summarized in Figure 1. As shown, the second chapter is followed by the background section, addressing and discussing relevant literature and theoretical frameworks. The third chapter deals with the research design and analysis while our empirical findings are analysed in the fourth chapter. Chapter five represents the comparison of our findings with established ideas from literature; with the last section providing the conclusions, research limitations and recommendations.

Figure 1: Structure of the Thesis

2. Literature Review

This chapter is a review of the commonest theoretical frameworks for risk identification in SOO. SMEs are described in terms of relevant features in O/O, service specific characteristics are highlighted and analysed in terms of congruence with existing O/O models. The aim is to find the relevant risks in SOO and how they are embedded in these theoretical frameworks. This should reveal why it is not always beneficial for organizations to outsource service activities as well as the possible reasons; as these are connected to specific SMEs characteristics. Additionally, we clarified the theoretical view on risk identification in SOO (which will further be evaluated in chapters four and five).

2.1. Small and Medium Sized Enterprises

Small and medium sized enterprises represent significant and major contributors to the global economy today. Available data show that SMEs constitute the biggest part of all businesses worldwide (Schmiemann, 2008). Compared to larger organizations, SMEs have specific characteristics that must be identified and considered in conducting SOO. These distinctive features are small size, independence, close ties with customers as well as business partners and limited resources (financial, personnel, knowledge) (Mac and Bhaird, 2010; Doole and Robin, 2008).

Table 1: European Commission’s Classification of SMEs

<table>
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<th>Enterprise category</th>
<th>Headcount</th>
<th>Turnover or</th>
<th>Balance sheet total</th>
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<tr>
<td>medium-sized</td>
<td>&lt; 250</td>
<td>≤ € 50 million</td>
<td>≤ € 43 million</td>
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<tr>
<td>small</td>
<td>&lt; 50</td>
<td>≤ € 10 million</td>
<td>≤ € 10 million</td>
</tr>
<tr>
<td>micro</td>
<td>&lt; 10</td>
<td>≤ € 2 million</td>
<td>≤ € 2 million</td>
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These specific characteristics significantly affect the strategies of companies. Usually, these companies do not really perceive and pursue well defined, formal action plans. Managed often by an owner, they rely heavily on personal experience, intuition or the so called “me-too” or “copy-cat” strategies already performed by other firms (Carter and Dylan, 2006). Because of limited resources, they do not usually engage professional consultants in strategic planning. The common case is when an owner solely defines the directions (actions) of a firm through what is termed “a shorter and more functional approach to planning” (Carter and Dylan, 2006, p. 293). Consequently, difficulties arise in
measuring success; as achievements are mostly directly connected with owner-manager goals and not much relevant to such common variables as profit, competitive position and market share (Carter and Dylan, 2006).

Without well-defined strategies, SMEs tend to compete on the basis of quality rather than pursuing cost leadership (Carter and Dylan, 2006). It is hard for them to benefit from both economies of scale and scope. This makes it difficult to arrange resources in a way that leads to their minimized usage or maximized profit (Grant, 2010). They are thus unable to commit large resources to specific products or services and so “tend to commit small resources at different stages, as and when opportunities emerge” (Carter and Dylan, 2006, p. 406).

Characterized by limited assets and executive skills, SMEs make themselves competitive by exercising entrepreneurial style of management; taking risks and changing the rules of competition (Carter and Dylan, 2006). Due to the less complex nature and absence of bureaucracy SMEs benefit more from new projects and ideas. This offers them an innovative edge; as reported by Acs and Audretsch that “changes in the economic and social environment have shifted the advantage of innovation towards SMEs” (Acs and Audretsch 2003, p.73). However, several researchers point out significant disadvantages in these innovative processes due to limited financial, technical and human resources since considerable investment of these resources (in research and development) is a prerequisite of such innovative processes (Carter and Dylan, 2006).

Despite these disadvantages, size has benefits that a firm can develop in its competitive advantage. For SMEs, flexibility and closeness to markets are the main strengths and most important ones. Flexibility means fast, effective and precise response to customer needs, market conditions, better communication along the value chain and consequently faster production systems (Carter and Dylan, 2006).

Another important feature of SMEs is their focus on not only the financial benefits but the interpersonal relationship business as well. About 75 percent of SMEs are owned and managed by one person who controls and guides the whole company (O’Regan et al., 2005). Such companies therefore tend to have strong focus on social and cultural dimensions. This may be explained by the fact that limited resources force managers not to rely on professionalism but build relationships based on trust (Jones and Tilley, 2003; Carter and Dylan, 2006).

Taking advantage of their small size, SMEs focus on delivering parts of the value chain in a high-quality level. Influenced by globalization, they also manage to stay competitive on a price dimension by seeking opportunities to lower expenses (BHP Information Solutions, 2010). A possible solution is partial outsourcing. Yet, SMEs usually do not have the capability to back-up their systems and in case of bad or non-performance of the vendor have higher risks of impact (Tate, 2009). Also, these risks are
heightened by low bargaining power in dealing with vendors. This results from a need for specialized services, need for flexibility and small contract size (Vachani, 2003).

Despite of the complexity of O/O, thorough risk assessment is rare in SMEs. Often, owner-manager performs it on individual basis without involving other employees, what leads to high degree of subjectivity (Carter and Dylan, 2006). Another reason for this is the lack of knowledge and experience in risk assessment (Henschel, 2008).

## 2.1.1. SMEs and the Service Industry

In the last decade, SOO significantly gained rising popularity in the global economy. Business researchers from all over the world predicted even faster growth of “ever-widening sphere of service activities [...] from accounting functions such as tax preparation to architectural design and medical imaging diagnostic interpretation” (Hahn et al, 2009, p. 598). In SMEs this raise is even more significant: in Europe, for example, companies working in the service sector increased to about 63 percent in less than a decade from 1994 to 2003 (Doole and Robin, 2008). Such remarkable growth may be explained by the rise in demand due to increased popularity of business-to-business services as well as the usage of consultancy and IT services (Doole and Robin, 2008).

Another reason why entrepreneurs outsource in the service sector is the limited opportunities to implement economies of scale (one of the key strengths of multinational corporations) (Tafti, 2005). To survive, SMEs exercise intangible advantages such as flexibility and closeness to markets. These being highly customized by nature is rewarding in the service industry, as service requires “personal attention to clients need, specialized expertise or products and established reputation” (Bryson et al., 1997, p. 352).

Currently, “IT maintenance, repair, training, applications, development and consulting, and reengineering are among the top most reported categories of outsourced services (68 percent) followed by administration (28 percent) and customer service (27 percent)” (BHP Information Solutions, 2010). These services usually do not directly represent activities related to the core businesses of companies but due to the availability of IT and with time, “have become mobile and outsourced offshore” (UNCTAD, 2005, p. 6).

## 2.2. Service Offshore Outsourcing

Characteristics of SOO are different from regular O/O (for example, manufacturing). In this section, the main characteristics of services are highlighted and explained, why in our opinion, they should be considered in risk management during O/O.
2.2.1. Reasons for Service Offshore Outsourcing in SMEs

For MNCs the driving forces for SOO vary from the pursuit of lower expenses to the possibility of penetrating specific markets due to closeness to local audience (Quinn and Hilmer, 1995). In turn, cost cutting has long been identified to be the main reason SMEs seek partners abroad although technological improvement and access to skilled labor are of great importance (Bryson and Daniels, 2007; Recklies, 2001). Decrease in expenses is mostly realized in the service sector through cutting down staff and technological costs, as well as selecting service providers (Gonzalez et al, 2010). Yet, the possibility of cutting costs is a prerequisite for survival rather than a voluntary decision. SMEs usually do not take advantage of the economies of scale. This means that other strategies for decreasing expenses are needed and O/O consequently becomes an option. (BHP Information Solutions, 2010).

Other important factors that drive SMEs to outsource are environmental pressure, efficiency, and competitive pressure (Tate, 2009). Lack of vital resources, such as natural resources, human capital and/or technology, forces companies, regardless of their size and market position, to seek new opportunities in other organizations or countries. Gonzalez et al (2010) reported on the forces that drive O/O of specific service functions. They highlighted strategic issues that companies should focus on to increase opportunities and to improve flexibility by getting rid of routine tasks (such as call centre or basic software development).

The destination should support the main prerequisite of the company; that is, the possibility of decreasing costs and/or improving quality (Stare and Rubalcaba, 2009; Gonzalez et al, 2010). In the service industry, where manufacturing and transportation costs are insignificant, the main sources of cutting expenses are wages and communication between the outsourcing company and the in-sourcing partner (Tate, 2009; Youngdahl, 2010). However, this rush for decreased costs (through offshore outsourcing) may harm the company in the long run. Often the decision is made with a “gain taking” mentality from the buying company which may lead to “opportunistic behavior” from the vendor (Tate et al., 2009). Eventually, decrease in service quality because of the problems in SOO directly lead to decreased competitiveness.

2.2.2. Service Specific Characteristics

Studies show that entrepreneurs, when deciding in which field to open businesses, often turn to the service industry (Carter and Dylan, 2006; Bryson and Daniels, 2007). Specific characteristics create this favorable ground.
What distinguishes a good from a service? Popularly, service is seen as a thing that one cannot touch, feel or smell until one gets it. In other words, it is “service is something that can be bought and sold, but which cannot drop on your foot” (Gummesson, 1987, p. 22). Researchers have not been able to formulate complete and scientific definition of service, taking into consideration all its specific characteristics (Bryson and Daniels, 2007). However, many scholars use the IHIP (intangibility, heterogeneity, inseparability and perishability) characteristics (Bebko, 2000; Bryson and Daniels, 2007; Grönroos, 1998; Møller, 2010). The characteristics of service with specific service knowledge base lead to great subjectivity in receiving and evaluating service by customers.

The IHIP model creates the awareness of specific service characteristics that strongly affect different processes (central or supplementary) in service (Bryson and Daniels, 2007). These characteristics can be summarized as following:

**Intangibility:**
This refers to the core feature that differentiates services from goods (Møller, 2010). Intangibility of service means that they cannot be touched and possessed, but are usually produced and consumed simultaneously. Some researches however, disagree with the notion of intangibility; referring to the physical environment and the accompanying goods and/or facilities as direct parts of service. Thereby, claiming that service can be measured and evaluated from a tangible perspective (Macintyre et al., 2011).

**Heterogeneity:**
This implies that the end “product” changes every time it is produced. Performance of services varies depending on the features and participants (Macintyre et al., 2011). In terms of quality of physical goods, consumers are exposed to higher risks as evaluation is only done after the service has been received and consumed (Bebko, 2000). Standardization of services is difficult as its delivery cannot be controlled or monitored like production in the manufacturing industry (Verma, 2009).

**Inseparability:**
Being inseparable, service occurs as a result of the cooperation between the provider and the customer, in which the customer is often a co-producer of the ‘offer’. Creation and consumption of the “offer” happens simultaneously meaning that services tend to be ordered, produced, sold and consumed (Macintyre et al., 2011). The value of a service is strongly connected with its consumption as it cannot be stored or postponed till later times, leading to perishability.

**Perishability:**
Due to this feature, services are vulnerable to variations in demand. It cannot be examined in advance leading to risks for both the provider and the consumer (Verma, 2009).

Another feature that is often added by specialists in the service sector is irreversibility. This is defined as an occurrence that cannot be remade or returned to the initial condi-
tion (such as surgery) (Bryson and Daniels, 2007). This exerts pressure on service workers to provide consumers with high quality otherwise a (slightest) mistake may significantly harm companies reputation and affect customer’s loyalty (Keller, 2008).

The IHIP model is widely used by researchers and practitioners and has received severe criticism in academia as a model characteristics of which are outdated. Evolved in the 1980s, this model does not consider all the elements that affected development of the service sector as well as outsourcing. The most important factors that are not treated fairly are the technological revolution and the development of communication technology; in particular, the internet and toll free distance calls (Lovelock, 2004; Vargo and Lusch, 2004). Additionally, restrictions necessitated direct communication of customers with service providers. Presently, due to technological developments, some services are performed without encounter with the service provider (an example is the automated teller machine) (Lovelock, 2004).

These characteristics warrant different approaches to managing services differently from managing goods (Sichtmann and Von Selasinsky, 2010). There are several specific features and risks that companies face in outsourcing. However, not all the pillars of IHIP create problems in offshore outsourcing and depending on the type of service, an element (or two) may become most influential (Verma, 2009). Nevertheless, services; due to great variability of outcomes, impossibility of quality control in “real time” and problems with standardization coupled with specific knowledge based characteristics (tacitness, hardships in knowledge codification) and significant importance of a human factors to some extent create difficulties on the way to successful O/O (Verma, 2009).

### 2.2.3. Risk Identification in Service Offshore Outsourcing

Due to the nature of the business relation (contractual partner that performs services in the name of the outsourcer in a different country), threats are usually much higher than within a single organization (Tafti, 2005). Aside the general risks in outsourcing (loss of direct control, increased communication problems, misunderstandings, diverse organizational culture and so on) there are other parameters caused by the physical distance between the outsourcer and the vendor (lack of process control, cultural conflicts, political issues, communication problems due to time differences and language asymmetries). (Dus et al, 2009). More so, there is a difference between general outsourcing (production, manufacturing) and offshore outsourcing of services (IT services, sales function, accounting). The service related characteristics of OOS make it even more complex due to problems associated with quality assessment, intellectual property rights, value creation in cooperation with the customer and motivation. These risks do not have the same effects and influence as in regular outsourcing (Dus et al, 2009).
The relation between the level of control of the processes by the (outsourcing) company, potential benefits and risks can be seen in Figure 2. In this case, a high level of control is perceived as an advantage due to the improved monitoring options, the authority to interfere and the reduced dependence on third parties (Grant, 2010). Out of the four options given in Figure 2, in-house production has the highest level of control, whereas O/O has the lowest one. However, the further the process is outside of the direct control of the company the higher the potential benefits are. These can be reached through relocation of processes to another country (with lower wages), subcontracting (to a party specialized in this process), or both of it which leads to decreased direct control (Rivard, 2005). But, these benefits can be offset by the possible risks which are negatively correlated to the level of control. The lower the direct impact of the (outsourcing) company,
the higher the possible problems due to a lack of direct monitoring, authority and increased dependence on the subcontractor (Tafti, 2005). Based on the results of Figure 2 it would be desirable for the outsourcing company to have a high level of control, high benefits but limited risks. The only way to achieve this in O/O would be to increase direct process control through close cooperation and monitoring of the vendor and to decrease potential risks as a result of a proper-working risk management process (Verizon, 2004).

Service characteristics should be given the relevant consideration before, during and after direct negotiations in offshore outsourcing contract due to specific treats during these phases (Wolff and Lazear, 2001). Companies should be aware of these potential risks in order to respond or take actions to exclude them in advance. If risk assessment is not done properly it reduces the benefits or even leads to losses compared to in-house production of the outsourced activities (Tafti, 2005). This is especially the case for offshore outsourcing of services that are not storable and standardizable due to internal processes and vulnerability in connection with direct contact with customers (Gonzalez et al, 2010).

In a study on risk management in service O/O, more than half of the participating companies responded that risk management and risk assessment were their main challenges. They also underscored the need for improvements in existing risk management practices (ESI International, 2010).

Coyne in his article, “Embed Your Risk Management” emphasised that it is important to connect risk assessment with all processes within the service sector in an organization’s operational network due to interconnectivity (Coyne, 2009). As a result of inseparability of production and consumption, issues in one process have direct influence on other organizational procedures. This means that risk management should not be limited to offshore outsourcing activities; it should “become an integral part of the supply chain” (Coyne, 2009, p.116). Other researchers critique this opinion arguing that most outsourced activities have limited impact on companies operations and that the costs for proper risk management especially in SMEs would exceed the benefits (Dus et al, 2009). In our opinion, the degree of risk management depends on several internal and external risk factors within the different stages of the outsourcing lifecycle (this will be explained later). Therefore, even if only fragments of services are outsourced, they still increase the vulnerability of the organization and have to be monitored and managed.
2.3. Overview of Existing Offshore Outsourcing Risk Identification Theories

Risk identification can help the outsourcing company to take the right decisions about what, where and to whom to outsource business activities. Risk identification should be an on-going procedure throughout the whole outsourcing lifecycle (Lavigne, 2010). In fact, for SMEs, due to their characteristics, good risk identification is even more critical and desirable (Quinn and Hilmer, 1995).

This part summarizes the most common frameworks of risk identification in O/O and analyses impact on them of the particular characteristics of SMEs and services. This section will also provide the basis for the empirical research in chapter four.

2.3.1. The Deloitte Offshore Outsourcing Lifecycle Model

The Deloitte model is an Offshore Outsourcing Lifecycle Model which serves as a guide for our risk identification analysis. This framework is a relatively new approach and divides the offshore outsourcing activities into five stages that are interconnected. Within these stages we refer to other relevant models and studies. The decision to focus mainly on the Deloitte Model stems from its approach to SOO (most of the other models focuses on regular outsourcing) and holistic view on risks during the different stages of the lifecycle (Keller, 2008). Although the Model has a more practical approach and was written more as a guide for companies than as an academic document. It combines different risk identification models in an effective and comprehensive way (Zechnich and Lee, 2009). To align the theoretical model with our topic, we added the characteristics of SMEs into the framework.

Figure 3 shows the five stages of the Deloitte Offshore Outsourcing Lifecycle model. They are sequential and provide risk identification throughout the whole process. This is in agreement with other theoretical models. Dus et al (2009) divides O/O lifecycle into three phases. Parameswaran (2009) developed a risk assessment model based on several layers. Chou and Chou (2008) created a seven stage risk identification model and Meijer (2009) also used a five stage framework for risk identification.

