Which factors determine location decisions in terms of outsourcing?
Outsourcing decisions are complex, and vital for the success of outsourcing strategy. One of the important decisions that have to be made for outsourcing is the location decision. It is important that the chosen location provides the outsourcing company with the benefits it wants to obtain. These benefits can range from cost reductions to an increase in flexibility and from the focus on core capabilities, to the access to superior suppliers knowledge. However, when companies face a location decision, several different factors have to be taken into account.

It is often so, that the outsourcing strategy for a company is not so successful as expected, part of this comes from the fact that the supplier cannot deliver the expected advantages due to the location it operates in. It is therefore important that companies analyze locations on forehand, so that they will not be surprised with lower than expected results.

This report tries to provide a framework with factors that should be analyzed when facing a location decision with regard to outsourcing. As concluded from this study, there is no hierarchy within these factors. Companies themselves should establish this hierarchy based on the relative importance of the factors to their strategy, with regard to their competitive priorities.

The purpose of this study is to enable managers to make a better, thoroughly analyzed decision for outsourcing locations. This is done by presenting a step-wise model through which every potential location is analyzed on the most important factors for the company, and the sustainability of these factors.
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1. Introduction

Business outsourcing has become an ever-increasing trend in today’s highly competitive markets. (Liou & Chuang, 2010). It is abundantly evident that outsourcing is a key business trend that has become increasingly important in recent years (Kroes & Ghosh, 2010). Because outsourcing has become increasingly important it has also become more important to choose the right strategy when outsourcing. The chosen strategy should be aligned with the overall business unit strategy, and therefore it is important that the outsourcing strategy reflects the key objectives of the outsourcing companies. Recent research strongly advocates that to realize the potential for improved competitiveness, outsourcing decisions should be strategic in nature, and made in alignment with the competitive priorities of the firm (Kroes & Ghosh 2010).

One of the important decisions that have to be made when outsourcing, is the location to which the company is going to outsource. It is important that the characteristics of the outsourcing country are aligned with the competitive priorities of the outsourcing company. As mentioned before it is important that outsourcing decisions should be made in alignment with the competitive priorities of the firm The chosen outsourcing location should therefore enable the outsourcing company to achieve their objectives within each of these competitive priorities.

The outsourcing market can be separated in many different segments. Two main separations will be made here. First of all, one can separate the outsourcing market by distinguishing manufacturing outsourcing and services outsourcing. Within these two fields there are many different types of outsourcing as well. This report will focus on the manufacturing outsourcing market. A second separation can be made when looking at the value chain of a company. This separation was also made by Porter (1985); Porter first makes a distinction between primary activities and support activities. Primary activities are directly concerned with the making and delivery of the product. According to Porter the primary activities can be separated into five different areas: inbound logistics, operations (production), outbound logistics, marketing and sales and service. This report will focus on the outsourcing of the operations (production) part of the value chain.
1.1 Problem statement
The following problem statement is answered in order to obtain an answer in the field of interest of this report:

Which factors determine locations decisions in terms of outsourcing?

1.2 Research Questions
The following research questions are answered in this report in order to get a clear and well formulated answer to the problem statement:

1) What is outsourcing, and what are the advantages of outsourcing for companies operating within the manufacturing industry?
2) Which factors have an influence on location decisions?

1.3 Research design

This research is a descriptive research on outsourcing location decisions. The research aims to find out which factors are important for companies when choosing the area to which they want to outsource. The research will focus on outsourcing decisions for manufacturing companies, with the production part of the value chain as the most important aspect.

1.4 Data collection

The research will rely on secondary data. This data will mostly be obtained through the library of the Tilburg University. Most of the sources found until know where obtained from the Outsourcing journal. Two of the most important readings that are used in this study are The Handbook of global outsourcing and offshoring (Oshri, Kotlarsky and Willocks, 2009) and Farrell’s article on smarter offshoring, which includes a framework on the most important factors that influence location decisions.
2. Outsourcing

2.1 Introduction

The first chapter consists of three parts. In the first part a definition of outsourcing is given, this definition is going to be used throughout the whole report. In the second part of this chapter the advantages and disadvantages that can be gained while outsourcing are presented. The third part of this chapter is going to discuss a few different types of outsourcing with regard to the location distance from the indigenous country of the outsourcer. The different types of outsourcing that are discussed are nearshoring, homeshoring, farshoring and bestshoring.

