A comparison of the offshoring and outsourcing strategies of German and UK multinational companies: a critical engagement with the 'varieties of capitalism' perspective.

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Abstract

The aim of this research is to examine the extent to which the offshoring and outsourcing practices in Multinational Corporations, when the headquarters are registered and located in either the UK or Germany; are embedded in the institutional contexts of their respective home countries. There are six research questions relating to differences in approach and choice of location, ownership and coordination, employment practice, cultural proximity, trade union influence and finally the extent of re-shoring. These are primarily assessed through the 'varieties of capitalism' perspective.

A comparative case study approach has been adopted with a focus on two sectors; airlines and engineering; in each case a major UK and German organisation are compared. Fourteen in-depth, semi-structured interviews took place in both the home countries and overseas locations in Europe, India and Asia. The sample size is small, however, each was with a senior executive and the transcripts revealed 'rich data' for compiling the case studies and answering the research questions.

The contribution to original thinking is a conceptual framework posited by proposing a taxonomy to analyse the relationship between coordinated and liberal market economies and the components of the offshoring and / or outsourcing process. Reference is made to theory drawn from the resource based view, global production networks, dynamic capabilities, embeddedness as well as varieties of capitalism to focus on competences, spatial dimensions and power. It is this collective approach that is considered to be novel.

Qualitative analysis is deployed to re-construct the actual framework for each industry sector. Constructs (Reichertz, 2004) combining abduction, deduction and induction are used to develop propositions that lead to conclusions.

The similarities between the two UK companies and the two German companies confirms the usefulness of the taxonomy and allows for its extension to other firms and sectors. Key findings and conclusions from the two case studies are that German organizations are less inclined to outsource (in both sectors) preferring to reduce costs and retain control through captive offshoring. The UK businesses were less risk adverse and more flexible and agile in their sourcing policies. There was evidence that the UK companies regarded outsourcing and offshoring as options for closer co-operation that may lead to strategic alliances and mergers or acquisition. The relationships' with trade unions / works council was also found to be very different, with a reluctance by management in Germany to progress radical initiatives. Other differences in terms of autonomy and division of labour were found. From an institutional perspective the German CME's cases were less able to deploy outsourcing and offshoring strategies with the degrees of freedom that the UK LMEs typically enjoyed. CMEs are constrained by their policies, interconnectedness and style of working. A number of ambiguities are highlighted.

The thesis argues that the outsourcing and offshoring practices are embedded to a high degree in the institutional practices of the home countries. Finally, the empirical novelty lies in the 'rich data' generated by valuable insights from the senior executive interviewees to which the researcher was privileged to have access.

Dedication

This thesis is dedicated to my late wife Cori with whom I shared twenty five short and glorious years. Cori left me the greatest gift possible with two children Francesca and Oliver to follow her unfinished journey. My wish is that she would have been proud of this work.

Acknowledgements

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CHAPTER 1

INTRODUCTION

1.1 The importance of this topic?

Offshoring and outsourcing represent an on-going and mostly accelerating trend in the reorganisation and restructuring of firms, and have become a major part of the globalisation trend. Offshoring can be defined as the performance of tasks in a different country to that where the firm's headquarters is located; while outsourcing may be regarded as the performance of tasks under some contractual arrangement by an unrelated third party (Harms et al, 2009). One contextual feature is that mergers and acquisition have a high risk of failure (Mitchell, 2004) and in recent years organisations have therefore sought alternative means of non-organic growth such as partnerships, joint ventures and alliances (Financial Times, 2011). While the initial justification to offshore is typically to arbitrage labour costs, the rapid growth in demand for outsourcing may lead to cost increases (Economist, 2011b) and justification increasingly becomes a complex balance of proximity to markets, suppliers, ability to innovate and institutional factors such as governance and immigration policy (Pisano, 2011). According to Kierkegaard (2008) few topics in international economics have risen faster to the top of the political agenda (e.g. the past two US Presidential campaigns), while also being so poorly understood and quantified as has outsourcing. Further, there is an increasing trend to outsource and offshore activities that demand higher levels of skills. In recent years as the global economy has experienced crisis to varying degrees in many mature Western markets (through the 'interconnectedness' of financial institutions in particular), so also have the political stakes started to shift from exports, growth and expansion back to the protection of labour and traditional home markets. While it might seem attractive for manufacturers to consider both outsourcing and offshoring at the same time, it is also important to separate decisions on *what to make* from *where to make* (University of Cambridge IfM, 2007). Recent economic pressures have led governments in the United States and Europe to 'encourage' multinationals to return jobs and investment back to home markets (BCG cited in Economist 2011b); beyond this, re-shoring has been motivated by poor or disappointing experiences in host countries, and declining economic conditions at home.

Although there is an extensive and growing literature however, the institutional aspects of offshoring are under-explored. This research aims to compare the practices, strategies and processes adopted by selected case study firms from Germany and the United Kingdom (UK), which are characterised by different capitalist models (Hall & Soskice, 2001; Lane, 1998). It is suggested that German firms for example, typically have stronger institutional links than typical UK competitors (Lane, 2006 cited in Morgan, Whitley and Moen). Furthermore, UK and German economies have different comparative advantages and industrial infrastructures, yet both countries also play host to a number of successful multinationals (MNC). The institutional context here can be understood as *both* the configuration of formal institutions (government, banks, trade unions and other firms) and as deeply embedded business practices and norms and 'ways of doing business'. This will shed light on how UK and German competing organisations differ in managing global expansion, and take advantage of the various resources and support available.

National economies follow cyclical patterns with the UK tending to exhibit shorter cycles of boom and bust compared with Germany. Following German reunification (1990) a period of austerity and strict wage control took place in Germany, and this helped to drive investment at home together with a strong export led economic revival. In 2012 German productivity was assessed to be 24 percentage points ahead of the UK in terms of output per hour (Financial Times, 2013b). UK productivity in 2013 was 16 percentage points below the G7 average – the widest gap since 1994. A contested area is that the UK has been retaining employees rather than losing jobs to offshoring, while new work is created by UK outsourcing providers. Throughout the 2008-9 recession, increased part-time working in the UK and even the hiring of new employees occurred at a time of minimal growth (Financial Times, ibid).

The salience of understanding outsourcing is reflected in Outsourcing Yearbook (Hickling, 2013) when a journalist spoke to economists at UK business schools and German banks. The interviews have been published (Outsourcing yearbook, 2013), and in summary all agreed that outsourcing contributes strongly to GDP, and has been a valued contributor to tax. There was also a unanimous opinion that the most common motivator for outsourcing is cutting costs, and that it is a 'shrewd' business decision to concentrate on core activities and competitive advantage. Furthermore, outsourcing generates certain transaction costs that need to be minimised in order to maximise the efficiencies of outsourcing. Finally, all agreed that outsourcing and associated division of labour is a positive thing in the manufacturing industry, and that the production of added value products and growing exports is the way to encourage economic growth. Hickling (ibid) concluded that a key message on outsourcing suggested that when done well, outsourcing reduces cost, but effective governance is still required to retain control as well as gain efficiency benefits.

This research thesis is of relevance to researchers, students and business managers; as well as of interest to national governments. Further, it will be of interest to those engaged in debates on globalisation, the role of the multinational corporation, the relationship between a headquarters and its divisional or national subsidiaries. Added interest is generated by challenging popular questions and criticism made of multinationals and their role in globalisation together with the debate by politicians and others on policy towards domestic employment and wealth creation at home at a time of prolonged economic uncertainty. This is often encapsulated by criticising the extent to which offshoring and outsourcing practices created wealth for shareholders, but at the expense of the host country, local community and employees.

1.2 Research focus and questions

The overall aim of this research is to examine the extent to which the offshoring and outsourcing strategies of German and UK based multinational corporations (MNCs) are embedded in the institutional contexts of their *respective home countries*, and in particular the extent to which this can be explained by the *varieties of capitalism* perspective.

Specific sub-questions will be developed as a result of the literature reviews and development of the methodology. These are likely to frame what, where, why and how German and UK MNCs manage outsourcing and offshoring activity.

1.3 Empirical Focus

Target sectors were selected on the basis of their competitiveness, complex dynamics and high profile; also where potential contacts were available. Germany and the UK were chosen because they are widely regarded as exhibiting contrasting styles of capitalist model, and because the researcher has experience and contacts in a number of competing MNCs based in these countries. Research was undertaken in the transport / airline sector with Lufthansa and British Airways, and in the engineering sector with CompanyABC [1] and CompanyXYZ (part of UK-Engineering Plc.). The research questions and methodology have been reviewed and a decision made not to extend the research to a third or even fourth sector (for example banking and / or pharmaceutical), but to go deeper into the two initially chosen sectors. The chosen sectors are also of interest in that the UK has been criticised for an over-reliance upon the service sector (and financial services in particular) and is now responding to fresh incentives to boost manufacturing and specialist engineering in pursuit of growth and a more balanced, UK economy (manufacturing and engineering are widely regarded as strong industrial contributors of the German economy). Airlines and transport are interesting in that national carriers have progressed in both the UK and Germany from public ownership into the private sector. Their success has been viewed by some as cyclical and a barometer on how well the national economy is faring; also they tend to be multi-business and so the fortunes of the passenger, cargo and engineering / repair, maintenance and overhaul (RMO) business units can actually be counter-cyclical (when passenger numbers are low, cargo and/ or maintenance activities increase).

[1] For this comparative case study it was requested that the company names be disguised.

1.4 Summary of conceptual approach

This research will contribute towards developing an understanding for the selected MNCs of their favoured approach towards: global restructuring, the reasons why outsourcing versus a wholly owned (captive) offshore subsidiary was adopted, an appreciation of the circumstances that led to policy decisions and the extent to which they are shaped by the corporate board and the geographical choice of location. The underpinning theory will be drawn from several selected bodies of literature.