Based on questionnaire, Deloitte (2008) found that O/O rarely offer full benefits to companies due to suboptimal management. They report lack of risk identification, mainly in the pre-contractual stages as one of the main reasons for this (Deloitte, 2008). Another survey confirmed these findings and categorically identifies risk management is the number one challenge for companies engaged in SOO (ESI International, 2010).
2.3.2. Stages of the Deloitte Model

Stage 1:
The first stage of the model deals with the strategic assessment. The O/O plans are developed based on strategic business goals (Deloitte, 2008). Identification of tasks suitable for delegating to an external service provider is essential in this stage (Fersht et al, 2009). This is also in agreement with Wolff and Lazear risk identification model of international business (Wolff and Lazear, 2001). In their opinion, specific risks arise through outsourcing of certain functions. It starts with the consideration whether it makes sense to contract other companies to perform tasks that previously were performed in-house. Prahalad and Hamel (2001) agreed with this; emphasizing that core competencies cannot be outsourced because of the requirement for tight control. To outsource parts of the business usually implies less independency. This creates new problems and disadvantages outweigh the benefits of outsourcing process (Aundhe and Mathew, 2009). Aron and Singh (2005) argue that one of the most common reasons companies do not benefit from O/O is that, not enough time is invested to analyze whether or not specific tasks are reasonable and prudent to outsource. In this case, it is important to consider the characteristics (IHIP) of services and evaluate their impact on the potential O/O activities. Depending on the desired results and the tasks outsourced, possible issues (like heterogeneity, inseparability and perishability) have to be consid-
ered closely. The more critical a function is for the organization the higher its specific risks usually are. SMEs rely strongly on their operational sequences; therefore it is essential to outsource the right tasks to a reliable vendor and still maintain control over the functions. SMEs are often dynamic and more flexible in their operations because they have to adapt to situations rather than create them (IISD, 2004). Therefore, more flexible O/O activities as well flexible vendors may be needed. The capabilities expected from the vendor to ensure homogeneity and cost control have to be defined. This has to be based on the sourcing model and the internal resource capabilities (Tafti, 2005).

The aim of this first stage is to align the business objectives with the potential sourcing risks, and to create a feasibility study in order to evaluate and maximize alternatives. The Deloitte study shows that about 39 percent of the companies surveyed committed shortages (of their O/O projects) in this stage. Such an underperformance in this phase can lead to disadvantages in the contractual phase, wrong activities and problems in detecting potential risks are experienced (Deloitte, 2008). Moreover, there was correlation between company’s activities in stage one and satisfaction of the outsourced initiative (the worse the preparations in stage one, the higher the dissatisfaction) (Deloitte, 2008). Compared to larger organizations, SMEs have a disadvantage in this stage due to non-existent or lack of well-developed business strategies (Parameswaran, 2009).

Stage 2:

It is called the business case development stage. After the strategic assessment, the next thing is to clarify objective of the project. The objective may be cost saving, higher flexibility, quality enhancement, reallocation of resources, skills improvement or reduction development processes. Depending on the goals, costs must be calculated and ranked with alternatives (Ye et al, 2007). These costs should consist of all direct and indirect expenses including those of risk management and exogenous factors. Wolff (1999) developed a framework for identifying exogenous risks. They are caused by the specific circumstances within a certain geographical area and can hardly be changed by an individual company (Danielsson and Song, 2002). These risks must be taken into consideration when deciding the location of the outsourcing and afterwards, during the SOO process. For an O/O, exogenous risks of a company are divided into three types (Figure 4).

According to Hill (2006), political risk is “the likelihood that political forces will cause drastic changes in a country’s business environment (or provide unfavourable surprise to begin with) which adversely affects the profit and other goals of a particular business enterprise” (Hill, 2006, p. 83). The political risks include property rights protection, changes in the legal system, labour restrictions, and access to resources among others (Dus et al, 2009). And these risks affect all the four characteristics of the IHIP Model and should therefore be watched closely (Clarke, 2006).
Cultural risk: “is the likelihood that differences in the implicit institutional framework will lead to a malfunction of the management tools traditionally used by a company” (Hill, 2006, p. 93). This includes language, education, attitudes and values, social organisation, political life, technology, material and religion (Hill, 2006). In SOO, cultural risks are usually the most critical due to labour intensity and the inseparability of production and consumption (Tate et al, 2009). Typically, only a few cultural differences are obvious, the rest are disguised or embedded and not visible at first sight (hence the name, iceberg model) (Hall, 1976). The later lead to confusion, delays, decreased quality and increased costs of outsourced activities. SMEs are usually affected more by cultural risks due to less international experience and fewer diverse workforces. Also, their generic strategy in delivering superior quality is more fragile to quality issues especially when in the case of services it is enhanced with the IHIP characteristics (Porter, 1980).

Economic risk: is the “likelihood that economic mismanagement will cause drastic changes in a country’s business environment that adversely affect the profit and other goals of a particular business enterprise” (Hill, 2006, p. 79). In the Wolff Model, economic risk covers business (competition, innovations and marketing), transportation, operational and financial (market, credit, liquidity and currency) risks (Bowe, 2000). In SOO, economic risks are shifted to the insourcing company leading to indirect risk for the outsourcer (Aundhe and Mathew, 2009) as a result of decreased service quality, higher costs or no service at all. Economic risks of SMEs are high due to lack of financial resources and the smallness in size which often do not allow the splitting of SOO processes among several vendors (portfolio strategy) (Zatolyuk and Allgood, 2004).

A company engaging in SOO is exposed to partly-shifted exogenous risks. It is therefore essential to highlight and note this so that other possible alternatives (a different
country or vendor) could be reconsidered during the outsourcing because once the outsourcer’s service facilities are divested and the vendor begins to operate, it becomes costly and time consuming to reverse a decision (Aron and Singh, 2005). Therefore, SMEs should consider these risks carefully for maximum benefits.

The development of a good business case helps companies to rationally compare O/O opportunities and determine their value (Fersht et al, 2009). However, others argue that it is hardly possible to have objective results or alternatives in most SOO initiatives, due to the fact that they are mostly ex ante. Again, the future of a lot of situations is hard to predict and risk estimation in such cases is based on subjective evaluation (Abraham, 2011). Furthermore, the costs of proper risk identification and evaluation of all possible solutions are time consuming and require internal (and sometimes, external) resources. This may increase the pre-contractual costs thereby minimizing the overall benefits. Also, most SMEs do not have the time and resources to evaluate alternatives according to the theoretical approach and decisions are often taken by one person or a small group of people (Mag, 2010).

**Stage 3:**
The third stage of the Deloitte Model usually referred to as “vendor selection” is a decision making phase that deals with the selection of the right business partner. The purpose is to minimize the individual risks identified by Wolff and Lazear (2001). They argue that there are information asymmetries between business partners. According to them, the outsourcer usually has less information compared to the potential vendor (Wolff and Lazear, 2001). This is called “adverse selection” which particularly harms the business in terms of engagement, capability, and costs. In order to get contracts, vendors have the incentive and tendency to present itself better than it is in reality, and to underestimate costs (Bahli and Rivard, 2003). This leads to flawed decisions by outsourcers who could have gotten better value by contracting a different vendor. According to Lavigne (2010), this is a common problem especially in service outsourcing where the output cannot usually be evaluated easily. He therefore suggested critical evaluation of potential vendors using a trial order (Lavigne, 2010). Another possibility mentioned by Meijer (2009) is the request of certificates of performance from vendors. Deloitte (2008) suggested a careful and holistic evaluation of the first and second stage based on their alternatives and contribution. In this case, exogenous risks play only subordinated role due to the factors discussed in the previous stages.

The focus now is on endogenous risk identification (Deloitte, 2008). Particularly, in long term contracts, which are common in SOO, the focus must be on constant service quality, cost control and data protection (Anderson, 2010). This fact must be considered as in the SOO, the main source of production is the contribution of individuals and little
of machines. Failure on the part of vendors to deliver the expected levels of quality and cost is one of the key reasons outsourcers withdraw initiations or terminate O/O contracts (Zechnich and Lee, 2009). Again, Deloitte suggested involving internal auditors in the identification and selection of vendors. The auditors are asked to look into the vendor’s internal and governance structure such as code of conduct, core competencies, security controls, policies and communication protocols (Deloitte, 2008). It is often hard to gain such vital internal information from potential vendors to ensure sound decision making. Nonetheless, Vatave (2004) critiqued that the choice of vendors is guided by past events and performance (resource-based theory) and does not guarantee success in future business relations as stated by the Deloitte Model. However, benchmarking vendors and incorporating termination clause regarding bad or non-performance may possibly overcome this disadvantage (Bahli and Rivard, 2003).

For SMEs, due to their limited resources, it is hard to base decisions of choosing vendors on the limited information gathered in stages 1 and 2. However, personal networks usually more developed may compensate this disadvantage (Anderson, 2010). Mag reported that SMEs have the advantage of keeping close and personal contact with vendors which leads to better personal relationship and risk identification; especially in cases where the vendor has about the same size as the outsourcer (Mag, 2010). A close connection between the outsourcer and the vendor gives both parties better insights about each other and decreases information asymmetries.

**Stage 4:**

Even though stage 4 usually takes the least time, it is one of the most important. It is the contracting phase which covers the aspects of direct negotiations between the business partners that should lead to agreements valid for the whole SOO period (Dus et al, 2009). After careful selection of suitable candidates, it is important to summarize the tasks, expectations and responsibilities in the contract. Deloitte (2008) underpins the cornerstones of the contract to be the outcome of the preparatory stages 1 to 3. During these direct negotiations, cultural differences play a vital role (as a result of diverse ways of doing businesses) in setting up the contract (Colwill, 2009). Regional differences must be noted and overcome (Wolff and Lazear, 2001). The goal is to have a mutually rewarding contract (Zechnich and Lee, 2009). It is essential to minimize risks that might appear later due to insufficient information during the design of the contract and to target a win-win situation. Two types of risks should be considered especially, when signing the contract; Moral hazard and Hold-up (Bahli and Rivard, 2003). These risks arise from information asymmetries and may drastically reduce the benefits.

Moral Hazard occurs as long as actions of vendors cannot be sufficiently monitored and results can only be partly evaluated (Steen, 2009). Monitoring of vendors is hardly pos-
sible because of much efforts and high expenses. Consequently, most companies expect vendors to act in the best interest of both parties (Aron and Singh, 2005); but this is not always possible. The main reason for this hazard is a lack of motivation for vendors to act in the best interest of outsourcers (Bahli and Rivard, 2003). This can be changed by establishing incentive packages such as bonus payments for good quality or the splitting of outsourcing activity between two or more providers to benchmark them (Aron and Singh, 2005). Notwithstanding, the problem of moral hazard is not restricted to vendors; it can also occur during in-house production of services but tight control and high employee commitment makes it easier to detect and also decrease its possibility within a company (Fabrizi and Lippert, 2004).

The reason for Hold-up is a forgone one-sided specific investment from the outsourcer (Holmström and Roberts, 1998). After tasks have been outsourced, companies do not see the need to keep up the same activities (that have been outsourced) in-house. Facilities are reduced, employees get laid off or transferred to other departments and knowledge is transferred to vendors to be able to perform the outsourced task appropriately (Quinn and Hilmer, 1995). With time, quality problems arise as a result of high dependence on the vendor (Dus et al, 2009). Hold-up also occurs often during the renewal of outsourcing contracts. A vendor may demand much higher prices all of a sudden than those agreed on, due to its increased bargaining power (Aundhe and Mathew, 2009). A solution to this is either to specify a timeframe for which the vendor must keep the service for a certain previously negotiated price after the contract has expired or split the task between two or more providers (Aron and Singh, 2005). Therefore, with a proper contract, it is possible to reduce the risks of hold-up and moral hazards. Another possibility is to invest and develop better personal relation between the business partners to build trust which is often the mark of SMEs. Therefore, SOO contracts between SMEs are usually relatively simple (Dus et al, 2009).

There is an argument in the literature that negotiating power depends on business partners, culture, preparation, kind and complexity of activity and monetary size of contracts (Mag, 2010, Rivard, 2005). The smaller the contract value the lower the bargaining power of outsourcers. Good management in the preparatory stages and knowledge of cultural differences may be advantageous during direct negotiations. Authors recommend the inclusion of success measurements as well as termination clauses for poor or non-performance (Tafti, 2005; Dus et al, 2009, Hahn, et al, 2009). This may heighten the motivation for vendors to act in the best interests of the outsourcer.

**Stage 5:**
The 5th and last stage of the Deloitte Model deals with the outsourcing action (service transition, delivery and post-transition management) and is termed the ‘execution
stage’. It represents the timeframe after signing the contract until the termination of the outsourcing initiative. Activities that were previously performed in-house are handed over to the vendor (Deloitte, 2008). During this stage, knowledge is transferred and training (if necessary) given to employees of the vendor; because it is crucial that the vendor knows what is expected and have the necessary inputs and capacity to perform these required tasks (Meijer, 2009).

Allocation of input resources may be a risk at this stage (Wolff and Lazear, 2001); because it includes all the data and supplies that the outsourcer provides to the vendor. As such, the vendor has to get the necessary information to be able to perform the task and employees have to be trained on how to use inputs (Deloitte, 2008). Coordination between the two parties is of great importance in order to ensure the right supply and homogeneity of service quality (Chou and Chou, 2009). A lot of companies treat outsourcing as a short term project (Amiti and Wei, 2004); so to be able to measure and reveal the benefits, much time is usually needed to optimize coordination, and equally for the vendor, much time is required to move up the learning curve. According to Aundhe and Mathew “short duration projects lead to more stringent delivery conditions, more overheads, less flexibility and difficulties to manage; in other words, project specific risks are high” (Aundhe and Mathew, 2009, p. 424).

Codification of work and the introduction of rules and regulations for the prospective vendor may increase productivity faster and also shows the expectations of the outsourcer (Aron and Singh, 2005). The size of a company has an impact on this particular characteristic. SMEs usually have the advantage of being more flexible and adapting faster to changing business situations (IISD, 2004). As a result codification and changes in work processes are done with high speed.

Another potential risk after the transition is the distribution of output (Wolff and Lazear, 2001). Perishability and inseparability of services (Verma, 2009) sometimes result in the direct contact of the vendor with customers of the outsourcer (for example in call centres). In such cases the quality of work of the vendor has a direct effect on the reputation of the outsourcer (Verma, 2009). SMEs (due to their focus on quality) are largely exposed to this type of risks and as such have to monitor service quality closely. Another important aspect is to clarify the rules and regulations for data and information output to third parties, and the feedback on output (if not already done in the SOO contract) (Aron and Singh, 2005). A positive aspect for SMEs is that they react more quickly to market needs and are also more flexible regarding feedback and identifying problems in the distribution of output. However, most of the risks of output are not visible in advance; this raises the necessity of creating, clarifying and protecting rules, policies and regulations, which due to lack of experience and limited resources, often do not exist (Bahli and Rivard, 2003).
Most of the risks in “service transition, delivery and post-transition management” occur as a result of “lack of clear ownership and standardized processes, lack of proper audit clauses, failure to detect overcharges and revenue leaks, and misperceptions” (Zechnich and Lee, 2009, p.33). Therefore, monitoring and compliance systems must be installed to keep track of costs, performance and compliance. This will also increase the trust, integrity and confidence levels between business partners (Gonzalez et al, 2010).

The characteristics of SMEs play an important role in service transition, delivery and post-transition management. Such companies rely a lot on the vendor for superior quality and yet lack resources for close monitoring of processes (Recklies, 2001). An advantage for SMEs is the closer cooperation and personal connection with the vendor; this helps to detect risks and avoids opportunistic behaviour (Dus et al, 2009).

**Conclusion:**
The Deloitte offshore outsourcing model emphasizes the pre-contractual phase but does not pay deliberate attention to the execution stage. According to Ketter (2008), most risk factors originate from this phase as a result of “inadequate risk identification early in the lifecycle” (Ketter, 2008, p.14). However, even with a good preparation, the execution phase usually takes several years and problems occur during this time (Meijer, 2009). A lot of companies have been very careful in the pre-contractual phase and still failed in the execution stage; either because of communication and quality problems or due to increased costs or bankruptcy of the vendor. Therefore, risk identification must be done in all the stages of the offshore outsourcing lifecycle model.

**2.3. Further Comments and Limitations of the Theory**

The aim of current chapter was to give a theoretical understanding of SMEs, SOO and present existing models for risk identification in SOO. To be able to reveal the full benefits of SOO, SMEs must be proactive in risk identification (Sichtmann and Von Selasinsky, 2010). To enhance the validity of the Deloitte offshore outsourcing lifecycle model (which was designed from the results of a survey conducted on large organizations) for SMEs, we considered the works of well-known authors. Based on theoretical findings, we conducted interviews of SMEs that are active in SOO described in chapter 4. Theory and empirical data are analyzed in chapter 5 to determine the specific characteristics of SMEs that influence SOO process and their effect on risk identification during the SOO lifecycle. Based on these results we highlight the strengths and weaknesses of SMEs. These, if adopted would help ensure better risk identification for SMEs leading to improved results from SOO activities.
3. Methodology

This chapter presents an outline of the methodology used in this current research. It begins with the identification of the research purpose, followed by the research strategy and description, continued with justification, reliability and validity of the study. It provides a broad overview on how the research was carried out and the data used.

3.1. Process

Research process is described as the overview of the defined actions to be performed on the way to the final goal (Blumberg, 2008). A simplified version of the research process is summarized in Figure 5.

**Figure 5: The Research Process**

Following the description of the process based on the abovementioned figure, our research is characterized as the following:

- **Situation**: reports show high rate of failure cases in offshore outsourcing in the service industry (about 30 percent) (Rottman, 2006).

- **Research topic**: lack of theoretical background regarding reasons for failure in service offshore outsourcing especially, for small and medium sized enterprises. Existing studies show that an explanation may be the lack of professional and thorough risk identification and overall management (ESI International, 2010).
Research methods: in order to research risk identification in service offshore outsourcing within SMEs, we used qualitative method. Interviews were used to gather information from companies regarding their behavior at different stages of offshore outsourcing, with particular reference to risk identification. In addition to these primary sources, we used secondary data in the form of industry reports and other statistical records.

Data: data was collected from in-depth interviews and extracts from secondary sources. The purpose was to acquire deeper insight to how risk identification in offshore outsourcing is practiced, most common risks and how specific features of SMEs affect the lifecycle of offshore outsourcing processes summarized by the Deloitte offshore outsourcing lifecycle model.

Conclusion: the last stage of the research draws conclusions and further application of the study (Walliman, 2001). The applications of the research are in the form of recommendations for SMEs engaged in SOO. These recommendations took into account the main risks due to specific features as well as particular characteristics of services SMEs outsource. The conclusions are based on data collected and narrowed down to outsourced IT functions in Ukraine.

3.2. Timeframe

The timeframe of this research is clearly defined – the beginning of February to the end of May. The choice of topic and the definition of its structure took almost a month, after what we needed to develop the theoretical background and to support our ideas with practical world trends. The theoretical background also took approximately a month. Relevant material was constantly edited throughout the process. Interviews with companies were conducted from the middle of March to the middle of April (lasting about four weeks). This (contact with participating companies) afforded us the opportunity to benefit from opinions of external specialist in the field of offshore outsourcing such as professor Bent Petersen from the Copenhagen Business School. We then proceeded with the empirical aspect which took two weeks (up to the end of April). May was solely dedicated to the analytical aspect of the research.