2.2 Definitions of outsourcing

In order to give a clear definition of what outsourcing really is a few definitions of outsourcing that are obtained from books and articles are presented. The first definition is given by Oshri & Kotlarsky & Willocks, (2009, p4): “Outsourcing is defined as contracting with a third party provider for the management and completion of a certain amount of work for a specified length of time, cost, and level of service.” Oshri, Kotlarsky & Willocks distinguish a few different types of outsourcing in which location plays an important role. They mention for instance the role of offshoring within the outsourcing market. For them “offshoring refers to the relocation of organizational activities to a wholly owned subsidiary or an independent service provider within another country.” They also mention that only in the case of an independent service provider one can refer to offshore outsourcing. Furthermore they state that when services are relocated to neighbouring countries one can speak of nearshoring.

A second definition is given by Greaver II (1999, p3): “Outsourcing is the act of transferring some of an organization’s recurring internal activities and decisions to outside providers, as set forth in a contract.” According to Greaver II outsourcing goes beyond the use of consultants because the activities are recurring and contracts are used. Furthermore he mentions that outsourcing goes beyond the outsourcing of an activity alone, he says that the factors of production and decision rights are also transferred.

The third definition is given by Varadarajan (2009 p1165): “Outsourcing refers to the practice of a firm entrusting to an external entity the performance of an activity that was performed erstwhile in-house.” He mentions that the outsourcing activity can either be the manufacturing of a good or the performance of a service. Another statement that was made by Varadarajan is the following:
Outsourcing is a pervasive business practice in a number of organizational functions such as accounting (e.g., bookkeeping and payroll processing), computers and information systems management, human resources management, facilities maintenance, logistics and supply chain management, manufacturing and marketing. Varadarajan also mentions the importance of off-shore outsourcing and off-shoring, he defines offshore outsourcing as outsourcing to a third party based in another country. His definition of off-shoring is the following: “sourcing from a firm’s subsidiaries located in other countries is often referred to as off-shoring.”

A last definition on outsourcing is given by Gilley & Rasheed (2000), According to them: “Outsourcing is not simply a purchasing decision; all firms purchase elements of their operations. On the contrary, we suggest that outsourcing is less common and represents the fundamental decision to reject the internalization of an activity. In this way, outsourcing is a highly strategic decision that has the potential to cause ripple effects through-out the entire organization.” They also state the outsourcing can occur in two ways. The first way represents the general view on outsourcing, this is when outsourcing happens because of substitution of external purchases for internal activities. This type of outsourcing can also be viewed as vertical disintegration, which was also mentioned Varadarajan. The second way in which outsourcing can occur is through abstention. This happens when a firm purchases good or services from outside on organization that have not been completed in-house in the past. According to Gilley & Rasheed: outsourcing only occurs when the internalization of the good or service outsourced was within the acquiring firm’s managerial and/or financial capabilities. In other words, they feel that outsourcing can only occur when the outsourcing company had the means to produce the outsourced product or service in-house.

All of these definitions, as well as most of the other definitions that can be found have a few things in common. The first thing all of these definition have in common is that in outsourcing a company always makes use of a third-party to which they outsource. The second characteristic that is mentioned in most outsource definition is that the outsourcing company hands out their control over the process. In other words, the outsourcing company does not decide how the work is done. The addition that was made by Gilley & Rasheed is also acknowledged in this report, because if the outsourcing company did not have the means to produce the service or product themselves, then they are not outsourcing but only purchasing. As mentioned in two of the three definitions given off-shore outsourcing is an important field of interest within the outsource market itself.
It is however mentioned by Varadarajan that offshore outsourcing is only a slice of a larger pie that also encompasses outsourcing that does not transcend national boundaries.

Based on the before mentioned information, this report will see outsourcing as a process in which a company transfers the control of either a primary or a secondary activity towards a third party by means of a contract. In this report outsourcing is both offshore outsourcing, nearshoring and outsourcing that does not transcend national boundaries.

2.2.1 Advantages of outsourcing

Companies that outsource the production part of their value chain can obtain many different benefits from it. During the last years a lot of research has been done on the benefits that can be obtained through outsourcing. According to Gilley & Rasheed (2000, p3): the potential benefits that are most often discussed are improved financial performance (attributable, in part, to almost immediate cost improvements) and various nonfinancial performance effects, such as heightened focus on core competencies. In this section the most important benefits that can be obtained through outsourcing are mentioned, such as cost advantages, quality improvements, concentration on core activities, access to superior supplier knowledge, a higher degree of flexibility and the ability to decrease the product/process design cycle time.