Varieties of Capitalism (VoC) theory helps to explore differences in economic and political institutions across the countries in which firms are embedded, and at a micro level a firm's motivation to relocate and restructure. At a macro level questions can also be addressed of a nation state's economic policy and the extent to which that has influenced the MNC. The Resource Based View (RBV) postulates that competitive advantage for one firm over another can be derived from the assembly and exploitation of key resources (or assets). Leveraging competences and agility in taking advantage of local skills in a changing and developing market, leads to a related concept of dynamic capability (Helfat, 2007). The burgeoning literature on Global Production Networks (GPNs) provides a spatial perspective in appreciating the complexity and inter-relationships that develop when producing commodities globally and leveraging the value added. Further considerations are how power and the influence of the lead firm can be deployed and how effectively communication takes place in coordinating work. The challenge and relevance is then in understanding how these three discrete sets of literature might combine and help us to compare and contrast offshoring and outsourcing practices by German based and UK based MNCs.

These theoretical concepts will be used to examine how the motivation for varying offshoring and outsourcing tactics or strategies are deployed together with the role of institutions and the extent to which practices then become embedded or require to be changed. Progressive stages of disaggregating a value chain will be explored as each of the chosen organisations also present a limited opportunity for longitudinal study from conception of the need to outsource and / or to offshore and to the current time as early policies mature. The implications of differing strategies on location, motivation, structure and control will be reviewed. Finally, the interface between operational, short term cost reduction and longer term strategic decisions will be explored by the extent to which policy is reversed and work returned to the home country; whether this is because the originally anticipated cost benefits did not materialise or there was substantive political pressure to return work and create jobs at home, or simply a change in strategic direction of the MNC.

1.5 Summary of methodology

A case study method with qualitative analysis is adopted with comparisons drawn across airline/transport and engineering sectors for both UK and German headquartered MNCs. Seven in-depth semi-structured interviews with eight senior executives in Germany, UK, India and Poland were undertaken in the first of two phases for the research. As a result of this work initial research questions were refined and additional data requested. Seven further interviews were undertaken with home and host locations and also with a former trade union representative. The responses were analysed on a qualitative basis including comparative costs and savings from the restructuring as and where available. Because the case studies inevitably comprise different sections of a business rather than the organisation as a whole the *unit of measure* is important in making comparisons and drawing wider implications.

1.6 Structure of thesis

Chapter one has explored the importance of this topic, how globalisation has led competitive MNCs in particular to explore ways of disaggregating and rearranging their value chain and how offshoring and outsourcing practices can evolve from simply the short term leveraging of lower labour costs to the added value of an integrated alliance or strategic partner when engaged in higher value activity. The research focus is then clarified as is the aim and the initial research questions. Data collection is outlined as part of the empirical focus. The conceptual approach is summarised with economic, geographic and business theoretical constructs deployed to explain differing outsourcing and offshoring approaches. See Fig 1-1 and Fig 1-2 below.

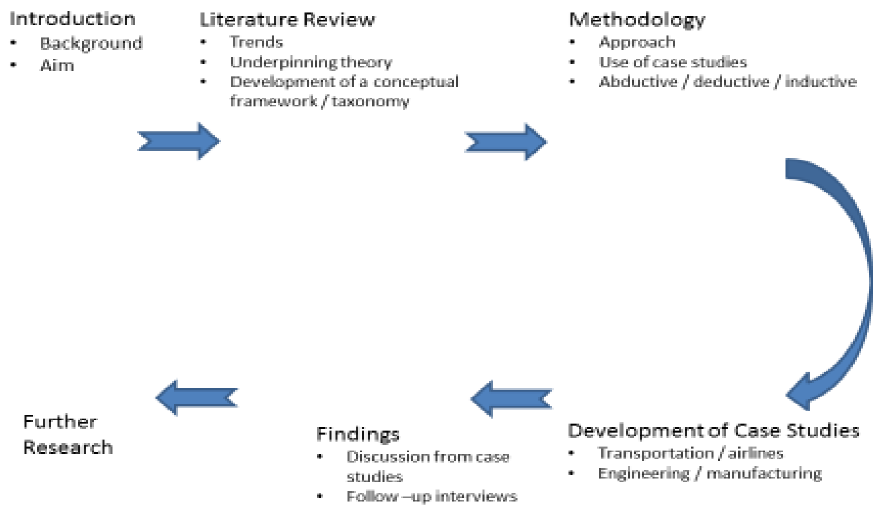

Figure 1-1 Thesis Layout

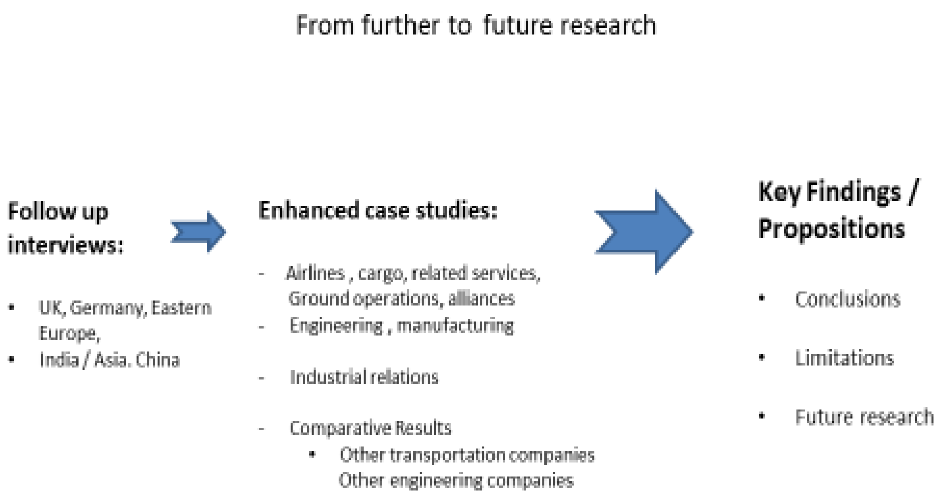

Figure 1-2 Thesis layout (continued)

The literature review is in two parts, Chapter 2 is contextual and explores the definition, trends and development of offshoring and outsourcing practice. The frequency with which work is typically returned home is also considered. Chapter 3 then explores underlying theoretical constructs drawing on the disciplines of business and economics for the Resource Based View (RBV) of the firm; from geography, sociology and economics, differing Varieties of Capitalism (VoC), and from operations management, strategy and geography, the concept of Global Production Networks (GPN) and the extent to which the activities and suppliers become embedded and extended through the value chain. The theory explores how competitors differently choose to use their resources, to manage and control their businesses in conjunction or even in spite of specific institutions; and to extend their supply chains differently because of local infrastructure, available skills and stability of political and other communities. The combination of related but differing strands of theory also helps to explore the motivation for why and how MNCs embark upon and implement outsourcing and offshoring practices. This contributes to the development of a conceptual framework and taxonomy (Table 3-3) that are central to the novel contribution of this thesis.

Chapter 4 outlines how the research questions have evolved in light of the literature review(s), the researcher's philosophy and personal journey; thoughts on an appropriate epistemology and ontology in shaping this research methodology. An examination is also made of the case study method and limitations to this research design.

The research is set out as the development of two industry case studies – for the Transport / Airline sector in Chapter 5 and the Engineering sector in Chapter 6 respectively. In each chapter a UK headquartered MNC is compared with a German headquartered MNC. For the transport sector the two airlines are direct competitors offering a similar portfolio of services. For the engineering case while at group level the businesses were historically similar (with the UK firm best known for automotive and aerospace instrumentation), and the German firm automotive supplies; today the UK business operates in different market segments, nevertheless the nature of the engineering work, the skills and experience also the market dynamics are sufficiently similar to make comparisons worthwhile. The chapters both start with an introduction to sector dynamics. Summary sections 5.9 and 6. 9 follow each of the case studies with an initial analysis in reference to the research questions and to the underlying theory. The rich data from the in-depth interviews is synthesized and critically assessed in relation to the research aim and questions in Chapter 7 which presents the findings, interpretation and discussion. For each case, comparisons are drawn between the UK and the German approach. Lessons are also drawn from differences by the industry sector. Conclusions follow (Chapter 8) together with suggestions for further research..

1.7 Synopsis

In Chapter 1 the importance of the chosen research topic, the focus, proposed approach and outline structure of the thesis has been described.

The next chapter turns to contextualising the debate on outsourcing and offshoring definitions, trends and the inherent problems of measurement as portrayed in the literature.

CHAPTER 2

LITERATURE REVIEW:

– TRENDS AND DEBATES

2.1 Introduction

The purpose of this first contextual stage of the literature review and this chapter is to review the varying definitions, challenges with measurement, recent trends, political and other issues that form a sometimes heated debate around the use of outsourcing and offshoring.

The controversy associated with outsourcing, and in particular offshore outsourcing, ranges from a concern that by disaggregating national and global value chains the corporate headquarters typically retain high(er) value functions, and that the benefits of lower costs are returned to shareholders with little reinvestment in the host business and nation; to a political concern that shifts in jobs and employment to lower cost nations have gone too far and that it is now time to re-create employment and protect interests at home.

Identifying the drivers for this disaggregation may not be easy. Although the focus initially might have been labour cost arbitration, customers now also demand high quality, value and reliability. The operational demands therefore become more complex and the availability of a workforce with the appropriate education, skills and competences grows in importance. Clearly such managerial choices and decisions carry risk. The level of risk may increase with distance and certainly does with instability in exchange rates, regional development, rapid or unpredictable changes in political stability, national security and environmental uncertainty. Sass and Fifekova (2011) also Hardy and Hollinshead (2011) have critically evaluated the assumption that low labour costs are the main criteria in selecting new offshore locations. Experience in process improvement, technical skills and service quality, along with a stable political and business environment, cultural affinity, financial or other government incentives all have a part to play.

In understanding the recent interest in re-shoring, MNCs may be recognising that their efforts to aspire to globalisation have simply gone too far, or that the initial justification in terms of cost-benefit is no longer valid, or that changes in the leadership team and policy are resulting in a different direction for the business and/or there is a growing need to mitigate risk.