3.3. Purpose

A well-defined purpose is the beginning and central point of any successful research paper. Thus, the identification of what the research is about, the dilemmas it deals with
and how useful it is for targeted audience is of supreme importance (Blumberg, 2008). The purpose of our research is to explore the risk identification of SOO activities of SMEs in the service industry and suggest appropriate recommendations. Based on the common categories and types of research (Goddard et al, 2007; Blumberg, 2008), we classify our research as a descriptive study with elements of an exploratory one (Goddard and Melville, 2007; Blumberg, 2008).

A descriptive study is a research that aims to give an overview of a particular situation or trend in order to gain understanding about who (is involved), what (happened), when and where an event took place (Blumberg, 2008). In our case the description is based on the problems SMEs usually encounter during offshore outsourcing, how specific characteristics affect the process and how appropriate risk identification can minimize the overall risks in this activity. This is as a result of the fact that many SMEs, especially in the service industry, underperform during O/O. A lot of studies proved this fact; and one of the main reasons offered for this failure is the lack of experience and adequate resources to perform holistic risk assessment (ESI International, 2010; Henschel, 2008).

Exploratory elements are widely used in our study. An exploratory element is defined as one that attempts to analyze “what is happening; to seek new insights and to assess phenomena in new lights” (Saunders et al, 2009, p. 139). Description of SOO processes and how SMEs conduct them, presents insight into which issues (strong or weak) that affect or offer competitive advantage.

The descriptive aspect of our study is the theoretical framework through literature in the forms of books, research papers, reports and statistical connecting risk identification processes with specific features of SMEs and the service industry. The exploratory aspect deals with answering questions on how and why; and is represented in the empirical part. However, to maintain focus and to accept or reject ideas from the frame of references constant connection and comparison between theory and practice is required. This requirement is described by Drongelen as an “iterative theory-building process” (Drongelen, 2001, p. 503). This implies that the research questions and the initial direction of the study (purpose) may be modified (with time) depending on theories reviewed, material gathered and data collected (Drongelen, 2001).

### 3.4. Approach

To investigate a particular phenomenon, two most popular methods (qualitative and quantitative) are used in literature; depending on the topic researched, perspective of the author and the availability of information. Very often, they are combined in order to give broader or more precise information on findings (Goddard and Melville, 2007).
Quantitative study is one that supports its purpose and findings with quantitative data; it relies on a variation in numbers rather than variation in kinds (typical of qualitative approach) (Blumberg, 2008; Marczyk et al., 2010). The qualitative method is described as the most appropriate when an investigation into reasons for the particular occurrence or motives of human behavior is necessary (Blumberg, 2008).

Blumberg (2008) states that the exploratory method (used in our work), usually relies on the qualitative approach, as this approach “develops more clearly concepts, operational definitions and establishes priorities” (Blumberg, 2008, p. 201).

In order to understand the nature of management decisions, we used qualitative analysis techniques such as in-depth interviews, expert interviews and document analysis (reports, public records). The interviews with business owners and managing directors were conducted to understanding the phenomena of human behavior. It offered us real life overview of the risk identification processes in O/O; made us better understand company’s motives; clarified the attitudes and perspectives of decision makers and the difficulties they encounter.

There are two types of research approaches in literature: deductive and inductive (Blumberg, 2008). In our work, we relied on the existing theoretical frameworks in order to define data to be used and how to analyze them. Our approach (from theory to practice); is regarded as a deductive one. This approach is based on a thorough investigation of literature as a ground for the research direction and narrowing it down to specific issues. For an inductive approach, the author builds up the work around earlier data gathered (Saunders et al, 2009).

### 3.5. Strategy

A research strategy is defined as a combination of research activities performed by an author to arrive to a particular conclusion (Walliman, 2001). Literature gives broad perspective on this (Goddard and Melville, 2007; Walliman, 2001; Mennen, 2010). The most common one is summarized in the work of Blumberg. Among the main methods of data collection he names: surveys, secondary data and archival sources, observations, case studies and qualitative interviews, and experimentation as the most important (Blumberg, 2008).
3.5.1. Data Collection

In order to have access to the most relevant theoretical information, we used up-to-date literature (mostly, articles from the professional journals). To include practical perspective in our research, we collected data from both primary and secondary sources.

Secondary data is defined in literature as data that “has already been collected and recorded by someone else” (Blumberg, 2008, p. 315). Using such data has several merits, among which are time and money savings. However, they lack detail, especially regarding reasons for a particular occurrence.

In our case, thorough analysis of secondary sources (both written and electronic) has guided research towards the specific focus in O/O activities of SMEs in the service industry; and annual reports and surveys in this area specifically narrowed our interest into risk identification issue.

In terms of deductive approach (from more general to more specific), secondary data shaped the direction and built the ground for the gathering of primary data. Primary data represents the data collected through semi-structured interviews. This is a qualitative analysis technique that helps to “achieve depth rather than breadth and helps in understanding a whole situation” (Mennen, 2010, p. 12). These interviews allow research into different perspectives of the same subject while following the direction. Semi-structured interviews “starts with rather specific questions but allow interviewees to follow their own thoughts later” (Blumberg, 2008, p. 385). By these interviews we intend to perform in-depth analysis of risk identification in SOO of SMEs. According to Eisenhardt (1989), the main challenge authors need to overcome in supporting their research with interviews is bias. To deal with this, he suggested the survey of only “highly knowledgeable” informants in the area of research. Accordingly, we selected candidates with in-depth knowledge of O/O activities in the IT sector.

Sample Selection
To analyze the performance of SMEs in SOO, we focused on the IT service business sector. IT is the main activity outsourced offshore all over the world (ESI International, 2010). With characteristics of traditional services (intangibility, heterogeneity and perishability), IT businesses, although specific, offer some general service recommendations.

To have deeper insight into the subject of SOO, it is vital use knowledgeable and experienced companies. In our case, this prerequisite limited the number of the firms because our focus for the interviews was on organizations with not more than 250 employees (Schmiemann, 2008).
The interview was conducted on five participants from four countries. It was done through Skype, or telephone because of time and resource constraints. The direction and questions evolved from theoretical perspective, where problematic or major advantageous areas in O/O from literature are highlighted and analyzed. Interviews were recorded manually on paper but recording of sessions on tape was difficult due to low speed of internet and frequent disconnections on the phone.

To have insight into issues of risk identification from the outsourcer’s point of view, we conducted three in-depth interviews with companies from Sweden, Denmark and the Netherlands. Access to these European companies we got with a help of director of company – outsourcer in Ukraine. Participants were top level managers who could answer precisely why options in terms offshore outsourcing were chosen and how procedures were followed during this process.

Complementarily, we interviewed two Ukrainian IT vendors. Candidates were chosen based on years of experience in the field of IT O/O, project leader position and experience in working with European clients.

For coherent and well-structured answers, questionnaires were sent to respondents some days before the scheduled interview date (each interview took about 45 to 60 minutes). The questionnaire is made up of about 30 questions and adjusted to outsourcers and vendors perspectives.

A pre-selective investigation of the companies was done using various databases, industry and annual reports. We concentrated first on active companies on the Ukrainian market; based on the services performed, experience with foreign clients, years of experience on the market and industrial ranking. Ukrainian Community of Programmers web page – DOU (http://www.developers.org.ua) was used to search for potential companies. This results in 581 companies currently active in the Ukrainian market. From which 179 are involved in O/O businesses. The next filtering was in terms of years of experience (minimum of three years) which narrowed the search down to 84 companies. This list, according to the ratings of the website, was scaled to 50 companies. The activities of these companies were analyzed in terms of client database (briefly presented on each company’s web site). This allowed us to select firms with significant number of European clients; specifically, those located in North-Western Europe. The final number of companies reduced to 23 and these companies were contacted only two responded.

According to Eisenhardt (1989), the ideal number of cases used for analyzing the validity of a theory ranges between four and ten. With less than four cases, validity is not clear and the more data collected the higher the theoretical saturation. In our situation, the results of the interviews led to theoretical saturation. Again, it was not easy to find appropriate organizations willing to participate. Therefore, we included in our analysis only those interviews that were appropriate for our research topic.
3.6. Case Study

For better understanding of how risk identification of SMEs in SOO is handled we collected empirical data. This part deals with specific focus on IT sector and Ukraine as an outsourcing destination.

3.6.1. The IT Industry: Representative of the Service Sector

The companies interviewed were all involved in IT offshore outsourcing. The decision to focus on IT was taken based on several aspects. To start with, during the last three decades the IT sector was growing much faster than the service sector itself (Ukrainian Hi-Tech Initiative, 2007). The production and delivery of IT services formed large part of the service sector and was even expected to grow above average in the future (Chadee and Raman, 2009; Rosin and Daim, 2009). Another reason is the need for highly skilled employees. Due to the fact that production of IT services require highly skilled labour (which is the main cost factor especially in high income countries) entrepreneurs prefer to look for business partners in low income countries in order to gain advantage in competition. This increases the overall pressure on the service sector to outsource IT activities (Gonzalez et al. 2010).

Therefore, IT is a good representative of the service industry. As a result of consistent technological growth and development, the sector is still very flexible, dynamic and offers many opportunities for SMEs to compete with large and established organizations globally (Anderson, 2006).

The IT industry represents a major part of the service industry (Youngdahl, 2010). To understand the role of IT in the whole service sector, it is important to consider how it differs with regards the IHIP characteristics.

The first point in which IT is partly invalid in terms of IHIP is the perishability. This does not apply, on a full scale, to IT because some IT products can be stored (an example is customer information on a compact disk) and transported. However, without supporting hardware (computer, smart phone, printer, etc.) the service may be useless.

The other feature is inseparability of production and consumption. This may not always be correct as there is the possibility to consume certain services without the cooperation between the customer and the service provider. This requires the option of storing the service such that it is available when needed by the customer. An example is installing an accounting program on the computer. Nevertheless, the program only produces value in connection with customer’s actions. In this case the computer performs the task as
representative of the producer. This allows for the geographical separation of producing a service and consuming it and provides the basis for SOO.

Certain characteristics of the IT industry promote the ability of benefiting from global production cost differences through O/O. Although the variety of services being outsourced is increasing, there are some services (for example, hairdresser or electrician) that are very unlikely to be performed away through geographical distances and therefore SOO in these areas is likely not to happen (but this does not mean that it is impossible). To sum up, the IT industry represents only a part of the service sector and the results of this thesis only have limited impact on other areas of the service sector.

### 3.6.2. Ukraine as a Representative for the Eastern European region?

The interviews conducted are limited to one SOO destination: Ukraine. The intent was to provide similar exogenous conditions for the companies questioned. For risk identification in SOO, we give a brief overview of the most important characteristics of Ukraine.

Ukraine might be considered good example of the Eastern European region but for general conclusion on the whole region, more research is needed. The IT industry in Ukraine is a strong and vibrant sector of the economy even although it is not subsidized or favoured by the government (Zatolyuk and Allgood, 2004). As such it attracted more companies for IT O/O than any other Eastern European country (Maznyuk and Sergiychuk, 2010).

Currently, European SMEs are outsourcing parts of their service production to Ukraine. Reasons for this are geographical location (not so far from the European home market), educated and motivated workforce, well developed IT sector, cultural similarities, low labour costs and availability of vendors of equal size (Ukrainian Hi-Tech Initiative, 2007). Also, Ukraine has advantages in terms of easy travelling and communication. For example, managers of European companies outsourcing to Russia will have to spend significant amount of time to obtain visas. Compared with other Eastern European countries such as Poland, Romania, Bulgaria which are also members of the European Union, Ukraine as outsourcing destination is advantageous. Poland does not have a big pool of IT specialists, which makes it harder for companies to get the possibility to have a choice. In Romania most IT companies are owned by US funds and do not have enough independence to set their own rules. Bulgaria is satisfied with its internal supply; because in the country, “the demand for software developers exceeds supply” (McKinsey Global Institute, 2005, p. 6).
The main disadvantages of Ukraine are complicated taxation system, no governmental subsidies, slow and corrupt administrative system, and lax treatment of property rights (Zatolyuk and Allgood, 2004). Both researchers and companies mention communication problems as one of the main barriers to successful offshore outsourcing processes (Mei and Th., 2009). This is mostly as a result of cultural differences. In Ukraine, these differences are smaller than, for example, in the case of India or China (Europe, 2010).

In general, Ukraine is a good representative of the Eastern European region in terms of SOO. The country owes its leading position in IT O/O to its early involvement and continuous development but to keep its lead in this sector will be more competitive in the future due to massive investment and growth of the IT industry in other East European countries (Maznyuk and Sergiychuk, 2010).

3.7. Data Analysis

Data analysis is an inseparable part of the research paper that aims to support future findings, not only with deep theoretical background but with empirical data as well. This process is not only about displaying the data to the reader, but rather about gaining a different practical angle of view on the research phenomena under consideration.

Stake described data analysis as “processing observations in order to draw out their meanings” (Stake, 1995, p. 170). Following the deductive approach to qualitative data analysis, the information we got from the industry reports, as well as interviewed companies, allowed us to continue and support the research, previously carried out on the theoretical basis. Yin mentioned that descriptive theoretical frameworks “rely more on prior experience and what you expect to occur” (Yin, 2003 in Saunders et al, 2009, p. 496) and consequently will direct the data analysis process.

In order to give the analysis of data a particular structure, Saunders et al (2009) suggest using one or a combination of following types of processes: summarizing, grouping and structuring of meanings. In other works we have found categorizations of stages of data analysis such as data reduction, data display and drawing and verifying conclusions (Miles and Huberman, 1994). During our empirical research we followed the classification offered by Saunders et al (2009) and used all three types of processes to one extent or another. Starting with summarizing the data after each interview, we aimed to find key points which would be useful to support or disprove our prior expectations regarding risk identification in O/O procedure within SMEs. The primary data from the interviews was used mainly as a supporting material, as the amount of questioned companies, does not support generalizing. However, we used summarized conclusions of each interview as well as quotes, in order to give deeper and more personal perspective on the subject of research.
The process of unitizing was performed in order to obtain a more structured approach to analysis. In the literature this stage of data analysis is characterized as “the fragmentation of qualitative data to further process the analysis” (Saunders et al, 2009, p. 497). We achieved this by grouping an interview data together with data from secondary sources depending on the role of a company (outsourcer or vendor), geographical area of data origin (West and East Europe), and stages of offshore outsourcing lifecycle (following five stages of Deloitte model).

Structuring of meaning refers to the stage when authors analyze what is the best way to present data in the paper. In our case the empirical part follows the same structure as we used in the theoretical one regarding the offshore outsourcing lifecycle model. We have organized the data analysis in a way that each of the five-stage Deloitte model includes practical perspective with examples from secondary sources as well as interview references and business cases from companies’ experience.

### 3.8. Validity and Reliability

Validity and reliability are two of the main criteria in the evaluation of trustworthiness of the information provided in the research paper. Jonker and Pennink (2009) describe research as reliable only when “it can provide similar results a second time round” (Jonker and Pennink, 2009, p. 103). Validity from their perspective is “based on an integral assessment of the extent to which empirical findings and theoretical considerations support the adequacy of argumentation” (Jonker and Pennink, 2009, p.103). It is divided into external and internal validity.

There are different approaches to measure these two parameters of the gathered information in terms of character of the data and sources of its origin. Authors can evaluate reliability and validity of the secondary data looking at the sources this data was extracted from (Saunders et al, 2009). The first can be assessed in terms of “authority or reputation of the sources” (Dochartaigh, 2002 in: Saunders et al, 2009, p. 274). Following such description of reliability, secondary sources in the current research work have a high level of reliability as all the information used, comes from well-respected official organizations such as European Committee of Statistics, United Nations, Employers’ Association of the Software and Swedish Trade Council Ukraine. Validity of secondary information is claimed to be harder to evaluate (Saunders et al, 2009).

Primary sources of information tend to have a higher level of subjectivity in terms of evaluating them on validity and reliability. As we mentioned above, in our research interviews represent the main type of the primary data. O/O process and identification of risks on the way to it are unique for every company. However, when it comes to SMEs,
which in our case possess similar resources and deal with comparable threats, the information gathered from respondents provides a valuable asset to our work and allows going deeper in the specific subject.

As was mentioned before, to evaluate data from validity perspective, it is important to understand external and internal validity of information. External validity can be described as the one that “refers to the generalizability of the results of a research study” (Marczyk, 2010, p. 67).

Our study shows limited external validity as it can be generalized only on a particular geographic region and companies which mostly offshore outsource their IT functions. However, when it comes to our particular research subject, the information received from the interviews as well as the one collected from secondary sources, allows us to cover the research area and show high validity on the scale of SMEs and their service offshore outsourcing processes, with focus of North Western Europe and Ukraine.
4. Empirical Part

This chapter illustrates our empirical insights in the actual risk identification processes of SMEs. It starts with the general overview of the companies, after which we present the summary of our findings. This should provide a basis for the analysis of the research questions in Chapter 5.

4.1. General Overview about Companies Interviewed

In this section we give a short general overview about the five companies interviewed: they are all SMEs and active in the SOO sector. Three of them (Betsson, Ebuilders, and World Ticket) are Western European companies that are actively doing SOO. The remaining two (Ciklum and Kuadriga) are performing as vendors and are located in Ukraine. The choice of the companies has proved to be efficient for our research as each of them represent a different type on the scale of SMEs: from micro enterprises (Ebuilders) to the medium sized ones (Betsson and Ciklum). A summary of the main features of the interviewed companies can be found in Table 2.