The first benefits that are discussed are the financial benefits, which are almost always obtained due to cost advantages. According to Oshri et al. (2009): A company may accomplish significant cost advantages through the creation of economies of scale, access to unique expertise of a third party, and the reduction or stabilization of overhead cost. Abraham & Taylor (1996) mention another reason why outsourcing could cut the costs for a company: contracting out may be a way for high-wage organizations to take advantage of low market wage rates for certain types of low-skill work. From this we can take that through outsourcing costs can be lowered due to many different reasons such as lower labour costs for the outsourcing company and more expertise within the outsourcing company that enables a more efficient approach.

The ability to focus on core activities is also often mentioned when benefits of outsourcing are being listed. This is because a firm that is engaged within many different activities can hardly be the best at all of these activities. Therefore it could be wise for companies to focus on just a small amount of different activities in which they can achieve a very high quality standard. This argument is made by Quinn & Hilmer (1994): Following a core competency through outsourcing strategy may enable a company to focus its resources on a relatively few knowledge-based core competencies where it can develop best-in-the-world capabilities.
When the advantages of focusing on core competencies are discussed the Nike example is often referred to, this is also done by both Quinn & Hilmer: Nike, Inc., is the largest supplier of athletic shoes in the world. Yet it outsources 100 percent of its shoe production and manufactures only key technical components of its “Nike Air” system, and Gilley et al.: Nike’s core competencies are in the design and marketing of shoes rather than in their manufacturing. Therefore, Nike has focused on these aspects of the athletic shoe industry and has relied on outside firms for virtually all manufacturing activities. Both of them refer to the fact that Nike was one of the most successful companies of the last centuries.

Another benefit that is often mentioned are the access to superior supplier knowledge, which can lead to a more efficient production cycle but also to innovation of a product and higher quality of a product. According to McCarthy & Anagnostou (2004): improvements in quality through innovation, and the development of new service products, can lead to new demands. The improvement in quality can be achieved because outsourcing can lead to increased competition between potential suppliers. According to Kotabe & Murray (1990): Outsourcing tends to promote competition among outside suppliers, thereby ensuring availability of higher-quality goods and services in the future. Quality improvements can also be obtained in a different way according to Dess, Rasheed, McLaughlin & Priem (1995): Quality improvements may also be realized by outsourcers, because they can oftentimes choose suppliers whose products or services are considered to be among the best in the world.

Two other benefits that can be mentioned are the increase of flexibility, and the decrease of the product/process design cycle time. The increase of flexibility can be obtained because a network of suppliers can provide any organization with the ability to adjust the scale and scope of their production capability upward or downward, at a lower cost, in response to changing demand conditions and at a rapid rate. (McCarthy & Anagnostou, 2003) The decrease of the product/process design cycle time is mentioned by Quinn: outsourcing can decrease the product process design cycle time, if the client uses multiple best-in-class suppliers, who work simultaneously.
2.2.2 Disadvantages of outsourcing

Now that the advantages that can be obtained from outsourcing have been mentioned we will now mention the disadvantages that can occur when outsourcing. The disadvantages that are most often mentioned are among others, the loss of management control, loss of skills, overdependence on outside organization and the threat the supplier bypasses you in the long-run. With regard to the loss of management control Oshri et al. (2009) mention the following: Another major issue is losing control over the timing and quality of outputs since these will be undertaken by an outside vendor which may result in a poorer quality of the final product or service and may generate effects which could be very negative to a company’s image. Some other disadvantages that can occur are mentioned by McCarthy et al. (2004) who mention that: outsourcing can generate new risks, such as the loss of critical skills, developing the wrong skills, the loss of cross-functional skills, and the loss of control over suppliers.

Overdependence or even reliance on a supplier can also be a disadvantage for the outsourcing company for a number of reasons. Oshri et al. (2009) argue that overdependence on an outside organization for carrying out important business functions may evolve into significant threats to a company’s well-being. Other researches mention that reliance on a supplier can also become a disadvantage for the outsourcer because of the loss of innovation that can occur, according to Gilley et al. (2000): One of the most serious threats resulting from a reliance on outsourcing is the declining innovation by the outsourcer. Outsourcing can lead to a loss of long-run research and development competitiveness because it is often used as a substitute for innovation. Kotabe goes even further in his arguments against outsourcing by stating that reliance on outside suppliers is likely to lead to loss of overall market performance.