2.2 Definitions and measurement

The increasing sophistication of both national and international sourcing processes, in particular by MNCs, has led to the popular use of a variety of terms, sometimes deployed without explicit definition: off-shoring, near-shoring, backshoring, re-shoring, far-shoring, next-shoring are just a few. This mixture of terminology, and in particular the classification of outsourcing, offshoring and re-shoring, has been widely reported (Bhagwati et al. 2004, Sass & Hunya, 2014, Hardy et al, 2011). Neither is offshoring a consistently defined statistical category when recorded in trade and employment data. Sass and Fifekova (2011) give as an example the Central and Eastern European (CEE) region that is becoming an increasingly popular destination for business service offshoring and outsourcing. For offshoring they draw a useful distinction between captive when provided by a subsidiary, and offshore outsourcing when an external provider is engaged. The General Agreement on Trade in Services (GATS) is one of the data sources. Sass discusses the shortcomings of quantitative data and provides a theoretical framework needed to understand the specific patterns of service sector FDI (both market driven horizontal and cost driven vertical) in the context of CEE.

Outsourcing refers to a situation when an organisation decides to move selected activities from in-house (inside the organisation) to a third party or external supplier through a formal contract arrangement. The supplier may or may not be in the same country of origin as the organisation undertaking the outsourcing. The reasons for doing this may be multiple, but the usual starting point is to reduce costs, often for direct labour and associated overhead charges. In so doing, the instigating organisation can be said to be reorganising its value chain and moving either core or support activities to the responsibility of another organisation.

Offshoring refers to work (production or may be service based) that is physically moved outside the home country, usually to a host country that can perform the work at a lower cost or perhaps has more appropriate skills available. There may also be a case for offshoring around market entry and the relocation of operations closer to the country of destination. Therefore this is a spatial concept that may have a range of institutional pressures at its heart for attracting work and firms to invest and relocate. Measurement difficulties often arise from problems associated with the identification beforehand and the allocation of costs and/or poor recording of government statistics. Offshoring work in particular may also be outsourced to a third party or indeed undertaken through a wholly owned subsidiary business, referred to as captive offshore (adapted from Contractor, 2010).

So while there may well be contested arguments for and against offshoring with disputes on the pros and cons of such a practice there is also a level of misreporting which confuses the facts. This is interesting to note as data reported tends to focus on jobs lost through offshoring misrepresenting the true effect; reconciling jobs lost and new jobs created (elsewhere) is extremely difficult. Gorg (2011) proposed four policy implications regarding employment: Firstly, that offshoring leads to higher job turnover in the short run. Secondly, low skilled workers suffer, higher skilled may benefit but no evidence of overall increased employment in the long run. Thirdly, different studies result in conflicting results; and fourthly, globalisation leads to structural changes in advanced economies from manufacturing to service sectors.

The other area of interest is re-shoring, also variously called backshoring or reverse offshoring. In practice, this is the return of work back to the original country of origin. This may be because of a change in policy, a mistake or a change in the original cost-benefit analysis, substantial problems with quality, delivery, a loss of intellectual property or other operational or customer reasons. There may also be pressure or encouragement on the firm to re-shore for political, or other institutional reasons. In recent years it is controversy around this trend that has dominated much of the literature. (Economist, 2014; McKinsey, 2012; Booth, 2013 and Financial Times, 2012 & 2014; et al).

2.3 Trends

Offshoring and outsourcing as it is now understood came into 'vogue' in the mid to late twentieth century. This was often a 'knee jerk' reaction to falling competitiveness, in the context of a recession following a steep rise in oil prices. Largely seen (in the UK) as a short term operational cost-saving the manufacturing sector typically downsized by eliminating secondary and what was deemed to be non-core functions and activities. In the UK and elsewhere this marked a period known as Post-Fordism that encouraged a turn against mass production and a shift towards meeting customer needs and specifically making to order; popularised by the idea of ‘just-in-time[2]’ (Lipietz, 2001). Production became less homogeneous and standardized and progressively market driven (Krishan, 1995). Changes in production process with a shift from ‘Fordism’ to ‘post-Fordism’ were accompanied by changes in the economy, politics, and prominent ideologies such as a decline of regulation and production by the nation-state and the rise of global markets and corporations – now referred to as ‘globalisation’. Organisations’ pronounced (but did not necessarily practice) an emphasis upon communication with the customer rather than ‘command’ to the workforce. The workforce in turn, changed with an increase in internal marketing, franchising, and subcontracting and a rise in part-time, temporary, self-employed, and home workers (Krishan, ibid). Class-based, political parties declined in significance and social movements based on region, gender, or race increased. Large trade unions reduced in both membership size and impact and were replaced with local plant-based collective bargaining where management increasingly ignored, or went over the heads of employee representatives. Cultural and ideological changes led to a rise in individual behaviour and a culture of entrepreneurialism. Education became less standardised (Krishan, ibid).

In the early 1980s outsourcing typically referred to procuring products (sourcing) from outside the firm that would previously have been made by the firm (Bhagwati, 2004). The 1980s were also the beginning of outsourcing especially from the UK to India. Subsequent intensity in competition and easier channels into China, Eastern Europe and South America led to even greater value chain fragmentation. By the 1990s a major survey of engineering and

[2] Just-in time (JIT) is largely accredited to Toyota when they introduced a new production method of ‘make to order’ (as opposed to make for stock), in small batch sizes with minimum inventories. This was to a large extent because Japanese factories had little space for storage. Minimum stock also meant that you had to reduce waste, have close partnerships with suppliers who could deliver what was required only when needed and improve quality – hence the Japanese parallel development of what became known as Total Quality Management (TQM).

manufacturing (Economist, 1998) pointed to a shift in industrial production from the US, Western Europe and Japan to Latin America, South East Asia and Eastern Europe.

By 2004 the terms outsourcing and offshoring strategies were increasingly being used to reflect the international purchase of services as well as products with internet and other supply channels. This led to a situation where it was clearly no longer the case that only blue collar or low skill level jobs were at risk to outsourcing and offshoring but many professional, higher skilled and management roles also. Concerns started to arise with the extent and time demanded of management to control the outsourcing contract, the ensuing quality, the subsequent realisable benefits and the performance and service levels against a contract to buy back the services or products. Other risks could include protection of intellectual property. Organisations may choose to start with less valuable support activities or simple assembly operations. As trust grows, or the supplier proves capable so more valuable activity might be offered.

Later in the next decade there is a further reduction in manufacturing output as an economic activity when compared to services (in 2010-2013 less than 20 per cent of GDP for Britain and below 30 per cent of GDP for Germany)[3]. However, the distinction between manufacturing and services is also becoming increasing blurred as more and more organisations are now more likely to offer both services and products in their portfolio and many engineering designs incorporate embedded software. One impact especially for MNCs is to organise their engineering and manufacturing activity around customers rather than the other way around. This means not only chasing cheaper and cheaper labour around the world for simpler parts of the supply chain; but

[3] Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources. The origin of value added is determined by the International Standard Industrial Classification (ISIC),

that they also have to meet customer demands to have both products and services supplied locally (Economist, ibid). Multinational firms such as ABB have deliberately developed ‘global managers’ as part of their expansion (Lynn and Salzman, 2009) with a cadre of managers experienced in running plants outside their home country. This coupled with huge numbers of international students often graduating in engineering and science from United States and European universities who on returning home to developing countries to work, has helped to assimilate MNCs into developing countries around the world and enabled a progression *higher-up* the value chain with the type of work handled. Such value chain enhancement starts with commodity work but gradually develops into highly engineered products with contract manufacturers becoming original equipment manufacturers (OEM)[4]. Examples would include China where they have gained access to the physical and human capital, and know-how of high income countries through their exports produced at low labour cost. China does not (yet) make Boeing aircraft and the United States now make relatively few garments (Wolf, 2005). Today South Korea’s wages are fifteen times higher than in China. Fifty years ago they were the same. China’s (also India) skills, wages, costs and productivity in 2013 and 2014 were rising, as they do so will their comparative advantage. Today, South Korea makes few garments, in time so will China (Wolf, ibid).

A recent text (Urry, 2014) argues that offshoring has become the *dark side of globalisation*. Money, goods, waste, energy, people can all be moved to offshore tax havens and / or countries with low labour cost.; avoiding laws, taxes, rules and regulation. Stories have spread of ‘sweatshops’ and goods being transported in huge container ships, flying flags of convenience

[4] Original equipment manufacturer (**OEM**) is a term used when one company makes a part or subsystem that is used in another company's end product.

and even mooring offshore until prices become favourable. Evidence (Urry, op cit.) has also been presented of income not being spent where it is generated thus further depleting local economies and contributing to poverty.

2.3.1 Re-shoring

A German perspective on the drivers and antecedents of manufacturing offshoring and backshoring (often called re-shoring) reviewed large data sets (Kinkel & Maloca 2009). Some 20 per cent of the organisations subsequently reverse their plan and re-shore (return to Germany) within 4 years. This is mainly due to a lack of flexibility and poor quality. A deeper study of 39 German manufacturing companies confirmed that a lack of attention was given to the success criteria and to the impact on competitive advantage. A UK study of offshore production in the years 2008-2009 (Liebl, 2010), found 14 per cent to have re-shored. This estimate for the UK has been updated by the Government’s Manufacturing Advisory Service to 16 per cent (FT, 2013d). Reasons cited included: quality, shipping costs, difficulties in training, reduced flexibility, international payments, higher than expected quality assurance; or costs that were simply not accounted for in the offshoring move. The reality is that it takes time for international markets to reach equilibrium, if ever. So one possibility is that given an initially over-enthusiastic trend to offshore; re-shoring is then simply part of the process of reaching steady state.

However, in 2012 there were further suggestions that some of these trends are indeed reversing and that the offshoring trend of engineering and manufacturing may have gone too far (The Sunday Times, 2012). A UK truck manufacturer has found that the introduction of a minimum wage in Thailand plus a 20 per cent increase in shipping costs now makes it more competitive to manufacture in Britain. Goods as diverse as textiles, high technology material coatings, diaries and (Filofax) books; and washing machines are also returning to the UK. While arguably a trickle, rather than a trend, the UK government are keen to rebalance the economy away from the service sector, as an example it is hoped to (re)create 20,000 textile jobs in the UK over the next five years. The devaluation of sterling against the euro and a reduction in corporation tax has also helped. A difficulty however, will be a skills gap especially in 'high end' fashion. Having said that, Marks and Spencer, Fat face, Acadia and Jaeger have 'all British' manufacturing (Financial Times, 2014). Other examples in the UK of work returned from Asia have included lawnmowers to Suffolk, domestic and office vacuum cleaners to Somerset, industrial machinery to Yorkshire, electronics and cable assemblies for Railways and Computers to Nottingham, and jewellery manufacture to Birmingham. In 2014, it was announced that Antler, the luggage company celebrating its 100th anniversary this year would now be bringing jobs back from China to the UK (having moved offshore 20 years ago. They argue that British made goods are important to both consumer and retail groups. Also that while it was still more expensive in the UK, lead times and lower shipping costs would result (Financial Times, 2014). It is interesting to note that advances in suitcase design and specialist materials meant that today production was more about engineering then the traditional skills of cutting and sewing.