Table 2: Introduction of the Interviewed Companies

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Betsson</th>
<th>Ebuilders</th>
<th>WorldTicket</th>
<th>Ciklum</th>
<th>Kuadriga</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOO activity</td>
<td>Outsourcer</td>
<td>Outsourcer</td>
<td>Outsourcer</td>
<td>Insourcer</td>
<td>Insourcer</td>
</tr>
<tr>
<td>Type of company</td>
<td>Public traded</td>
<td>Privately owned</td>
<td>Privately traded</td>
<td>Privately owned</td>
<td>Privately owned</td>
</tr>
<tr>
<td>Main business</td>
<td>Online gambling</td>
<td>Online marketing solutions</td>
<td>IT solutions for SME airlines</td>
<td>IT outsourcing company</td>
<td>IT outsourcing company</td>
</tr>
<tr>
<td>Headquarter</td>
<td>Stockholm/ Sweden</td>
<td>Amsterdam/ Netherlands</td>
<td>Copenhagen/ Denmark</td>
<td>Kiev/ Ukraine</td>
<td>Kiev/ Ukraine</td>
</tr>
<tr>
<td>Number of employees</td>
<td>282</td>
<td>6</td>
<td>73</td>
<td>180</td>
<td>65</td>
</tr>
<tr>
<td>Activity in SOO</td>
<td>IT development</td>
<td>IT production &amp; development</td>
<td>Online support &amp; IT development</td>
<td>IT service insourcing</td>
<td>IT service insourcing</td>
</tr>
<tr>
<td>Start of SOO</td>
<td>In 2008</td>
<td>In 2002</td>
<td>In 2007</td>
<td>In 2002</td>
<td>In 2008</td>
</tr>
<tr>
<td>Locations of SOO</td>
<td>Ukraine &amp; Indonesia</td>
<td>Ukraine</td>
<td>Ukraine &amp; China</td>
<td>Ukraine, Belarus &amp; Pakistan</td>
<td>Ukraine</td>
</tr>
<tr>
<td>Locations of SOO</td>
<td>Ukraine &amp; Indonesia</td>
<td>Ukraine</td>
<td>Ukraine &amp; China</td>
<td>Ukraine, Belarus &amp; Pakistan</td>
<td>Ukraine</td>
</tr>
</tbody>
</table>

Source: Conducted interviews of Betsson, Ebuilders, WorldTicket, Ciklum and Kuadriga, 2011.
Betsson is a Swedish online gaming service provider registered at Stockholm stock exchange (NASDAQ OMX Nordic Mid Cap List). Their “business concept is to invest in and manage fast-growing companies that operate in the online gaming industry” (Betsson, 2011a, p. 1). Betsson’s main subsidiary is Betsson Ltd. Malta, which owns the gambling license for all their online gambling activities. In 2010, Betsson provided online gambling services in 23 countries, whereas the majority is located in Europe (Betsson, 2011). It has 282 employees and exceeds the category of being a SME (maximum number of employees: 250) marginally in this point. We still decided to include this company as a SME because when it started SOO in 2008 if fulfilled the requirements with 185 employees (Betsson, 2009). For three years now, the company outsourced its IT development department to project teams in Ukraine and Indonesia. Our interviewee was Owe Laestadius, an experienced project manager and local supervisor of Betsson for the vendor’s project team; he was already in charge of SOO activities in other companies and was directly involved in all the decision-making processes of Betsson’s SOO activity. The interview was conducted by phone on the 17th of March 2011.

Ebuilders regards itself as “a creative production studio for the design and development of online communication and web applications” (Ebuilders, 2011, p. 1). Headquarter is in Amsterdam/Netherlands and it has six employees. Ebuilders is active in web programming, interactive design, campaign localization and optimization (Ebuilders, 2011). Founded in 2002 by Joris Barendregt, it has well-known customers, such as: Air France-KLM, Nike, ING, DHL, Center Parcs and Swisscom (Ebuilders, 2011a). Ebuilders’ generic strategy is to focus on top quality, including flexibility, reliability and creativity (Ebuilders, 2011b). Since its foundation, the company offshore outsourced its production to Ciklum in Kiev/Ukraine. There, Ebuilders has a project team of six people and an additional team upon request. Joris Barendregt, the founder and CEO of Ebuilder was interviewed by us via Skype on the 21st of March 2011. He has extensive SOO experience from his former work in Ukraine. His experience and personal network was used for the SOO initiative. Mr. Barendregt took part in all important decision for the SOO process.

WorldTicket A/S is a Danish based company that develops and maintains online sales and seat reservation systems for small and medium sized airlines. (WorldTicket, 2011, p. 1) It is active in the flight business since 2002 and today numbers 73 employees. By implementing their web-services, the airlines can focus on their core competencies and benefit from lower overhead costs and increased flexibility. Its programs are officially licensed by the IATA. WorldTicket has 25 customers around the world in twelve different countries. (WorldTicket, 2011, p. 1) As Ebuilders, WorldTicket has its focus on providing “superior level of quality and customer service” (WorldTicket, 2011, p. 1). It partly offshore outsourced its online support offices to Ukraine and China. Mr. G. (we were not allowed to reveal his real name) is a manager of WorldTicket responsible for
the SOO initiative in Ukraine. His main tasks are to ensure proper workflow, to work as a contact person and to eliminate problems during the cooperation with the vendor. Mr. G. regularly travels to Ukraine for meetings with the vendor. He was hired due to his extensive experience in O/O after the failure of former SOO projects at WorldTicket. The interview was done via Skype on the 14th of April 2011.

Ciklum is a Danish organization that helps other companies manage their SOO operations. Therefore, it has locations and project teams in Ukraine, Belarus and Pakistan. Ciklum has representative offices in several Western European countries. It was founded in 2002 and employs 180 people in its Kiev office. (Ciklum, 2011) The relatively new approach developed by Ciklum to be geographically close to the clients, with the administrative functions and having production facilities in low-labour countries, led to several awards from within its industry. (Ciklum, 2011a) Clients discuss and negotiate their SOO processes in their home countries. Ciklum then hands over the tasks to its production facilities and a project team will be established, that is in charge of the activities for the client. The IT workforce in Eastern Europe and Pakistan can be seen as a number of independent teams, each one working for one client. IT specialists are working for several projects at a time, which allows them to exchange knowledge. (Ciklum, 2011b) The contact person at Ciklum was Vladimir Vorobyov, an experienced Ukrainian programmer and project manager. He has been part of several projects and was also involved in negotiations with outsourcers. At the time of the Skype interview on 11th of March 2011, Mr. Vorobyov was the project leader for the Uguland SOO initiative. He is responsible for the results of his team and the personal relationship with the outsourcer.

A similar approach as Ciklum offers Kuadriga. It is a Danish service organization with development centres in Ukraine. Kuadriga was founded in 2008 by Jesper Lindholt and accepts orders from companies which want to offshore outsource parts of their IT services and hands it over to internal project teams. Its focus is on allowing cost control and increasing flexibility and predictability for the customer. Therefore it uses the SCRUM method which “is an agile software development methodology that forces daily dialogue” (Kuadriga, 2011, p. 1). Its main customers are SMEs and start-ups. Kuadriga has 65 employees. On the 1st of April we interviewed Nataliya Stoyanovich, the managing director of Kuadriga. She is part of the administrative line organization and her main tasks are to coordinate workflow and customer care, which also covers direct negotiations. Mrs. Stoyanovich is part of Kuadriga since the foundation in 2008.

The fact that both vendors were initially foreign companies, in this case, the Danish investors can bring some differences, to the research in comparison to purely Ukrainian companies. However, following the data collected from the interviews, the difference in working with purely Ukrainian companies or as in our case, with the ones that are branches of the foreign organization, is visible only in pre-negotiation stages. These first stages are usually done in the home country of the supplier, as a big part of the ad-
ministrative work is performed there. When it comes to the offshore outsourcing project itself, Ukrainian subsidiaries behave as autonomous entities.

Our study is also backed up with three recent O/O reports (European IT outsourcing Intelligence report 2010, Central and Eastern European IT Outsourcing review 2010 and 2009 ORN service provider survey report) that focus on SOO, in particular on IT O/O and partly on SMEs. This enriches our thesis with already researched data in some parts of our analysis, thus improving the validity of our findings. Although these reports do not focus on SMEs in particular we decided to include them in the analysis due to the fact that most interviewed companies in these reports were SMEs and there is a lack of pure O/O studies for SMEs.

4.2. Summary of Collected Data

A summary of conducted interviews provides the basis for the analysis. It gives a general overview of how the companies performed and acted in the different phases of the SOO activity. Our observations are also compared to O/O reports. To get a better understanding of an O/O process we divided the interview guide into three phases: before direct negotiations, during direct negotiations and after signing the contract. These stages represent simplified classification perspective but are the exact reflection of Deloitte model, where the two first stages – strategic assessment and business case development refer to “before direct negotiations”; vendor selection and contracting correspond to “during direct negotiation”; and service transition, delivery and post – transition to “after signing the contract”.

4.2.1. Before Direct Negotiations

The general results of the interviews in the pre-contractual stage can be seen in Table 3. Due to our focus on outsourcers, two different questionnaires (one for outsourcers and one for vendors) were designed. Therefore, and because of their different characteristics, not all questions could be answered by the vendors. We decided to include the view of the vendor in the pre-negotiation stage, due to some important insights they offer in this phase. The questions asked in the interview were based on the theory (Deloitte model, IHIP characteristics, service characteristics and features of SMEs). Table 3 summarizes the received data in the pre-contractual stage, which is then described in further detail in this section.
## Table 3: Data of Companies Interviewed in the Pre-Contractual Stage

<table>
<thead>
<tr>
<th></th>
<th>Betsson</th>
<th>Ebuilders</th>
<th>WorldTicket</th>
<th>Ciklum</th>
<th>Kuadriga</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main reasons for SOO</strong></td>
<td>Qualified staff, better service, costs</td>
<td>Qualified staff, better service, costs, flexibility</td>
<td>Qualified staff, better service, costs, expanding</td>
<td>Qualified staff, costs,</td>
<td>Better service, flexibility</td>
</tr>
<tr>
<td><strong>Types of out-/insourced activity</strong></td>
<td>IT development department</td>
<td>IT production department</td>
<td>Software development, customer service</td>
<td>IT development</td>
<td>Software development and maintenance</td>
</tr>
<tr>
<td><strong>Size of outsourced activity</strong></td>
<td>30 employees (15%)</td>
<td>6 employees (50%)</td>
<td>25 employees (40%)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Initiative for SOO</strong></td>
<td>Management</td>
<td>Management</td>
<td>Management</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Former experience in SOO</strong></td>
<td>Not company, but individuals</td>
<td>Not company, but individuals</td>
<td>Former experience</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>First vendor contact through</strong></td>
<td>Recommendations</td>
<td>Personal relations</td>
<td>Personal relations</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Strategic assessment done</strong></td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>First country or vendor</strong></td>
<td>Vendor</td>
<td>Vendor</td>
<td>Country</td>
<td>Country</td>
<td>Country</td>
</tr>
<tr>
<td><strong>Important characteristics of region</strong></td>
<td>Qualified staff</td>
<td>Qualified staff, motivated staff, low labour costs</td>
<td>Inseparability of production &amp; consumption</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Search for suitable vendor</strong></td>
<td>Internet</td>
<td>Internet, personal contact</td>
<td>Internet, 3rd party, personal contact</td>
<td>Internet, fairs, personal contact</td>
<td>Internet, fairs, personal contact</td>
</tr>
<tr>
<td><strong>Important characteristics of services</strong></td>
<td>control over processes &amp; knowledge</td>
<td>communication &amp; continuity in quality</td>
<td>No, personal information</td>
<td>Yes, especially financial</td>
<td>No</td>
</tr>
<tr>
<td><strong>Risk assessment</strong></td>
<td>Contractual, political, cultural &amp; financial risks</td>
<td>No, personal information</td>
<td>No, references and feedback of clients asked</td>
<td>Yes, especially financial</td>
<td>No</td>
</tr>
<tr>
<td><strong>Time from decision to do SOO until signing the contract</strong></td>
<td>9 month</td>
<td>1 year</td>
<td>5 month</td>
<td>2 month up to two years</td>
<td>2 month up to 1 year</td>
</tr>
</tbody>
</table>

Source: Conducted interviews of Betsson, Ebuilders, WorldTicket, Ciklum and Kuadriga, 2011.

The main reasons why SMEs prefer SOO are cost savings and improvement in service (mentioned by four out of five companies), followed by access to qualified staff (mentioned by three SMEs) and the increase in flexibility (two companies). Only World-
Ticket regarded its O/O activities as a chance to expand to new markets. The reasons to O/O services are coherent with the study of Lewin, et al (2010) in which all of these motives were ranked within the eight most important drivers for SOO.

The types of activities outsourced were related to the IT business (IT development, online support centre and maintenance of IT functions) and mainly business-to-business (B2B). The motives for O/O of these activities were: problems in finding qualified workforce in the home country (four out of five), need to increase flexibility (three out of five), concentration on core business (two out of five), cost advantage (two out of five) and coverage of different time zones (one out of five). The reasons for O/O IT services can be also found in the reports of IT Sourcing Europe Ltd. (2010) and Lewin, et al (2010) as important motivators.

The size of the outsourced activities in terms of employees differed among the companies. While Betsson's offshore outsourced personnel accounted for 15 percent, WorldTicket had a number of 40 percent and more than half of Ebuilders staff was working for the company but employed by another organization. We saw that the smaller the interviewed company was, the larger the percentage of its offshore outsourced personnel - but the number of interviews conducted is not sufficient to proof this statement.

In all cases, the decision to look for a business partner that will be in charge of tasks that were previously performed in-house, was done by the management. Some managers already had experience with O/O from past employers (Betsson and Ebuilders) or they had managers of vendors within their personal networks (Ebuilders and WorldTicket). The interviewed vendors stated that, despite offering fairs and being available on industry events, the majority of customers, especially of SMEs, got interested in this particular vendor because of personal relations, or as a result of recommendations of business partners. Therefore, it is important for Ciklum and Kuadriga to have a good reputation and a large network.

The question whether strategic assessment was done before deciding what, where and to who to outsource was negated by all companies. In the majority of cases, grievances (for example: lack of qualified staff, problems with flexibility and high costs) was a reason to implement SOO. Ebuilders which started SOO from the beginning saw this as the only possibility to stay competitive within the market that is dominated by large organizations. In general, it can be said, that the interviewed companies did not perform strategic assessment due to the lack of a clear strategy, fast changing business environment and dependency on big customers that demanded flexibility of their suppliers.

The companies gave different answers to the question how they ended up with a vendor in Ukraine. Betsson and Ebuilders were looking for a suitable vendor independently from its location whereas, WorldTicket was specifically looking for a region in which it will have time-zone advantages for its business, and then was looking for a suitable
vendor. Some companies (Betsson and WorldTicket) already had negative experiences in SOO in other regions which were not regarded as possible locations anymore.

To be considered as a potential O/O region, the companies listed the following characteristics as the most important: qualified IT workforce (five out of five), motivated staff that was willing to do routine tasks (four out of five), low labour costs (three out of five) and good infrastructure (one out of five). These requirements (except good infrastructure), are also within the most important reasons for choosing a region in the report of IT Sourcing Europe Ltd (IT Sourcing Europe Ltd., 2010). None of the companies stated that they designed a timeframe or project plan for their pre-contractual stages.

To obtain data related to the potential O/O location and vendors the companies mostly relied on the internet research (three out of five companies) and personal networks (two out of five). WorldTicket was the only company who involved a third party in its information gathering by sending a request to the Danish chamber of commerce. The reasons why the other outsourcers did not use the possibility of a third party (for example: consultant, or outsourcing specialists), were mainly due to additional costs and time delays in the SOO process and already existing personal relationships to potential vendors.

The question about which characteristics of services were important to consider when planning doing SOO were answered differently by the participants of our study. For Betsson, it was important to keep further control over their processes and knowledge, so the intangibility of services was their main concern. Ebuilders mentioned communication problems and continuity in their product’s quality, especially for routine tasks. For them homogeneity was significant. Due to the O/O activity of WorldTicket, in which the vendor had direct contact with customers of WorldTicket, this organization was concerned with delivering superior quality to the buyer. Inseparability for services was mentioned as one of their biggest challenges, especially due to negative experiences of this characteristic in the past. Additionally, WorldTicket mentioned intellectual property right protection (including customer data) as the main risk when considering SOO.

Substantial risk assessment was only done by Betsson by considering contractual, political, cultural and financial risks. This company considers risk assessment as an on-going process and also included “lessons learned” from previously negative experiences into its considerations. Nevertheless, it also considered close personal contact to the vendor as part of their risk minimization strategy. Ebuilders used the market and vendor knowledge of its founder and CEO, who was an expatriate in Ukraine for two years to evaluate the market. Its small size of six employees in the Netherlands and the resource restrictions only allowed a basic analysis about the potential vendors. WorldTicket instead relied on references and feedback of other companies. When choosing a vendor for example, it asked for clients of the vendor or researched them online and contacted them in order to find out more about the satisfaction and the level of quality.
The different ways of researching and contracting potential vendors also resulted in different timeframes from the decision to do SOO and the start of the transition phase. The fastest organization was WorldTicket with five month, followed by Betsson with nine months and Ebuilders with one year (here it also has to be considered that Ebuilders was within the process of foundation and not yet operating). Interviewed vendors stated a regular timeframe of three month until two years depending on the complexity and size of the project, number of involved specialists and frequency of the communication.

### 4.2.2. During Direct Negotiations

Table 4 summarizes our findings in the negotiation stage of the SOO process. Due to our focus on outsourcers and the specificity of questions asked in this stage, the interviewed vendors are not included in this table.

**Table 4: Data of Outsourcers Interviewed in the Contractual Stage**

<table>
<thead>
<tr>
<th></th>
<th>Betsson</th>
<th>Ebuilders</th>
<th>WorldTicket</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of contracted vendors</td>
<td>One in Ukraine, One in Indonesia</td>
<td>One in Ukraine</td>
<td>One in Ukraine, one in China</td>
</tr>
<tr>
<td>Selection of vendor</td>
<td>Local visits &amp; fulfillment of Betsson's CSR requirements</td>
<td>Presentations at HQ of Ebuilders, personal impression</td>
<td>Results of performance in trial tasks</td>
</tr>
<tr>
<td>Consideration of risks</td>
<td>Control over business processes &amp; knowledge, possibility of contract termination</td>
<td>Keeping project team in case of vendor bankruptcy, intellectual property rights</td>
<td>Intellectual property rights, constant service quality, accuracy</td>
</tr>
<tr>
<td>Creation of SOO contract</td>
<td>Betsson</td>
<td>Ebuilders + 3rd party</td>
<td>WorldTicket + 3rd party</td>
</tr>
<tr>
<td>Renegotiations necessary</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Negative experience in contract phase</td>
<td>No</td>
<td>Yes, down-prioritized</td>
<td>Yes, down-prioritized</td>
</tr>
<tr>
<td>Duration from vendor selection until signature of contract</td>
<td>One week</td>
<td>Two month</td>
<td>Three month</td>
</tr>
<tr>
<td>Duration of the SOO contract</td>
<td>Ten Years</td>
<td>Three Years</td>
<td>No duration, flexible contract conditions</td>
</tr>
<tr>
<td>Measurement of success and failure</td>
<td>Own local manager</td>
<td>Quality has to be &quot;above market average&quot;</td>
<td>Trial period in IT development, constant evaluation of service centre</td>
</tr>
<tr>
<td>Use of personal relations</td>
<td>Yes, recommendations of other companies</td>
<td>Yes, personal contacts</td>
<td>Yes, recommendations &amp; personal networks</td>
</tr>
</tbody>
</table>

Source: Conducted interviews of Betsson, Ebuilders and WorldTicket, 2011.
After evaluating the potential regions and vendors, the most promising ones were invited for direct negotiations. The vendor selection process among the companies interviewed was different. For example, Betsson was in direct negotiations with several companies and finally contracted two vendors for similar tasks (one in Ukraine and one in Indonesia). This allowed the company to increase its bargaining power. Members of Betsson also visited the vendors and convinced themselves of their capabilities and the service quality. Additionally, the potential vendor had to fit the company’s own corporate social responsibility requirements in order to avoid problems with the customers later on. Ebuilders invited vendor representatives to its headquarter in order to give a presentation regarding their background and capabilities. In the final decision also personal impression of the company and its management were taken into consideration. Personal relations of the founder of Ebuilders with vendors were also important. WorldTicket chose its vendor according to its performance during a trial period. Tasks that did not require confidential information (for example writing an addition to a company own program), were given to the vendors to test their creative abilities. The one that was performing best in the eyes of the WorldTicket management and had a high level in service quality was chosen.

