

Outsourcing and Offshoring of Professional Services

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Globalization, digitization, and pressures to reduce costs have given rise to the outsourcing and offshoring of professional services. Outsourcing and offshoring are two outcomes of the same strategic drivers triggering firms to reconfigure their activities organizationally and geographically. This chapter analyzes the causes and consequences of this phenomenon from the perspective of professional service firms (PSFs).

In order to fully capture the drivers behind this phenomenon, the chapter is predicated on three framing assumptions. First, we position PSFs in a global value chain, mindful of strategic interactions for all actors in the value chain. Sandwiched between corporate clients and suppliers of outsourced services, PSFs are both outsourced providers and outsourcers of services. Given this positioning, PSFs are intermediaries competing against new entrants with alternative business models. New entrants are potentially disruptive, with ramifications for the governance of professional service firms and the ecology of professions.

Second, this broad scoping requires maintaining a porous boundary between professional services and non-professional business services. It adds complexity to analyzing professional services, a category with considerable heterogeneity. But it also enables us to investigate how the disaggregation of professional tasks is transforming the boundary between professional and non-professional work. In order to focus on this aspect, we examine what Porter (1980) refers to as primary activities, not support activities, in the value chain. PSFs outsource and offshore both their support activities and primary activities, the latter being legal work for law firms, financial modelling for investment banks, design services for architectural firms, or business research for strategy consulting firms. We focus on primary activities to test the analytical purchase of existing theories about outsourcing and offshoring, when applied to PSFs.

Third, our core concern in this chapter is PSFs' strategies for outsourcing and offshoring. Outsourcing and offshoring are conceptually distinct. A different set of factors determines each. But as strategic decisions, they need to be analysed simultaneously (Contractor, Kumar, Kundu, & Pedersen, 2010) because no decision is organizationally or geographically 'neutral'. PSFs, as other firms, are confronted with a combinatorial choice, for instance between captive offshoring and offshore outsourcing. Arriving at an optimal choice requires drawing on a number of theories, and gauging whether different determinants (e.g. proximity vs ownership) are substitutes or complements.

The practice of outsourcing and offshoring in professional services is of recent origin compared to the practice in manufacturing and services at large. Moreover, business corporations, and not PSFs, initiated outsourcing and offshoring as part of their corporate restructuring drive. Corporations make

outsourcing and offshoring decisions in a range of business functions, including information technology (Lacity, Khan, & Willcocks, 2009; Willcocks & Lacity, 1999), engineering services (NAE, 2008), R&D (Manning, Massini, & Lewin, 2008), finance and accounting (Bangemann, 2005), human resources (Adler, 2003; Gospel & Sako, 2010), customer relations (Holman, Batt, & Holtgrewe, 2007), and legal services (Sako, 2011b). Consequently, the approach taken in this chapter is to review theories developed largely for business corporations in manufacturing and services, and draw implications for PSFs.

The chapter is structured as follows. Section 1 reviews various theories that are relevant to outsourcing and offshoring, and makes links to professional services. Section 2 discusses digital technology and the production-line approach (Levitt, 1972) as pre-requisites for outsourcing and offshoring. Section 3, the core of this chapter, homes in on PSFs, and analyses the impact of governance structures on the outsourcing/offshoring decision. We identify in what ways partnerships make some PSFs reluctant outsourcers and offshorers. Section 4 discusses the consequences of outsourcing and offshoring by PSFs with specific reference to the ecology of professions and the potentially disruptive nature of new entrants in business services. Section 5 concludes with suggestions for future research directions.

1. Theories relevant to Outsourcing and Offshoring

Although the terms ‘outsourcing’ and ‘offshoring’ have a contemporary ring, the phenomenon is as old as the hills in professional services. Historically some liberal professions, such as in accounting and law, predated the rise of the modern corporation. Other professionals were created by corporations to meet

their business needs in marketing, human resources, procurement, and later information technology (Galambos, 2010). These organizational professionals and earlier 'liberal' professionals always had the choice between working in market or in hierarchy, i.e. choosing between working outside business corporations as sole practitioners or in PSFs, and working inside business corporations (Sako, 2013).

In the twentieth century, corporations rather than PSFs initiated outsourcing and offshoring. The first corporate activities to be outsourced and offshored were software programming and information technology (IT), dating back to the 1980s. In the 1990s, so-called IT-enabled services spread from customer relationship management, in the form of call centers, to other corporate functions in human resources (e.g. payroll administration), finance and accounting (e.g. accounts payable), procurement and logistics, and legal services (e.g. contract review and litigation support). The timing coincided with the integration of low-cost locations into the world trading system, in India, China, Philippines, South Africa, Latin America, and central Europe.

From the perspective of business corporations, outsourcing and offshoring of professional services is part and parcel of corporate restructuring involving the 'unbundling of corporate functions' (Sako, 2005, 2006). This is the separation of administrative business processes from divisional business units to create corporate-wide shared services in pursuit of cost reduction, risk mitigation, and process improvements. Shared services centres may then be outsourced and/or offshored.

Outsourcing is a decision to change the firm boundary, by choosing 'buy' over 'make'. *Offshoring* refers to the decision to relocate from within domestic

borders to overseas. They are conceptually distinct, each with a different set of determinants. But as strategic decisions, outsourcing and offshoring need to be analysed simultaneously, as no decision can be organizationally or geographically 'neutral'. Combining the two dimensions in a two-by-two matrix, firms have a choice among being in one of four 'boxes', namely onshore insourcing, onshore outsourcing, offshore insourcing, and offshore outsourcing (see Figure 1). Often times, insourcing of business services is known as 'shared services', and offshore insourcing is referred to as 'captive' offshoring (McIvor, 2010).