Dr Jagjit Singh Srai head of the centre for international manufacturing at the University of Cambridge is yet to be convinced of *re-shoring* as a definite trend (Sunday Telegraph, 2014).

> *The data's really unclear, but anecdotal evidence says that re-*shoring *is now a very hot issue. Firms are talking about it and considering carefully whether it is good to be at home or offshore.*

Location, Srai argues could now be something that companies look at more closely than before. Any firms that do return are likely to receive a warm reception.

The United States presidential election of 2008 (even more so in 2012, author) and the debate on offshoring of service activities has put globalisation back onto the agenda (Wolf, 2005). Politicians still struggle with the integration of the world economy and recently have resorted to financial incentives to backshore or reverse previous offshoring activity in favour of the domestic economy and employment. (Wolf, ibid; and BCG cited in Economist 2011b). At the same time General Electric (GE) plan to invest $1Billion in the group's United States domestic appliances business returning jobs previously outsourced to China and Mexico (Financial Times, 2012a). This is a result of rapid wage growth in emerging markets while the United States experiences sluggish pay thus eroding the labour cost advantage. Some companies have found a one-off cost saving from offshoring but over time with extended supply chains that were not as agile as the market demanded, also an approach that proved unsustainable. Meanwhile, lean manufacturing and design techniques coupled with restructuring has enabled considerable productivity savings back in the US. This argument is enhanced further with huge oil prices and transport costs, plus some $17m of government incentive. Overall the United States has added 429,000 jobs in 2009-2011 replacing 20 per cent of jobs lost during the recession. (ibid). Experience has often shown that while Britain lags what happens with various business initiatives in the US, the UK does then later follow the US. Germany and other parts of Europe may well in turn follow the UK with such operational and business trends. This has been the case to date with Total Quality Management, Benchmarking, Six Sigma and other such initiatives (Author, also see footnotes in Chapter 5 Transport).

The dramatic increase in labour costs in both China and India has again led to evidence of re-shoring (Financial Times, 2012a). A move out of the financial sector intensifies as there is a rebalancing of the economy back towards production industries and away from an over-reliance upon financial services. The results of a survey of 362 UK manufacturers organised by General Electric (GE), suggested that this was because of a number of factors including a weakness of sterling against other currencies and rising costs in China (and India). The trend from 1997 to 2012 to buy cheaper parts from overseas is now starting to reverse. In balancing often conflicting stakeholder desires of politicians, shareholders and others the question that needs to be asked is (Financial Times, 2012a):

> *How much outsourcing is actually sensible when the economy needs growth and it is possible to revisit the advantages of local sourcing with the benefits of quicker reactions, more control over lead times, and a lower risk of long complex supply chains?*

A special supplementary report in the Economist that examines the changing economics of offshoring in the corporate world argues that offshoring in its traditional sense, in search of cheaper labour anywhere on the globe, is maturing, tailing off and to some extent being reversed (Booth, 2013). Multinationals will not become any less global as a result, but will distribute their activities more selectively around the world, taking account of a far broader range of variables than labour costs alone. That offers a huge opportunity for rich countries and their workers to win back some of the industries and activities they have lost over the past few decades. Developed countries will have to compete hard on factors beyond labour costs. The most important of these are world-class skills and training, along with flexibility and motivation of workers, extensive clusters of suppliers and sensible regulation. In 2005 labour costs in China and India offered a 20 per cent saving compared with United States cost, Mexico a 10 per cent saving. In 2012 the saving with China had reduced to only 5 per cent and is estimated to break-even by 2015. In the past three years United States re-shoring activity is estimated to have increased from nine to nineteen per cent (Booth, 2013 based on data from McKinsey). Wages in China and India have been going up by 10-20 per cent a year for the past decade, whereas manufacturing pay in America and Europe has barely budged. Other countries, including Vietnam, Indonesia and the Philippines, still offer low wages, but not China's scale, efficiency and supply chains. Gaps between wages in different parts of the world remain, but other factors such as transport costs increasingly offset them.

Furthermore, a number of large American firms (not just GE) now believe that they went too far in sending work abroad and now need to re-shore, well-known companies such as Google, General Electric, Caterpillar and Ford Motor Company are bringing some of their production back to America or adding new capacity there. In December 2012 Apple announced that it would start making a product line of its Mac computers in America later this year. Lenovo is a Chinese company that acquired IBM's computer business is re-shoring manufacturing to the United States for the local market. Labour costs in North Carolina will still be higher than in its factories in China and Mexico, but the gap has narrowed substantially, and so it is no longer a decisive reason for manufacturing in emerging markets. The president of Lenova in North America Mr. David Schmoock has suggested that:

> *…… with increased automation, the labour cost share of total costs is shrinking anyway. Lenovo has its own factories in China, and so another reason for moving some production to America is to customise its computers for American customers and respond quickly to demand. If it made them in China they would spend six weeks in transportation on a ship.*

Choosing the right location for producing a good or a service is not a precise science, companies make mistakes and offshore too quickly and too much, just as many mergers and acquisitions fail to deliver results. Europe seemed less enthusiastic for offshoring than America and the small number of European companies that did offshore appear less anxious to return. In the 1990s GE pioneered the offshoring of services, setting up one of the very first "captive", or fully owned, offshore service centre in Gurgaon in 1997. Up until 2012 around half of GE's information-technology work was being done outside the company, mostly in India, but the company found that it was losing too much technical expertise and that its IT department was not responding quickly enough to changing technology needs. It is now adding hundreds of IT engineers at a new centre in Van Buren, Michigan (Booth, 2013). GE traditionally manufactured domestic appliances in Louisville, Kentucky. Under the previous CEO Jack Welch, some 8000 jobs were outsourced and moved offshore to a Chinese contract factory. During 2012 some 1700 jobs were returned and since 2009 GE have hired 500 designers and engineers to support the new manufacturing (Fishman, 2012). The number of firms known to have re-shored manufacturing to America is well under 100. Doubtless many more are doing so quietly. The re-shoring movement has to be kept in proportion. Most of the multinationals involved are bringing back only some of their production destined for the American market. Much of what they had moved over the past few decades remains overseas. And for many of the biggest firms the amount of work that they are still sending abroad outweighs the amount that they are bringing back onshore. Caterpillar, for example, is opening a new factory in Texas to make excavators, but has also just announced that it will expand its research and development activities in China. But re-shoring amounts to much more than public relations. It is being driven by powerful forces and will only get stronger. In a survey of American manufacturing companies by the Boston Consulting Group (BCG) in April 2012, 37 per cent of those with annual sales above $1billion said they were planning or actively considering shifting production facilities from China to

America. Of the very biggest firms, with sales above $10 billion, 48 per cent were admitting to re-shoring. The most common reason given was higher Chinese labour costs. The Massachusetts Institute of Technology looked at 108 American manufacturing firms with multinational operations last summer. It found that 14 per cent of them had firm plans to bring some manufacturing back to America and one-third was actively considering such a move (Hagerty, 2012). A study last year by the Hackett Group, a Florida-based firm that advises companies on offshoring and outsourcing, produced similar results. It expects the outflow of manufacturing from high to low-cost countries to slow over the next two years and the re-shoring to double over the previous two years.

Transport costs are playing a big part in re-shoring. Rising shipping, rail and road costs are most damaging for companies that make goods with relatively low “value-density”, such as consumer goods, appliances and furniture, according to a recent McKinsey report on global manufacturing making re-shoring or near-shoring more attractive. Emerson, an electrical-equipment maker, has moved factories from Asia to Mexico and North America to be closer to its customers. IKEA, a Swedish firm that makes products for the home, has opened its first factory in North America as a way to cut delivery costs, and Desa, a power-tools firm, has returned production from China to America because savings on transport and raw materials offset the higher labour costs (McKinsey, 2012).

Finally, re-shoring is now an integral part of the UK government’s policy (Economist, 2014) to re-balance the UK economy with less reliance on financial services and banking in particular. A government agency has been established ‘Reshore UK’ to help manufacturing firms in particular to return work. While the business case has become increasingly persuasive with rising labour costs in emerging markets, and a need for control of quality and retain proximity to key markets, the evidence of significant levels of re-shoring is still weak in spite of the rhetoric. A 2014 survey by the EEF suggested that one in six has re-shored some production in the past three years. A figure that is similar to that reported in earlier surveys (Liebl 2010, FT 2013d). The significant challenge to be overcome is that decades of manufacturing decline in the UK has led to a decline in labour skills, a lack in supply of machine tools and a weakness in local supply chains. High property prices and continued controversy over immigration (as a possible solution to the local skills issues) remain formidable barriers (Economist, ibid). Germany is less exposed in each of these areas.