During direct negotiations, every company put emphasis on the different risks areas. For Betsson, it was important to keep close control over business processes and knowledge. Therefore, they negotiated the possibility that an employee of Betsson will be able to work in the outsourced team. Another reason for this was the chance to spread the company’s own culture to this team to improve effectiveness. Moreover, there is the opportunity for Betsson to take over the whole team from the vendor after a certain time period for a previously negotiated price. Another important aspect was to have a simple way to exit. It included a termination clause in case of bad- or non-performance.

Ebuilders on the other hand, considered the case of bankruptcy of the vendor and its consequences due to the dependence in the vendor, as its whole IT development was outsourced. In the case of insolvency of the vendor and no pre-negotiated solution, this might lead to the liquidation of Ebuilders. Therefore, it was important to be able to keep the team. Another risk that Ebuilders considered was the protection of intellectual property rights; everything that is developed by the project team has to be handed over to Ebuilders. By not allowing direct customer contact, potential competition of the vendor and misuse of customer data is minimized.

WorldTicket also considered intellectual property rights as an important aspect. Therefore, certain clauses in the O/O contract were designed which would lead to extensive fines in case of violation. Moreover, service quality and availability are of special interest of WorldTicket. In the software development centre, accuracy and specific knowledge is needed to be able to develop innovative products according to the needs of the customers and the rules and regulations of the IATA.
Consensus was handled between the interviewed companies in terms of who was in charge of designing the O/O contract; this was done by the outsourcer. The process of how it was done varied between the companies. Betsson used its internal resources and internal policies to write the agreement, whereas Ebuilders and WorldTicket used the help of external specialists; in this term, lawyers that were expert in O/O, created a legal binding contract according to their needs. Even though this resulted in extra costs and efforts, the companies saw this as an investment for creating a basis for the upcoming relationship with the potential vendor. During the vendor selection process, two out of three companies (Ebuilders and WorldTicket), stated that they partly faced problems in being down-prioritized by the potential vendor due to the small size of their contract. In such cases, they were given a standard contract by the vendor without being allowed to design by their own according to their needs. As a result, the outsourcers ended the negotiations with the vendor without signing the contract.

The experience and the use of resources had an impact on the speed of negotiations. Betsson, whose management had experience with SOO and only used internal resources for designing the contract, took one week from the choice of the vendor until the signature of the contract. Ebuilders which was in its foundation and needed external resources needed two month from choosing the vendor until signing the deal. On the other hand, WorldTicket used another strategy. It had a pre-contract for the chosen vendor during a trial period. Performance during the trial period was measured constantly and all issues that appeared were analysed and partly included in the real SOO agreement. Due to the dynamic structure of the tasks that have to be performed by the vendor a certain contractual flexibility is needed. Therefore, WorldTicket sees its SOO activities as an on-going project rather than a fixed order. The O/O agreement itself only covers key points and is relatively flexible, compared to regular SOO contracts. It is renegotiated once a year. The designing of the contract took four month including the pre-contract.

To be able to evaluate the O/O initiative, there has to be an agreement in the contract on how to measure success or failure of the vendor’s performance. It also gives guidance for the vendor to clarify expectations and to guide each other’s behaviours to a win-win situation (Dus et al, 2009). Betsson decided for the direct control and sent a manager to the Ukrainian project team in order to supervise and to measure performance in development-processes. The manager also has the authority to give incentives for good work or to renegotiate payments and conditions in terms of underperformance. Ebuilders measures its vendor by finding the right employees, assuring proper work conditions, being able to cope with uneven workload and keeping time-limits which are negotiated for every project. The quality of work delivered is checked by Ebuilders and has to be “above market average” due to the SOO contract. Because of subjectivity of measuring service quality, this clause is just used in case of obvious violations against instructions and visible underperformance. WorldTicket which has strict quality regulations,
measures quality for its support centre continuously by randomly recording telephone calls or data traffic between the vendor and its customers. Important criteria are; friendliness, problem identification, problem solving and professionalism. In its development unit, WorldTicket implemented a trial period for the generated software before paying the remaining amount. That gives the company time to get certification from the IATA for its new products and also customer feedback.

4.2.3. After Signing the Contract

Our findings of the execution stage of the SOO process are summarized in Table 5. Due to our focus on outsourcers, the results of the vendors could not be included here but are partly mentioned in the explanation part of this section.

<table>
<thead>
<tr>
<th>Was knowledge transferred?</th>
<th>Betsson</th>
<th>Ebuilders</th>
<th>WorldTicket</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT development knowledge</td>
<td>Ideas</td>
<td></td>
<td>Customer base &amp; service knowledge, development ideas</td>
</tr>
<tr>
<td>Training at HQ of Betsson, local manager assigned to project team</td>
<td>cultural &amp; organizational education on-site in Ukraine</td>
<td>Local on-site training in Ukraine about IP rights &amp; customer treatment</td>
<td></td>
</tr>
<tr>
<td>Way of protecting knowledge</td>
<td>Transfer of company culture &amp; direct control of local manager</td>
<td>No direct communication with clients, good personal contacts</td>
<td>Incentive schemes &amp; contract clauses</td>
</tr>
<tr>
<td>Controlling/Monitoring process</td>
<td>Through local management &amp; close personal contacts</td>
<td>3 layer system: 1. local team leader, 2. management of Ebuilders, 3. formal evaluation process</td>
<td>Supervisor in Denmark, formal assessment, incentive schemes</td>
</tr>
<tr>
<td>Problems during the execution phase</td>
<td>Problems in cross-departmental tasks</td>
<td>Hither employee turnover at vendor</td>
<td>Service availability on holidays, cultural issues</td>
</tr>
<tr>
<td>Frequency of communication</td>
<td>Local manager daily, employees depending on position &amp; task</td>
<td>At least once a day</td>
<td>Several times a week</td>
</tr>
<tr>
<td>Form of communication</td>
<td>Email, Skype, telephone, local management</td>
<td>Email, Skype, telephone, local visits</td>
<td>Email, Telephone, local visits</td>
</tr>
<tr>
<td>Intention to establish close relationships with vendor’s employees</td>
<td>Yes, including transfer of company culture &amp; knowledge about individuals</td>
<td>Yes, only way ensure superior quality and to minimize risks</td>
<td>Partly, mainly restricted to supervisors &amp; the team as a whole</td>
</tr>
</tbody>
</table>

Source: Conducted interviews of Betsson, Ebuilders and WorldTicket, 2011.
During the transition period, knowledge was transferred and the vendor trained by the outsourcer as it was done in different ways. Betsson despite of common theory assumptions regards its SOO activity as long-term investment and involved many resources in the transition stage. Employees of the vendor were trained at Betsson’s headquarters in Sweden. Besides getting insights in knowledge and work processes, it also aimed to transfer the company culture to the new project team. Moreover, a manager of Betsson was assigned to the project team in Ukraine in order to supervise the vendor’s specialists. As a result, this helps to avoid risks and problems often in advance and has proven to be a good solution. Ebuilders on the other hand, had nothing to transfer to the project team except ideas because SOO started with the foundation of the company. Nevertheless, employees were educated to be able to satisfy the needs of Ebuilders clients and to adapt to the Western-European management style. This was done through personal lessons given by the founder of Ebuilders who had experience in SOO in Ukraine. The company’s own knowledge was generated over time and exchanged between outsourcer and vendor continuously. WorldTicket sent a manager to Ukraine at the beginning of the transition phase to educate the employees. Especially intellectual property protection and the right customer treatment were important aspects. This should provide the basis for transferred knowledge (customer base and software knowledge). Incentives in terms of good cooperation and strict punishment of violation shall motivate the vendor to act in the interest of WorldTicket.

Even though the SOO agreement points out expectations of the outsourcer, all three interviewed companies state that they are regularly controlling the processes and quality of the vendor. This is done without the involvement of a third party. For example, Betsson evaluates and checks its vendor continuously through its local management. Due to Betsson, contacts on a private level help to avoid risks by forehand. For example, Betsson regularly invites all employees (including the project teams of the vendor) to special events.

Ebuilders designed a control system based on three layers. The first layer is the local team leader in Ukraine who is responsible for the actions of the group. The second layer is a production manager from Ebuilders who travels to Ukraine once a month to discuss the details of new projects, feedback and daily business with the project team. This person is also a contact person for team members in case they have issues with the local team leader. The third layer is the formal control process done by the management of Ebuilders if the vendor’s projects are done according to the project plan and if the progress fits to the needs of the customers.

At WorldTicket, every outsourced project has a supervisor based in Denmark who is in charge of evaluating the progress, workload and quality. This individual has to be available for the project team all the time in case of emergency or serious problems. Formal assessment is done every two weeks according to pre-negotiated goals and key points
for the whole team and every two month for the individuals. Good performance may lead to a bonus payment for the employee. Due to the interviews with the vendors, controlling processes are common and desired. This helps the project team to become more efficient and avoids getting on the wrong track.

Despite the already mentioned methods to reduce risks, the interviewed companies still faced problems during their SOO activities. As agreed by most managers, it is hard, or even rather impossible to completely avoid all kind of risks. But by early recognition them early and taking initiative to minimize them, the potential damage can be limited. In the Betsson case, the company did not face critical problems thanks to the local management and personal relationships between employees and vendor’s specialists. This might also be an outcome of the previous negative experiences of the main project manager who put efforts in the SOO initiative to avoid former experienced problems. However, as a result of the geographical distance, problems arised, especially when it came to cross-departmental tasks. In this case, the lack of direct interaction, physical participation in meetings and informal follow-up sessions which are often held in a coffee break or during lunch time are not possible what prevents a free informal flow of ideas.

Thanks to the personal experience of the Ebuilders’s founder and the close personal contact to the vendor and the project team, no major obstacles have occurred until now even they do not possess a local manager of Ebuilders being permanently in Ukraine. The only disadvantage until now was a higher employee turnover in the vendor’s project team compared to the outsourcer itself. This represents additional efforts in training and reduced efficiency.

At the beginning of the SOO transition, WorldTicket realised a drop in service availability due to the different holidays in Denmark and Ukraine. At some point, an emergency schedule had to be developed because of the lack of staff at certain days. Incentives and a better planning helped to solve this issue. Another risk emerged from not taking into consideration cultural differences. Due to their education, Ukrainian employees tend to have problems in expressing that they are not able to perform certain tasks because of a lack in knowledge, or similar. Moreover, they are used to a hierarchical management style. For this matter, the cultural aspects were also confirmed by the experience of Ebuilders and partly of Betsson. A seminar in cultural diversity and closer communication helped to solve this issue.

All interviewed companies stated that communication between the outsourcer and vendor is done frequently. Despite personal meetings around once a month after the transition phase, Skype interviews, telephone calls and emails are the most used methods of communication. The frequency depends on the project and on the position of the employee. In general, project managers have contact to the outsourcer more often (around once a day), than regular team members (sometimes just once a month). All interviewed
companies stated that communication is very important in order to know how is the other party operating, what progress was made and to clarify details of the work. Moreover, all companies stated that communication is a central point for risk identification, especially after the contract is signed. It should be intensified in order to solve problems in advance; to integrate the vendor’s team and to become more efficient. According to IT Sourcing Europe Ltd. (2010), communication plays a central role in the SOO process and is the main cause of risk factors.

4.3. Overall Perception of the SOO initiative

In general, all three outsourcers stated that their SOO initiative is a success as it allowed them to achieve their goals (Betsson: to find skilled employees; Ebuilders: to get a competitive advantage despite its size; WorldTicket: to develop innovative products and to offer superior customer service). In addition, all of them decided to enlarge their SOO activities (Betsson set up a project team in Indonesia, Ebuilders arranged a flexible second project team in case of heavy workload and WorldTicket outsourced parts of its service facilities to China).

Despite their success, most of them had negative SOO experiences in the past (the local manager of Betsson with SOO in India, the founder of Ebuilders as part of a vendor with Western European companies, WorldTicket with partners in India and Ciklum with outsourcers from Western Europe). Furthermore, they also stated that they have learned from their mistakes and invested more time in the vendor selection, construction of the contract and building up personal relationships with the vendor in the execution phase.
5. Analysis

In this chapter, we compare the theoretical framework adopted with our empirical findings in order to answer the research questions. In the end of the chapter, based on our results, guidelines for SMEs are given which intend to improve their risk identification throughout the SOO lifecycle.

5.1. Analysis of Theory and Empirical Data

In this part, we analyzed the data collected and compare them with the theoretical models. We structured the section in line with the Deloitte model, describing each stage with primary and secondary sources. The purpose is to better understand the behaviour of SMEs during service offshore outsourcing and to identify the main risks involved.

5.1.1. Strategic Assessment

“Well, when it comes to the risk assessment, my one is usually done on the back side of the napkin during the lunch time.” Joris Barendregt, Ebuilders about risk assessment in O/O

The main idea of strategic assessment is to bring the strategy of companies and O/O procedures into coherence with existing goals and future aspirations (Fersht et al, 2009). It includes the identification of functions that can be handed over to a third party without harmful effects on the rest of a company’s activities.

For SMEs, theory defines the possible risks in this phase. SMEs often do not possess long term strategic plans and use SOO as a short term measure for issues triggered by competitive environment. Such an approach neglects the importance of thorough risk assessment and does not allow companies to have all the long term benefits of the O/O processes (IT Sourcing Europe Ltd., 2010). Our research supports these assumptions. The advantage of SMEs lays in the fact that due to their size (small) the involvement of the founder/owner in this decision is relatively common and done in the interest of the SME. Three SMEs that are actively engaged in IT offshore outsourcing admitted the lack of strategic planning or thinking. This is as a result of the absence of clearly defined long term plans and inadequate resources to create these strategic plans.
Short term thinking is partly connected with the necessity to be flexible and dynamic rather than being long term oriented and averse to risks. This gives significant advantages to SMEs when competing with other market players in the particular segment.

Referring to the data collected from interviews with Ebuilders, decision making is a responsibility fully placed in the hands of its owner, Joris Barendregt. He also recognized the lack of strategic thinking but strongly highlighted the importance for his organization to be dynamic and close to the market. Concerning the description of strategic thinking in literature, Ebuilders rely on short term goals and does not have any written or formal guidelines on how the company is supposed to look and where to be in more than five years. The existing course of actions mostly occurs in the head of the owner and is not accessible to company members. Similar situation is reflected in the cases of Betsson and Worldticket. The interviewees collaborated that decisions regarding outsourcing were made by one (maximum of two) people involved in top management.

According to Intelligence Report on IT Outsourcing, the main factor that affect outsourcing decisions is cost reduction (IT Sourcing Europe Ltd., 2010). However, the companies we interviewed identified the lack of accessible highly qualified specialists in the IT industry as main driving force behind outsourcing decisions. These companies thus consider it an opportunity to broaden their specialist pool and access high quality service by working in Ukraine.

The common feature of the companies interviewed is that they all perceive IT and IT outsourcing as one of the central elements necessary to support their main businesses. In such cases, although IT function does not refer directly to the core competences of the organizations, the quality of outsourced IT products is highly connected with the main business of the company. This requires highly skilled labour as loss of quality at the early stages of outsourcing leads to inevitable loss in the quality of the end product. Understanding this helps to recognize the importance of outsourced activity and contribute efforts and resources in order to mitigate undesirable consequences.

Despite the common characteristics of strategic thinking for SMEs, every company has its own assessment of possible alternatives and reasons for implementing an approach. Our research supports the theoretical assumptions that SMEs emphasize personal relations and neglects developing strategies. This reliance on personal relations with vendors is well known and supported in many studies. For example, the European IT Outsourcing Intelligence Report stated that “the major challenge related to IT outsourcing is the lack of proper communication between the client and vendor” (IT Sourcing Europe Ltd., 2010, p. 10).

There may be other problems in IT O/O as IT is part of the service sector. This may cause additional difficulties, and highlights even more the necessity of risk assessment where service specific characteristics (which describe IT as intangible and heterogeneous-
uous) are considered. These characteristics in intercultural context become even more visible and need to be approached differently. Without adequate resources (to turn to consulting companies or other external parties), SMEs follow the vision of an owner/manager and rely heavily on personal experience rather than on professional assessment of the different criteria and possible risks (Seth, 2008).

In conclusion, the strategic assessment of the Deloitte model requires SMEs to have different approaches from other big companies. Among the main features to consider are absence of well-defined strategy and lack of resources. Due to these characteristics, (mostly) SMEs tend to be flexible and dynamic. This also illustrates the absence of long term contracts with vendors and O/O activities are often shared between the few parties involved (Mag, 2010).

All of the SMEs interviewed had the same strategy and tend to find other ways to secure strategic assessment in O/O. Another course of actions used by SMEs is “gaining experience through trial and error” (Hahn et al, 2009, p. 601). This allows the companies to develop the so called “economy of experience” to explore more alternatives to meet challenges (Hahn et al, 2009).

5.1.2. Business Case Development

This stage is described as one where companies identify what to, why to relocate and where to find a business partner (Deloitte, 2008). In our research, the services relocated are related with IT and directly affect core competence of the organizations interviewed.

Betsson based the decision to outsource on personal experiences and network of the project manager. However, after years of close interaction and outsourcing, it recognizes effect of the emphasis on improving cultural integration with the vending team. According to Owe Laestadius, “It was important for Betsson to export the company’s culture and outsourced other departments”. The close cooperation with the vendor prevents Betsson from a lot of possible misunderstandings.