INSERT FIGURE 1 ABOUT HERE

Beyond these definitions, different social science theories use different levels of analysis to explain why outsourcing and offshoring occur. There are three types of theories, some addressing geography (i.e. for offshoring) only, others analysing organizational boundary (i.e. for outsourcing) only, and yet another category dealing with both (see Table 1 for a summary).

First, with a focus on crossing national borders, international trade economists use the theory of comparative advantage to associate the concept of offshoring with international trade and foreign direct investment. In addition, economic geographers analyze locational and regional cluster advantages (Storper, 2000). These disciplines have in common the national economy (or sub-national region) as the unit of analysis, without attributing much agency to firm-level decision-makers. Ownership structure of firms and make-or-buy decisions are not objects for analysis in identifying trade and FDI flows, nor in identifying global production networks and regional clusters.

INSERT TABLE 1 ABOUT HERE

In the past, manufacturing sectors dominated the empirical context for applying these theories. But more recently, previously non-tradable services have become increasingly tradable, resulting in services offshoring and ‘trade in tasks’ (Baldwin, 2006). Some of these services and tasks are in technical and administrative services (Kenny, Massini, & Murtha, 2009), a category that includes professional services. Services offshoring, identified as import (i.e. payment for services rendered overseas), was estimated to be in the range of \$90 - \$100 billion in 2009, although the figure could be as high as \$380 billion if intra-firm trading (i.e. captive offshoring) was taken into account (UNCTAD, 2011). In a subcategory, ‘business, professional and technical services’, offshoring activities are dominated by the US and EU, which both have a trade surplus (i.e. the supply of offshore services out of these locations outweigh their demand for offshored services) (see Figure 2).

INSERT FIGURE 2 ABOUT HERE

A second set of theories, organization economics and managerial theories of the firm, focus on firm-level outsourcing decisions, relegating relocation decisions to be of secondary importance. Theories of the firm range from transaction cost economics, property rights theory, resource-based view and its various renditions involving knowledge and capabilities (Gibbons, 2005; Grant, 1996; Teece, Pisano, & Shuen, 1997). Firms readjust their boundary by outsourcing or insourcing whenever changes occur in transaction costs, resources, or capabilities in market relative to hierarchy.

The dynamic aspect of firm boundary choice is important. In the professional services context, just as in the early days of adopting a new piece of technology, professional services may bias firms towards ‘make’ because the

underlying 'knowledge is often tacit, that is, uncoded, non-verbalized, and often embedded in organizational routines' (Afuah, 2001). However, professional services are not associated with fast rates of technological change. Perrons, Richards, and Platts (2004) found that 'make' is preferred in industries with very fast or slow rates of technological change, while 'buy' is more appropriate in industries with medium pace. Thus, the slow technological 'clockspeed' in professional services might bias the firm's value chain design towards insourcing.

A third category of theories gives equal regard to offshoring and outsourcing, with certain assumptions made to make this possible. The eclectic paradigm in International business (IB) represents a good example. Multinational corporations, as they expand internationally, leverage a combination of 'location advantages' and 'internalization advantages' (Dunning, 1988). Location here embodies both costs, enabling arbitrage between locations, and benefits deriving from the quality of national institutions. Internalization, i.e. make rather than buy, derives from multinationals' attempt to avoid factor market failures in overseas locations.

Another approach, focusing on job characteristics, could address both offshoring and outsourcing, although studies were carried out primarily to address the fear of job loss due to offshoring. Blinder and colleagues make a distinction between 'personal services' requiring face-to-face contact and 'impersonal services' that do not and therefore can be delivered to, and from, remote locations. He also noted that both low-skilled jobs (e.g. hairdressers) and high-skilled jobs (e.g. court judges) require face-to-face interaction. Similarly, some low-skilled (e.g. typing) and high-skilled jobs (e.g. computer programming) may be in 'impersonal services'. Thus, jobs requiring higher skills are not

necessarily less 'offshoreable' than those with lower skill content (Blinder, 2009; Blinder & Krueger, 2009). By implication, professional jobs, whilst highly skilled, are 'offshoreable' to a different degree, with some jobs (e.g. client-facing advisory work) containing greater elements of face-to-face interaction than other jobs (e.g. research).

Moreover, the underlying assumption that 'impersonal services' are inherently offshoreable can be extended easily to the claim that they are also outsourceable. The reason for this ease of extension is that firm-level decisions are not theorized. Without decision-making agency, it is difficult to gauge under what conditions offshoreable jobs are actually offshored.

Eclectic combinations of the above theories would provide much insight into the outsourcing/offshoring decisions by PSFs. However, to date, outsourcing and offshoring tend to be treated separately in social science disciplines, privileging either the firm boundary decision or the relocation decision. The two need to be brought together more fully to analyse decisions by PSFs. For example, to what extent might geographic proximity replace or complement ownership as means of control? What is the impact of governance structures on the decision-making process?

2. Understanding Transformation in Professional Work

The nature of professional work has evolved over decades due to a complex set of factors, including digital technology, corporate strategy, and government regulation. In this context, outsourcing/offshoring is simultaneously a cause and a consequence of such transformation. It is a cause because outsourcing and offshoring require a certain degree of disaggregation,

standardization and modularization of tasks before services can be delivered from one legal entity to another at a geographic distance. It is a consequence also because the application of these operational techniques may be triggered by, and therefore follow, the decision to outsource or offshore.