2.4 Application of theory to Outsourcing & Offshoring

Questions have been asked as to whether some of the existing theory supporting international business management should be revised given the proliferation of outsourcing and offshoring practices. For example, disagreements especially over economic theory and managerial decision making; (Doh, 2005) challenge whether the Resource Based View (RBV) of the firm is applicable at times of turbulence and significant changes in the business environment (Barney, 1991). Similarly, it can be argued that offshoring is not a defensible market barrier to competition (Levy, 2005) as it is widely imitable and far from unique. Both Doh and Levy refer to offshoring resulting in the creation of a commodity chain (and market) for particular skills, resulting in shifts of power not just new pools of talented workers. ‘Ownership, Location and Internationalisation’ are three criteria given the acronym ‘OLI’ (Dunning, 1980) with a warning of the potential for loss of intellectual property, and of course there have been many such stories. Intellectual capital plays an important part in the global wealth creation process, and companies will exploit this in different locations (Dunning, 2009). There is increasing significance of firm specific created assets that are influenced by government and benefit from spatial clusters. Transaction and coordination costs are high, but in general they are not allocated specifically to cross border markets, and thus may create voids. There are consequences for the common governance of MNCs cross border activity. The paradox of sticky places yet slippery slopes is used (Markusen, 1996) to describe a tendency to (over) concentrate in specific regions. Doh is also critical of the suggestion that MNCs move work to low cost countries for competitive advantage (Porter, 1990) when there may be little evidence that there is a requirement for home demand, as is often the case with manufacturing and call centres in the case of India. It is suggested that while rather different propositions, the choice of when and whether to outsource and offshore should be fully analysed simultaneously (Contractor, 2010). Decisions on disaggregating a value chain and slicing up core and support activities are strategic not operational decisions as they have the potential to totally change the purpose of a firm. A further useful distinction is that the nature and attributes of the work are significant, if comparing the outsourcing of manufacturing, R&D, IT and administrative services (Jensen 2011). It is proposed that Western European manufacturers wishing to reduce costs have a preference for CEE countries, R&D work migrates to the United States while IT moves to Asia and CEE, administrative services move worldwide and are often pooled in clusters. Firms use outsourcing and offshoring to disaggregate their value chain seeking improved control, cost and choice of location (Mudambi and Venzin, 2010). It is further claimed that offshoring hastens the demise of weaker firms yet enhances value for those that vertically integrate successfully. Offshoring and outsourcing also increases complexity and creates other costs (Contractor et al, 2010). An argument, based on the fit of destination attributes with those of business activities, is that it is logical to move manufacturing to low cost destinations and retain R&D in relatively high cost locations (Jensen and Pedersen, 2011). However, advanced activities demand further care. Asia and Western Europe seem to attract advanced activity, but not as much as in the US. Central and Eastern Europe attract basic but not advanced activity in manufacturing and IT offshore.

Multinational organisational strategy has changed the manner in which the Engineering sector distributes and utilises technology. Field studies in South Korea, China, India, Japan, United States as well as the UK and Germany in Europe have identified the recent offshoring of advanced engineering to emerging economies (Lynn and Salzman, op cit.). This has consequences, often unintended for the multinationals, their home country, managers and government policymakers. Whereas ten years ago typical MNCs were vertically integrated and hierarchical with key functions organised in one of the triad economies (US, Japan or Europe). Core engineering and R&D would be retained at home, with only limited engineering activity taking place in emerging economies. Profound shifts have now taken place as core activities are dispersed, often outsourced and or moved offshore unlocking them from prior organisational integration. The geographical embeddedness of regions such as Silicon Valley needs re-examining. Software, pharmaceuticals, telecommunications, aerospace work is now undertaken in India, Brazil, Eastern Europe. Specialised firms now provide key design and research services from a low cost base to multinationals.

Cost, resource and entrepreneurial drivers have been investigated (Roza et al, 2011) in terms of a relationship with firm size; also choices of offshoring were related to function, location and governance. Multi country data of the Offshoring Research Network (ORN – see Roza, ibid) with over three hundred functions offshored from firms in the US, UK, Netherlands, Germany and Spain demonstrated that offshoring could be deployed, undertaking either a cost, resource or entrepreneurial strategy. Small firms prefer to use ‘far-shoring’ (Roza’s terminology for long distance offshoring as opposed to near-shoring) as a cost strategy for specific functions (Engineering, R&D, product design). Medium sized firms use offshoring as a resource strategy relatively often far-shoring. Large firms will offshore as a cost and resource strategy, and again relatively often will far-shore, relocating competence exploiting functions (Accounting, HR, IT, Procurement, Sales & Marketing). Entrepreneurial firms prefer ‘near-shoring’ and finally, Roza reports that firm size does not affect the offshoring governance mode (licensing, joint ventures, acquisitions) either captive (full or shared ownership) or outsourcing offshoring (no ownership).

The United States is returning work previously outsourced to China, India and Mexico. While the new jobs (GE, Boeing, IBM and others) may be different to those lost prior to the outsourcing, United States labour costs are now less than they were prior to the crisis. United States labour costs are changing far slower than in China and India, and energy costs in the United States are also lower as are the ‘time to market’ and storage costs etc. (Holmes, 2013). Changes in trade union policy have also been a key part of the puzzle. Many United States companies have traditionally relocated work to locations that have not been receptive to unions. Existing plants often have unionised blue collar workers alongside non-union white collar staff in R&D laboratories. Changes in the ‘right to work’ laws prohibit compulsory membership as a requirement for employment, and have now helped the automotive sector in Michigan recover since the 2009 crisis.

So MNCs are ‘unlocking’ their core engineering and manufacturing activities, emergent countries increasingly recognise the opportunities and amend policies such that they become attractive hosts. The spread of the world's wealth to a much larger share of the world's population is an enticing prospect. There is also a challenging debate around aspects of globalisation and management practice in respect of transferring core competences and processes when offshoring; these concerns are often directed towards the developed countries where jobs and wages are under threat. Where offshoring is unrelated to domestic demand then the developing countries may be reliant upon capital and resources from traditional industrialised nations and the vagaries of MNCs who shift production (Doh, op cit.). By disintegrating production stages along a supply chain and transferring work elsewhere so conditions are created where ownership is eroded along with intellectual property. A growing trend has been for complex supply chains to be outsourced, this leads to what is known as 'Third party Logistics (3PL)'[5]. That supplier might in turn decide to further outsource part of the local operation, for example the manning of a warehouse thus leading to 'Fourth Party Logistics (4PL)'.

2.5 The debate

The controversy around offshoring is often around a loss of jobs at home, and / or a lack of real investment in the country of destination, seeking only to improve shareholder returns at the expense of exploiting a cheap workforce. Ethical and sustainability concerns may be raised. Some organisations might seek to mix approaches, perhaps offshore outsourcing of simple administrative tasks, home outsourcing of catering or facilities management and offshore outsourcing of engineering assembly work. Forrester Research estimated that in the United

[5] A third-party logistics provider (3PL) is an asset based company that offers logistics and supply chain management services to its customers. It commonly owns and manages distribution centres and transport modes. A fourth-party logistics provider (4PL) integrates the resources of producers, retailers and third-party logistics providers in view to build a system-wide improvement in supply chain management. They are non-asset based meaning that they mainly provide organizational expertise.

States 3.4 million jobs would be lost by the year 2015 (McCarthy, 2004). Early studies by Stern Stewart Research of 27 United States companies undertaking large scale IT outsourcing suggested an average gain in shareholder value of 5.7 per cent over and above the market trend (Glassman, 2000). A more recent UK study by LogicaCMG estimates a 1.7 per cent rise in the share price as a result of an outsourcing deal, rising to 11 per cent in some sectors (The Human Capitalist, 2012).

Questions continue to be raised about the value of multinational expansion (Contractor, 2012). At the time such decisions on relocating to lower cost countries was made, savings largely based upon labour costs might have been considerable. However, over the past five to seven years wage costs in the US and Western Europe have been contained and often reduced in real terms. On the other hand as demand has increased, so have labour costs in China, India and Eastern Europe increased. Transport costs may also have changed and so the cost-benefit case for offshoring or global expansion may well have been diluted when comparing total costs. It may also be the case that once a decision is made the costs are regarded as *sunk* and then changes over time that affect the wisdom of that choice may well be ignored. It also often the cases that senior management move to different roles and that reporting controls over time may not be in place. While sourcing costs may be reduced locally, and foreign knowledge and intellectual property may be acquired in rapidly developing markets as can the hedging of currency risks; there are a number of other costs to consider. For example, R&D and headquarter costs that are often retained in the home market may increase substantially. Each foreign affiliate may have to incur substantial reorganisation costs and change, for example to incorporate group information and accounting systems, there may also be increased overheads to facilitate policies on group control and quality systems. Central costs of coordination will increase as the number of foreign markets rise, along with supply chain and inventory costs, risks of stock-out, supply failures. Institutional and cultural distance issues again add complexity, communication challenges and potential cost.

Outsourcing in the United States was not just the result of market forces but also the consequence of management decisions, based on often superficial spreadsheet calculations assuming 25 Chinese workers as equivalent to one United States worker in Louisville. Work practices in GE have become flexible; workers, unions, wages and under the new CEO Jeff Immelt, an increased participation in workplace decisions has been encouraged. The GE appliance unit is a $5 billion business, by 2015 75 per cent of revenue will be derived from United States manufactured products – dishwashers, water heaters and refrigerators. The reason for returning jobs is a mixture of simpler transport, IP security, transparency of cost management and the political value of ‘made at home’ (Fishman, 2012).

Given the political pressure, it is natural for companies to want to publicise anything that looks like re-shoring. Lenovo says that its decision to bring back computer-making to North Carolina was a way of looking after the firm’s reputation as well as bringing direct business benefits. Although the migration of jobs to Asia has caused plenty of angst in parts of Europe too, the continent has little hope of wooing back many of the jobs it has lost. There are some signs that in Britain firms are starting to look for local suppliers in order to simplify their supply chains. But China’s importance as a low-cost supplier to continental Europe will continue to rise, for several reasons. First, Europe’s labour markets are still fairly inflexible and costly, so even if conditions in China and elsewhere are becoming less favourable there is still a substantial labour arbitrage to be had. Second, European firms had been offshoring less in the first place. Cultural factors are partly responsible; for instance suggests Hans Leentjes, Northern Europe head of Manpower:

> *Germany's Mittelstand of mid-sized family firms, for instance sell their products globally but are more inclined to make things in their own backyard.*

Europe has a high concentration of family companies, and families tend to be more loyal to their countries of origin. Companies in northern Europe are the most inclined to offshore, whereas French, Spanish and Italian firms have been held back by political and social pressures (Booth, 2013). Restrictive rules on firing employees mean that it is difficult and expensive to shut down capacity at home. So for the time being European firms, if anything, want to offshore more. Indian outsourcing firms hope that Europe will provide them with their next decade of growth. Many European firms have exported jobs to countries in the CEE. German firms have sent work to a place even closer to home: former East Germany, where pay is still lower than in the country's west. French companies prefer Morocco and Romania. This "near-shoring" avoids some of the transport cost and a cultural difficulty of sending production to places a long way from home, as many Anglo-Saxon companies have done.