One other important disadvantage that is often mentioned is the threat that the supplier will evolve into a competitor in the future. According to Quinn et al. (1994): Some suppliers after building up their expertise with the buyer’s support may attempt to bypass the buyer directly in the marketplace. This statement is also acknowledged by Gilley et al. (2000) who states that: as suppliers gain knowledge, they may use that knowledge to begin marketing that product on their own.
2.3 Types of outsourcing

In this section of the report, a few important types of outsourcing market are discussed; the distinction between the different types of outsourcing is based on the location to which the outsourcing is done. There are four types of outsourcing that are discussed in this section of the report namely near shoring, home shoring, far shoring and best shoring. In the first two types a company decides to outsource towards a location that is close to their home or to a location then lies within their home country. In the third type a company outsources towards a location that lies far from to indigenous country. In the fourth type of outsourcing the three other types are combined.

2.3.1 Nearshoring

The first two important trends that are often mentioned within the field of outsourcing are nearshoring and homeshoring, as mentioned before both of these trends deal with location. When companies decide to nearshore or homeshore they have decided to outsource much closer to home. Nearshoring is off shoring to a country that is much closer to the home country of the outsourcing company, while homeshoring means outsourcing to a company in the same country. According to Carmel & Abbott (2007, p42): Countries and companies viewing themselves as nearshoring claim to offer some of the benefits of off-shoring (namely, cost-reduction) while mitigating difficulties imposed by distance from the client. According to them these difficulties that can arise from distance are issues of communication, control and supervision and coordination. These difficulties can be reduced when distances decrease. The concept of nearshoring and its importance in the outsourcing market is also mentioned by Tjia (2007, p11) who states that during the last years many countries occur who do provide the advantages of outsourcing, but decrease the disadvantages of outsourcing. According to Tjia the countries that qualify as nearshore countries can mostly be found in Central en Eastern- Europe. Carmel & Abbott distinguish two big clusters that can be qualified as nearshore countries. The first cluster is located around the U.S. and Canada, these countries are mostly located in Central-America, South-America and the Caribbean. The second cluster that is identified is located around the Western-European countries with the locations of most of these countries in Central Europe and Eastern Europe. A third smaller nearshoring cluster lies around Japan and Korea, these companies have the opportunity to nearshore to other Asian countries such as China.
2.3.2 Homeshoring

Homeshoring works about the same as nearshoring, with a difference on the fact that outsourcing does not pass national boundaries. With homeshoring activities are not outsourced to another country, but towards another company operating in the same country. This is also mentioned by Crane, Stachura, Dalmat, King-Metters & Metters (2007, p79): In homeshoring a process is decoupled, just as it would be if it were offshored, but the work is sent to low-wage areas within a firm's own country, rather than to another country. According to Crane et al. the motivation behind homeshoring is primarily to cut costs, just like it is with offshoring. The benefits mentioned are almost the same as with nearshoring. It makes communication and coordination easier because cultural differences are avoided, and differences in time-zones are avoided as well. Another benefit that is mentioned is that when outsourcing does not transcend boundaries, no difficulties with other government regulations can arise. According to Crane et al. another important factor when choosing between offshoring and homeshoring is the image that a company wants to have. If a company wants to have or maintain the image of being concerned with the local environment, then they might decide to choose for homeshoring because. As an example they mention a response from the chairman of the bank of America, who was asked about outsourcing towards India. The chairman answered that he could not see that happen, simply because they are the bank of America, and the public relation aspect would become to difficult if they were to practice offshoring. The last reason to choose for homeshoring instead of offshoring is the fact that with homeshoring a company does not take risks when it comes to cultural bias. According to Crane et al. this become an important aspect in America, they mention that: The media hype, political campaigns, and terrorism of past years have made consumers much more conscious of protecting American workers and American jobs from overseas concerns. They also mention that cultural bias issues are also important for employees, because workers may feel greater pride in the firm and identification with their employer due to the decision to remain in the indigenous country.

2.3.3 Offshoring/Farshoring

As the term itself implicates farshoring is the opposite of nearshoring. When a company engages in farshoring, they outsource an activity towards a country that lies far away from the home country in terms of distance. The reason that companies might choose for farshoring instead of choosing for nearshoring or homeshoring is because the nearshore and homeshore locations cannot provide the outsource company with the same benefits as the farshoring locations.
These benefits are often in terms of cost. For instance, the wages for the homeshoring and nearshoring can be relatively low when looking at the outsourcing companies’ perspective, but these wages can still be much higher than in certain farshoring locations. According to Carmel & Abott, India can be seen as one of the most important farshoring locations. They mention that problems that can occur when farshoring are the following: difficulties on communication, control and supervision, the creation of social bonds and the building of trust.