A comparison with manufacturing highlights the challenges professionals and PSFs face in responding to offshoring. Offshoring in manufacturing, in the form of sourcing components and contract assembly from around the world, began in the middle of the twentieth century (Sturgeon, 2002). But offshoring in services, particularly in professional services, is a relatively recent phenomenon. Trading at a distance requires the routinization and standardization of tasks. In manufacturing, modern technology and Taylorist principles of scientific management were applied to this end first, well before offshoring became prevalent (Gereffi, Humphrey, & Sturgeon, 2005; Sturgeon, 2002; Thun, 2010). In professional services, offshoring is on the rise at the same time that task standardization is spreading. In many cases, offshoring is a trigger to routinize tasks in professional jobs. In professional services, as in other sectors, offshoring is equivalent to turning an employment contract into a sales contract (Simon, 1951).¹ This contractual shift, to an extent, necessitates codifying things that had been implicit prior to the shift (Davis-Blake & Broschak, 2009).

Professional services are a subset of services. Services may, in turn, be categorized into high- and low-contact services, with contact defined as the physical presence of the customer in the service delivery system (Chase, 1978). Another related distinction often made is between back-office and front-office operations. In a PSF context, law firms' front office provides legal advice to

¹ I thank John Forth for this insight.

clients, whilst their back office includes managing billing and payment processes. Back-office operations require low or no customer contact and lend themselves to what Levitt called a production-line approach to services (Levitt, 1972). By this, he meant that services could significantly improve their performance in both productivity and quality, if managers adopted the manufacturing principles of task standardization, clear division of labour, and process flows. By contrast, it is more challenging to apply the production-line approach to front-office services that require high levels of customer contact and inputs in the course of service delivery.²

A different kind of scholarship, led by economists interested in the impact of computer technology on skills, has developed a typology that sheds light on the substantive nature of professional skills. Building on cognitive and behavioral sciences, Levy and Murnane (2004) draw a distinction between ‘rule-based’ tasks (for which information processing can be fully described in rules) and ‘pattern recognition’ tasks. In the latter, rule-based solutions are not possible, and people solve problems through case-based reasoning, a type of pattern recognition, constructing analogies between the new problem and past problems. Computers change the task composition of human work. They substitute for workers carrying out routine ‘rule-based’ tasks, whilst they complement workers carrying out non-routine problem-solving tasks (Autor, Levy, & Murnane, 2003) thus preserving a high level of discretion in professional work (e.g. use of video links in courts or digital images in open heart surgery).

² In reality, both front-office work and back-office work can be decomposed into tasks, some of which are more routine than others. In considering employees who work within any corporate function, firms often make a distinction between ‘strategic partners’ who make judgments (e.g. a finance manager involved in devising investment decisions) and ‘administrative experts’ whose primary concern is to make routine business processes (e.g. accounts payable, non-judgmental audit procedure) more efficient.

The task analysis lens leads to a realization that the balance between routine and non-routine tasks varies across different profession work. This avoids the blanket application of 'digital Taylorism' to describe the trend towards standardization in all professional jobs (Brown, Lauder, & Ashton, 2011). Task disaggregation and routinization occur in part due to digital technology, automating manually intensive tasks. But we expect automation to happen less at PSFs with a partnership structure, which do not allocate or raise large sums for non-human capital investment (Greenwood & Empson, 2003). Equally important is the brake on task disaggregation placed by self-regulating professions, who regard it as a threat to their professional identity and ethics.

Last but not least, the deregulation of some professional services markets (e.g. Legal Services Act 2007 in England and Wales) facilitates task disaggregation. Such policy puts pressure on professionals to justify the esoteric nature of their work that only fully qualified professionals are permitted to undertake. Deregulation facilitates the decomposition of professional work into tasks some of which may be carried out by semi-professionals and non-professionals. The more disaggregated the tasks the easier it is for non-professionals to carry out those tasks. Contract specialists who draft and review contracts (e.g. in derivatives) in financial services are one such example.

In short, professional services are receiving transformational pressures simultaneously from the 'production-line approach' (Levitt, 1972), digitization, and deregulation. All these forces have contributed towards disaggregating professional work into constituent tasks and standardizing some of those tasks. Disaggregation and standardization are a pre-requisite for the efficient and effective outsourcing and offshoring of professional services. However, the

extent to which they are adopted depends on the governance of PSFs, a topic to which we turn next.

3. Outsourcing and Offshoring by Professional Services Firms

A central concern of this Handbook lies in understanding the nature of PSFs and their strategic management processes. The nature of an organization inevitably influences such processes (Greenwood, Hinings, & Brown, 1990). This section draws out the implications of different governance structures of PSFs for their outsourcing/offshoring decisions. Since PSFs are governed in different ways across sectors and over time, we identify enablers of, and barriers to, outsourcing and offshoring in each governance type – the public corporation, professional partnership, and managed professional business. In particular, consulting firms and investment banks practised offshoring and outsourcing earlier and more widely than law firms because some of them adopted ownership structures other than partnerships (Greenwood & Empson, 2003).