Ebuilders implemented a similar approach. With over nine years of experience in the O/O sector, the company relies heavily on experience of its founder in decision making. The owner had previous interactions with the Ukrainian business sector and developed significant network of contacts. Contrary to Betsson’s approach, Ebuilders first chose the company (Ciklum) to relocating their IT activities to Ukraine. They emphasise the need for communication this relations; for it enabled the company to avoid difficulties in personal relations and established common goals.

WorldTicket entered the Ukrainian SOO market in order to ensure innovative products and high quality service. Having had bad experiences with previous vendors, it put ef-
fort in the business case development stage. However, it limited its geographical scale to Eastern Europe and China.

Theory mentions two types of risks in this stage; endogenous and exogenous. While the first one is directly connected with the nature of the company itself, exogenous risks do not lie in the influence area of the company and require a lot of additional.

The Wolff model (Figure 5) classified exogenous risks into political, cultural and economic risks each of which must be assessed with regard to the destination of favourable alternative locations. From surveys and reports and statistical data, majority of SMEs pay attention to the choice of a country and lower costs; relegating cultural profiles and political stability to the background (IT Sourcing Europe Ltd., 2010). Available theory supports the importance of this ‘choice’ and its high impact on the whole outsourcing process; “in undertaking IT offshoring, firms must make many decisions; however, the determination of the appropriate country in which to offshore has especially critical ramifications” (Hahn et al, 2009, p. 598). Deliberate risk assessment of potential countries may prevent future difficulties connected with significant cultural differences, government pressure and insufficient legal system (Hahn et al 2009).

All the companies we interviewed had different approach to the choice of a country. None of them confirmed the use of a particular model or other tools in their decisions in favour of Ukraine. All of them (three outsourcing companies) were guided by recommendations or personal experience. In our opinion, the common mistake was the false assumption and confidence that because of their size, they do not experience exogenous risks on a full scale. During the interviews, we asked managers to reflect back and describe what they mainly consider as exogenous risks. Cultural risks were identified as the most problematic, although statistical data shows these risks to be easily avoidable if vendors are located within three time zones (IT Sourcing Europe Ltd., 2010).

They identified good infrastructure, accessibility, highly skilled and educated workforce and flexibility in production as the main criteria for countries “to be on the list” of favourable destinations. Low cost, contrary to various reports (IT Sourcing Europe Ltd., 2010; Maznyuk and Sergiychuk, 2010) was considered among the least important criteria.

5.1.3. Vendor Selection

Vendor selection is the third stage in the Deloitte O/O lifecycle the theory. Our empirical finding showed some similarities as well as differences. As expected, most of the SMEs interviewed did not fully evaluate potential vendors due to limited resources.
Interviews were conducted through the internet except in one company that had in-depth market knowledge and more experience with SOO processes; where it was handed over to a third party.

Reliance on limited internal resources usually leads to lesser alternatives but faster decision-making as a result of a smaller amount of data. In all the cases, the founders (Ebuilders and WorldTicket) or top management (Betsson) were actively involved in the selection of vendors. The advantage in this is that decisions are made in the best interest of the company (to maximise their capital). Top managers and founders are usually the most experienced and entrepreneurial persons and their decisions are respected by other employees (Johnson, 2010).

In cases of individual risks, most of the companies already had experience in SOO (WorldTicket) as well as personal relationships with managers of the vendor (Betsson, Ebuilders and WorldTicket). This is a major advantage for SMEs in vendor selection. Personal relationships between decision makers of both parties dramatically reduce the risk of adverse selection and other endogenous risks. By including a social constraint, the potential vendor also has a personal motive to act in the best interest of the outsourcer to sustain the good personal relationship (Rustichini and Siconolfi, 2004). Ciciklum stated that about 50 per cent of its new customers initiate their first contact due to recommendations or through personal contacts.

From the companies interviewed (Betsson and WorldTicket) it showed that wrong vendor selection without building personal relations drastically impacts the benefits of the SOO activity. In Betsson’s case, a large Indian company performed the SOO tasks. Due to lack of capacity coupled with cultural and communication problems, the SOO initiative did not yield the expected benefits and was terminated before the contract even expired. In case of WorldTicket, the vendor could not keep its promised quality and costs. This would have been visible if proper information was available at the time of vendor selection or if a social constraint was added to offer insights into vending organisation.

Close personal relations with vendors does invalidate risk identification in the vendor selection stage it only helps to identify and evaluate companies with limited resources (a main constraints for SMEs). It also allows access to internal data of business parties leading to better assessment of the needs of the outsourcer and the capabilities of the vendor. The disadvantage of personal relations to the vendor is that an outsourcer may just be focussing on one potential vendor in the selection process. However, the interviews showed that all the three outsourcers considered and evaluated the capabilities and offers of other service suppliers despite their limited resources. This increases the bargaining power and helps to choose the most suitable vendor.

As stated by Mag, all the SMEs interviewed mentioned that they prefer to have business partners of about the same size and of the own organization (Mag, 2010). With similar
structures (for example the influence of the founder, experience of the management and number of customers) they can easily simplify SOO processes leading to equal bargaining power in the contracting phase.

The selection processes of the companies were different. Some of them inspected the local facilities and other waited for the vendor to come to them.

Personal impression of the management plays an important role too. For outsourcers who rely on the vendor for several years the company’s culture, reliability of management and close communication between business partners are significant aspects. Due to none existing documents such as code of conduct, strategic long-term planning and corporate social responsibility guidelines personal meeting of both management is often a good opportunity to find out to what extend the potential business relation is possible. In this case, SMEs have an advantage because in such negotiations the leaders who also set the strategy and culture are involved and can distinguish suitable business partners.

None of the companies interviewed approved the necessity to put attention to quality certifications requested by Meijer (Meijer, 2009). The reasons for this may lie in the fact that the certifications are not known by the outsourcer, they have little significance in assuring good quality, they are not common for vendors in Ukraine, or they do not reflect the specific needs of the customers.

This is an interesting field of research and should be investigated further. Most companies pay attention to references of the vendor. With well-known satisfied customers, vendors are more credible. A lot of companies give brief overview of references on their homepage, annual reports and press messages. WorldTicket require vendors to provide a list of customers through whom further information could be obtained.

The companies also stated that it was essential to plan enough time for the vendor selection process as this may take a long time (Meijer, 2009). A rush to this limits the choices and exposes the outsourcer to unfavourable conditions during the contract negotiations stage. This is confirmed by Deloitte; who report that about 35 per cent of the companies interviewed in a survey regretted not investing more time in the vendor selection process (Deloitte, 2008).

In conclusion, there are lots of factors that are important to consider in the vendor selection processes in SOO of SMEs. Existing personal relations with the vendor is a huge advantage for SMEs in the selection process in order to avoid adverse selection and endogenous risks. Again, the involvement of business leaders in the vendor selection helps to separate suitable and appropriate candidates, and to find out the best possible outcome for the company’s interest. Besides the capabilities of the vendor, other characteristics such as company culture, size and the quality of management must be considered in selecting appropriate partners.
5.1.4. Contracting

After one or more appropriate vendors are selected for the SOO initiative, direct negotiations start. Due to the need for increased flexibility, SMEs may have disadvantages in this stage (Vachani, 2003). Two of the outsourcers interviewed (Betsson and WorldTicket) reported down-prioritising in their contracts already in the contract phase. This could be seen in inflexible treatment, long waiting times between the different meetings and ready to be signed contracts exclusively designed by the vendor. Down-prioritisation by the vendor can result in severe problems in business relations. In our cases, the affected outsourcers did not continue the negotiations with such companies and looked for those that were more similar to them.

The specific characteristics of SMEs to be dynamic, flexible and to be more dependent on customers’ needs also increase the necessity for a dynamic and flexible SOO contract. The development projects of WorldTicket for example require specialists from different fields, mostly just for a short time. According to the theory, large organizations often have much more structured SOO processes in which all kind of specialists work full-time and therefore, they do not have to restructure their project teams all the time or to involve further outsiders. Terms like flexibility and dynamism are hard to include in the agreement with the vendor, especially when it comes to description of tasks and requirements of personnel. This often leads to a less specified SOO contract which increases flexibility for the outsourcer but also allows interpretation or lack of clear requirements for the vendor. This can be seen at Ebuilders which needs a flexible project team due to its small size and included in the agreement the term “above market average” for how to measure quality. Especially in services, quality cannot be measured easily and can lead to different assumptions on what is market average and what not by the outsourcer and vendor. Nevertheless, by not fixing the tasks, processes and routines, the contract is valid for a broader spectrum.

Another drawback of SMEs is high costs as a result of several characteristics. First of all, the contracts are designed more flexible which increases the number of specialists needed to fulfil the different tasks and projects. Secondly, SMEs usually have high chances to become insolvent as they can lack in funds and are often not backed by banks, investors and state run institutions in economic terms. Thirdly, due to their small size of SOO activities but at the same time their need for a highly qualified workforce results in disadvantages in economies of scale. Fourthly, because of their small contractual size SMEs often have only a limited bargaining power, especially when it comes to negotiations with large vendors. Finally, independently of the contract size, efforts in the pre-execution stages (strategic assessment, business case development, vendor selection and contracting) are often significant. (Lacoma, 2010) By adding these costs to
the contract which is comparatively small, the proportional pre-execution costs for SMEs are high.

The theory argues that due to the small monetary size of the SOO contract it is often not possible for SMEs to split up their O/O activities into several projects with different vendors to decrease the risk impact of non-performance of one or several business partners (Bahli and Rivard, 2003). The results of our interviews however disproved this statement. All outsourcers had at least two different project teams and some of them even diversified the risk of O/O to different countries. Betsson is active in Ukraine and Indonesia and WorldTicket has vendors in Ukraine and China. To have different project teams, ideally by different vendors increases the negotiation power, especially during renegotiations and contract extensions. It shows that the company is less dependent on only one supplier and often motivates the vendor to put more emphasis on this relationship in order to retain it. Even though it might lead to higher (initial) costs due to smaller contract size, higher expenses in the pre-execution stage and additional monitoring expenses the benefits of increased motivation of the vendor, risk portfolio management, the ability to benchmark the business partners, the opportunity to have access to a larger pool of resources and an improved bargaining power for renegotiations and contract extensions might lead to higher benefits. (Zatolyuk and Allgood, 2004)

An advantage for SMEs is usually the faster progress during the direct negotiations in case when the companies have fair conditions and are not down prioritized. Betsson, Ebuilders and WorldTicket needed from one week to two months to strike the deal. The vendors interviewed stated that it usually takes more time to design the contract and to negotiate the details. In extreme cases, the contracting can take up to one year.

Another plus for SMEs is close contact to the vendor, especially within already existing personal relationships as mentioned by some interviewed companies (Ebuilders, WorldTicket and Ciklum). This can simplify the contracting phase. However, private arguments and disputes (by removing the social constraint) can then also have a negative impact on the contractual relations between outsourcer and vendor, so at least the key agreements should be noted down. Already existing positive personal relations between the business partners usually have a positive impact on finding a mutually rewarding contract (Dus et al, 2009).

The outsourcers interviewed by us were all in charge of designing the SOO contract. Betsson did this individually but Ebuilders and WorldTicket included external legal support and experience. They hired a lawyer specialised in O/O processes who took care of the judicial validity of the agreement. To design the agreement as a SME offers opportunities but also entails risks. Advantages in this case are that the outsourcer is able to describe the desired tasks, the involved specialists, the method of measuring success and failure, the protection of intellectual property, the inclusion of a termination clause.
in case of bad- or non-performance and other details. Disadvantages occur if the knowledge of the outsourcer is not sufficient and results in a legally not binding agreement due to, for example, judicial differences between the counties of outsourcer and vendor, or clauses that lead to an invalidity of the contract. Even though designing the SOO contract is usually more cost intensive it often pays off by giving the company a possibility to reach a better position in the transition and execution stage. (Meijer, 2009)

Leaving the creation of the agreement to the vendor usually leads to contracts that favour the rights of the vendor. Such contracts are often standardized and do not include the specific needs of the outsourcer, proper quality measurements or a termination clause.

In general, a contract should be a mutually rewarding agreement (Zechnich and Lee, 2009). Good long-term relationships are created if both parties benefit from the corporate deal. Outsourcers who managed to bargain a contract to their advantage were at the end worse off because they gave the vendor no other option than to try to get their deficit back in other ways (mostly by impedance hidden costs). (Deloitte, 2008)

In the case of SMEs which are dependent on third parties even in their SOO processes which have access to internal data increases their vulnerability to be victims of insider threats (Colwill, 2009). This enlarges the need for intellectual property protection clauses in the contract to increase the hurdles for data misuse. All outsourcers interviewed stated that protection of their intellectual property was an important aspect. This is also confirmed by Dus, Nassimbeni and Sartor who analysed the impact of information security problems in SOO and stated that the contract is “one of the most important protection tools” against opportunistic behaviour, especially for intellectual property rights security (Dus et al, 2009). By not having included these aspects in the contract sufficiently, companies risk to lose some of their main advantages in the service industry which might result in huge problems (Ghelfi, 2005). Nowadays, most of the companies are aware of these risks and even the questioned vendors stated that in case they are designing contracts, the intellectual property rights of the outsourcer are protected. This also shows professionalism and good intention to keep a long-term relationship with the client. However, IT Sourcing Europe Ltd. states that in about five percent of the cases in their study reported issues in intellectual property right protection. (IT Sourcing Europe Ltd., 2010). Due to the size and the limited resources of SMEs they often have limitations in contracting stage as they do not employ lawyers or involve a third party for these issues. Nevertheless, the issue of intellectual property is widely known and considered by most of the companies.

To conclude, SMEs have noticeable difficulties in the contraction stage. They have decreased bargaining power, higher costs, less experience and increased need for flexibility of the project team. The use of personal relations and involvement of a third party can help to overcome some problems and minimize risks. It would be advantageous for
outsourcing SMEs to be in charge of designing the contract to split the risk between one or more vendors and to put emphasis on personal relations in this phase.

5.1.5 Service Transition, Delivery and Post-Transition

The interviews show, that to ensure a good transition of knowledge and information to the vendor, several methods can be used. All three outsourcers questioned managed to transfer their activities within a short period of time. Betsson educated the new team at their headquarters which gave them insight into company culture, working processes and desired results. Moreover, a local manager was sent to the outsourcing location permanently in order to supervise vendor’s team. To have a competent person that has extensive experience of the outsourcing company can be helpful for the project team, especially during the transition phase. This helps to identify risks quickly and to find appropriate solutions to them, usually faster, than in business relationships that only communicate through long distances. The solution of Betsson is only cost efficient in large outsourced projects. Their vendor’s project team in Ukraine consists of about 30 employees and justifies the additional expenses for permanently sending an expatriate. For Ebuilders, such a solution was not taken into consideration because of their small SOO contract which currently employs six people and another six ones on a flexible basis. Their service transition consisted of educating the vendor’s employees in Ukraine by the founder of Ebuilders in task and culture specific topics. Methods and ideas were spread and knowledge developed during time. Especially during the transition phase Ebuilders faced its most critical stage. It had to deliver extraordinary results for its first clients to convince them of their capabilities and to establish long-term relations. In case of non- or underperformance it could have brought serious consequences for the company and would also have resulted in a bad reputation which could have led to bankruptcy. To minimize these risks, during the transition phase, only easy accomplishable business deals were accepted by Ebuilders. “The complexity of tasks grew with our capabilities” stated Joris Barendregt. This view is shared by several authors who state that the vendor often needs time to be able to fulfil the same tasks that were previously done in-house. (Aundhe/Mathew, 2009) To ensure a successful transition phase, WorldTicket trained the outsourced project team. A manager went to Ukraine for three weeks and acted as connector between outsourcer and vendor. Also the interviewed suppliers state that after signing the contract, the transition phase is the most critical one. It provides the basis for the business relationship and often it can be already seen if the whole SOO initiative will be successful or not. Lewin et al (2010) found out in a survey that 21 percent of the SOO contracts are terminated as a result of “poor work transfer” (Lewin et al, 2010, p. 13). Therefore, both parties should put effort into this stage.
As was already mentioned regarding other stages, communication between the business partners is essential. The data collected shows that the business partners are permanently in contact with each other. Nevertheless, IT Sourcing Europe Ltd. states that twelve percent of the companies questioned stated that they have communication problems within their business relationship which leads to lots of other problems and risks (IT Sourcing Europe Ltd., 2010). Although the companies interviewed by us were communicating frequently, all of them regarded this issue as an area with need for improvement. The main issues in communication in SOO are the geographical distance between the business partners, different company cultures and management structures. Betsson for example stated that due to the geographical separation, employees of the vendor are excluded from informal meetings (for example in coffee, or lunch breaks). Ebuilders answered that cultural differences also affect the process. As for example it is not common in Ukraine to be able to report personal weaknesses and to accept negative feedback. WorldTicket identified differences in the management style between Danish and Ukrainian companies which led to organizational issues because Ukrainian employees did hardly accept instructions given by people below their hierarchical level which is usually not a problem in Denmark.

Communication is also an important tool to establish personal relationships. This can be an advantage in the execution phase between SMEs. Implementing a social constraint and intimate interaction between the business partners can develop into a successful tool for risk identification and problem management. Even by starting a business relationship without former private connection, SMEs tend to connect with each other during the execution period. Strong dependency on good results and a specific company culture are some of the main drivers. Dus et al (2009) confirm the building of close relationship during the execution stage of the Deloitte lifecycle model. They also state that this is the most important tool to a better and mutual rewarding business relationship. After some time a strong connection between outsourcer and vendor can get priority over a contractual relationship. It can even help to correct mistakes made in the contracting phase. Betsson for example tries to strengthen the ties to its vendors in inviting their project teams at least once a year to a special event together with the own workforce (in 2010 they went to a three day poker tournament to Las Vegas). Those events should support the personal interaction which is an important aspect of their risk management. The distribution of output of the vendor seems not to be an issue of any SME questioned. The suppliers of Betsson and Ebuilders do not have direct customer contact. This reduces the risk of forward value chain integration of the vendor on the expenses of the outsourcer. Moreover, it provides a layer for quality checks by the outsourcer before the outcomes are handed further to its customers. This is only possible due to the partial storability of IT services. WorldTicket which vendor has direct customer contact got extensive rules and guidelines for the handling of clients and the expectations of
WorldTicket. Codification of work processes helps the vendor to become more efficient and to know how to do the tasks and WorldTicket has the advantage of being able to measure and evaluate the outcomes easily. Less complexity of outsourced tasks, the ability to check the outcome and main focus on business-to-business relations reduce the risk of distribution of output for SMEs.