2.3.4 Bestshoring

A new buzzword used by service providers and consulting firms is bestshoring, reflecting the experience of firms that not all offshoring decisions are satisfactory and strategically effective. (Winkler, 2009) According to Oshri et al. the concept of bestshoring can best be explained through the example of the outsourcing contract between TCS and Abn-Amro. In this contract TCS provides services to the bank from offshore locations (Mumbai and Sao Paulo), from nearshore locations (Budapest and Luxembourg), and from an onshore location (Amsterdam). In other words this means that bestshoring tries to obtain benefits from the three on the different strategies. This is also underlined by Oshri et al. who argue that the client and the vendor assess the most appropriate location to provide services on certain criteria (e.g. availability of skills, language, cost)

2.4 Summary

This chapter of the report started with providing a definition of what outsourcing really is. In order to determine this definition, four views on what outsourcing is were presented. All of these views had several things in common. Through these four views a definition was derived that is used throughout this whole report. This definition saw outsourcing as a process in which a company transfer the control of either a primary or a secondary activity towards a third party by means of a contract. After a definition of outsourcing was given a overview was presented with the risks and benefits that can occur with outsourcing. The most benefits that were mentioned are among others: Cost cuttings, focus on core competencies, increase in flexibilty and the access to superb supplier knowledge. The most important risks that were mentioned are among others: the loss of management control, loss of skills, overdependence on outside organization and the threat that the outsource supplier is able to bypass you in the long-run. In the last part of this chapter we described four different types of outsourcing with regard to the location where the outsourcing takes place. The four types that are described are: nearshoring, homeshoring, farshoring and bestshoring.
3. Location decisions

3.1 Introduction
This chapter will deal with the concept of locations decisions in outsourcing. The chapter consists out of two parts. In the first part an explanation is given about the importance of location decisions for companies when outsourcing. In the second part the factors that have an influence location decisions will be presented. These factors can be economic factors that deliver the benefits to the outsourcer is presented in the last chapter, but it can also be political or geographical factors.

3.2 Importance of location decisions

Recent research strongly advocates that to realize the potential for improved competitiveness, outsourcing decisions should be strategic in nature, and made in alignment with the competitive priorities of the firm (Kroes & Ghosh 2010). Selecting location is one of the major challenges organizations face when making offshoring and outsourcing decisions. (Oshri et al.). Therefore it is very important to align the chosen outsourcing location with the competitive priorities of the firm. If the country of choice is not able to provide the outsourcing company with the desired benefits, that the outsourcing company can end up losing. According to Aron and Singh (2005) location is one of the two most important factors that decide the fate of offshoring strategies. It is often said that location is not as important as it was because of the world’s globalization. The argument for this is that due to the globalization almost anything can be reached and therefore the differences in quality for different locations are decreasing. However this argument is countered by Porter (1998, p78) who states that: the enduring competitive advantages in a global economy lie increasingly in local things that distant rivals cannot match. In other words, Porter argues that due to the increasing globalization in the world economy locations have become more important when trying to obtain a competitive advantage over competitors.

3.3 Factors influencing location decisions

According to Oshri et al. several different frameworks for selecting offshore and outsourcing destinations have been offered in the existing academic and professional literature. A few of these frameworks will be discussed here, because they consider the factors that have an influence on location decisions. The frameworks that will be considered are Farrell’s six factors model (2006), which is acknowledged by Oshri et al. to be the most effective framework, and A.T Kearney Global three factors model.
According to Sharma (2010 p9) practically all outsourcing location frameworks primarily consider costs, business environment, linkages & trust, availability of infrastructure, labour resources and specific skills as the key factors affecting the success of outsourcing. This is partly acknowledged by Oshri et al. who state that all of the frameworks at least consider costs, business environment, availability of skills and specific skills.

### 3.3.1 Farrell’s six factor model

Farrell’s six factor model considers the variables costs, availability of skills, environment, the quality of infrastructure, risk profile and market potential. A list of the six factors with the subcategories can be found in Appendix A. Within the field of costs a few different types of costs are considered according to Farrell, these different type of cost include labour costs, infrastructure cost, real estate costs and corporate taxes. Labour costs are the average wages for skilled staff and managers. Infrastructure costs are unit costs for the use of among others telephone, internet and power. Real estate costs include only the costs of a class A office space, while corporate taxes costs refer the tax burden, or conversely the text breaks and other incentives for local investments. Within outsourcing location decisions the total amount of costs between different potential locations are compared to each other.