Evidence of outsourcing and offshoring by PSFs

Gary Senior, Managing Partner of Baker & McKenzie in London, defines offshoring as ‘teaming with people in another country in the provision of services, whether it is through the back office or the direct provision to clients’.³ He further states that offshoring is a technique to be efficient. Three things are of note about this particular perspective on offshoring. First, offshoring is regarded as an operational technique for enhancing efficiency, remote from strategic concerns of value creation. This implies that decentralized organization

³ <http://www.youtube.com/watch?v=uVpS0Nik0o> (accessed on 7 August 2013).

units can make offshoring decisions. Second, offshoring involves teamwork that crosses geographic boundaries. Although perhaps not fully intended, the term 'teaming' implies an ambiguous division of labor with workflows that may go back and forth between locations. Third, offshoring applies equally to the back office and the front office. In fact, the same set of providers may supply to both offices.

Accounting firms, investment banks, and management consulting firms are seen as pioneers in creating captive offshore units in low cost locations such as India. For example, Ernst & Young established captive offshore units to prepare client tax returns, and other large accounting firms offshore non-judgmental audit procedures (Deloitte, 2007). Similarly, investment banks have set up offshore units to undertake financial modelling and analytics, whilst strategy consulting firms have captive offshore 'knowledge centres' to support onshore teams that undertake powerpoint documentation and market research.

More recently, law firms have joined in to create 'shared services' for back-office functions, and 'knowledge centres' to deliver legal support work. Table 2 provides some examples of outsourcing and offshoring by law firms. For example, Clifford Chance and Allen & Overy have their knowledge centres in India and Northern Ireland respectively. As shown, support functions (such as secretarial work) are listed alongside tasks that are closer to professional legal work such as litigation document review, due diligence, and legal research. Several mentions of cost savings in the Table reveal the efficiency focus of offshoring. So why have PSFs come to take this particular approach to offshoring and outsourcing?

INSERT TABLE 2 ABOUT HERE

Public corporations

In the absence of systematic evidence from PSFs which are public corporations, we draw on the experience of publicly quoted business corporations first. Hierarchical managerial control and centralized decision-making are clear facilitators of strategic outsourcing.

Outsourcing and offshoring at business corporations used to be about factory-level decisions to close down in-house production and to source from third-party suppliers. The firm (or plant) boundary was affected, but not much else. More recently however, business services outsourcing combines internal corporate restructuring of the administrative hierarchy and a make-or-buy decision (Gospel & Sako, 2010). Distinct from vertical disintegration, the unbundling of corporate functions occurs when business processes at divisions in an multidivisional corporation are brought together into a company-wide shared services (SS) center before it is outsourced to a third party.

The creation and outsourcing of shared services by business corporations amount to the centralization of corporate functions at the headquarter level. Much of the cost savings and efficiency gains arise from corporate-wide standardization of business processes that such centralization enables. For instance, the corporation might decide to adopt a single accounting standard and a uniform enterprise software system. But existing corporate structures affect the process of implementation. For example, the more centralized structure led Proctor & Gamble to create a central shared service first before outsourcing (Gospel & Sako, 2010). By contrast, a more decentralized structure at Unilever meant outsourcing initiatives at the regional level first before diffusing such practices gradually within the corporation.

Thus, publicly listed corporations (PLCs) exercise hierarchical managerial control to make outsourcing and offshoring decisions. But some PLCs are more centralized than others, and centralized firms are better positioned to reap the benefits of outsourcing and offshoring more quickly as they can move decisively towards company-wide shared services.

Professional partnerships

Compared to public corporations, traditional professional partnerships are characterized by peer control rather than hierarchical control (Empson & Chapman, 2006). Professional partnerships, with partners combining the role of owner, manager and producer, have multiple benefits, including low costs of monitoring complex non-routine activities, high incentives for sharing proprietary knowledge, and superior career progression incentives resulting in higher effort and productivity (Greenwood & Empson, 2003). However, constraint on managerial authority and protection of professional autonomy imply that it is difficult to get all partners to cooperate with a specific management initiative (Empson & Chapman, 2006). An initiative such as outsourcing and offshoring is no exception.

The configuration of controls for large professional partnerships articulated by Greenwood et al. (1990) provides a useful framework to analyse the consequences of the P² Form for outsourcing and offshoring. Compared to the public corporation, professional partnerships are characterized by the decentralization of operating control, the use of general (rather than specific) financial control, and a consensus-building approach to strategic control (Greenwood et al., 1990).

First, professional autonomy implies extreme decentralization of operational control, with individuals deciding what to do and how to do it. Therefore, actual decisions on what to outsource or offshore are left up to individual practice areas, or to individual partners or associates. Professionals are also reluctant to let go of their own work. Applying professional knowledge to complex problems requires one professional to have purview of the entire picture. Professionals also lack trust in the competence of semi-professionals and lay people, and therefore are bad at delegating tasks without close supervision. This makes it challenging to manage a clear division of labor and geographically dispersed teamwork.

Second, the use of general financial targets with low-powered incentives and accountability may hinder the use of outsourcing and offshoring. In professional partnerships, financial incentives for offshoring or outsourcing are opaque, absent, or adverse. For captive offshore operations, professional partnerships might have a profit share arrangement between the onshore and offshore operations, but this is not common practice. Given weak internal drivers to outsource or offshore, meeting client demand (e.g. for cost savings) is often the main reason why professional partnerships implement outsourcing and offshoring. Putting the client interests first is psychologically wired into some professionals (Moorhead, forthcoming), and is used in their outsourcing/offshoring decisions.

