What is the difference and why is the gap between different companies so large when it comes to the success or failure of offshoring?

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Abstract

While much of the research on outsourcing and offshoring have been done with quantitative studies, where the respondents’ estimate what positive or negative effects measured by selected indicators on the Likert scale, offshoring has on the company (Freel M., 2000). Little attention has been paid to understand the deeper development of the companies’ offshoring in a qualitative study. The aim of this study is to explore the transaction costs’ the companies has by moving to low cost countries (LCC) and how they utilize and develop their resources in form of dynamic capabilities and all this in relationship to the companies’ offshoring performance. We attempt to contribute to literature with a quality research approach, including three interviews from three Swedish small or medium sized companies, offshoring to an LCC. In the study empirical evidence suggests that it is very important what type of product you intend to offshore. Secondly it was found that when offshoring to an LCC, long term planning enhances the performance. Furthermore, the empirical evidence suggests that there is a positive relationship between the offshore unit’s development of dynamic capabilities and performance improvement. We recommend that management from the start acquire knowledge of local culture and the way of doing business and develop capability of handling that knowledge. Corporate management is advised to provide the offshore unit with necessary capabilities so that the offshore unit may be able to develop necessary production capabilities.

**Keywords:** Outsourcing, Offshoring, Low cost countries (LCC), Resource Based Perspective (RBP), Transaction Cost Economics (TCS), Supply Chain Management (SCM), Small to Medium Enterprises (SME).
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1 Introduction

This section will introduce the reader into this study concerning the success or failure of offshoring to low cost countries. It will also take the problem into discussion followed by the presented research questions and the thesis layout.

1.1 Background

Since the beginning of the millennium many companies have offshored their production to low cost countries, for the reason to lower their production costs. For some of these companies, the decision to offshore eventually paid dividends. But for many of them the offshoring was as costly as keeping the production in-house, and for some of them it was even more costly to offshore the production, than it was before. The goal with our research is to find out what was the failing factors for the companies that did not succeed. Some early thoughts may be pointing to that the contracted manufacturer was the wrong one. Maybe the contract manufacturer did not have the right knowledge or, was the offshoring company naive and did not take every aspect in consideration whilst making their decision to offshore. Aspects such as, transport time and cost, storage costs due to the much longer delivery time. There are many factors that could fail and make the decision to offshore to a bad and costly one.

This research is greatly relevant for the subject of offshoring. Due to many costs that are very hard to account for whilst the plan to offshore still is on the “drawing board”, many of the offshoring companies fail in their quest of saving money in the production. A study conducted by Afrandkhalilabad and Rghanian (2012) shows that more than 50% fail within 5 years. This leads us to think that offshoring is not always the answer when it comes to save money in the production. The relevance for the authors is also of importance, since it is likely to think that we could get an occupation in a production company that might have offshoring in mind.

1.2 Problem

A problem today is the hidden costs of offshoring. Many companies actually fall for peer pressure from their surroundings to offshore some or all of their production. It can also be management decisions that some parts of the company’s production should be offshored. These decisions are not always made with the whole picture in mind. These decisions are often only taken on the terms on lower production costs by the economics department, without consulting with engineering and production departments. These hidden costs are something that we are not able to, or have a very hard time to account for. Examples are fluctuating quality, delivery time or communication difficulties.

1.3 Purpose

Our purpose with this thesis is to provide rich empirical data and we mean to do a case study with theoretical interpretation of the interview analysis. It will give the study many incidence angles, which in turn can bring benefits for further
investigation (Kvale & Brinkmann, 2009). The grand theories we analyse the data with is Transaction Cost Economics and Knowledge Based View.

1.4 Definitions
This thesis is about offshoring to low cost countries. Here follows a brief explanation of the terms offshoring and Low Cost Countries. Outsourcing is the term for when a company lets another company manage some processes for the outsourcing company. It is often a smaller process and not one of the company’s core competencies (Jennings, 2002). We adopt Brown and Wilson’s definition of offshoring (2005), “Offshore outsourcing, or offshoring, refers to the procurement of goods or services by a business or organization from an outside foreign supplier, typically to gain the benefits of labour arbitrage” (Brown & Wilson, 2005)

Low Cost Countries (LCC) are countries where production costs are very low, where the offshoring company can make a benefit to offshore their production, in terms of labour cost.

1.5 Thesis layout
The thesis proceeds as follows: first, a literature review over the subject of offshoring and the theoretical framework that will be referred to is presented; in the second part the qualitative research methodology is explained; third, the data from the interviews are presented; fourth, the data is analysed with a theoretical interpretation; fifth, the conclusions and implications, limitations is presented.

2 Literature review
Offshoring has been a hot topic since 1980 when China opened its borders for outside import/export (“Opening to The Outside World”, 2002). So the literature is extensive and will be shortly described and categorised below.

Our literature review consists of articles on the subject. All the articles have a different standpoint whether production offshoring is profitable or not. Today, the most successful offshoring companies see their contract manufacturer as business partners rather than suppliers (Neal, 2007). We will group the articles together considering their standpoint towards offshoring. We will also look into the literature of resource based perspective and transactional cost economics.

Companies offshores their activities or processes for different reasons. Among the most frequently mentioned reasons for offshoring is reduction of costs (Espino-Rodriguez & Padron-Robaina, 2004; Jennings, 2002; Arnold, 2000; Aubert, Patry, & Rivard, 2003; Beinstock & Mentzer, 1999; Bergsman, 1994; Brandes, Lilliecreutz, & Brege, 1997; Fan, 2000; Kriss, 1996; Laarhoven, Berglund, & Peters, 2000; Vining & Globerman, 1999; Willcocks, Fitzgerald, & Feeny, 1995). Cost aspect of offshoring includes various types of costs. Some companies are offshoring in order to achieve better control over costs (Alexander & Young, 1996) and others wanted to change fixed costs (Andersson, 1997). But in recent years companies start to look more and more at sophisticated and soft reasons of offshoring. Thus Scheuing (1999) lists the following groups of reasons for
offshoring and their consequences: organizational, developmental, financial, income, cost and human factors. Brown and Wilson (2005) argue for the elimination of a range of activities including a clarification: acquisition of new skills, access to better management, focusing on strategy, avoiding large investments, to support rapid growth, improve flexibility, improve the financial situation, beginning a new strategic initiatives to improve business performance, reduce costs, acquire credibility and use of offshoring as do other companies.

Neal, H (2007) says that offshoring production operations are the ultimate no-brainer. It can save on manufacturing labour costs and capital equipment costs, and allow more time spent on innovative product designs that lead to new revenue streams. If one avoid focusing solely on potential up-front cost savings, and instead look at offshoring as part of an overall business strategy. Neal, H. (2007) mean that offshoring allow more time to be spent on innovative product designs, and that, that will lead to new revenue streams.

Often mentioned positive effects: focus on core activities, increased productivity and quality, utilization of capacity, creativity, improvement in financial indicators, positive financial impact, cost reduction, access to specialized knowledge, reengineering of processes in the company, new services, increased employee productivity, improved company image (Schniederjans & Zuckweiler, 2004; Hendry, 1995; Zhang & Cao, 2002; Lankford & Parsa, 1999; Franceschini, Galetto, Pignatelli, & Varetto, 2003).

On a theoretical level, offshoring reduces costs, and then the costs of offshoring together with remained costs in the company will be lower than the company itself, performing the same activities or processes (Bers, 1992; Harler, 2000). However, in practice it is very difficult to include all costs for evaluation (Ellram & Maltz, 1995). Beimborn (2006) tries to do this when comparing own production costs and the transaction costs. Own production costs are all costs arising from the internal implementation. However, transaction costs are a function of several types of costs in his model, consisting of costs of adaptation, negotiation costs, costs of coordination (relationship management within TCE) and agency costs. Beside the positive evidence on costs in the literature is significant evidence of negative impact of offshoring on costs (Bryce & Useem, 1998; Vining & Globerman, 1999).