The second variable that is considered by Farrell is the availability of skills; this variable consists out of three different parts. These three parts are *skill pool*, which refers to size of the labour force that has the desired skills, *size of offshore sector*, refers to the dollar volume in the country and the share of employment in the sector and the vendor landscape, which measures the size of the local sector that is able to provide the desired services. According to Oshri et al. the scalability of labour resources in the long term is a major issue to consider while deciding on a sourcing destination.

The environment is the third factor that is mentioned by Farrell, the factor environment includes the government support, the business environment, the living environment and the accessibility of the region. With regard to the government the policy on foreign investment, the laws on labour and the level of corruption play an important role. Some other frameworks, such as Carmel’s oval eight factor model (2003) see the government as a factor on its own. Carmel has separated Farrell’s environment factor into three different factors: The government, the industry environment and the quality of life. The business environment in Farrell’s model includes the differences in culture and ethics. The living environment refers to the overall quality of life as well as the prevalence of HIV infections and the serious crimes rate per capita. Accessibility measures the flight time, the frequency of flights and the time difference.
Another factor that is mentioned by Farrell is the quality of infrastructure. This includes the quality of telecommunication and IT (network downtime, speed of service restoration and connectivity) it further includes the availability and quality of real estate, the quality of transportation (the scale and quality of roads and rail networks) and the quality of power in terms of reliability and power supply. The importance of the quality of power and telecommunication is also mentioned by Carmel, he argues that in many developing countries stoppages of power occur at a daily basis and the costs of communication remains high in these countries.

The risk profile of a potential outsourcing location is another important variable that should be taken into consideration according to Farrell. According to Graf & Mudambi (2005) companies seek to limit their risk exposure by restricting the resources committed when the risk in a country is high. For outsourcing this means that a high risk profile will likely lead to a decision not to invest in a certain country. In Farrell’s model the factor risk profile consists out of five different variables. These five variables are disruptive events, security, regulatory risks, macroeconomic risks and intellectual property risk. Disruptive events refer to the risk of labour uprisings, political unrest and the occurrence of natural disasters. Within the variable security the risks of fraud, crime and terrorism are considered. Regulatory risks contain risks in stability, fairness and the efficiency of the legal framework. Furthermore the risks of inflation, currency fluctuation and capital freedom are considered within the macroeconomic risks and intellectual property risks include the strength of data and IP protection regime.

The last factor that is mentioned by Farrell is the market potential of outsourcing locations. The market potential of a location can be measured by the attractiveness of the local market (based on the current GDP and the GDP growth rate) and the access to nearby markets (in the host country and adjacent regions). According to Oshri et al. this access can take one or more of the following forms: as a captive operation using local labour, infrastructure and resources; as an outsourced operation using local IT service suppliers; and as an potential suppliers to organizations that are based in the host country and nearby regions.

3.3.2 Measuring attractiveness

A.T. Kearney Global location index is a different model that assesses the attractiveness of locations for outsourcing and offshoring. According to Oshri et al. A.T. Kearney’s model is less detailed than Farrell’s six factors model. Within A.T. Kearney’s model three different scores are given to each potential outsourcing location. The scores are given on financial attractiveness, people and skills availability and the business environment. These scores are than added up to produce a final score for the outsourcing country. For the factor financial attractiveness the
scores can differ between zero and four. For the factor people and skills availability and the business environment the scores can differ between 0 and 3. Therefore A.T Kearney states that the scale of the three scores is forty, thirty and thirty. According to Oshri et al A.T. Kearney’s model is not complete. They argue that a qualitative assessment should be combined with the quantified approach to decide on the attractiveness of a location for outsourcing. They also argue that giving outsourcing scores to a whole country is a bit short-sighted, since costs, availability of skills and infrastructure may vary quite significantly across cities within the same country. This is also mentioned by Vashista & Khan (2008), they argue that comparing countries is superficial because no two cities of a country would be at the same level of skills maturity or offer the same cost advantage. They further mention that attractiveness for outsourcing can better be measured on city level, because it is rather the city than the country which represents a more accurate package of attributes.