Last, but not least, a consensus-building approach to strategic control implies that outsourcing and offshoring decisions are not only decentralized, but are also given a status of operational trial-and-error in response to client demand. Outsourcing and offshoring is not a topic of strategic importance for

managing partners in professional partnerships, in the way that it might be for members of the boards of public corporations. Moreover, as professionals dominate decision-making, non-professional business managers are subjugated in the outsourcing/offshoring decisions.

Managed professional business

Managed professional business (MPB) involves the introduction of a corporate style (replacing collegial control by hierarchical control) in managing PSFs. This adaptation in governance emerges as PSFs grow in size and geographic reach. Such growth pressurizes MPBs to introduce a degree of heterogeneity inside the firm, whilst attempting to commoditize client-specific bespoke services (Greenwood & Empson, 2003). Thus, work handled by MPBs makes outsourcing and offshoring attractive.

In MPBs, non-professional business managers increase proportionately. Those managers led by a Chief Operating Officer are seen to lead the outsourcing/offshoring initiative at PSFs, distancing it from strategic control by professionals. This contributes to a tendency for outsourcing/offshoring to be sidelined in terms of strategic importance. Thus, with the rise of 'organizational professionals' (i.e. non-professional managers) to manage PSFs (DiMaggio & Powell, 1983), MPBs have to deal with the tension between professionals who own the PSF and non-owner managers.

As PSFs go global, Falconbridge and Muzio argue in favour of bringing the professionals back in, that is to make the autonomy professionals normally expect and demand as a central plank in understanding decision making (Falconbridge & Muzio, 2007). In this context, outsourcing and offshoring

decisions by globalizing MPBs are likely to continue to respect the autonomy of professionals. Consequently, the dominance of professionals in decision-making in MPBs leads to decentralized outsourcing and offshoring. Or else, if non-professional managers are given a seat at the table, they would most likely focus on centralizing the outsourcing and offshoring of back office services, away from direct control by professionals.

To summarize, PSFs have different ownership structures, ranging from partnership to privately held and publicly listed company. Governance structures of PSFs, the institutional arrangements that legitimize how decisions are made, influence the pattern of outsourcing and offshoring. This section detailed the various reasons why PLCs tend to have a governance structure that predisposes them to make more decisive (strategic) moves towards outsourcing and offshoring than MPBs, and MPBs than traditional professional partnerships. However, within each ownership mode, the more centralized the decision-making, the more quickly and decisively PSFs can implement firm-wide outsourcing and offshoring. By contrast, preserving the autonomy of professionals in both traditional partnerships and MPBs contributes towards decentralized, case-by-case applications of outsourcing or offshoring. Consequently, efficiency gains resulting from discrete changes in workflow and project management are hard to garner.

4. Consequences of Offshoring and Outsourcing in a Global Context

What are the key consequences of the offshoring and outsourcing of professional services? Perhaps the most topical aspect is the impact on job loss

and the resulting international division of labour. This section also reviews two further significant consequences, namely the impact on the ecology of professions and the structure of the professional services industry.

Impact on the ecology of professions

How many jobs are displaced by offshoring? McKinsey (2005) provided an estimate for service jobs in eight sectors (namely packaged software, IT services, banking, insurance, pharmaceutical, automotive, healthcare, and retailing).⁴ The study calculated that 18.3 million jobs in these sectors could be done by people located anywhere in the world in 2003. They estimated that by 2008, 160 million jobs, or about 11% of total global service jobs, could be carried out remotely, but only 4.1 million of those would actually be offshored. This modest projected take-up was attributed to company-specific barriers rather than regulatory barriers. Such barriers were said to include operational issues, hostile management attitudes to offshoring, and insufficient scale.

The McKinsey study assumed that the nature of jobs that existed in the sectors they examined would remain unchanged as a result of offshoring. The same limitation is reflected in any analysis that is based on official employment statistics. However, the mix of tasks within jobs changes over time. There is evidence that such task changes within jobs have been quite large (Levy and Murnane 2004, p.52). For example, in financial services, exceptions processing clerks in banks might have specialized in handling a single kind of exception, e.g. overdrafts. With digitization of checks, clerks' task scope has expanded to

⁴ A similar approach for IT jobs is taken by ACM. 2006. Globalization and Offshoring of Software: A Report of the ACM Job Migration Task Force. New York: Association of Computing Machinery.

handle all types of exception – overdrafts, stop payments, address changes, etc. (Autor & Levy, 2002).

Thus, outsourcing and offshoring, just like digital technology, may bring about a change in the mix of tasks in jobs. In fact, it is fully intended that with outsourcing and offshoring of professional services, the onshore in-house professionals allocate more of their time to essential tasks that require professional expertise and judgement, leaving photocopying, document drafting and contract review to semi-professionals and non-professionals. As already noted in Section 2, the disaggregation of professional work into constituent tasks enhances the domain of tasks that could be done by those other than fully qualified professionals.

In this way, outsourcing and offshoring may be regarded as a trigger in disturbing the ecology of professions, along with other exogenous and endogenous forces identified by Abbott (1988). Each professional is part of a broader system competing with others for the exclusive right to solve the public's and the state's problems. But if semi-professionals and non-professionals are deemed competent to provide disaggregated services in competition with professionals, clients now have a choice. Obtaining the same service from alternative sources potentially undermines the legitimacy of professionals' claim and pushes back their jurisdictional boundary.