Often mentioned negative effects of offshoring are often mentioned: high hidden costs, difficulties in developing new management skills and decision-making capacity, errors in identification of key and support activities, poor management of the offshoring relationship, loss of control over critical functions, problems with quality, dependency on partners, damaged company image (Schniederjans & Zuckweiler, 2004; Harland, Knight, Lamming, & Walker, 2005; Hendry, 1995)

A recent AMR Research study of 80 manufacturers found 56% of companies that are offshoring production operations have experienced cost increases. Deloitte Consulting (2005) study has shown that, 64% of the participants in their survey indicated that they had taken offshored production back in-house and 44% could not make a distinction for the cost savings. In the meantime, they could figure
out that 20-25% of all offshoring relationships fail within 2 years and half fail in 5 years. Another study on 300 business executives conducted by Deloitte (2012) revealed the need for improved offshoring practices. The study illustrated that only 34% were satisfied with the provider’s innovation and 61% claimed that they needed to “escalate” problems to senior management within the first year. In addition, it has been mentioned that 75% of interviewed service providers felt that their clients were ill prepared for the purpose of offshoring.

The dynamic capability approach has emerged in strategic management literature to explain competitive advantages in globalized and knowledge-based economies where intangible assets dominate (Helfat et al., 2007). Essentially, the approach says that companies must rely on their ability to integrate, build and reconfigure internal competencies to respond to changing environments (Wan, Hoskisson, Short, & Yiu, 2011; Teece, Pisano, & Shuen, 1997). Furthermore, the approach is an extension of the work of, for example, Grant (1991), arguing that the company’s resources and capabilities are the most stable basis on which to explain competitive advantage. We adopt Grant’s resource definition and we consider resources to be the inputs into the production process. The individual resources of the company include items of capital equipment, knowledge, skills of individual employees, patents, brand names, and so on. Capabilities are what the company can do as a result of the resources and capabilities are specified as the key ingredient of an organization to coordinate and exploit the firm’s resources (Grant, 1991). Research on resources and capabilities has, however, evolved and today it is suggested that resources and capabilities alone cannot be a direct source of competitive advantage, they must be translated into dynamic capabilities in order to realize competitive advantage and thus achieve performance improvement (Wan et al., 2011).

In addition to current research on companies’ operations on a foreign market shows that performance improvement is not only due the company’s portfolio of resources and capabilities, but also on its ability to constantly adapt the portfolio to contingencies (Pehrsson, 2010). The study emphasizes the importance of understanding resource capabilities stemming from the parent company and resource capabilities concerning creation of knowledge of local competition. Thus, a unit located on a foreign market may build knowledge capabilities on its own, or receive capability support, from elsewhere, either inside the company or outside the company, regarding the handling of knowledge.

In a comprehensive review, Wan et al., (2011) show recent developments in research that applies the resource-based view. Amongst these developments the increasing popularity of dynamic capabilities is obvious. For example, Døving and Gooderham (2008) studied 254 Norwegian small accountancy firms and conclude that dynamic capabilities have a distinct impact on the scope of the service. Ng (2007) clarifies that the company’s strength of dynamic capabilities is associated with strategy. Furthermore, Galunic and Eisenhardt (2001) conclude that corporate units can be viewed as combinations of capabilities and product-market areas that may be combined in various ways.

Our study covers the developments of three Swedish SMEs operations on the Asian market. We adopt the definition of SME as Hill (2001) describes a SME (small to medium sized enterprise) is defined as being an independent business
having fewer than 500 employees. The local unit may build a dynamic capability of handling knowledge on local competition, and building a capability through the support from the parent company.

After reviewing the literature, we also found that authors use different types of performance criteria, including financial and non-financial. Many authors measured the impact (both financial and non-financial) on the Likert scale (Freel M., 2000). In doing so, the respondents’ estimate what positive or negative effects measured by selected indicators, offshoring has on the company.

3 Theoretical framework

This chapter will describe the foundation on which this study has developed theory from. It will also describe why some of these previous mentioned authors are important to this study and how the theoretical framework was developed.

We will base our theoretical framework on two grand theories. We did this to get a theoretical perspective over our research and to view it from different angles. The two theories are; Transaction costs economics and Resource based view. With these theories we will analyse the companies we conduct our case studies on. We find this important since there can be more than economical costs with offshoring. To make savings on offshoring production the offshoring company must fire their production personnel. This means a loss in knowledge within the company. The company will probably sell equipment and the premises that housed the production as well and therefore loose in-house resources. But will they gain more resources offshore?

3.1 Transaction costs economics (TCE)

Companies are economic systems (Salter, 1930). In economics and related disciplines, a transaction cost is a cost incurred in making an economic exchange. TCE views the firm as a type of governance structure (Williamson, 1998). Meaning that firms are governed through hierarchies within the organization.

TCE is divided into three subcategories:

- **Search and Information cost**: The cost that the company have from searching for their offshoring partner.
- **Bargaining cost**: Are the costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract and so forth.
- **Policing and enforcement cost**: The costs of making sure the other party sticks to the terms of the contract, and if necessary the cost from taking appropriate action (often legal) against them.

By analysing these three categories we will see the total transaction cost for the company by moving the production to an LCC.

Historically most of the economic activities were conducted within the organizations itself. Typically backward integration to upstream activities such
as raw material acquisition and forward integration with downstream activities such as marketing were undertaken within single firms (Chandler, 1962). However with the evolution of markets and increased number of specialized service providers within these markets, the scope for offshoring some of the non-core activities from beyond the firm boundaries has increased significantly (Jennings, 2002). Offshoring is increasingly being used as a process tool in industrial sectors such as Manufacturing, Information, Insurance and Professional Services. Trying to explain these practices through a TCE viewpoint, the theory provides a credible explanation why certain activities might be suited for offshoring by stressing efficiency gains in terms of transaction and production costs.

There is some cross-referencing between the TCE and supply chain management (SCM) literatures not anything withstanding, because these two are mainly disjunctive. Arguably, the complementarities and tensions between them should be more fully worked up, but that is a way to large of a project to undertake here. What is done instead is to look at SCM from the TCE perspective.

The comprehensive nature of the SCM literature is widely regarded as a virtue, as illustrated by the influential survey paper on “Defining Supply Chain Management” (Mentzer, DeWitt, Keebler, Min, Nix, Smith and Zacharia., 2001). Thus Mentzer et al. (2001) hold that the object of SCM is “to integrate and manage the sourcing, flow, and control of materials using a total systems perspective across multiple functions and multiple tiers of suppliers” (Mentzer et al., 2001, p. 6). Indeed, SCM “extends the concept of partnerships into a multiform effort to manage the total flow of goods from the suppliers to the ultimate customer” (Mentzer et al., 2001, p. 7). The “key processes” through which SCM works “typically include customer relationship management, customer service whereas the Council of Logistics Management (1998) defined logistics as “that part of the supply chain process that plans, implements, and controls the efficient flow and storage of goods, services, and related information from the point of origin to the point of consumption in order to meet customers’ requirements” (Mentzer et al., 2001, s. 16), the scope of SCM goes further to include “planning and control, work structure, organization structure, product flow facility structure, information flow facility structure, product structure, management methods, power and leadership structure, risk and reversal structure, culture and attitude” (Cooper, Lambert, & Pagh, 1997, p. 10). Indeed, SCM is referred to as an “integrative philosophy” (Cooper & Ellram, 1993, p. 13) by some and as a “management philosophy” (Mentzer et al., 2001, p. 7) by others. As reported in Mentzer et al. (2001, pp. 15-18) this comprehensive view of SCM is shared by many others.

On a theoretical level, offshoring reduces costs, and then the costs of offshoring together with remained costs in the company will be lower than the company itself, performing the same activities or processes (Bers, 1992; Harler, 2000). So to measure this we will look at the total cost of producing the product in an LCC. This cost will be calculated by adding the costs of employees with the cost of freight and the cost of the production in the LCC.
3.2 Resource based perspective (RBP)

The resource perspective is a model where the company's internal assets, capabilities and knowledge, instead of market factors, should determine the company’s strategy. This could be linked to offshoring. The resource perspective holds that a company can be competitive with its rare and non-substitutable resources

In essence, the resource-based view is based on the idea that the effective and efficient applications of all useful resources that the company can help determine its competitive advantage.