Another significant process for risk identification during the execution phase is controlling and monitoring. All interviewed companies have their methods to observe and evaluate the progress and the quality of the vendor’s work. This helps to detect risks and problems in the SOO activity when they still can be solved. We found out that, controlling is needed in order to be able to evaluate complex projects and to ensure that the vendor acts as agreed upon. In SMEs permanent and intensive communication including feedback and less complexity in outsourced activities usually simplify the monitoring process. Moreover, good personal relations are often an advantage to keep the vendor on track. Nevertheless, mutual trust should not completely eliminate formal controlling processes according to the well-known statement of Lenin “Trust is good, but control is better” (Mayer and Steingart, 2009, p. 3). Anderson states that due to limited resources, SMEs are more exposed to frauds, especially in times of booming business (Anderson, 2010). In such situations companies are busy with fulfilling orders and they often do not pay extra attention to monitoring the vendor. This often leads to negative consequences as during booms SMEs are more dependent on proper work of the vendor than ever to satisfy the strong demand. The interviewed companies confirmed these problems but also stated that during boom times at least the formal monitoring processes are done regularly. Betsson has the advantage of an own local manager, Ebuilders keeps up its three layer controlling system and WorldTicket evaluates vendors performance due to its formal assessment.

In case of bad- or non-performance of the vendor, the outsourcer should act immediately to find out the reasons for this behaviour and to be able to prevent disadvantages as soon as possible. Possible solutions would be to cooperate with the vendor to find a solution, to renegotiate the SOO agreement or to finish the relationship. Two of three outsourcers interviewed (Betsson and WorldTicket) had pre-negotiated termination clauses in case of bad- or non-performance of the vendor. More than one third of all SOO contracts are terminated before expiring because of a lack in quality. Another 30 percent end due to not sufficient skills and resources of the vendor (Lewin et al, 2010). In case of splitting up, it has to be ensured that the vendor will handle the transferred knowledge confidential and will not misuse it (Deloitte, 2008, p. 10). Contractual clauses usually prevent opportunistic behaviour by the vendor after contract expiration and sometimes it is possible for the outsourcer to take over their project team of the vendor for a pre-negotiated price (as for example at Betsson).
To recap, SMEs can often compensate lack in formal risk identification and risk management in the execution phase through superior communication and personal relationships with the vendor. Nevertheless, if problems occur, they usually have more impact on SMEs as a result of need for superior quality, low bargaining power with customers, higher dependency on vendors and need for flexibility. The aim of the execution stage should be to establish a good relationship with the vendor with clear expectations and feedback in order to reduce risks.

### 5.2. Study Results

After presenting the theoretical model in Chapter 2, summarizing our empirical findings in Chapter 4 and analysing both of them in Chapter 5, we are now able to answer the research questions. Table 6 shows the characteristics of SMEs influencing the SOO process. As a reference, we use the Deloitte O/O lifecycle model. The effect of the specific characters in the different stages can be an advantage or a disadvantage for SMEs.

As it can be seen in Table 6, base on specific SMEs characteristics as well as the Deloitte model, the small size is a drawback in the strategic assessment and vendor selection stages. This can be explained by the fact that divisions and departments of SMEs are interlinked with each other what makes it hard to find out the right tasks for SOO. This was also confirmed by Betsson which reported a drop in productivity of other departments after its IT development was outsourced. The disadvantage in the contracting stage is caused by the down-prioritising as a result of a small size in the SOO contract and higher costs experienced by Ebuilders and WorldTicket. An advantage of small size can be seen in the transition and execution stage, due to faster knowledge transfer and less complex projects.

Limited resources of SMEs usually lead to disadvantages in all five stages. In the first three stages (strategic assessment, business case development and vendor selection) it might result in decreased alternatives, in the contracting phase to a suboptimal contract and in the execution stage, to issues in controlling, efficiency and cultural complications. This is the reason why most SMEs develop their own methods and processes to be able to use their resources as efficient as possible.

A lack in back-up will cause disadvantages in case of bad- or non-performance of the vendor which may then affect the outsourcer-client relations, as happened to WorldTicket in the past. Therefore it can be seen as weakness in the execution stage.

SME face disadvantages as a result of their strong dependency from customers in the contracting and executional stages. Mostly customer dependency leads to a requirement of a more flexibility of the SOO contract to adapt the outsourced tasks to the needs of
the customer as in Ebuilders and WorldTicket. The outcomes are higher costs for more flexibility and potential problems in the transition and execution stage.

### Table 6: Characteristics of SMEs and their influence on the SOO process

<table>
<thead>
<tr>
<th>Characteristic of SMEs</th>
<th>Influence in stage of the SOO process</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small size</td>
<td>Business case development (disadvantage)</td>
</tr>
<tr>
<td></td>
<td>Contracting (disadvantage)</td>
</tr>
<tr>
<td></td>
<td>Transition &amp; execution (advantage)</td>
</tr>
<tr>
<td>Limited resources</td>
<td>All five stages (disadvantage)</td>
</tr>
<tr>
<td>Lack of back-up systems</td>
<td>Transition &amp; execution (disadvantage)</td>
</tr>
<tr>
<td>Strong dependence from customers</td>
<td>Contracting (disadvantage)</td>
</tr>
<tr>
<td></td>
<td>Transition &amp; execution (disadvantage)</td>
</tr>
<tr>
<td>Need for flexibility</td>
<td>All five stages (disadvantage)</td>
</tr>
<tr>
<td>Closeness to the market</td>
<td>Strategic assessment (advantage)</td>
</tr>
<tr>
<td></td>
<td>Business case development (advantage)</td>
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<tr>
<td>Entrepreneurial style of management</td>
<td>Strategic assessment (advantage)</td>
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<td></td>
<td>Business case development (advantage)</td>
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<tr>
<td></td>
<td>Contracting (disadvantage)</td>
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<tr>
<td></td>
<td>Transition &amp; execution (disadvantage)</td>
</tr>
<tr>
<td>Main focus on differentiation &amp; quality</td>
<td>Strategic assessment (advantage)</td>
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<tr>
<td></td>
<td>Business case development (advantage)</td>
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<tr>
<td></td>
<td>Vendor selection (advantage)</td>
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<tr>
<td></td>
<td>Transition &amp; execution (disadvantage)</td>
</tr>
<tr>
<td>Lack in strategy</td>
<td>Strategic assessment (disadvantage)</td>
</tr>
<tr>
<td></td>
<td>Business case development (disadvantage)</td>
</tr>
<tr>
<td>Strong involvement of owner/founder</td>
<td>All five stages (advantage)</td>
</tr>
<tr>
<td>Independent from public interest</td>
<td>Strategic assessment (advantage)</td>
</tr>
<tr>
<td></td>
<td>Vendor selection (advantage)</td>
</tr>
<tr>
<td>Aim to build personal relationships</td>
<td>Vendor selection (advantage)</td>
</tr>
<tr>
<td></td>
<td>Contracting (advantage)</td>
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<tr>
<td></td>
<td>Transition &amp; execution (advantage)</td>
</tr>
<tr>
<td>Simple internal structures</td>
<td>All five stages (advantage)</td>
</tr>
<tr>
<td>Less bureaucracy</td>
<td>Strategic assessment (disadvantage)</td>
</tr>
<tr>
<td></td>
<td>Business case development (disadvantage)</td>
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<tr>
<td></td>
<td>Vendor selection (advantage)</td>
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<td></td>
<td>Contracting (advantage)</td>
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<td></td>
<td>Transition &amp; execution (advantage)</td>
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<tr>
<td>Focus on social &amp; cultural dimension</td>
<td>Strategic assessment (disadvantage)</td>
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<td></td>
<td>Business case development (disadvantage)</td>
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<td></td>
<td>Vendor selection (advantage)</td>
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<td></td>
<td>Transition &amp; execution (advantage)</td>
</tr>
<tr>
<td>Lack of knowledge &amp; experience</td>
<td>All five stages (disadvantage)</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.

Closeness to the market of SMEs, due to their specialisation brings advantages to them in strategic assessment and business case development. Extensive market knowledge helps to find the right activities to outsource to the right locations. Betsson and Ebuild-
ers realized quite easily possibilities for SOO and potential locations in which specialists can maintain good service quality.

An entrepreneurial management style can help to widen the horizons and to find suitable, but uncommon alternatives in strategic assessment and business case development of the O/O lifecycle model. By outsourcing its whole production functions right from the beginning and achieving good service and low costs, Ebuilders was able to attract well-known customers such as Nike, KLM and so on. Disadvantages of entrepreneurial management can appear in the contracting and execution stage, where consistence and reliability speed up the learning curve and can lead to better results.

To be able to survive, SMEs often have a differentiation strategy with focus on customer needs and quality. This is an advantage in the pre-contractual stages because it simplifies the evaluation processes as far as the strategy is known. WorldTicket for example, focused its pre-contractual stages on alternatives that promised superior quality and put less attention on cost savings. This reduced the alternatives already in the early stages and simplified the decision-making process. A disadvantage of SMEs quality focus can appear in the transition and execution stage, where the bad quality of the vendor can have a much higher impact on the results and business negotiations. Especially for SMEs in the service sector, the words of Huddle “It takes years to win a customer and only seconds to lose one” are even more important (Huddle, 2011, p. 2).

The lack of strategy in SMEs as a result of market and customer dependency can be a disadvantage in the strategic assessment and business case development. By not knowing core competencies and priorities, or the internal profitability of division and not having a long term planning, wrong decisions can be made in these stages which would have negative consequences for the whole SOO process. This was observed at 39 percent of the interviewed companies in the Deloitte survey. (Deloitte, 2008) This can be compensated by a strong involvement of the founder or owner who obviously tries to decide in the best interest of the company. His or her visions often work as substitution of written strategic documents. At Ebuilders Mr. Barendregt decided to outsource the IT production unit successfully without paying attention to the guidelines and internal documents. Moreover, the influence of the founder/owner also has positive impact on the remaining stages of the O/O lifecycle from the fact to make decision in the best interest of the SME. In other organizational types, with more influence of stakeholders and management decisions may not always be a gain for the company.

An advantage in the strategic assessment and the vendor selection process of SME is their independence from the public interest. In cases of large organizations that announce to outsource parts of their services abroad and have to dismiss workforce in their home countries, stakeholders and especially the media can become an obstacle. SMEs with less stakeholders and public attention are able to focus on their own interests.
which could lead to better results. All interviewed companies absolved the pre-contractual stage without external interference.

One of the biggest advantages of SMEs is their intend to focus on personal relations. This can offset many risks, especially during vendor selection, contracting and execution. Personal relations help to choose a competent and reliable vendor, to create a mutual rewarding contract and to ensure cooperation in the transition and execution phase. By installing a social constraint, the vendor will more likely act in the interest of the outsourcer in order to create value for both of them. Therefore, more than half of the SMEs are contracting vendors based on personal relations, or recommendations.

Simple internal structures can be a plus in all stages. It leads to faster and better decisions. This also shows the result of the questioned companies who all were faster than average in the different phases of the O/O lifecycle.

Minimal bureaucracy which is common in SMEs has a shared outcome for the SOO activities. In the strategic assessment and business case development, it can be a disadvantage due to a lack of grounded analysis of “what and where” to outsource. On the other stages, less bureaucracy however has advantages due to faster decision-making, the possibility to find beneficial, but uncommon ways and to a more flexible execution phase. WorldTicket for example, adapted some processes of the vendor which led to higher efficiency in their own customer service center.

SMEs usually have a stronger focus on social and cultural dimensions. This can lead to problems in strategic assessment and business case development because they often do not reveal the best alternatives in order not to be forced to dismiss a larger number of employees. However, in the contracting and executional stages, it can be an advantage to focus on social and cultural factors in order to increase employee’s motivation. Betsson for example even invites its vendor’s project teams to their own events. This lowered the turnover rate of the project members thus attracting highly qualified workers.

The last point of the influence of SMEs characteristics in the SOO process is their lack in knowledge and experience. This may have negative consequences in all stages of the Deloitte model. Due to their size, SMEs often do not have specialists for the SOO process, especially when they do SOO for the first time. Lots of them also do not involve third parties, such as lawyers, or SOO specialists due to a lack of (i.e. financial) resources. This can lead to disadvantages up to the failure of the SOO activity and is one of the most common reasons for premature contract termination. (Lewin et al, 2010)

Our research shows that there are lots of specific characteristics of SMEs that have to be taken into consideration before and during the SOO process. By being aware of them, SMEs could explicitly work on them in order to improve their total outcome of the SOO process. The interviewed companies were aware of most of their characteristics and did
the right steps to ensure a good outcome. Nevertheless, some actions and results could have been improved.

The answer to the second research question, which describes how characteristics of small and medium sized enterprises affect their behavior in risk identification during the service offshore outsourcing lifecycle, is possible after analyzing what differs between these two perspectives. The abovementioned characteristics of SMEs have their influence throughout the whole lifecycle of SOO, following the Deloitte model. However, to answer the second research question, we will concentrate on the SMEs’ features which have the main influence in each stage.

To start with, on the first stage, where strategic assessment is performed, it is important for SMEs to consider the following characteristics and to be aware of how they can affect the outsourcing lifecycle:

Limited resources both in theory as well as practice, are described as main restrictions for SMEs to perform a good analysis of O/O process and risk identification activity. Restrictions in time, financial assets and human resources result in excluding external parties from the risk evaluation process when dealing with O/O. Often one employee is entrusted with different functions, even if the knowledge and skills of that person are not equally good in all the fields of responsibility. Being characterized as well by strong involvement of the owner/founder (especially when talking about micro and small sized enterprises) the authority and responsibility for taking important decisions is concentrated in the hands of one person, who often does not have specific qualification to perform for example, risk identification process. In this case both literature and practical evidence support one of the consequences limited resources lead on this stage – no possibility to turn to professional help in risk analysis. In addition, both theory and practice recognize the increased necessity of involvement of external representative in SOO.

The findings from both theory and practice regarding the second stage of the Deloitte model – business case development, lead to the highlighting of the following elements:

Lack in the strategy, as was already mentioned before, results in overlooking long term benefits from O/O. Collected data however partly disprove it as many of the companies perform this activity for quite a long time and are planning to practice it further in the future.

Entrepreneurial style of management as another feature of SMEs strongly affecting strategic assessment stage, leads to less risk aversion in terms of outsourcing process. SMEs by nature are more curious and ready to change the routine way of performing tasks and do not spend long time or significant amount of resources in order to support or disprove their actions by exercising risk identification activity.
Size of SMEs is said to be one of the two main criteria on which the division of types of the companies is made. The consequences the small size of the company feature brings to the business case development stage lie in the area of understanding how to relocate and where to do it. Theory states that the best way to get maximum benefits is to outsource activities which are not directly involved in the core business. However, practice of SMEs show that when it comes to the service sector and in particular to the IT industry, companies tend to outsource functions which have a direct effect on the end product offered to the consumer. Moreover, in many cases, the outsourced service is the one offered to consumers. These findings support the importance of performing risk identification activity.

The third stage, which refers to the vendor selection from our point of view, is mostly affected by size of the company, its limited resources and aim to build personal relationships.

The influence of the first criteria is visible when choosing a business partner. Studies as well as empirical findings from our interviews show that SMEs prefer to deal with an outsourcing partner of a similar size with as the client company itself.

Limited resources in turn, can create difficulties in this stage as SMEs do not perform extended research on the vendor company and do not use risk identification in its theoretical understanding. Instead, SMEs use to rely on personal experience and recommendations from other companies, which previously dealt with offshore outsourcing.

The aim to build personal relations is another distinctive feature of SMEs in the process of offshore outsourcing. This leads to some kind of neglecting the risk identification process in this stage and the final decisions are mostly made on personal impressions from the vendor rather than as a result of professional evaluation.

Contracting represents the fourth stage of the Deloitte model. The effects of the following features can be mainly seen on this phase: risk of SMEs to be down prioritized, lack of knowledge and experience of management in writing contracts and limited possibility to create a detailed contract and specify expected results.

The first risk factor connected with down prioritization increases the necessity of performing the risk identification activity. In order for a SME to realize that it is being down prioritized, companies should have market knowledge and analyze the behavior of different vendors in order to develop a contract which secures their position during negotiations and initial contracting process.

Lack of experience and knowledge of management in legal issues, makes it beneficial for SMEs to consider involvement of the third party at least on this stage as differences in countries’ legal systems and lack of juridical education might put SME in a disadvantage in this.
The third factor which strongly affects the risk identification activity is high dependence of SME on a few key customers, the need for flexibility and as a result low possibility to develop extensive detailed contract which increases uncertainty for both parties. Involvement in SOO increases this uncertainty even more as in this case, to suggest sufficient measurement tools or to exactly identify desired outcomes, is even more complicated.

The last stage, SMEs go through when deciding to O/O activities is Service transition, delivery and post-transition stage. On this phase, the most important features to consider are: main focus on differentiation and quality and aim to build personal relationships.

Main focus on differentiation and quality makes it crucial for SMEs to perform the last stage of Deloitte model successfully. Risk identification in this area, is more complex than in pure manufacturing. As mentioned before, already in the contacting phase, this focus on quality on the one hand and specific feature of service industry on the other hand creates more complexities.

The aim to build personal relationships has important effects on risk identification on every stage of the O/O lifecycle. In the service transition phase, this affect is revealed through social constraints which are created as a result of development of personal relationships between two parties. As an outcome, the vendor acts more in the interests of the outsourcer. If problems occur, the vendor has the intention to communicate with the outsourcer in order to find a solution and to preserve a long term relationship instead of hiding it. In such a way, the necessity of professional support in risk identification on this stage is decreasing.

5.3. Guidelines for Small and Medium sized enterprises

This chapter provides the result of our findings of the analytical part and leads to recommendations for SMEs in order to make the O/O process less risky and more beneficial. The chapter is structured following the five stages Deloitte O/O lifecycle and describes specific characteristics of SMEs and service sector, advantages and disadvantages they bring into offshore outsourcing activity and provides companies with recommendations regarding each stage of the process.