Impact on the structure of professional services industry

Outsourcing and offshoring of professional services have led to an industry structure in which incumbent PSFs source from, and compete with, new entrants. These new entrants are suppliers of business services, known as

knowledge process outsourcing (KPO) providers. They are typically limited liability corporations (LLCs), funded in part by private equity or venture capital. KPO processes include business research, R&D, engineering services, financial research, patent filing, and legal research. Some KPO providers had been captive offshore units which were spun off (for example, Genpact had been part of GE). Others are start-ups founded by entrepreneurial professionals who had worked for PSFs as consultants, accountants, financial analysts, or lawyers. Some new entrants have also bought captive offshore units established by investment banks, accounting firms, and consulting firms.

These new players in the globalizing professional services markets start with providing low-end low-value support work for business corporations and PSFs. In the medium to long term, they intend to accumulate capabilities to create and capture value in global value chains, by pursuing three types of strategies, namely climbing up, scaling up, and broadening out (Sako, 2011a).

First, just as contract manufacturers evolved into original design manufacturers, KPO providers have climbed up the value chain by providing higher value-adding services. This may involve writing an entire research report on the basis of business research for a consulting client or on the basis of the analysis of a valuation model for an investment-banking client. The clients then put their own brand onto the report and make recommendations. In legal services, KPO providers are not permitted to practise law, but may accumulate broader capabilities over time, so that a request to do prior art search initially may evolve into undertaking all necessary steps to file a patent short of prosecuting it.

Second, some KPO suppliers have scaled up their operations, investing heavily not only in IT infrastructure but also in process and quality improvements for their information processing factories. The LLC ownership structure of KPO providers enables them to make swift technology investment decisions, with ambitious growth targets that come from their private equity investors. The growth potential of offshore outsourcers is predicated not only on low labour costs, but also on investment in software tools and process improvement, regarded as a more sustainable source of competitive advantage.

Third, some KPO suppliers have pursued a diversification strategy by bundling different professional support services, for example by pulling together business, financial, and legal research under one roof. These KPO providers seek to work closely with functional heads of global business corporations, rather than with PSFs.

The 'pure strategies' described above are combined in different ways by KPO providers which have an edge over PSFs (especially traditional partnerships) in pursuing these strategies. Table 3 summarizes the contrast between KPO providers and partnership PSFs (to make the contrast stark). First, the ownership structure is different. As a consequence of this difference, the nature of strategic control is different with a KPO provider having more top-down hierarchical control than a PSF. At the same time, operating control is different, with the KPO provider able to standardize tasks more easily than PSFs. These contrasting dimensions result in differential sources of competitive advantage. KPO providers can leverage their global delivery model with more standardized services, whilst PSFs excel in bespoke customized services delivered to clients face-to-face. Last but not least, KPO providers are subjected

to explicit performance metrics in the form of service level agreements. By contrast, performance contracts remain implicit and taken on trust for PSFs, even as corporate clients attempt to introduce alternative billing arrangements to replace the billable hour.

INSERT TABLE 3 ABOUT HERE

What is the significance of KPO entry for the structure of the industry and the capabilities of PSFs? Given the importance of intangibles such as brand and reputation in driving power in global value chains in professional services, can KPO providers capture value away from PSFs, just as component suppliers such as Intel and Microsoft took away value from IBM?

The future structure of professional services industry depends on interactions between the strategies of PSFs and those of new entrants. In this context, the pure cost drivers of outsourcing and offshoring should hold little long-term strategic interest for any firm, be it a PSF or an outsourcing provider. Cost savings in themselves do not provide sustainable competitive advantage, and will be superseded by other capabilities in the dynamics of competitive interaction within the industry (Kenny et al., 2009).

In response to KPO providers scaling up and excelling in delivering services more efficiently, PSFs have a choice between competing (by adopting the same strategy) or cooperating (by outsourcing more heavily to KPO providers for the sort of tasks that require volume). The latter might be an attractive division of labor for PSFs, but would lead to wiping out the in-house training grounds for junior professionals expected to experience some 'grunt work' as part of their apprenticeship.

In response to KPO suppliers broadening out to provide a one-stop shop for business corporations, PSFs have to consider diversification within, by setting up a multi-disciplinary practice, or across by forming alliances with PSFs in different domains. This puts further pressure on traditional professional partnerships, and gives an incentive to adopt different governance structures (as facilitated, for example, by the Alternative Business Structure in England and Wales). A failure to adapt heightens the threat of disintermediation of PSFs, as corporate clients go direct to alternative providers.

KPO providers' strategy to climb up the value chain should be understood in the context of disruptive innovation. Just as other industries were disrupted by new entrants that started by addressing low market segments ignored by incumbents (Christensen, 1997), KPO providers begin with satisfying latent demand for clients who could not afford the service previously. Consulting is arguably on the cusp of such disruption (Christensen, Wang, & Bever, 2013). Here, the fact that McKinsey has set up McKinsey Solutions to leverage analytics and rely less on human capital, indicates that PSF response is likely to take the form of a captive (rather than an outsourced) solution. This underpins the importance of brand and reputation in many areas of professional services.

In short, KPO providers pose both a threat and an opportunity for PSFs as they attempt to align their geographic presence with a target client base of global corporations and financial institutions. It poses a threat because KPO providers have been accumulating deeper skills and experience in global service delivery. It creates an opportunity for PSFs because KPO providers are at best potential

joint venture partners, or else provide a template for transforming the governance of PSFs themselves in a globalizing world.