The knowledge based view is about the knowledge that can be lost if a company offshores the whole production or just a part of it. Imagine that the company offshores the metal cutting department where all the CNC-manufacturing occurs. The company will most certainly lay off all the CNC operators and sell all the equipment. This will result in an enormous loss in knowledge. As an operator you have a working knowledge that takes a long time learn. If the company then fails with their goal to save money on offshoring, they will probably want to bring their production back home. Then they already have lost all the competence possessed by their former operator/s, which probably already have a new job.

“Most successful companies will tell you that their two greatest assets are the people that work for them and the knowledge they possess” (Trepper, 2000, p. 1)

3.2.1 Dynamic capabilities

A major recent development in research on SMEs internationalization is an increased adoption of the theory of dynamic capabilities. The theory of dynamic capabilities is a holistic view of the company, implying that key internationalization decisions are coordinated with capabilities of the company as a whole, in regards to local phenomena (Prange & Verdier, 2011). Acquisition of the requisite new capabilities can be supported by existing capabilities that have been garnered previously (Liu & Hsu, 2011). Prange & Verdier (2011) show that the local unit’s capability of assimilating knowledge transferred from the parent company is a key driver of performance of the offshore unit. The transfer is manifested by formal structure and informal relations (Hansen & Løvás, 2004). Current research (Tang & Rowe, 2012; Pehrsson, 2010; Fang & Levinthal, 2009; Tanriverdi & Venkatraman, 2005) suggests that the exploitation of a common pool of capabilities between the parent company and the foreign unit provides benefits to the foreign unit. The key rationale is that the closer the foreign unit is to the parent company’s core competence, the more it gains from the parent company’s company-specific advantages.

However, although relatedness with the parent company gives advantages, there is scepticism towards being to closely related (Tang & Rowe, 2012; Pehrsson, 2010; Fang & Levinthal, 2009). An offshore unit may rely on its parent company’s company-specific advantages to overcome its liability of foreignness, such a cultural, political, and economic differences of the host market from the host home market, however; the foreign unit has to adapt the parent company’s company-specific advantages into the host market in order to be successful.
(Pehrsson, 2010). Research by Tang and Rowe (2012), says that the foreign units relatedness to the parent company has a positive effect on the foreign units performance, however; the effect is not linear but has an inverted U-shape. Market- and product variables are commonly used to measure relatedness (Pehrsson, 2006). High relatedness between products reduces the complexity of the development of new market-specific capabilities, since the company already possesses a base of capabilities. Similarly, high relatedness between markets reduces the complexity of the developments of approaches of target customers. Hence, Pehrsson (2006) suggests that business relatedness is conceptualized as similarities between organizational units along central product- and market dimensions.

We adopt Kotler's (2003) definition as product use as an indication applied to characterize a product from a user’s perspective as opposed to the product’s physical features. It is also important to highlight product similarities in terms of measuring product relatedness (Pehrsson, 2006). Furthermore, we adopt Frasquet, Dawson and Mollas (2013) view of sales channel as definition of market. The latter indicate that several channels can be used to access markets; wholesaling, company owned stores, concession in other stores, and sales without a fixed point.

3.2.2 Informal relations
Research by Hansen and Lövås (2004) underscores that informal relations between the parent company and the foreign unit is central for the transfer of capabilities to the foreign unit. The study implied that the social structure in which the parent company and the foreign are embedded in, have an impact on the knowledge transfer. Informal relations are continuous work-related relationships between individuals in the company as a whole. This differs from formal mechanisms in the sense that informality is rooted in norms, habits, and personal reciprocity rather than authority and formal hierarchy (Hansen & Lövås, 2004).

The main concept behind dynamic capabilities is the company's ability to quickly and efficiently responds to external market changes (Wan et al., 2011; Teece, Pisano, & Shuen, 1997). According to Kuuluvainen (2012) and Eisenhardt and Martin (2000) dynamic capabilities should be seen as processes in response to environmental and market changes. Through these changes, the local unit integrates, combine and use resources to generate performance improvement. Thus, since the local unit is behind the process in the local market, the local unit should be seen as a key driver of their dynamic capabilities. As environment changes are market specific, and the magnitude and importance of the environmental changes differs, Prange and Verdier (2011) implies that the development of dynamic capabilities to treat knowledge of varying market conditions is crucial for the foreign unit. Hence; the foreign unit, thus, plays an important role in the process of creating company capabilities. Current research by Frasquet et al., (2013) shows that increased complexity and dynamics in the company’s environment emphasizes the development of dynamic capabilities. Augier and Teece (2007) argue that a greater variety in the company’s environment gives more critical dynamic capabilities. Research by
Fang and Zou (2009) shows that the effects of dynamic capabilities on performance are pronounced more in a more dynamic environment. Dynamic environment could characterize many international markets; however, the essence is its presence of new opportunities. Being able to sense opportunities and threats and to seize opportunities from different cultural environments is the company’s challenge (Frasquet et al., 2013).

Research by Døving and Gooderham (2008) enhances an association between the product range and the company’s dynamic capabilities. The study suggests that a company exposed to a variety of products has relatedness to higher dynamic capabilities of the firm. Similarly, a company with a narrow product line continues using the same dynamic capability-base. Furthermore, a study by Frasquet et al., (2013) suggests an association between the market range and the company’s dynamic capabilities. The study suggests that companies that are active in different markets are vulnerable to various customers and competitors and as well as various routines, standards and regulations. Hence Frasquet et al., (2013) say that a company exposed on a variety of markets has relatedness to higher dynamic capabilities of the company.

4 Methodology
The method section outlines the selected research approach, method, data collection and analysis of the data collected. This chapter will explain why certain methods where chosen and how the sampling and collection of data was conducted and analysed.

4.1 Methodological choices
Most of the problems arise when measuring the effects of offshoring. After reviewing the literature, we found that authors use different types of performance criteria, including financial and non-financial. Many authors measured the impact (both financial and non-financial) on the Likert scale (e.g. (Gilley & Rasheed, 2000; Freel M., 2000). In doing so, the respondents’ estimate what positive or negative effects, measured by selected indicators offshoring have on the company. There is also a big gap between the different researchers in what they think on the subject. Some as for example Neal, H (2007) said that offshoring is the ultimate no brainer. Others like Schniederjans and Zuckweiler (2004) argues for the total opposite, that there is to many hidden cost that no one can account for and because of this uncertainty one should not offshore parts of their production.

This thesis was executed in three independent cases of Swedish SMEs. The case method facilitates a deeper understanding of the context (Yin, 2003). So we gathered the data through case studies to get a more detailed look into Swedish SME’s and to fill the research gap. The considered companies operate in the manufacturing industry. The three companies are located in the same region in southern Sweden and were founded around the same time around the late 70s and the early 80s.

We have done a case study with theoretical interpretation of the interview analysis. Having a theoretical interpretation of an interview analysis requires the
researcher to analyse its investigation using various theories, then the analysis becomes theoretically characterized. Based on various theories the situation can be analysed and interpreted in several ways and be viewed from several different perspectives. It will give the study many incidence angles, which in turn can bring benefits for further investigation (Kvale & Brinkmann, 2009). The grand theories we analyse the data with is Transaction Cost Economics and Knowledge Based Perspective.

4.2 Research Approach
The research approach will be with qualitative research, conducted with case studies with offshoring companies. Qualitative research is about recording, analysing to uncover a deeper understanding. Researchers using qualitative methods are interested in gaining a richer and more complex understanding of experiences and peoples knowledge. While collecting qualitative data, the researchers develop a theory and looks for patterns in the data they have collected. The qualitative approach allows a greater flexibility than quantitative methods. (Alzheimer Europe, 2009)

4.3 Case Study
Case studies will be conducted with companies who have offshored some or all their production. The interviewees will be with C.E.Os, financial managers, chief engineers and marketing managers. We prefer these positions because it is often these who are involved in the decision to offshore some or all of the production.