5.3.1. Strategic Assessment

Being connected to company’s goals and future vision strategic assessment allows guiding the outsourcing process in the most beneficial direction. However, as mentioned before, SMEs experience a lot of hardships on this stage as do not possess clear well established and deliberate strategy. This also leads to the fact that offshore outsourcing is mostly perceived as a short term solution rather than long term alternative.
Table 7: SMEs characteristics in SOO in the Strategic Assessment stage

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advantage</th>
<th>Disadvantage</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited long term thinking</td>
<td>Solution of short term problems. Support of flexibility and dynamism.</td>
<td>Often long term benefits are overlooked</td>
<td>Outsourcing should start to be seen as a long term strategy</td>
</tr>
<tr>
<td>Companies managed by an owner</td>
<td>Entrepreneurial management style and lower risk aversion.</td>
<td>Often lack of skills in risk management. No long term thinking.</td>
<td>Involve specialists to evaluate owner’s decision.</td>
</tr>
<tr>
<td>Limited resources</td>
<td>Entrepreneurship management style and lower risk aversion.</td>
<td>No involvement of external expert opinion. No possibility to compete on economies of scale and scope.</td>
<td>SMEs should exercise their strengths such as flexibility, dynamism and closeness to the market. Chose focus strategy</td>
</tr>
<tr>
<td>Flat company organization</td>
<td>Free ideas flow. Development of informal relations with vendor team.</td>
<td>No formal organizational guidelines. Excessive reliance on trust.</td>
<td>Create formal guidelines within the organization. Communicate goals to the employees.</td>
</tr>
<tr>
<td>Reliance on personal experience rather than on professional judgment when choosing vendor</td>
<td>Fast choice of country and vendor. Opportunity to establish informal relationships.</td>
<td>Excessive reliance on personal relations. Sometimes not everything is mentioned in the contract.</td>
<td>Personal relations and unwritten contracts should be always supported by written version.</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.

As it can be seen in Table 7, the main characteristics of SMEs which should be considered in this stage are no deliberate strategy, management by an owner and reliance of personal evaluation more that on professional one. These features can be explained by limited resources and necessity for companies to be flexible and to be able to respond fast to the market needs.

5.3.2 Business Case Development

On this stage SMEs experience main difficulties as a result of shallow analysis of vendor’s country profile. However, exogenous risks such as economic, political and cultural are important to consider well in advance before outsourcing process has started. The recommendations showed in Table 8 do not require a significant amount of additional assets from the outsourcing company perspective, can however bring higher efficiency and security of outsourcing process.

Among the main features to follow on the stage of business case development are: division of outsourced activity between few companies and improvement of knowledge re-
garding country profile. The latter should be the main criteria when assessing SOO exogenous risks. As was mentioned before, theory supported with empirical data claim cultural differences to be the most problematic ones in working with vendors abroad.

Table 8: SMEs characteristics in SOO in the Business Case Development stage

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advantage</th>
<th>Disadvantage</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relocation of highly important for core business activities</td>
<td>Access to innovations, highly skilled professionals. Possibility to significantly (40 – 60%) to cut costs.</td>
<td>In case of bad or nonperformance of the vendor, core service of the company can be harmed.</td>
<td>Division of outsourced activity among several companies</td>
</tr>
<tr>
<td>Choice of the country based on availability of skilled workers and low costs</td>
<td>Limitation of potential countries from the beginning. Faster choice of outsourcing location</td>
<td>Economic, political and cultural factors are considered among the last ones.</td>
<td>Better assessment of a country profile. Cultural knowledge is very the most.</td>
</tr>
<tr>
<td>Excessive reliance on the vendor</td>
<td>Development of strong informal connection.</td>
<td>Decreased bargaining power. Threat to be down prioritized</td>
<td>Division of outsourced activities among few parties. Written expression of negotiated deals</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.

5.3.3 Vendor Selection

Our findings show that especially in the vendor selection stage SMEs can have advantages compared to the theory. Their outsourced activities are often less complicated and in case SMEs are choosing a vendor of similar size, structures and characteristics may be alike, too which implies the advantage of creating personal relations between the two business partners in order to minimize risks. Drawbacks in this stage are limited (internal) resources of SMEs which can be offset by the involvement of external specialists. Table 10 shows the most important characteristics of SMEs in the vendor selection stage, their consequences and recommendations based on our findings.

Careful consideration of the characteristics can help SMEs to find a more appropriate vendor and to avoid negative consequences for the execution stage. An objective evaluation scheme, personal relations including recommendations and a reasonable time frame for this phase can help to increase the effectiveness of the vendor selection stage.
Table 9: SMEs characteristics in SOO in the Vendor Selection stage

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advantage</th>
<th>Disadvantage</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vendor search &amp; evaluation: reliance on limited internal resources</td>
<td>Faster decision-making process, cost savings in this stage</td>
<td>Limited alternatives for vendor selection, increased risk of failure</td>
<td>Involve experienced internal &amp; external resources</td>
</tr>
<tr>
<td>Relying on references and personal recommendations</td>
<td>A way to find suitable vendors with minimal effort</td>
<td>More suitable vendors with no former connection could be disregarded</td>
<td>References &amp; personal recommendations are minimizing risks but also choices.</td>
</tr>
<tr>
<td>Involvement of the founder or top-management</td>
<td>Decisions in the best interest of SME &amp; accepted by staff</td>
<td>Sometimes not the most experienced ones in SOO</td>
<td>Also involve experienced staff or help from a third party</td>
</tr>
<tr>
<td>Aim for a close relationship between vendor &amp; outsourcer</td>
<td>Adding a social constraint which can minimize individual risk</td>
<td>Companies do not put enough emphasis on designing a comprehensive contract</td>
<td>Emphasis should be on personal relations but also on creating a formal agreement</td>
</tr>
<tr>
<td>Vendors of similar size to outsourcer preferred</td>
<td>Similar structures &amp; generic strategy, equal bargaining power</td>
<td>More expensive, often less experienced, higher risk of bankruptcy</td>
<td>Vendors of similar size can be beneficial but should not be overestimated</td>
</tr>
<tr>
<td>Including personal impression of vendor’s characteristics &amp; management</td>
<td>Social aspect important, replaces non-existing documents like code of conduct, mission statement...</td>
<td>SMEs are dynamic &amp; flexible, management &amp; strategy can change fast</td>
<td>To find an appropriate vendor, fitting of culture is a factor but more important are its capabilities</td>
</tr>
<tr>
<td>Planning enough time for vendor selection process</td>
<td>Helps to improve quality of vendor selection &amp; decreases risks</td>
<td>Higher costs, delay in start of SOO</td>
<td>Do stage 3 carefully, this can help to avoid additional costs in the following stages</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.

### 5.3.4 Contracting

The companies interviewed in our thesis were successful in their SOO initiative. Table 10 points out the most important characteristics for SMEs to be successful in this phase due to the results of our analysis. In general it can be said that the outsourcer should be in charge of designing the contract and that a third party should be involved to avoid opportunistic behaviour of the vendor and to ensure validity and efficiency of the agreement which leads to decreased potential risks.

The contract should evolve to a legal binding document which both business parties should respect. Nevertheless, there should be options for re-negotiations which can help SMEs to keep the contract in line with their business objectives and clarifies expectations for the vendor. Our findings showed that in the contracting phase a mutual reward-
ing agreement combined with a good relationship minimizes risks in the service transition and delivery stage.

### Table 10: SMEs characteristics in SOO in the Contracting stage

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advantage</th>
<th>Disadvantage</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contracting large vendor with well-known customers</td>
<td>Existing capabilities, experience, low risk for bankruptcy</td>
<td>SMEs often down-prioritized, social constraint hard to establish</td>
<td>Depending on task &amp; complexity, vendors of similar size are often better choices</td>
</tr>
<tr>
<td>Creating a detailed contract with fixed tasks &amp; responsibilities</td>
<td>Reduces the risk of uncertainty, both parties have a clear &amp; common basis</td>
<td>Decreases flexibility &amp; dynamism for outsourcer</td>
<td>For routine tasks, a fixed contract, for other tasks a flexible agreement</td>
</tr>
<tr>
<td>Small size of SOO contract volume</td>
<td>Decreased complexity, focus on quality, improved monitoring process</td>
<td>Higher costs, low bargaining power</td>
<td>SMEs have cost disadvantages, therefore they should focus on qualitative aspects</td>
</tr>
<tr>
<td>Contract different vendors to decrease risk</td>
<td>Increased bargaining power, larger pool of ideas &amp; resources, ability to benchmark vendors</td>
<td>Higher costs, increased administration efforts</td>
<td>A portfolio strategy decreases dependency and risks. However this is not always a good solution</td>
</tr>
<tr>
<td>Relying on personal relationships to create a mutual agreement</td>
<td>Lower risk for disadvantages, faster contracting process</td>
<td>Risk of agreeing on a too simplistic contract which may lead to disadvantages in the execution phase</td>
<td>Personal relationships should be used but the agreement should be written down properly</td>
</tr>
<tr>
<td>Leaving the creation of the contract to the vendor</td>
<td>Usually better knowledge in contract designing</td>
<td>Not considering all needs of the outsourcer, risk of one sided interest</td>
<td>SOO contract should be designed by the outsourcer to reduce risks, a 3rd party can help avoid invalidity</td>
</tr>
<tr>
<td>Intellectual property protection as clause in the SOO contract</td>
<td>Essential in cases of knowledge transfer, clarifies expectations</td>
<td>IP protection not only part of contract but also in the monitoring process</td>
<td>The protection of IP for SMEs is important in case of knowledge transfer</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.

### 5.3.5 Service Transition, Delivery & Post-Transition

The findings of the service transition, delivery and post-transition stage can be found in Table 11. SMEs should consider that it usually takes time for the vendor to move up the learning curve to be able to produce as efficient as in-house. To speed up the process, vendor’s employees can be trained and/or supervised. Close communication between the both business parties and personal relationships are important factors for good risk
identification. Moreover, a proper working monitoring and controlling system should be set up which also gives feedback to the vendor about its performance.

Table 11: Findings of SMEs characteristics in SOO in the Execution stage

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advantage</th>
<th>Disadvantage</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial training of vendor’s employees at outsourcer’s facility</td>
<td>Better understanding of processes &amp; tasks, direct contact with employees of outsourcer, insights in company culture</td>
<td>Costly &amp; resource consuming, often no adequate trainer, sometimes not desired by vendor</td>
<td>If possible, vendor’s employees should be trained. This helps to improve efficiency &amp; can save costs</td>
</tr>
<tr>
<td>Direct supervision of vendor’s project team by a local manager of outsourcer</td>
<td>Good way to detect problems &amp; risks in early stages, can help to increase efficiency</td>
<td>Costly to relocate manager, sometimes not desired by vendor, too much authority at one person</td>
<td>In larger SOO contracts, it can be a pro to have a local manager. Cultural experience is needed</td>
</tr>
<tr>
<td>On-site training of vendor’s project team by the outsourcer</td>
<td>Training can be done according to the needs of the employees, better understanding of work processes for outsourcer</td>
<td>No insights of vendors employees to needs of outsourcer, costly in complex projects</td>
<td>In less complex SOO contracts of larger size on-site training may be most beneficial, cultural sensitivity of trainer needed</td>
</tr>
<tr>
<td>Close communication between the business partners</td>
<td>Helps to detect risks early, increases fine-tuning of processes, fastens the social constraint, decreases drawbacks from geographical separation</td>
<td>Can cause cultural difficulties, resource intensive</td>
<td>Close communication is one of the main advantages of SMEs in SOO &amp; helps to create personal relations. Cultural sensitivity is needed</td>
</tr>
<tr>
<td>Installing methods to reduce insights &amp; power of vendor</td>
<td>Reduces risks of vertical development of vendor, can work as a “quality buffer”</td>
<td>SOO advantages might not be revealed to its full extend, limitations of SOO activity</td>
<td>A balance between risk reduction methods &amp; profitability of SOO initiative has to be found</td>
</tr>
<tr>
<td>Establishment of a controlling &amp; monitoring process</td>
<td>Detects &amp; eliminates risks, increases efficiency, gives feedback</td>
<td>Costly, can harm more if not done in the right way, can cause cultural issues</td>
<td>A monitoring system should be installed according to needs of the outsourcer</td>
</tr>
<tr>
<td>Fast reaction of outsourcer in terms of vendor’s bad- or non-performance</td>
<td>Minimizes negative consequences, helps vendor to improve</td>
<td>In transition phase, it takes time for the vendor to become efficient</td>
<td>Problems should be tackled immediately to show the vendor a way for improvement</td>
</tr>
<tr>
<td>Cancellation of SOO contract in case of vendor’s bad- or non-performance</td>
<td>May lead to a better solution, opens path for other alternatives</td>
<td>Costs for new pre-execution stage, problems could be solved in other ways</td>
<td>Finding out the reasons for bad- or non-performance can lead to a solution, Termination should be done if clear that contract is not beneficial</td>
</tr>
</tbody>
</table>

Source: own illustration based on results of analysis.
In case of problems, a dialogue between outsourcer and vendor often can help to come up with a solution. Also good insights in vendor’s processes and project team employees’ capabilities usually support early risk identification with limited negative consequences. SMEs with their limited resources need to find a balance between tight process control and additional expenses for controlling mechanisms.
6. Conclusion and Implications

The last chapter of our work provides the final overview of the paper, highlights the progress and outcome of our research and explains how the findings can be used both by future researchers and practitioners. As well it gives a broad perspective on limitations experienced by us during the writing process.

6.1. Overall Conclusions

Risk identification is an important part of management decision. The aim of this thesis was to have better understanding of importance of this activity and how it is performed by organizations in theory and in practice. This leads to the summary of the main findings and ending with helpful recommendations for companies and interested for future researchers.

We analyzed risk identification, its importance and main benefits within the SOO of SMEs. The choice of this subject was triggered by several factors. These are the ongoing growth trend of service offshore outsourcing, and lack of available theoretical literature on the subject. To formulate theoretical foundation for SMEs in SOO, further research into existing literature (mainly associated with large organizations) requires specific adjustments.

To be able to structure information to adequately illustrate how risk identification is affected by specific features of SMEs and the nature of the service industry, we formulated two research questions to enable us understand the characteristics of SMEs which strongly affect O/O and to identify how these characteristics influence risk identification during the O/O lifecycle.

After having conducted the research we can state (without any ambiguity) that limited resources, extensive dependence on manager-owner, lack of coherent strategy, strong connection with customers and focus on quality differentiation are the main features of SMEs that affect O/O processes. Other characteristics are mentioned extensively in the body of the work. These are entrepreneurial style of leadership, less bureaucracy and simplified organizational structure. They affect the O/O lifecycle but do not directly relate to risk identification. Consciousness of the connection of these characteristics of SMEs and risk identification would allow companies function more efficiently by directing available resources in most favorable ways.

After these characteristics were identified, we determined their effect. Based on careful investigation of the available literature and the gathered empirical data, we conclude
that each of these characteristics affect the process and on each stage of the lifecycle differently; and with their own unique consequences. We compared theoretical and practical information and discovered that in many cases SMEs substitute professional risk identification with processes that are easily available to them (such as the development of personal relations). Yet, this is justified especially in outsourcing service operations because formal guidance and development of detailed contract is not always possible due to the nature of the service industry, and flexibility competitive advantage.

However, without risk identification, companies interviewed recognized that the activity saves a lot of resources during the O/O process. Their experience with vendors currently and in the past reveals incidents that could be better managed if the companies were prepared in advance.

Therefore, risk identification is not treated as a crucial element by SMEs in offshore outsourcing, neither in literature nor in practice. Many companies do not spend resources to perform thorough evaluation of the country of outsourcing destination, company to be worked with or contracts to be signed. However, analysis of available theory and the companies interviewed, prove that such activity saves time, financial and human resources in more efficient ways than the reliance on just personal experience and informal relationships.

### 6.2. Limitations

Our analysis and findings are based on comparison of theoretical frameworks with empirical data from personal interviews. The results would have been different if another theory was used or different persons were interviewed.

Our sample size (five companies) for the empirical part is sufficient for this thesis. However, larger sample size would increase the validity and reliability of results. We used existing studies of risk identification in the empirical part. This could increase the validity of the primary sources but we could not replace interviews conducted, and also could not place them on the same level as primary sources.

Again, vendors questioned were founded by Danish investors and may partly differ from purely Ukrainian companies. Nevertheless, most Ukrainian IT vendors were set up by foreign direct investment and have Western European or American owners.

In addition there is that of lack of available literature; particularly those designed for risk identification of SMEs in SOO. The models used are based on records and data from large organizations. Specific characteristics of SMEs might have resulted in the
construction of different and unique models. However, we adapted the models to suit SMEs as much as possible.

The results of our findings differ from those of theory in several points. One explanation may be that the characteristics of SMEs differ from the ones used in the theoretical frameworks. Another explanation may be that our sample does not represent the general characteristics of the industry. Further research in this direction is needed.

Finally, interviews were conducted in a limited timeframe with limited resources. Although this was the best under the circumstances, further insights could have been gained without these restrictions.

6.3. Implications

Our findings can be used for several purposes. In this chapter, we highlight the possible use of our paper for both researchers and practitioners. We hope that companies who participated in our research as well as those who did not will find it useful in order to enhance their understanding necessity of appropriate risk identification in offshore outsourcing activities in the service industry.

6.3.1. Implication for Managers

The growth of O/O trend in the service industry, and its strengthening competition on the global market, makes it valuable for the SMEs committing limited resources (between 20 - 50% of all businesses) to be aware of the main threats beforehand. We aimed at providing recommendations on how conduct risk identification and the main factors to consider. Offshore outsourcing activities differ for every company that is why we consider our findings a guide on efficient risk identification rather than a manual.

We hope that SMEs intending to outsource parts of their services see that the decision of what to, where to and how to outsource lies far beyond realm of competence of the owner or manager, and personal judgements. Considering limitation such as restricted resources in SMEs we hope our work fills this gap to make clearer the potential of risks identification for companies so as to save time and resources.
6.3.2. Implication for Theory

Visible lack of theory in our focal area makes us hope that our findings be accepted as contribution to the theoretical world. In analyzing the available literature and empirical data, we noticed what seem to be a contradiction between theory and practice. Majority of literature states that companies deciding to outsource their services think about cost reduction outcomes first and foremost. Meanwhile, empirical data from three European SMEs interviewed show that for IT outsourcing, the main concerns are the availability of speciality and the potential to gain high quality service.

6.3.3. Implications for Further Research

Risk identification in SOO within SMEs is a fruitful ground for future research since the area is not extensively highlighted in the literature. Also, our study has a lot of limitations warranting further investigation.

We analyzed risk identification from client company point of view. However, interviews conducted with two vendor companies in Ukraine showed that they are as well exposed to threats during offshore outsourcing process and often need to conduct their own risk identification activities.

Another area for future research is in choosing different offshore outsourcing model, consequently different classification steps and processes would be realized.

Finally, further investigation could be done within the different organisational types of SMEs (micro- small- and medium-sized enterprises). Results of our analysis show that even in the category of SMEs there are variances as a result of the organizational size (for example in involvement of third parties, or the level of dependence from the vendor). This could result in an even more precise analysis and theory.
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