Finally, a different kind of re-shoring is beginning to emerge where Chinese and in particular Indian companies are recruiting workers in the UK and Western Europe creating 'new' jobs and further adding to the complexity of employment numbers and the implications of offshoring. Although the numbers and reported incidents are again small, UK professionals are increasingly in demand with specialist skills in language, translation, copywriting, web design, design and technical development. It is not just about price competition with UK rates typically three to four time the equivalent jobs in the Philippines, India or China. Translate Media can earn 10 per cent of revenues from emerging market companies (which has doubled in the past 18 months). The CEO reports (Financial Times, 2013a) that this:

> *…reverse offshoring is generated by the original wave of offshoring……..and that Indian off-shorers' are now coming back to us because they have promised clients in the US and Europe multi-language marketing and they cannot find the quality of resources locally.*

Contrary to this, Adam Hughes at PA Consulting's office in India doubts that this level of re-shoring will last; and suggests (Financial Times, 2013a):

> *……we are also seeing a lot of Indian nationals, who have spent ten years in the UK or US now moving back. They have earned their dollars or pounds and can have a good lifestyle in India while taking that skillset back*.

Hence the economic benefits of offshoring have often been immense. For workers in low-cost countries it has meant jobs and rapidly rising standards of living. Rich-world workers have been able to leave the drudge work to someone else. For companies lower labour costs have brought higher profits. Western consumers have enjoyed access to more goods at far lower prices than if production had stayed at home. But offshoring from West to East has also contributed to job losses in rich countries, especially for the less skilled, yet increasingly for the middle classes too. It has become the aspect of globalisation that workers in the developed world dislike and fear the most. The anxiety increased during the 1990's when the internet was used to offshore information technology and back-office work to places such as India and the Philippines. India's outsourcing industry developed quickly and is still growing (Booth 2013).

If globalisation is driven by lower costs of cross border transactions in the context of offshoring, then economies that are advanced with offshoring should be well positioned to gain further benefit (Kohler, 2010). Offshoring is widely associated with job losses. In reality there are two sides to the debate. Decision makers will profit maximise by moving more tasks offshore as improved technology enables better linking of processes across country borders. On the contrary, cost-savings from technology improvements induce firms to expand production and hence labour demand. One assumption with offshoring is that firms freely split their production into steps that can be ranked by cost saving from overseas production (Jones and Kierzkowski, 1990). Whether or not offshoring is successful from a corporate perspective depends in part on international wage differentials and transaction costs associated with resources for transmitting information and monitoring overseas activity. Firms might resist offshoring even if relocating individual steps would be advantageous. Conversely, small variations sometimes lead to a large increase in offshoring (Harms, Lorz and Urban, 2009). It is argued that there are three offshore regimes, partial, full or none (Harms et al, op cit.) and the transition depends in a non-trivial way on costs of transportation and delegation. There is a 'tension' where minor changes in cost or technological innovation affect the structure of the production process and may result in relocation of additional stages all at once. A challenge to offshoring practices, often as part of the lead firm strategy within a GPN (Levy, 2005), is whether offshoring is simply another form of trade with mutual benefits for the host country and the lead firm; or, does the saving in labour cost simply benefit shareholders? Many of the concerns and reasons for re-shoring can be traced to a desire to reduce risk. Nine offshore risks to be managed include sovereign risk, intellectual property, proprietary knowledge, data security, corruption, system security, contractual failures, infrastructure, and regulatory changes (Carmel & Tjia, 2007). So economic fortunes vary, trade cycles exist and both outsourcing and offshoring have taken on different approaches; e.g. a model to help explain offshore progression and diffusion (Carmel and Agarwel, 2002) identified four stages from 'Early Bystander', 'Experimental', 'Cost strategy' and finally 'Leveraging offshore'. At the third stage, cost savings ranged from 15-40 per cent once offshore for at least a year.

This thesis is focused on how large multinational corporations (MNC) operate globally, how decisions on outsourcing and offshoring are made and the role played by institutions and the parent headquarters.

2.6 Synopsis

Chapter 2 has reviewed the various definitions, concepts, political and other controversial factors that surround outsourcing and offshoring, also the trends and in particular the more recent development of re-shoring.

Next, Chapter 3 will explore the underlying theory from a variety of disciplines drawing ideas from economics, sociology and geography as well as business management. This will enable the formulation of a conceptual framework and the development of an appropriate methodology to test hypotheses and explore the theory in use.

CHAPTER 3

CONCEPTUAL FRAMEWORK

3.1 Introduction

Chapter 2 explored the definitions, trends and the context for outsourcing and offshoring initiatives. The purpose of chapter 3 is to explore insights from interrelated, but also complementary strands of underlying theory and to provide a theoretical underpinning for the research; the several strands of literature are: one the resource based view, two global production networks and the implications of institutional effects on embeddedness, and finally varieties of capitalism.

Taken from business and economics, the resource based view (RBV) focuses on organisations and reviews concepts such as 'core competences' and competitive advantage' to underpin an understanding and strategy for deciding which resources are to be retained in-house and which might be outsourced. The intention is to create 'value', enabling a more nuanced albeit complex understanding of how to re-structure a firm's operations. Furthermore, at a time of considerable change in the business environment, many writers consider that a related approach to RBV known as 'dynamic capabilities' provides compelling insights and so this will also be explored. The RBV therefore helps our understanding of why and what a firm decides to outsource and / or move offshore, and the implication that has in terms of employment, skills and the handover or transfer phase.

However, the RBV has little to say on location and geographical dispersion. For this reason the second area of academic literature is global production networks (GPNs). Drawing on ideas from operations management, business strategy and economic geography GPNs together with RBV offer complementary literature that enables an understanding of how outsourcing (from RBV) and offshoring (from GPNs) might be linked in complex configurations. The RBV and

GPNs in addition offer a broad understanding of why it is that UK and German based MNCs choose to move or develop activities offshore. GPNs in particular provide a theoretical approach for how firms control policy and practice, how they manage to coordinate head office with the network or supply chain; and the extent to which policy becomes embedded and institutionalised in the host country. The power exercised by the lead firm in the GPN will also be a consideration.

The final and central strand of literature draws on economics, sociology and politics and is the concept of differing 'varieties of capitalism' (VoC). This theory helps to appreciate how the constellation of inter-related institutions gives rise to a taxonomy of different capitalist models, and how various institutional policies and configurations develop and then impact upon a firm. VoC will be used to explore the extent to which institutional practices in the UK and Germany influence where MNCs choose to locate offshore and the policies / culture that they either decide to transfer, encourage or adapt. A key consideration then is the extent to which MNCs practice is embedded within a constellation of institutions such as a country, a territory, working with local government agencies, work forces and other relevant parties.

The intention is to synthesise the above ideas and to develop a conceptual framework that will form a basis for primary research and data analysis. The framework is used to generate a taxonomy that can be deployed for exploring institutional impacts of the firm. While RBV and GPN refer to the decoupling of competences, strengths and connections across national borders; the issues of whether or not firms are embedded in national institutions and an understanding of VoC provides insights on location choice and how the outsourcing or offshoring is to be managed. Assimilating these three approaches, together with an understanding of outsourcing and offshoring, will aid an exploration of the differences in how UK and German multinationals operate in specific business sectors, and manage, control or coordinate offshoring / outsourcing processes in particular. The following three sections explore these literatures in detail.

3.2 From Resource Based View of the firm to Dynamic Capabilities

The current literature on RBV can be traced back to 1959 and the highly influential work initiated by Edith Penrose on strategic management and organisational economics (Penrose, 1959). RBV is a generalised theory on the growth of a firm (Mahoney, 1992) advocating that competitive advantage is derived from an ability to assemble and then exploit an appropriate combination of resources (these can be both tangible and intangible assets). It is argued by Kor and Mahoney (2004) that Penrose (op cit.) both directly, and indirectly, contributes to our knowledge of the endogenous creation of competitive advantage with path dependent and firm specific operational processes and isolating mechanisms. However, this is contested as Rugman and Verbeke (2002) considered that Penrose concentrated rather more on the growth of a firm and an emphasis on profit maximisation than on causal links with the usage of resources (and hence a contribution to the thinking behind the RBV).

What is agreed is that as MNCs grow organically so resources become scarce and competences change thus starting a search for alternative access to resources (or assets) through acquisition, mergers, partnerships and other means. Outsourcing is now part of that menu of choices. RBV is also of specific interest because it stimulates debate from several perspectives. Firstly, competences, the allocation of resources and diversification of strategy (Ramanujam cited in Mahoney, 1992) become key considerations for MNCs and whether or not to outsource (or in conjunction with GPNs to offshore). Secondly, organisational economics, the allocation of property rights, agency theory, and transaction costs (Coase, 1964 and Willamson, 1979) influence negotiation between the lead company and partners, also between subsequent suppliers within the network, on type and sources of rent. Thirdly, RBV starts with an inside-out approach by looking at internal alignment and then reviewing the competitive environment, thus internal capability determines strategic choices. This is complementary to organisational analysis (Porter, 1980) which starts with industry analysis and leads to adjustments in a firm's resources to seek competitive advantage. Resources can be evaluated using the VRIN (Valuable, Rare, Inimitable, Non-substitutable) characteristics that are necessary, but not a sufficient condition, for competitive advantage (Barney, 1991)[6].

It is also suggested that both resource capital and institutional capital are indispensable to a sustainable competitive advantage. Strategic management literature also struggles with the application of resource based perspectives in business environments that display turbulence and change (hence the related concept of dynamic capability). By disintegrating production stages along a supply chain and transferring work elsewhere so conditions are created where ownership is eroded along with intellectual property. This is where the resource based view of management (RBV) together with outsourcing and/or offshoring and its ability, or otherwise, to help organisations cope with a changing environment becomes of keen interest.