4.4 Data Collection
The main data source of this exploratory was primary data and secondary data, which were collected in 2014. The primary data is composed of a total of 3 personal interviews. The interview-guide consisted of open-end questions and the interview was informal and done in person. All interviews, which took one to two hours, were recorded and then transcribed. The secondary data applied were collected through various media such as annual reports, internal reports, memos, articles as well as photographs and contacts.

4.5 Data Analysis Procedure
Data analysis is widely recognized as the most difficult and least structured area of case study research (Eisenhardt K., 1989). Two ways of analysis were applied to overcome this weakness. Analyse the results the within-case perspective as well as the cross-case perspective were applied. In the within-case analysis, the evidence from each of the three cases was analysed separately, utilizing the frame of reference as a basis. Any similarities or dissimilarities compared to the frame of reference and to the theoretical framework are the findings of the within case-analysis. Once the within case analysis is complete, a cross-case analysis is initiated to uncover cross-case patterns. Therefore, the underlying analysis focuses on issues and aspects that can only be understood by comparing the cases. The comparison between the cases was made along predetermed measurement of indicators. They where: low, medium and high. This type of analysis is common in qualitative studies (Eisenhardt & Graebner, 2007). Based on the theoretical framework and the collected data, subjective assessments of whether an indicator would be low, medium or high were done.
Table 1 summarizes the case evidence and indicate how the focal construct is measured, thus increasing the testability of the theory and creating a particularly strong bridge from the qualitative evidence to theory-testing research (Eisenhardt & Graebner, 2007).

Our performance criteria are success or failure. We regard moving the production back to Sweden as an offshoring failure.

4.6 Trustworthiness of the Study
This method has certain limitations on the studies validity, making it unfair to generalize the result because only three cases were analysed (Eisenhardt & Graebner, 2007). We intertwine the theory to demonstrate the close connection between empirical evidence and emergent theory. This intertwining keeps both theory and evidence at the forefront of the thesis (Eisenhardt & Graebner, 2007). Finally, this table can illustrate that the development of dynamic capabilities impact its relationships with performance and how this then impacts the three companies’ successes factor. Although summarizing case evidence within the table and organizing the text around the theory may seem trivial, it is usually helpful to remind reviewers that the objective is theory development, and further emphasizes the rigor and depth of the empirical grounding of the theory (Eisenhardt & Graebner, 2007).

5 Empirical data
In this chapter the empirical data of the study will be presented. The interviews will be compiled into a story and expressed in company descriptions.

5.1 Case

5.1.1 Company A

5.1.1.1 Company description
Company A is a global company positioned as one of the world's leading suppliers of sophisticated rubber products for different applications. Company A's heritage dates back to the end of the 19th century, a lot has happened since then.

Today Company A comprises three product areas: Gaskets, Profiles and Rubber compounds, employing around 200 employees. They are a global market leader in gaskets for plate heat exchangers offering high quality products and solutions to customers worldwide.

5.1.1.2 The offshoring Journey
Company A started their offshoring project in 1995. They then sought a subcontractor in a low cost country. Their search led to Sri Lanka, to a region where they are known for being good at producing different kinds of dies. They got this information from a contact that worked at another company within the same industry. This other company had at the time been doing good business, since a few years past, with some of the companies in this region.
"Because there already was an established production of rubber products, it wasn't any rocket-science to just follow in their footsteps." The Logistics Manager (personal communication, 2014-05-05)

Company A then begun producing the dies to their rubber gaskets in Sri Lanka in 1995. They also began to manufacture the rubber gaskets, which are supplied in large batches to the end customer, in Sri Lanka. This is to keep the price low so they can stay more attractive on the market.

Both factories, the one manufacturing dies and the one that presses the gaskets, and all workers were ISO certified in both ISO 9000 and ISO 14000, between 2005 and 2010.

“It was a long process and took a lot of time, but once it was finished it became much easier to communicate because then everybody spoke in the same terms, and understand what the requirements are and why.” The Logistics Manager (personal communication, 2014-05-05)

5.1.1.3 The challenges
In the beginning the quality was very poor. They did not understand the tight tolerances and why the markings shall be located on a specific place with specific intervals, this was something that took a long time to come to an agreement on. Communication was also a big problem in the beginning. But both of these problems were solved with many frequent meetings and audits.

“The communication difficulties, you always work around. It takes a little longer and you will usually have to declare the issue a number of times. But when you come to an agreement and understand each other the products become very good.” The Logistics Manager (personal communication, 2014-05-05)

One part where the company in Sri Lanka fail, both on the factory floor and in the office, is to say in time when they have done something wrong. There is something in their culture that says you cannot do wrong, and they are still bad at this. It will always come to light in the end and in some cases these problems have affected the end customer. It has usually been solved by airfreight but then it immediately ruins the profit by producing in Sri Lanka. This is not at an acceptable level and this is something that needs more work. If they would alarm Company A immediately when something went wrong, it could probably be solved without it affecting the end-customer.

Something that affected the lead-time significantly, was in 2008 during the production peak of all time, a few times the cargo-ship sailed past the harbour, because they were loaded already. Company A’s cargo was thus too small and was then removed to prioritize bigger shipments.

“You can never become a big manufacturer in Asia if you only sell on the European market.” The Logistics Manager (personal communication, 2014-05-05)
5.1.1.4 The success factors
The staff that works with logistics and sales, has always been easy to talk to. They are very good at logistics because they have always, ever since the English colonization, worked with westerners and western companies when it comes to the shipping of goods. Thanks to this, they are very service-minded and keen on taking care of their western customers.

When the dies which are to be used for production at Company A’s factory in Sweden, is completed in Sri Lanka it is put on a ship for 6-8 weeks. These dies have more or less always arrived in good condition, sometimes the packaging has been damaged, but then it have done what it was meant for and protected the product.

The lead-time has naturally become longer now that they have the production in Sri Lanka. But that’s something they easily come to an agreement on together with their customer.

"With proper planning, the longer lead time is completely accepted because it’s much better money, and that is what the customer focuses on." The Logistics Manager (personal communication, 2014-05-05)

Company A have always had production in Sweden as well, so they have never been forced to decline a customer’s request, even if they needed the product within a very short amount of time.

When the manufacturer is far away it is very important to have frequent telephone-conferences and much e-mail contact to check up on production and so that the employees can plan along the new data. In recent time, Company A has expanded their contact with their unit in Sri Lanka. Today, they communicate by e-mail on a daily basis and over telephone at least a couple of times a week. Since this, they have noticed that the need of utilizing airfreight has decreased and they have been able to solve problems that occurred, much faster.

"Everything is all about communication and planning. This is everything in this context". The Logistics Manager (personal communication, 2014-05-05)

5.1.1.5 Where they are today
Nowadays when more and more young highly educated personnel, with high skills in English are employed at the companies in Asia, communication is not a problem anymore. But there is still a problem on the cultural side. Planning the work tends to be difficult. The Sri Lankans do not understand why we in the west always have to be in such a hurry. That is a big problem from the Swedish side too. In Sri Lanka, they only shut down the factory for one week a year. This to celebrate the New Year, which occurs sometime between the middle of January, to the middle of February. Company A has a big problem with this. Even though they know they have to plan for a production stop, they are always forced to produce something that week. In Sri Lanka, just like all other countries, the employees can take a vacation, but they choose not as they want the money
instead. They do not have the same legislation as in Sweden, where you are forced to take a holiday. They can work as much as they want. (Söderqvist, 2014)

The gaskets that are manufactured in Sri Lanka are nowadays up to a good standard, but still, now and then, there are faulty items. Is a gasket flawed it have to be discarded. There is nothing that can be recycled. This was a major problem in the beginning. Many gaskets got thrown away, but this is something that they have become much better at. In the current situation, there are some gaskets that have to be discarded, but it’s usually only a few in a batch of a few thousand. It is because in the Sri Lankan factory there is 600 workers, working 5 shifts and it’s obvious that there is one and another gasket that is discarded due to errors of some kind. Its very man intensive, every gasket has to be trimmed manually by an operator, and therefore quite easy to get wrong. Based on the above, Company A has to have a quality control department in Sweden who checks the gaskets before they are sent to our customer.