5. Conclusions and Further Research Directions

Professional service firms play a dual role in the broad canvas of outsourcing and offshoring. They are, first and foremost, outsourcing providers, increasingly subjected to metrics (customer satisfaction, responsiveness, etc.) by which they are judged. They are also users of outsourced services, provided either by captive units or third party suppliers. Sandwiched between these two roles in increasingly globalizing value chains, PSFs may end up with a larger or a smaller segment of the pie depending on how they play their intermediary role.

This chapter began by defining outsourcing and offshoring, and reviewing relevant theories in international trade, economic geography, organization economics, managerial theories of the firm, international business, and job characteristics. By comparing with manufacturing, the chapter also noted the challenges professional services face in adopting a production-line approach at the same time that the industry is globalizing via offshoring and outsourcing. The chapter then examined the impact of governance structures at PSFs on their outsourcing and offshoring decisions. Lastly, we compared PSFs and outsourcing providers, their capabilities and sources of competitive advantage, in order to delineate possible future scenarios in professional services industry.

The need to draw on a variety of theories and empirical contexts from manufacturing and business corporations is a reflection of how nascent the research on outsourcing and offshoring by PSFs is. Thus, there is no shortage of topics for future research, as follows.

(a) *Governance and decision-making.* What is the impact of different governance structures on the outsourcing/offshoring decision by PSFs? What is the relation between professionals and non-professional managers when making outsourcing and offshoring decisions in Managed Professional Businesses? How does it differ from profession to profession? What design principles are effective in using outsourcing and offshoring as part of restructuring PSFs with a global presence? Answering these questions is important, particularly as decision-making is the mediating factor that links the characteristics of jobs to the outsourcing/offshoring of those jobs. Much more work needs to be done to analyze what turns offshoreable jobs into actually offshored jobs.

(b) *Job quality, training, and careers.* How are job quality and work team dynamics of professionals changing at PSFs implementing outsourcing and offshoring? What is the evolving job quality at providers of outsourced and offshored professional services? What is the impact of professional identity as task disaggregation changes the boundary between professional and non-professional work? How is career progression and work-life balance being reconfigured for professionals working in sectors with outsourcing and offshoring? Answers to these questions touch on the very survival of professions, and address in what ways professional work might follow a path that is similar or different from that for manufacturing and clerical work. Such comparison is important for testing the generalizability of existing theories on job quality, de-skilling, and career development when applied to under-explored contexts.

(c) *Globalization and comparative national systems.* Outsourcing and offshoring is part and parcel of the globalization of professional services markets. Further research on international comparisons would also give much traction (Allsop et al., 2009) Offshoring in particular provides a good context for enquiring whether or not the dominance of the Anglo-American pattern of professionalization increases or decreases with globalization. In particular, in what ways are PSFs' outsourcing and offshoring decisions influenced by the varieties of capitalism (Hall & Soskice, 2001)? For example, if German lawyers are less entrepreneurial and more business oriented (Morgan & Quack, 2005), what does this imply for the geography of development of outsourcing and offshored markets? Would the globalization of PSFs, facilitated by outsourcing and offshoring, lead to more dispersed nationalities amongst the top PSFs?

(d) *New entrant strategies and industry evolution.* Outsourcing and offshoring are not just about shifting the location of professional jobs. It is important to emphasize that they have also created new markets for business services, attracting new entrants with a different governance structure and business models from incumbent PSFs. From this industry evolution perspective, what are plausible scenarios for competitive dynamics between PSFs and new entrants in developed economies? What are the possible scenarios in emerging markets? And what are the long-term implications for the international division of labor in professional work?

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Figure 1: Defining Outsourcing and Offshoring

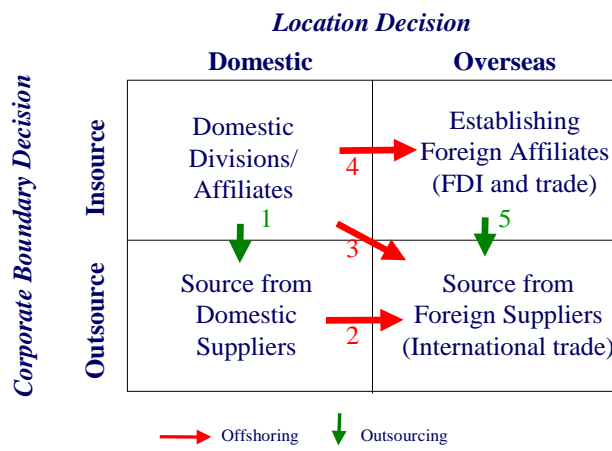
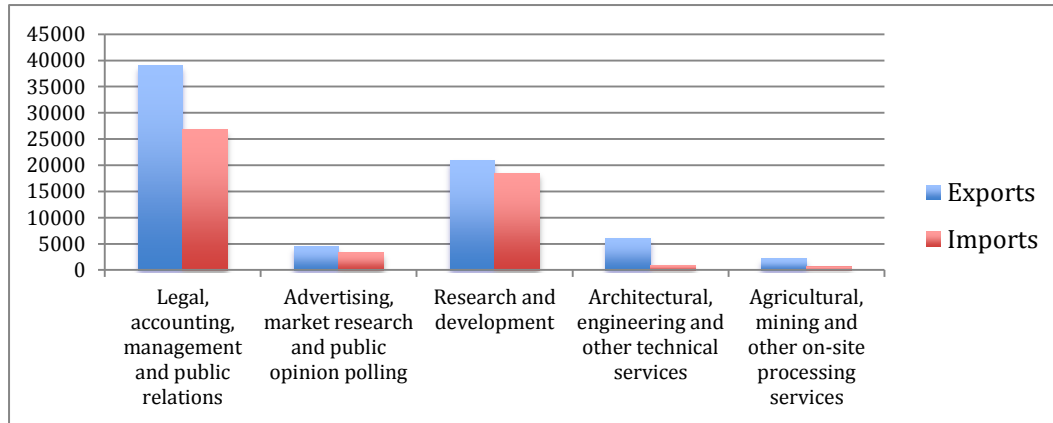
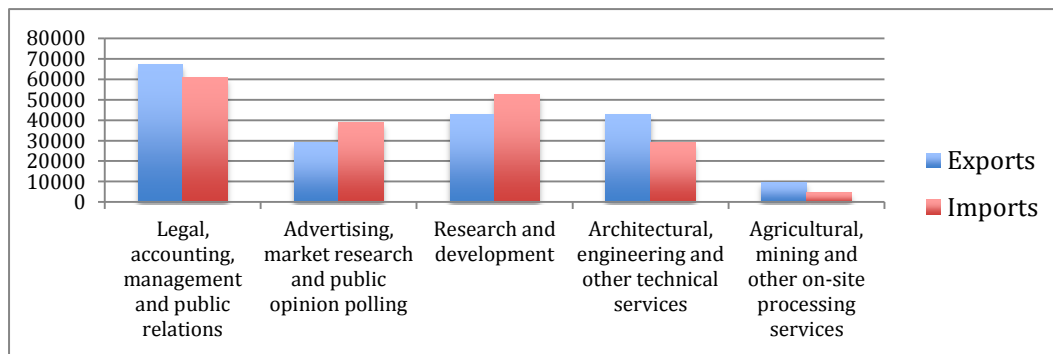