Another approach for assessing the attractiveness of locations is given by Farrell (2006); According to Oshri et al. this model assesses among others the scale and quality of workforce as well as the business catalyst, cost, infrastructure and quality of life. According to Farrell there is no real hierarchy within the factors that influence location decisions. She mentions that every company should articulate precisely what it requires from an offshore location and assess all the location that could meet those needs into the future at acceptable cost and risk. She further states that a company should weight data on alternative sites on the basis of relative importance of the factors driving its decisions to offshore.

Farrell’s location decision model consists out of four steps. During the first step a list of all potential locations is drawn, while doing this certain locations that do not meet criteria (e.g. to much distance or political instability) are eliminated already. The second step is to define the decision criteria, according to Farrell these criteria always belong to the six factors that were described in her model. After defining the decision criteria a company needs to gather information on the potential locations that were obtained during step one, this data can be both quantitative (e.g. costs) or qualitative (e.g. perception of risk). In this step Farrell mentions that the scores on the variables should not be obtained for countries, since these scores can vary significantly across countries. During the fourth step a company should give more or less weight to each of the criteria based on the relative importance to the company. The fifth step is to make a ranking of the potential locations in order of their attractiveness to the company. The sixth step is to measure whether the quality of the location is sustainable. During this step companies have to estimate future supply and demand for young professionals by assessing how many young people will graduate in the upcoming years. It is also important to take into account whether the current wage levels are likely to last in the upcoming years.
3.4 Summary

In this chapter several different factors that can have an influence on location decisions for outsourcing were distinguished. This was mainly done through the use of Farrell’s six factor model. This model considered many different factors that have an influence on location decisions and divided these factors into six main factors which were costs, availability of skills, environment, quality of infrastructure, risk profile and market potential. The different variables that should be considered within each of these six factors were presented as well. It was also mentioned that the six factors should not only be considered on the current availability but also on their sustainability with regard to the future. Furthermore, a framework of how outsourcing location decision should be made was given. In this section it was also mentioned that there is no general hierarchy for the factors concerning outsourcing location decisions. The importance of each of the factors can differ between cases, and therefore the outsourcing company itself should establish a hierarchy in the factors based on the relative importance to the company.
4. Conclusion

In the two previous chapters the two research questions were answered in order to draw a conclusion on the main question of this report; which factors determine location decisions in terms of outsourcing?

The first research question handled the concept of outsourcing, in this section a definition of outsourcing was given that was used throughout the whole report, in this section the definition of outsourcing that was drawn was the following one: outsourcing is a process in which a company transfer the control of either a primary or a secondary activity towards a third party by means of a contract. In this section a few different types of outsourcing were distinguished with regard to the location where it takes place. The different types that were mentioned were homeshoring, nearshoring, farshoring and bestshoring. Furthermore the most important advantages and disadvantages when outsourcing were discussed. The most important advantages that can be obtained through outsourcing are financial benefits, which occur mostly through cost cuttings, an increase in flexibility, the ability to focus on core competencies and the access to superior supplier knowledge. The most important risks that were mentioned are the loss of management control, overdependence on supplier, the decline of innovation, and the risk of being outsmarted by the outsourcing supplier.

The second research question gave an explanation about which factors are important when making a location decision in outsourcing. Several different factors were mentioned which could all be grouped into six main categories. These six categories were costs, the availability of skills, the environment, the quality of the infrastructure, the risk profile and the market potential. It was also established that there was no real overall hierarchy between these six different factors. From the conducted research, the conclusion was drawn that every company should establish there own hierarchy based on the relative importance of each of the influencing factors.

So, when answering the main question, it can be argued that each of the different factors have the ability to influence location decisions. It is depended on the company itself which factors are perceived as important and which factors are not. However, it can be established which factors have the biggest influence in most of the cases. In order to do so, the drivers of outsourcing for companies should be analyzed. Lewin & Peeters (2006) have made a list of the factors that drive outsourcing for companies. The list of these drivers including percentages can be found in Appendix B. Lewin & Peeters asked several respondents which factors drove their outsourcing decision by letting them assign points to these drivers on a five point Likert scale. They marked a factor as important when a respondent gave a driver a four of a five.
It was estimated that for 93% of the respondents, taking out costs was one of the important drivers when making outsourcing decisions. Therefore, it can be argued, that in most cases the factor cost is an important factor when making location decisions. Furthermore, 55% of the respondents, argued that accessing qualified personnel was an important factor for them. For these respondents it seems that the factor availability of skills is an important factor. 33% of the respondents stated that the access to new markets was important when making outsourcing decisions, for these respondents the market potential of an outsourcing location is an important factor as well. The other three factors, which are environment, quality of infrastructure and risk profile, do not seem to drive outsourcing location decisions. Yet in order to be considered as a potential outsourcing location, the ratings for these three factors should be higher then a certain minimum. For instance, when a location scores very poor on risk profile, for example due to high political instability, there exists much perceived risks, and companies will then be very reluctant to outsource their activities towards this location. The same can be said for quality of infrastructure. When power supply is not reliable, and hence the occurrence of power stops is likely to occur on a daily basis then companies will not consider outsourcing to these locations.