The Logistics Manager simulates the whole operation in Sri Lanka as a super tanker. It requires slow movement and a gentle hand to control the entire operation. A super tanker cannot accelerate like a sports car, and it cannot be stopped quickly either. It cannot be controlled with abrupt changes and changes all the time. That will end up in total chaos. There are six to twelve-months of planning for Company A to be able to control it all. But even though it is a major operation the cost reduction for the products have been great, both for Company A and for the customers.

5.1.2 Company B

5.1.2.1 Company description

Company B develops, manufactures, markets and distributes products and system solutions for simplified construction and improved indoor climate. The products are characterized by high quality, easy assembly, energy and environmentally friendly, and are delivered with a high degree of service. Altogether, this increases customer value.

5.1.2.2 The offshoring journey

Company B bought garbage collector to downspouts of a manufacturer in Sweden. These garbage collectors were manufactured by injection moulding of plastics.

When the manufacturer's patent expired in 2004, Company B took the chance to buy the product rights, so that they could manufacture the product as their own. As soon as Company B got the rights to the product they moved the whole production to China. This was to get a more attractive product price on the market. Company B had a Chinese contact in China, who had contact with a factory that could manufacture the product for Company B. This meant that the start-up process of the production in China went relatively quick, as they did not have to search for subcontractors in low cost countries. In 2004, the production of garbage collector was up and running in China.
5.1.2.3 The challenges

Company B had some quality problems with the products that came from China. One major problem was that the subcontractor sometimes changed their supplier of raw materials for injection moulding. This meant that the quality could vary, which was not approved on by Company B. Company B always demanded that samples were sent to Sweden, before the subcontractor sent the entire batch. This is so that Company B will be able to test the product to ensure that it maintains both the quality and standard. If Company B discovered shortcomings in quality, the products were discarded and had to be redone by the subcontractor in China. Company B never paid the subcontractor in advance, only when they received the entire batch back to Sweden and they could ensure that the quality and standard was as promised. Company B felt that the quality of the first shipment from an Asian subcontractor usually was satisfactory, or even better. It was not until the second or third delivery that errors usually arise. Company B told us that this was because their subcontractor sometimes changed their suppliers or manufactured in machines other than what was agreed upon.

If the production was as scheduled and the quality were as agreed upon, the lead-time were 12 weeks. This was from the point that Company B received the orders from the customer until the products were in stock in Sweden. If something went wrong in the production, this time would be extended, because all the faulty products had to be discarded and new needed to be manufactured. If that happened, the products needed to be shipped by airfreight to Sweden instead of being transported by boat. Airfreight is very expensive, but then the products would be in Sweden within a day, instead of the six weeks it takes by boat. If something failed in production Company B were forced to ship the products with airfreight in order to meet their customers' expectations on delivery. The cost of this was so great that the savings from manufacturing in China rapidly disappeared, which made the deal unprofitable. When 42% of what Company B paid for the product in Sweden consisted of freight, the shipping was very expensive in comparison to the product manufacturing cost. When they were forced to ship with airfreight it was not profitable at all.

Company B manufactured their products depending on the status of their storage. Because of this Company B had a hard time with the fluctuating demand from the customers. They were also pressed to keep stock status to a minimum so they did not tie up capital in finished products. All this led to that the orders sent to China often were late and therefore the products from China were delivered late to Sweden when the storage already was empty. This also led to that Company B had to send finished products by airfreight rather than by boat, to shorten the lead-time.

5.1.2.4 The success factors

It is easy to believe that it was pointless for Company B to produce in China. Such was not the case. The cooperation between them went well and Company B succeeded in saving two million SEK annually compared to purchasing the product from the former operator in Sweden. Company B’s contacts in China were highly educated and mastered the English language well. Company B has hence not suffered from some communication difficulties with their
subcontractor. The only problem they had with the subcontractor was to agree on their contract. The Chinese are afraid of making mistakes, because in their culture, it is like making a fool of themselves. This meant that the contractual process could take a long time. Company B experienced it, as what they agreed on one day was not the same the day after. This made the agreement process protracted in comparison to a negotiation with a European or Swedish customer.

Eventually Company B realized that production in China did not suit them or their customers. Difficulties in planning for customer demand while keeping stocks to a minimum finally became too much. Company B also discovered that the type of product and how it is produced played a big part in whether it was profitable to manufacture offshore or not. A fully automated process was not much cheaper to manufacture in China than in Sweden. An important factor is how many man-hours it is in the process. Chinese workers do not cost much in labour costs. A process that demands a lot of manual labour will therefore be much less expensive to perform in China compared to Sweden. But the process in this case was automated, and therefore required fewer workers, and was manufactured in China not much cheaper than it was to manufacture it in Sweden.

5.1.2.5 Where they are today
In 2010 Company B chose to take their production back to Sweden. Now, the products are manufactured by a subcontract in Ängelholm. Since it is easier to plan and therefore place orders at the subcontractor, they do not miss delivery dates to their customers. They do not have the long shipping time and quality problems are not an issue anymore. They even saved half a million SEK annually to bring home the production to Sweden.

5.1.3 Company C

5.1.3.1 Company description
Company C was originally operated by two men, which had customers in the local area. One day the orders stopped dropping in. Many of their customers had started to look at other channels to purchase, with higher capacity and to a lower price. They reckoned that they probably had to do something, or shut down their business.

5.1.3.2 The offshoring Journey
They took contact with a Swedish person that had moved to China a couple of years earlier, to work at IKEAs lighting division. This person had an idea to start up some sort of business between China and Europe. He had previous experience of plastic moulding from IKEA, and he knew how labour intensive it was and the huge costs of the dies. He saw the opportunity to produce the dies for a low cost in China, and sell them in Europe.

So in a joint venture, the two founders in Company C together with their contact in China took the decision in 2002 to offshore Company C’s entire production to China. Their contact contacted interested subcontractors in China and the founders started to sell the concept to their customers. In the beginning they had Swedish personnel in China, who handled the contacts with the Chinese
subcontractors. The sales went well and the company had a desire to grow. The Chinese part of the company had some Chinese customers as well, which did not really fit into any other sales offices. This was because the quality and therefore the price were too high for Chinese customers.

At the end of 2004, they decided to start up their own factory in China. With the founders’ experiences within the field, they began to buy equipment and to hire employees. Today the factory has 180 Chinese employees and three Swedish employees whom work as managers. Company C was unique on the market for having their own factory when they started it in 2004, and they still are to this day. This made it very easy to convince their customers to buy from them. In 2004 our contact, the management director, started working for Company C. He had previously worked for one of Company C’s customers. This made it easy for him to convince his former workplace to buy dies from Company C.

When Company C started to offshore their production, they had a quality control station in Sweden in the workshop they used to manufacture their products. When Company C built their factory in China, they did the testing in the factory. This eliminated the need for the quality control station in Sweden.

5.1.3.3 The challenges
In the beginning of the production in their own factory, Company C had some difficulties with the cultural differences. They told us that the Chinese workers “never ever did anything wrong” (Management Director, Personal Communication, 2014-05-08). In fact, they did a lot of things wrong. Even when they did something wrong, they did not stop doing it, because their leader had told them to do it. The Chinese workers are not dumb for not doing things the right way “they do exactly as they are told, because they are raised that way” (Management Director, Personal Contact, 2014-05-08), so if there was any misunderstandings with the communication, something will easily go wrong.

5.1.3.4 The success factors
For Company C, it was not only the low price that made the choice to manufacture in China a good one. The capacity is much larger than it could ever be in Sweden. In Sweden the projects were often offshored to many subcontractors, who had a hard time to cooperate. It was hard to get all the different components to work together in one product when all the components were built at different subcontractors, who did not work together.