Ideas on dynamic capability have developed from the difficulties that a firm experiences while trying to maintain competitive advantage as well as reducing cost, shifting production with new

[6] A more fully developed theory on the expansion of the firm is a challenge; requiring Production theory to explain the extent to which manufacturing can provide a competitive edge (Hayes & Wheelwright, 1984), Investment theory (Hirshleifer, 1970) and Portfolio theory (Sharpe, 1970).

technologies, markets and competition. The basic assumption behind dynamic capability is that a firm can be agile and flexible in modifying core competencies for short term positional advantage – leading to longer term competitive advantage (Helfat et al, 2007). The dynamic capabilities approach emphasises difficult to imitate combinations of organisational, functional and technical skills integrating the management of R&D, product and process development, technology transfer, intellectual property, manufacturing and human resources; and as such is an emerging approach to understanding competitive advantage because the above fields are outside the traditional boundaries of economic approaches to strategy (Teece et al, 1997). In this context the authors Teece et al believe that the term 'resource' as in the resource based view is misleading and that a more appropriate term are firm-specific assets that are difficult or impossible to imitate. Examples would include specialised production facilities, engineering processes and trade secrets. Such assets are difficult to transfer among firms because of transaction costs and tacit knowledge.

While it can be argued that the RBV of the firm and dynamic capabilities complement each other there are a number of ambivalent issues (Wang and Ahmed, 2007) where a deeper insight is warranted to establish whether dynamic capabilities are specific to a firm and industry sector. Wang and Ahmed (ibid) propose three 'component factors' i.e. adaptive capability (ability to identify and capitalise and adapt to emerging market opportunities), absorptive capability (ability to recognise the value, assimilate and apply new information for commercial gain) and innovative capability (ability to develop new products and/or services with pioneering methods and behaviour). It is interesting to note that the authors go on to suggest that firms ought not to reverse or re-direct efforts at the first sign of failure or when results disappoint. This of interest given the recent levels of re-shoring, especially in the US. Effective capability development requires a consistent long term vision and has long term performance at its heart (Wang and Ahmed, ibid). This may represent a challenge for firms located in countries such as the UK and US because they largely represent so called Liberal Market Economies (in Varieties of Capital terms) and are shorter term in their horizon as well as essentially shareholder driven. Some recent research at Ashridge supports this hypothesis with a review of the entrance of low-cost carrier (LCC) passenger airlines into the market; and applying dynamic capabilities as a strategic framework to explain the actions of different airlines. (Collins et al, 2013).

While the RBV and dynamic capabilities literature gives important insights into what might be outsourced it provides no insight onto the spatial aspects. This leads us to the second strand of literature Global Production Networks (GPNs).

3.3 Global Production Networks

As organisations extend their global reach so the way in which MNCs manage, control and allocate resources throughout their supply chains becomes increasingly critical. The supply chains grow in length and complexity with multiple nodes. Their efficient operation is crucial in terms of matching supply side policies of production with the demand side polices pursued by sales and marketing in a world that has become more 'interconnected'. What is to be done, where and how, becomes a more complex consideration; as new markets are developed, production is shifted from the home market to new locations with differing levels of infrastructure, logistics suppliers, labour capabilities, political stability and so on. With the movement of physical goods then the logistical challenges of getting the right product to the customer on-time may be enormous. In the current 'information age' it can be argued that the provision of services is little different as more and more firms now serve both sectors. The theory that underpins supply chains depends in part upon a collection of ideas around global commodity chains (Gereffi, 1994), global value chains (Gereffi, 2005) and global production networks (Coe, 2008). Choices on offshoring and outsourcing are therefore inextricably linked to an understanding of both supply chains[7] and value chains, where choices are decided of what to keep in-house and what can be outsourced.

There is a growing recognition that global business relationships and production straddle local, national, regional and global spheres in a non-linear, 'spider's web' fashion (Dicken, 2007). Firstly, global commodity chains (GCC) have been referred to as a 'structuralist world systems' perspective (Gereffi and Korzeniewcz, 1994) and it has been argued that closer attention should be given to large institutional and structural environments (in which commodity chains are embedded) to more fully inform our understanding of contemporary capitalism (Bair, 2005). A GCC is a situation specific, socially constructed, locally integrated network which underscores the social embeddedness of economic organisation (Gereffi, 1994). The chains not only link firms in different locations, but also the social and institutional contexts from which the firm arises and to varying extents remains embedded.

Secondly, global value chains (GVC) are where governance is dependent on the complexity of transactions and capabilities of the supply base (Gereffi, 2005); hence a focus on inter-firm linkages and the power relationships between buyers and suppliers. Gereffi proposes five types of global value chain governance – hierarchy, captive, relational, modular, and market – which

[7] In business management the term supply chain is used to link suppliers, producers, intermediaries such as wholesalers and distributors through to dealers, retailers or direct to the customer. The focus is on optimising the cost of production operations and the stockholding of raw material, semi-finished and finished goods. Value chains focus on reducing transaction costs and using agency theory to improve value. Networks tend to place the emphasis on social relationships, knowledge gathering and specialisation.

range from high to low levels of explicit coordination and power asymmetry. A key finding of various value chain studies undertaken by Gereffi is that access to developed country markets has become increasingly dependent on participating in global production networks that are led by firms based in developed countries. Thus, the governance of global value chains is essential for understanding how firms in developing countries can manage the fragmentation of production as well as gain access to global markets. Also, what the benefits of access and the risks of exclusion might be, and how the net gains from participation in global value chains might be increased.

Thirdly, the global production network (GPN) explores sub regions and clustering dynamics; and when combined with thinking on varieties of capitalism helps with understanding power, relative values and embeddedness (Dicken and Henderson, 2003). The term GPN builds on Gereffi's work on GCCs and according to Henderson et al (2002) allows for far greater complexity and geographical variation where agents in a variety of locations can combine and influence the production process (Henderson, op cit.). It is suggested that Global Production Networks (GPNs) are discontinuously territorial in so far as the networks cut through state boundaries. GPNs are useful in that they help direct the attention of institutional practice, particularly government agencies but also trade unions, employer associations and NGOs. All influence the strategy of a firm in each particular location within the chain and as such is relevant to where MNCs expand to and how they then choose to operate.

GPNs with diverse actors and institutions, each with their own agenda are therefore often highly contested fields (Levy, 2008). The struggle for power is between the virtues of cooperation and collaboration on the one hand, versus the challenge of competition and conflict on the other.

GPNs go beyond production supply chains in the shifting of goods (or services) from one stage to the next in logistical terms by also exploring connections to labour markets and development (regional, community, national) policies and hence the interest to geographers (Coe, 2013). There are several gaps in our understanding of GPNs (Coe et al, 2008). The firm is often regarded as a 'black box'; and may belong to several GPNs and a lead firm will coordinate and control operations. This gives the lead firm power (often in more than one country) in spite of not owning a supplier within the network (Dicken 2007). It would be a mistake to ignore the impact of global finance on GPNs, also tensions between the complexity of theoretical frameworks and their practical use by policy makers (Coe et al, 2008). The Japanese automotive industry has taught others to seek close technical and logistical cooperation with suppliers and customers, some concluding that lean production and international sourcing are incompatible (Hoffman and Kaplinsky, 1988). A criticism of GPN research (Hess and Wai-chung Yeung, 2006) is that empirical studies have a preference for qualitative interviews with actors rather than empirical research data on the mechanisms and processes of GPNs.

MacKinnon (2012) suggests that GPNs have become a focus of research in economic geography and related fields in recent years because of the contribution to rethinking regional development processes and the notion of 'strategic coupling' in particular. Also of significance is the concept of path dependence to develop a broader and deeper appreciation of the coupling, recoupling and decoupling of processes that take place between regions and GPNs. A case is also made for the GPN approach being based on three conceptual categories (MacKinnon, ibid): Firstly, '*value'* in terms of a surplus, economic rent, synergies and value capture – highlighting questions of ownership and control for both actors and the locations in the network (Henderson et al, 2002). Secondly, *power* (Dicken et al, 2002) spatial aspects - the control of the lead firm, institutional power (national, local states, credit rating agencies etc.) and collective power from actors, trade unions and NGOs. The third category is *embeddedness* (Hess, 2004) – societal, network and territory. This embeddedness may be eroded over time as competitive pressures encourage a move to less costly locations.

A discussion follows of the institutional aspects of GPNs and their governance, which encourages us to consider the extent to which firms therefore become embedded in countries, networks (and vice versa) and provides a context for exploring approaches to differing varieties of capitalism (VoC).

3.4 Institutional effects and embeddedness

Having explored trends in both outsourcing and offshoring, and key strands of academic literature a common theme is the acknowledgement that institutions often play a key role, and questions as to the extent that practices become embedded. It is necessary to better understand how the institutional context of an individual economy might affect a company decision on outsourcing and offshoring. This section explores briefly the role played by institutions and the nature and significance of 'embeddedness', and helps to establish an institutional context to review next the varieties of capitalism literature. This will contribute towards development of a conceptual framework to analyse data and to explore the theory in use through observed practice.

RBV often assumes rational, self-interested behaviour with only a minimum affect from social relations, yet the converse argument may be true. That is where economic institutions may be regarded as a basis for argument about the embeddedness of economic goals in social structures.

Some of these differences in perspective can be exaggerated, and be reduced to questions of 'balance' or 'stretch' or 'core competences' (Hamel and Prahalad, 1993).

Oliver (1997) has suggested that the context and process of selecting resources influences firm heterogeneity and competitive advantage. Oliver (ibid) continues to argue that a firm's advantage will depend on an ability to manage the institutional context of its resource decisions and that implies the internal culture of the firm as well as broader influences from the state, society, and inter-firm relations that define socially acceptable economic behaviour.

It is acknowledged that institutional factors play a key role in all aspects of the economy (Martin, 2000) from the structure and functions of the firm, operation of the market and the form of state intervention. There has been a blurring of the boundaries between the various social sciences which has reinforced institutionalism as a research framework; in economic geography three main conceptual approaches have been suggested (Martin, ibid): rational choice institutionalism, sociological institutionalism and evolutionary institutionalism. If institutions function to reduce transaction costs that helps to explain the development of local and regional economies deploying agency theory, contract and property rights. Sociological institutionalism deploys network, group and cultural theory and helps understanding of a socially constructed and embedded system. Evolutionary or historical institutionalism draws on post-Keynesian economics, long wave theory and comparative politics helping our understanding of the capitalist economy.