Figure 2: International trade in business, professional, and technical services 2010

United States (million dollars)



European Union (27 countries) (million dollars)



Source: World Trade Organization

Table 1: Theories relevant to outsourcing and offshoring

Subject area	Theories, concepts, frameworks	Outsourcing (firm boundary)	Offshoring (location)	Key implications
International trade	Comparative advantage	☐	☐	<ul style="list-style-type: none"> • Countries specialize in sectors which use a relatively abundant factor of production • Explains patterns of exports/imports and foreign direct investment
Economic geography	Agglomeration Clusters Global value chains	☐	☐	<ul style="list-style-type: none"> • Location or space continues to matter beyond claims of international economists, e.g. in the form of externalities that exist in export-oriented industrial clusters and cities • Offshoring might take the form of 'deterritorialized' global commodity chains, but it might also create regional (sub-national) clusters
Theories of the firm	Transaction cost Resource-based view Dynamic capabilities	☐	☐	<ul style="list-style-type: none"> • Firms decide on their boundary giving regard to transaction costs, contracts, resources, and capabilities
International business	Internalization theory Location advantages	☐	☐	<ul style="list-style-type: none"> • Multinational firms choose to make overseas investment based on location advantages • Multinational firms also take advantage of 'internalization' in the presence of market failure
Job characteristics	Job design	☐	☐	<ul style="list-style-type: none"> • Jobs with certain characteristics (no face-to-face or interactive tasks) are more offshoreable than others

Note: ☐ = theory addresses it; ☐ = theory does not address it.

Table 2: Outsourcing and Offshoring by Law Firms

Firm	What	Provider, location, outcomes
Allen & Overy	Litigation document review	Transaction specific outsourcing to Integreon in New York, US and Mumbai, India. 30-50% cost saving.
Clarke Willmott	Support functions	Secretarial (typing) work at its Birmingham office to Exigent in South Africa.
Clifford Chance	Document review and due diligence. Support function: IT and document production.	Legal services offshored to CC wholly-owned subsidiary in Gurgaon, India. Support function is delivered with Integreon from the same location.
Eversheds	Support - document production	UK-wide secretarial work to be outsourced offshore to Exigent.
Linklaters	Support - finance, leisure, accounting	Looking to outsource an onshore picture administration centre and knowledge process outsourcing
Lovells	Litigation document review. Real estate document production	Transaction specific. Exigent in South Africa. Unnamed provider in India.
Osborne Clarke	Non-strategic support functions	Onshore - £1m saved annually. Plans to extend
Pinsent Masons	Secretarial work, Document review and due diligence	Estimated 50% saving on low level legal work. Dedicated team of qualified lawyers employed by Exigent in Cape Town.
Simmons & Simmons	Document review, due diligence and research	Dedicated outsourced team of 5 lawyers employed in Mumbai.
Slaughter and May	Document review and due diligence	Triggered by request from specific client.

Source: Based on Luke McLeod-Roberts 'A&O signs outsourcing deal with LPO provider Integreon, *The Lawyer*, 18 November 2009.

Table 3: Comparing PSF Partnerships and KPO Providers

	PSF partnerships	KPO providers
Ownership form	Limited liability partnership (LLP) with professionals as owners	Limited liability corporation (LLC) with investment from outside capital
Strategic control	Consensus/collegial	Hierarchical
Operating control	Via standardization of skills training	Via standardization of routines and tasks
Competitive advantage based on:	Bespoke, customized services	Process efficiency from standardization and economies of scale
Service delivery model	A federation of practice areas/regional offices, with higher elements of need for proximity to clients	Global service model, with higher elements of remote delivery
Performance contract with clients	Implicit and taken on trust	Explicit, with performance metrics specified in service level agreements