Company C developed their own way of communicating. They have all communication by E-mail and include a lot of pictures when they need to explain something. This is all to make it easy to understand. The Chinese workers like to work for Scandinavian companies, because they can take their own initiatives and come with their own ideas to solve problems. This motivates them quite hard. Company C is very considerate with their employees. They want to make a pleasant workplace for their employees, so that they don’t quit. They are also meticulous with reporting the progress to their customers. “We are very open and honest with our customers if something would go wrong. This way, we are often capable to solve the problem before the product should be delivered to the customer” (MD, personal communication, 2014-05-08)
In China they celebrate the New Year sometime between the middle of January and the middle of February. Company C closes their factory for one week when everybody is on vacation. This does usually not cause any problem for Company C. They rarely have any problems with planning for this special occasion.

When Company C built their factory in China, they started doing the testing in the factory. This eliminated the need for the quality control station in Sweden, which meant that they could send the products directly to their customers. This reduced the lead-time significantly since the product does not have to be tested in Sweden and then sent to the customer. Instead, they test all their products in the factory in China. They even invite their customers to come and see the products while they are being tested. All this reduces time in the process, and is a sign of the high quality of the products. It is even a great benefit for the customers.

Instead of bringing the product back to Sweden, to test it in the customer’s factory, they test it under live conditions with Company C’s own plastic moulding equipment. This means that they can do final adjustments at the factory before sending the die to the customer. This means that the customer do not have to shut down their production while testing the tool, which saves them time and money.

As mentioned before, when Company C started to offshore their production, they had a quality control station in Sweden in the workshop they used to manufacture their products.

The Swedish workshop was bought by one of the former employees who worked in the workshop. When something needs to be adjusted in Sweden, Company C often sends the products to their old workshop if it is not too far from their customer. They have contacts with other workshops all around Sweden, so they usually go for the one nearest the customer. This is to save time in shipment.

5.1.3.5 Where they are today

Company C manages the freight by themselves. They have Chinese personnel in China to handle that. Many customers have tried to handle the freight by themselves, but it is always more expensive and not that convenient as when Company C handles it. Of all the products the manufacture, they ship 70 – 80% by boat. The rest is freighted by airfreight. There is a breakpoint around 100 kilos, where the price of the shipping is the same with airfreight as it is with boat. When the product weighs less than this, Company C ships it by airfreight. Airfreight is very convenient because you can track the shipment-number and therefore you always know where the shipment is, and when it will arrive. Tracking of the boat freight is much harder. You get an arrival announcement two weeks before the ship arrive, in every harbour. So the only information you know is where the boat roughly will be within two weeks, after you get the announcement.

The most important factors for Company C is that they have their own factory in China, because of this they have been able to avoid having any other company that can control how they want to do their business. They have also been able to do live testing in their factory in China. Thanks to this, they have been able to...
remove a dicey part of their customers production, because now they don´t have to do these tests themselves, and thus gained more customers. This, coupled with that their final inspection also is in China, have led to that they can send out their products directly to the customers and thus will not have to stock them in Sweden. So thanks to these three major factors Company C´s offshoring project has gone really well. It is in fact going so well, that they are expanding their business all the time.

6 Empirical analysis: Within-case and a cross-case analysis

Empirical analysis section will contain discussions of the empirical data collection. The data will be interpreted, analysed and connected to the theoretical framework and parallels will be drawn to the literature.

In this study three Swedish companies are analysed. The firms are analysed along the two dimensions of the framework: Transaction cost economics and Resource based perspective. We seek to identify patterns of developments and relationships with performance in terms of success. Table 1 summarizes representative information on the cases.

6.1 Company A

It was high transaction cost connected to move Company A to an LCC. The reason for high transaction costs where correlated to the extensive work it took to find a suitable subcontractor. Company A did not know in the beginning that they were to offshore their production to Sri Lanka. Therefore they sought through several LCCs before the came to the conclusion that Sri Lanka was suitable for them. Company A had no problems with the subcontractor keeping to the agreed terms of the contract. So because of this, their policing and enforcement costs are low. After a couple of years, Company A bought their whole subcontractors factory in Sri Lanka. This bargaining cost was very high, but they now had control over their own factory in Sri Lanka, which made the whole process more efficient, less expensive and they are able to work as one company, meaning that they share information and culture. To have a common pool of capabilities increases the performance of the foreign unit (Pehrsson, 2010). In comparison to the parent firm in Sweden, Company A produced their products cheap in Sri Lanka. This depends on three factors:

In comparison to the products price, and the amount of products in every shipment, the freight cost is very low. In every container shipped from Sri Lanka, there can be between 2000 and 200 000 items, which makes the shipment cost a small part of the total product cost. The wages in Sri Lanka is very low when compared to the wages in Sweden. Because of the high amount of manual labour in the production, the total production cost is very low. If the company produced the same amount of items in Sweden the cost for wages would make the total production cost largely expensive in comparison to Sri Lanka.

Company A has an extensive exchange of dynamic capabilities between the parent company and the Sri Lankan unit, e.g. ISO standardization and extensive communication on a daily basis, which heightens the informal relations. Recent development in research on SME internationalization has led to the increased
adoption of dynamic capabilities based theory as an integrated platform for explaining company-level internationalization (Prange & Verdier, 2011). When the product batches are small, Company A produces them in Sweden. When the batches grow, they are moved to the LCC unit in Sri Lanka. This means that they produce the same products in both Sweden and Sri Lanka, and therefore the product relatedness is high between the two units. Tang and Rowe (2012) published, that product and market relatedness has a positive impact of the company’s performance. Compared to the Swedish manufacturing unit, the quality of the items made in Sri Lanka is high. They find some faulty products in every pallet, but it is a small number compared with the quantity in every shipment. They seldom have major problems with faulty products coming from the Sri Lanka unit. The unit in Sri Lanka has good, well-educated logistics personnel, but the manual labour does not require any specific skill or education. Therefore the competence level scores a medium. This because logistics personnel is one of the key-personnel in a successful business, as the Council of Logistics Management (1998) defined logistics as “that part of the supply chain process that plans, implements, and controls the efficient flow and storage of goods, services, and related information from the point of origin to the point of consumption in order to meet customers’ requirements” (Mentzer et al., 2001, p. 16). Informal relations between the parent firm and foreign unit are essential for the capabilities of the foreign unit (Hansen & Lövås, 2004). The informal relation between the two plants is very extensive. They communicate on daily basis through e-mail and talk over telephone a few of times every week. The Swedes visit the Sri Lanka unit a couple of times a year and the Sri Lankan chiefs and supervisors visit Sweden once a year. But, the Sri Lankans are bad at communicating with the Swedes when something goes wrong. This implies that the parent firm and the local unit are embedded in the same social structure, and therefore they may exhibit a higher capacity of information sharing and a degree of mutual problem solving in informal relations (Hansen & Lövås, 2004).

The factory in Sri Lanka is much larger and has a bigger machine park than the Swedish factory. Also they have a larger number of employees to man the machines and do the manual labour. Therefore they can produce a larger quantity of items in the same duration of time as the in Swedish factory. When Company A bought the factory in Sri Lanka, they invested a lot by making it ISO – 14001 and ISO-9001 standardized. Today, they have a high production standard in the Sri Lankan factory. The R&D is done in the Swedish factory. In the factory in Sri Lanka they do not have any personnel with a suitable education for R&D. Also, all the smaller batches of products are made in the Swedish factory, and then moved to the factory in Sri Lanka when the batches quantity rises. The R&D is also one of Company A’s core competencies, and therefore they want to remain in Sweden.

6.2 Company B

The transaction costs for Company B to move to an LCC was low because they already had a contact down in China. Because of this they did not have to invest time and money to find a suitable subcontractor. Company B had problems with the subcontractor keeping to the agreed terms of the contract. Because of this, they had from time to time to check up on their supplier. This cost some money in form of trips to China and time to renegotiate the terms of the contract.
Because of this, their policing and enforcement costs are medium. Company B’s bargaining cost were very low. They only have to travel there to agree on the terms of the contract. In comparison to the parent firm in Sweden, Company B’s Chinese factory produced their products for approximately the same price. This depends on three factors:

In comparison to the products price and the amount of products in every shipment, the freight cost is very high for Company B. The freight is as high as 42% of the total product price. Therefore the score is high in freight cost.