Based on the before mentioned information the conclusion is drawn that all of the factors are important when choosing a location. However, some of the factors that influence location decisions can be seen as qualifiers, while other factors can be perceived as winners. The environment, the quality of infrastructure and the risk profile seem to be factors that need to reach a minimum amount of quality before a location is considered as a potential outsourcing location by companies. The other factors, availability of skills and the market potential, and costs seem to be factors that drive the location decisions when comparing the potential outsourcing locations. With cost as the most influential factor in most of the decisions.
5. Future research

This study handled the concept of outsourcing location decisions. With regard to the factors that influence outsourcing location decisions, a few different models were analyzed, with Farrell’s six factor model as the most important one. From some other articles and books it was derived that this six factor model was one of the most efficient models with regard to location decisions. Furthermore, regarding the concept outsourcing, several articles were used to sketch a reliable overview of what outsourcing is, and what advantages and disadvantages can occur in outsourcing.

However, all information presented is based on sources that are of secondary nature. Therefore, in order to increase the validity of this research, it could be useful to include some primary data obtained through analyses of cases regarding outsourcing location decisions and a survey that measures the incentives that drive outsourcing.

Furthermore, it could be interesting to conduct a research that measures whether companies align their competitive priorities with the chosen outsourcing location in an appropriate way. This could make managers and company more aware of the importance of outsourcing locations within the overall strategy of the company.
6. References


Factors in Choosing a Location

To make the right offshoring decisions, companies should assemble detailed information on a number of factors:

Cost
- Labor: current average wages for skilled workers and managers
- Infrastructure: unit costs for telecom networks, Internet access, and power
- Real estate: cost of class A office space
- Corporate taxes: the total tax burden or, conversely, the tax breaks and other incentives for local investment

Availability of Skills
- Skill pool: size of labor force with the required skills
- Size of offshore sector: dollar volume and share of employment in the sector, as well as share of these services as a percentage of total exports

Vendor landscape: size of local sector providing IT services and other business functions

Environment
- Government support: policy on foreign investment, labor laws, bureaucratic and regulatory burden, and level of corruption
- Business environment: compatibility with prevailing business culture and ethics
- Living environment: overall quality of life, prevalence of HIV infection, and serious crimes per capita
- Accessibility: travel time, flight frequency, and time difference

Market Potential
- Attractiveness of local market: current GDP and GDP growth rate
- Access to nearby markets: in the host country and adjacent region

Risk Profile
- Disruptive events: risk of labor uprising, political unrest, and natural disasters
- Security: risks to personal security and property from fraud, crime, and terrorism
- Regulatory risk: stability, fairness, and efficiency of legal framework
- Macroeconomic risk: cost inflation, currency fluctuation, and capital freedom
- Intellectual property risk: strength of data and IP protection regime

Quality of Infrastructure
- Telecom and IT: network downtime, speed of service restoration, connectivity
- Real estate: availability and quality
- Transportation: scale and quality of road and rail network
- Power: reliability of power supply
### Appendix B

Retrieved from Lewin & Peeters 2006

<table>
<thead>
<tr>
<th>Strategic Drivers</th>
<th>% of respondents citing driver as important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taking out cost</td>
<td>93%</td>
</tr>
<tr>
<td>Competitive pressure</td>
<td>69%</td>
</tr>
<tr>
<td>Improving service levels</td>
<td>56%</td>
</tr>
<tr>
<td>Accessing qualified personnel</td>
<td>55%</td>
</tr>
<tr>
<td>Changing rules of the game</td>
<td>41%</td>
</tr>
<tr>
<td>Industry practice</td>
<td>37%</td>
</tr>
<tr>
<td>Business process redesign</td>
<td>35%</td>
</tr>
<tr>
<td>Access to new markets</td>
<td>33%</td>
</tr>
<tr>
<td>Enhancing system redundancy</td>
<td>27%</td>
</tr>
</tbody>
</table>

% of respondents who answered 4 or 5, on 5 points Likert scale, to proposed strategic drivers of offshoring.