The wages in China are very low when compared to the wages in Sweden. But because almost the whole process is automated and the amount of manual labour is low in the production, the total production cost is almost the same as in Sweden. Therefore the score is high in production cost but low in the cost for the employees. Company B is not producing the same products in China as they do in Sweden. Compared to the Swedish manufacturing unit, the quality of the items made in China is low. They had to have a lot of controls on the product so that they kept up to the quality agreed up on. The unit in China has good, well-educated personnel, but the manual labour does not require any specific skill or education. Therefore the competence level scores a medium. The informal relation between the two plants is very high. The Swedes visit the Chinese unit a couple of times a year and the Chinese personnel have visited Sweden. Related to Hansen and Lövás (2004), informal relations between the parent firm and the Chinese unit are important for the capabilities of the foreign unit. The subcontractor in China is much larger and has a bigger machine park than the Swedish factory. Also they have a larger number of employees to man the machines. Therefore they can produce a larger quantity of items in the same duration of time as the in Swedish factory. They also keep up to a high production standard when all the terms of the production are agreed up on and they keep to this and do not try to change something. The R&D is done in the Swedish factory. In the factory in China they do not have any personnel with a suitable education for R&D. The R&D is also one of Company B’s core competencies, and therefore they want to remain in Sweden.

6.3 Company C

The transaction costs for Company C to move to an LCC was high. In economics and related disciplines, a transaction cost is a cost incurred in making an economic exchange (Williamson, 1998). Company C needed to find a suitable subcontractor, a factory and personnel. Therefore their search and information cost would be high, but because Company C had a Swedish contact in China, who knew the process of plastic moulding and the time spent on manufacturing the dies, their search and information cost is Medium. After Company C had bought their own factory they had no problems with policing and enforcement, as they had while producing at their subcontractor. Therefore their policing and enforcement cost is medium, this because they do not need to agree with another party anymore. Because they built their own factory, bought their own machine park and hired a lot of personnel, their bargaining cost was very high. The positive side of this was that they now had control over their own factory in China, which made the whole process more efficient and less expensive. This made them, and they still are, unique on the market with their own factory in China. Mentzer et al., (2001) hold that the object of SCM is “to integrate and
manage the sourcing, flow, and control of materials using a total systems perspective across multiple functions and multiple tiers of suppliers” (Mentzer et al., 2001, p. 6). Indeed, SCM “extends the concept of partnerships into a multiform effort to manage the total flow of goods from the suppliers to the ultimate customer” (Mentzer et al., 2001, p. 7). In comparison to the former production in Sweden, Company C produces their products cheap in China. This depends on three factors:

In comparison to the products price and that the whole process of developing a die is a big commitment, the freight cost is very low compared to the other costs related to the product.

The wages in China are very low when compared to the wages in Sweden. Because of the high amount of manual labour in the production, the total production cost is very low. If the company produced the same amount of items in Sweden the cost would sky rocket, it would be impossible to produce like this in Sweden, at the same low costs and still have the same production volume.

The product relatedness between the two units is high, since it is the same products manufactured in China, as the ones that were produced in Sweden, before Company C took the decision to offshore. They still have knowledge in Sweden to produce the dies and they are able to adjust and do changes on the dies if necessary.

Compared to when the dies was produced in Sweden, the dies holds the same quality from the Chinese factory. Therefore, the quality is still high. They seldom have any problems with faulty products coming from the Chinese unit. And if a problem would occur, they can adjust the products in Sweden. The Chinese unit has well-educated personnel. Therefore the competence level is high. The informal relation between the plant in China and the administration office in Sweden is extensive, and therefore high. They communicate on daily basis through e-mail and over telephone a few times every week. They also have three Swedes on site all the time and the Swedes in the administrative office in Sweden visit the Chinese unit a couple of times a year and all the personnel in the Chinese unit visit Sweden at least one time during their employment.

Related to Hansen and Lövås (2004) informal relations between the parent firm and the foreign unit signified that they are included in the same social structure, which leads to a higher capacity of information sharing. This share of information is the essence of problem solving in informal relations. The factory in China is much larger than the Swedish one ever was and has a bigger machine park than the Swedish factory. Also they have a larger number of employees to operate the machines and do the manual labour. Therefore they can produce a high quantity of items in the same duration of time as the in Swedish factory produces a lot fewer. Company C have been producing under their customers’ standardization. Although they are not standardized themselves, they already meet the high criteria’s to be standardized, which will soon be completed, since the German headquarters demanded the factory to be standardized.

The development is made in Sweden. Then the drawings sent to Chinese factory where the product is manufactured and tested. It is sometimes needed to continue the development in the Chinese factory. Since all the development is not done in China, the factory only scores medium, when it comes to R&D.
6.4 Summarizing tables
This table summarizes above-mentioned information on the cases. We will grade the scaling Low with one point, Medium with two points and High with three points. In the TCE dimension it is desirable to have low scores, as this reflects the cost of moving the production to an LCC and the total product cost. In the RBP dimension it is the opposite. High scores are desirable, as these reflect the companies’ abilities to exploit their resources.

6.4.1 Table 1. Transaction cost dimension

<table>
<thead>
<tr>
<th>Concepts and indicators</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TCE</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Search and information cost</td>
<td>High (3p)</td>
<td>Low (1p)</td>
<td>Medium (2p)</td>
</tr>
<tr>
<td>Policing and enforcement cost</td>
<td>Low (1p)</td>
<td>Medium (2p)</td>
<td>Medium (2p)</td>
</tr>
<tr>
<td>Bargaining cost</td>
<td>High (3p)</td>
<td>Low (1p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td><strong>Transaction cost for moving to LCC</strong></td>
<td>High (7p)</td>
<td>Low (4p)</td>
<td>High (7p)</td>
</tr>
<tr>
<td>Cost of freight</td>
<td>Low (1p)</td>
<td>High (3p)</td>
<td>Low (1p)</td>
</tr>
<tr>
<td>Cost of production</td>
<td>Low (1p)</td>
<td>High (3p)</td>
<td>Low (1p)</td>
</tr>
<tr>
<td>Cost of employees</td>
<td>Low (1p)</td>
<td>Low (1p)</td>
<td>Low (1p)</td>
</tr>
<tr>
<td><strong>Total product cost by producing in an LCC compared to producing it at the parent firm</strong></td>
<td>Low (3p)</td>
<td>High (7p)</td>
<td>Low (3p)</td>
</tr>
</tbody>
</table>
6.4.2 Table 2. Resource based dimension

In the RPB dimension, high scores are preferable, since these reflect the companies’ abilities’ to utilize their resources.

<table>
<thead>
<tr>
<th>Concepts and indicators</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RBP</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product relatedness</td>
<td>High (3p)</td>
<td>Low (1p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td>between the parent firm</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>and the LCC unit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product quality in the</td>
<td>High (3p)</td>
<td>Low (1p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td>LCC unit compared to the</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>parent firm</td>
<td></td>
<td></td>
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<tr>
<td>Competence level in the</td>
<td>Medium (2p)</td>
<td>Medium (2p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td>LCC unit compared to the</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>parent firm</td>
<td></td>
<td></td>
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<tr>
<td>Informal relations</td>
<td>Medium (2p)</td>
<td>High (3p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td>between the parent firm</td>
<td>+</td>
<td>+</td>
<td>+</td>
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<tr>
<td>and the LCC unit</td>
<td></td>
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</tr>
<tr>
<td>The production speed in</td>
<td>High (3p)</td>
<td>High (3p)</td>
<td>High (3p)</td>
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<tr>
<td>the LCC unit compared to</td>
<td>+</td>
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<td>the parent firm</td>
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<tr>
<td>The production volume in</td>
<td>High (3p)</td>
<td>High (3p)</td>
<td>High (3p)</td>
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<tr>
<td>the LCC unit compared to</td>
<td>+</td>
<td>+</td>
<td>+</td>
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<tr>
<td>the parent firm</td>
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<tr>
<td>Production standards in</td>
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<td>High (3p)</td>
<td>High (3p)</td>
</tr>
<tr>
<td>the LCC unit compared to</td>
<td>+</td>
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<tr>
<td>the parent firm</td>
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<tr>
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<td>Low (1p)</td>
<td>Low (1p)</td>
<td>Medium (2p)</td>
</tr>
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<td>=</td>
<td>=</td>
<td>=</td>
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<td></td>
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<tr>
<td>Dynamic capabilities</td>
<td>High (20p)</td>
<td>Medium (17p)</td>
<td>High (23p)</td>
</tr>
<tr>
<td>stemming from the parent</td>
<td></td>
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</table>

| Offshoring performance | Success | Failure | Success |
6.5 Cross-case analysis

As Neal, H (2007) says that offshoring production operations is the ultimate no-brainer, was the case for Company C. Buy producing in China they can have a much higher production capacity to a fraction of the price. This is also shown for Company A, which is operating a similar business. Both these companies had a big success when offshoring the manufacturing of their dies, and Company A also had a success with their gaskets because they can produce them in a much higher quantity in Sri Lanka and to a lower price. But both of these companies had a very high transaction cost by moving to an LCC. So to reach break-even will take a fair amount of time, but by buying up the subcontractor or buying an own factory in an LCC, you can have much bigger control over the foreign unit, and you may easier share information without any hassle of contracts, like Company B had. As related to Hansen and Lövås (2004) informal relations between the parent firm and the foreign unit signified that they are included in the same social structure, which leads to a higher capacity of information sharing. This share of information is the essence of problem solving. So by having a high frequency of information sharing like Company C, “We are very open and honest with our customers if something would go wrong. This way, we are often capable to solve the problem before the product should be delivered to the customer” (MD, personal communication, 2014-05-08) will according to Hansen and Lövås (2004) lead to a higher likelihood of success. This is something Company A has to work on, because their employees in Sri Lanka are still having a hard time being open and telling the parent company if something has gone wrong.

Regarding dynamic capabilities stemming from the parent company the foreign units primarily demonstrate an increase. This is corresponding to previous findings (Prange & Verdier, 2011; Liu & Hsu, 2011; Pehrsson, 2006). However, there is one foreign unit, which show a failure performance result. But still, two of the units have a positive development and one has a negative development. Thus, it is realistic to state that foreign units primarily develop capabilities with the help from parent companies.

During the whole period of time, the table shows that the foreign units are developing their dynamic capabilities. Looking at dynamic capabilities stemming from the parent company, the foreign units primarily extend their dynamic capabilities. This corresponds to previous research (Wan et al., 2011; Teece et al., 1997; Kuuluvainen, 2012; Eisenhardt & Martin, 2000). With that being said it is not right to state a steady increase in development, since there is one foreign unit with a negative performance result. Hence, the findings in the table indicate something more than the above-mentioned researches.
Our conclusions are that the most important aspects to take in to consideration when offshoring to an LCC, is to consider what type of product the company is offshoring and how it is produced. If the production is fully automated, the cost of production is not much cheaper in an LCC than in Sweden. The low wages in the LCCs’ is what the companies save money on. A totally manual process is many times cheaper in an LCC than in Sweden. The ability to plan way ahead is also important. If the company have a fluctuating order income, the planning becomes challenging, and will probably become a problem. Another crucial factor is where the products are produced. We have found that the companies that have their own factory in an LCC are more successful than the companies who use a subcontractor. The reason for this is because they have more control over the production, suppliers and their employees. This also has a big impact on culture. Because when you do business with a subcontractor the cultural factors can become a problem. Company A and Company C found a way around this by intertwining the Swedish culture with the LCCs’ cultures. And because of this the relations have been enhanced. This relates to the research by Hansen and Lövås (2004) that underscores that informal relation between the parent company and the foreign unit is central for the transfer of capabilities to the foreign unit. The study implied that the social structure in which the parent company and the foreign are embedded in, have an impact on the knowledge transfer. Informal relations are continuous work-related relationships between individuals in the company as a whole. This differs from formal mechanisms in the sense that informality is rooted in norms, habits, and personal reciprocity rather than authority and formal hierarchy (Hansen & Lövås, 2004).

It is important to study the culture in the country the company is planning on offshoring to. Some companies miss this crucial step, and have a naïve attitude that it will work itself out, without any trouble. In the words of our contact at Company A “It’s a little too nonchalant to just believe that it will work directly” (Operational director, personal contact, 2014-05-05). Having this said it is necessary to discuss alternative explanations for the results seen in the table. In particular, the context of the foreign units is important. In this study, three SMEs are studied and since all of the studied of the foreign units operate in industries with a high threat of substitutes, it could be argued that this impacts on performance. Hence, the industry might have an impact on these findings. In addition, firm size may explain aspects of capability development, as larger firms frequently possess larger capacities. A final interpretation of our empirical findings underscores the importance of experience. Most probably, experience of parent companies and foreign units are central to the development of dynamic capabilities.
8 IMPLICATIONS AND LIMITATIONS

This section will present the implications and limitations the authors think are of importance of the study. It will also contain suggestions from the authors on different and possible angles on how to go into further research.

8.1 Managerial Implications

Corporate management is advised to provide the foreign unit with necessary capabilities so that the foreign unit is able to develop necessary capabilities. It may be the case that the foreign unit initially needs extensive support, or the case may be that the foreign unit just needs specified support provided that the foreign unit has developed some capabilities to handle knowledge about production. If the corporate unit is not sensitive enough to the needs of the foreign unit there may be a conflict between the expectations of corporate management and those of foreign management. To a large extent it is a matter of balancing needs of both parties. Hence, the foreign unit will get high performance if it improves the capabilities to handle production and receives appropriate support from corporate management.

Based on the discussion presented above it is possible to put forward four key learnings, these in form of suggestions to a general manager. These rely on the identified empirical patterns regarding different transaction costs when moving to an LCC and the utilization of resources, in form of dynamic capabilities, and how this can relate with offshoring performance:

The first key learning comes after analysing Company B. It was found that it is very important what type of product you intend to offshore. Thus, the first suggestion is:

- The first thing to do when offshoring to an LCC is to check what type of product you intend to offshore. It is more probable to be profitable if it is a very manual labour extensive product.

The second key learning comes after analysing Company A. It was found that one of the most important factors when offshoring to an LCC was the ability for planning. Thus, the second suggestion is:

- The second thing is that when offshoring to an LCC, long term planning enhances the performance.

The patterns among the companies show that building dynamic capabilities will have a positive relationship with the performance. Hence, the third suggestion is:

- A company’s foreign unit will perform better if it builds dynamic capabilities to handle production and gets capability support from the parent company.

How to better build dynamic capabilities could be handled in many different way’s and the field of dynamic capabilities is massive. We suggest managers to
read the three highly cited articles (Wan et al., 2011; Augier et al., 2007) and (Helfat et al., 2007).

Company A and C shows that having an own factory will have a positive relationship with the performance. Hence, the third suggestion is:

- The Company will perform better if the factory is fully owned in the LCC, than if they do business through a subcontractor in an LCC.

This will enhance the intertwining of the factories and the company will share habits and informal culture. Because of this it will be easier to solve problems when they occur and therefore have a larger likelihood of good offshoring performance (Hansen & Lövås, 2004).

### 8.2 Policy Implications

Production offshoring may have many implications. If you take away the jobs from the people hired in the Swedish company with goals to offshore, the Swedish economy will be damaged. This is also a moral issue. A large production unit consumes a lot of workforce, which will be left without occupation. This could harm the company in ways of reputation. Another implication could be backwards integration of the contract manufacturer.

### 8.3 Theoretical Implications and Future Research

Like most studies the present study has several limitations, which at the same time provide avenues for future research. First, in order to lay the basis for general assumptions, the key learnings in form of managerial suggestions, may be turned into testable hypotheses. For example, we found that it is important with a long-term plan in these types of industries, but it is more likely that a short-term plan is essential in a more dynamic industry. A test can be conducted using a large sample of foreign units of firms of different character. For example, companies may originate from different countries and units on a variety of foreign markets may be analysed. Second, we studied small or medium sized manufacturing companies. The industry and the size of the company may play a critical role. In a statistical test it is important to control for effects of, for example, industry belongings of firms and firm size.
9 Works Cited


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