The extent to which the executives at a corporate headquarters behave in a coherent or rational way with their globalisation plans and (inter) connectedness leads to what Evans (1995) refers to as 'embedded autonomy'. The state is involved with industrial transformation to varying degrees. Korea is an example of where the state becomes involved, Brazil and India less so. Embedded autonomy implies dense links not so much with society, but with industrial capital (Evans, op cit.). Evans goes on to argue that the state and social structures shape each other. Hess (2004) suggests a less ‘fuzzy’ concept that is spatial-temporal i.e. the forming and change of societal structures in space and time. As such the history of its actors and the territorial conditions are deemed significant. However, it could now be argued though that given the recent changes in economic, political and societal policies that history is less of a guide today to what the future might hold.

With regard to other key considerations: places of work, issues of race, gender, worker identity all now receive attention as part of the institutional and social embeddedness of labour markets (Peck, 2000). Because national capitalism is to a large extent embedded in the production systems of a particular society; Japanese work practices, American work based welfare reform or German works council policies cannot be readily transferred from one spatial context to another. International competition is therefore seen as a political and economic struggle between alternate varieties of capitalism (Peck, ibid). This is of particular interest to this thesis when MNCs move work offshore and choose to retain the operation as a wholly owned subsidiary rather than outsource to a third party.

Markets are embedded to the extent that economic transactions are conducted through pre-existing social ties (Granovetter, 1985). Economic sociologist Granovetter developed a new research paradigm arguing that the neo-liberal view of economic action which separated economics from society and culture promoted an 'under-socialized account' that atomises human behavior. Similarly, he argued, that others had an "over-socialized" view of economic actors, refusing to see the ways that rational choice could influence the ways they acted in traditional, "embedded" social roles (Granovetter, ibid). He applied the concept of embeddedness to market societies, demonstrating that "rational" economic exchanges are influenced by pre-existing social ties. Economic exchanges are not carried out between strangers but rather by individuals involved in long-term continuing relationships. Economic institutions may also be regarded as social constructions (Granovetter, 1992). That is a broad foundation of classical sociological arguments about the embeddedness of economic goals in social structures. This is contrary to neo-classical economic studies based upon assumptions of equilibrium and rational, self-interested behaviour with only a minimum affect from social relations.

Swedberg and Smelser (1996) reflect on a recently renewed interest in institutional theory and contrast 'economic sociology' with a more traditional and mainstream approach. In the former, key distinctions are that actors are influenced by other actors, not all decisions can be regarded as rational, social structures as well as resource scarcity acts as a constraint, the economy is part of society and not 'a given', multiple methods of analysis are appropriate not just quantitative. Industrial networks are arguably more than a mechanism for the flow of information, products or services (Grabher, 1993). The actor's capability is influenced by a combination of social knowledge and culture, which in turn affect the distribution of information, the structure of power through the network and poles of attraction. MNCs are embedded in networks of relations with a number of important external actors, not only governments (Sally, 1994). These networks display marked differences between nations and regions, with implications for production and service delivery, managerial arrangements within the firm, public policy choices as well as MNC - government relationships. In the distribution of wealth and power, MNCs are situated at the interface of domestic structures in national and regional political economies, and the process of internationalization within global political economic structures.

As firms become increasingly embedded within a territory they both absorb and become constrained by economic and social dynamics (Henderson et al, ibid). Lead firms may take advantage of clusters of small and medium enterprises which get drawn into the network. This embeddedness offers advantages through 'spatial lock-in, further benefits arise from tax advantages, training programmes and so on from local or government policies. If the lead plant then withdraws e.g. closes a plant then a process of dis-embedding may take place potentially undermining the previous vale capture (Henderson, ibid). Network as opposed to territorial embeddedness arises from a process of building trust between agents as in joint ventures – which might be a precursor to outsourcing or merger / acquisition and as such is again of particular interest to this thesis.

Also relevant to this research is a warning that extrapolating from specific case studies should be done with caution, the global economy and power relations need to be discussed as a structural whole argues Dicken *et al* (2001) in their seminal exploration of shifts in the global economy. The context of complex territorial embeddedness of networks is of interest in that some networks are controlled locally, others more at a distance. National policies of regulation lead to the creation of 'bounded regions' of economic activity across geographical spaces. The analytical lens to understand these clusters may be multi-factorial combining sectors, organisation, social actors such as unions and influential individuals. Dicken further suggests that while networks are embedded within territories, so are territories embedded in networks.

Finally, the influential literature on Varieties of Capitalism (VoC). As reflected in the title of this thesis, VoC is considered to be a key focus for the research. While a number of the ideas embedded in this theoretical concept have been criticised it is felt that the theory as a whole is sufficiently compelling that it can be central to our understanding of why German and UK companies compete and behave in rather different ways.

3.5 Varieties of Capitalism

How then might a MNC strategy be influenced by alternative capitalist models, also the institutional frameworks operating at home in the country of origin of the lead firm in the markets where it seeks to operate? The varieties of capitalism (VoC) approach that follows is a grounded method of exploring the wider webs of social relations (Hall and Soskice, 2001); such criteria might include (see Table 3-2 below) inter-firm relations, production modes, legal systems, wage bargaining and sources of comparative advantage.

VoC is based on differences in economic and political institutions across countries (Hall and Soskice, ibid). On the one hand questions can be addressed on the economic policy of nation states, and on the other hand at the level of a firm, questions on location, structure and strategy. Comparative advantage arises from one nation, or firm, coordinating the varying institutional policy making regimes better than another, leading to trade advantages from lower relative costs. Blending forms of capitalism are likely today; so called *'Command economies'* such as China have recently started to privatise parts of their industry and *'Transition economies'* such as in CEE provide relatively cheap, increasingly open markets to neighbouring countries such as Germany where there may also be a stronger affinity to cultural patterns and language. An inherent weakness in the traditional VoC approach is the positioning of countries against a static stereotypical position. In practice, countries, their economies, government and institutions often need to adopt a more dynamic approach to economic and trade difficulties. The recent government bail-outs for major banks in the UK and car companies like GM in the US also blur the transition from state to public ownership, and what is or not corporate policy. This distinction is important because it is precisely the blurring of boundaries, or the clarity of demarcation between differing capitalist models that is at the heart of this thesis.

Hall and Soskice (ibid) posit that the VoC approach is actor centric with relevant actors in a capitalist economy comprising companies, individuals, interested groups and governments. The actors develop and exploit core competences or dynamic capabilities. The quality of their relationships and the contracts formed with suppliers, partners, trade unions and business associates are all critical to success, and may be judged by how well these *relational capabilities* are coordinated. The authors further suggest that the coordination of policies can be judged within five separate spheres of industrial relations, vocational training and education, corporate governance, employees and inter-firm relations.

In the paradigm of private enterprise it is typically considered that Liberal and Coordinated market economies are distinct polar extremes, while also accepting that there may be some overlap as countries and individual firms are in varying degrees dynamic and may or may not choose to shift their policies. Firstly, *Liberal Market Economies* (LME) e.g. UK and US where firms coordinate primarily through hierarchy and competitive market arrangements and so for example, at a time of change in exchange rates, a UK firm would typically pass any price increases along to customers so as to maintain profitability. This is because in a LME, a firm's access to capital is primarily through the financial markets and the firm can absorb lost market share with help from flexible labour markets. We often also refer to this style of operating a firm as driven by (or attempting to maximise) shareholder value.

At the other extreme, in a *Coordinated Market Economy* (CME) e.g. Germany or the Netherlands, when exchange rates change then firms would be more inclined to maintain prices, and accept lower returns to preserve market share as they depend rather more on mixed stakeholder coordination and collaboration. Capital can be raised independently (large German firms usually have senior members of leading German banks on their management board). Labour institutions such as the Works Council operate at a national level, work closely with member firms and encourage long-term employment strategies – so lay-offs are difficult. This is often referred to as operating with a multiple stakeholder model or market focused (rather than financially controlled) approach.

Similarly, it is argued by Murtha and Lenway (1994) that the often opposing interests of public and private political economic interest have led to stereotypical patterns. Again two contrasted styles of VoC are of particular interest, this time; *Pluralist Private Enterprise* e.g. UK and also USA, India and Canada with high market transactional governance; can be compared with *Corporatist Private Enterprise* e.g. Germany and also Austria and Netherlands, influenced predominantly by central or regional government planning, with high institutional involvement. Both categories sit in the private sector in terms of property rights allocation.

Much of the literature on institutional systems including VoC, is based on an assumption of stability with intermittent disruption. A weakness in any 'clustering' approach is that by grouping nation states in this way e.g. the UK and USA, we fail to recognise some important differences. A national industrial strategy i.e. Government central or regional policy affects a MNC strategy when it causes the firm to take different actions from those previously planned (Murtha and Lenway, 1994) and this is of paramount interest to this research. Fig. 3-1 below is based on a comparison of shifts in transactional governance (central to market planning) and the reallocation of property rights (from the public to the private sector). In reality a country VoC while largely stereotypical e.g. China once clearly a ‘command economy’ is changing quickly, increasingly privatising a number of State Owned Enterprises (SOE’s); and as such often manages to operate in a dynamic but also duplicitous manner. A shift in traditional positioning can also be brought about by changes in the role and behaviour of institutions such as central and other banks, national and regional governments, company and employee representative groups. Lane (2006) considers that Germany was gradually shifting from a Corporatist Private Enterprise (also referred to as a Coordinated Market Economy) towards the US / UK model of a Pluralist Private Enterprise (or Liberal Market Economy). However, the recent recession across Europe in particular left Germany in a position of supporting weaker members of the Euro and tended to reinforce their good practices within the corporatist sector rather than the demonstrably less successful policies pursued, at the time, by the US and UK in the pluralist sector. Thus the reality in a more dynamic global world might be a blend moving selectively towards a central ‘mixed’ VoC model, see Fig 3-1.

However, this does help to explain why outsourcing and offshoring trends that often started in the US were copied in the UK and then spread to Europe over a ten year period. Germany has a reputation for waiting and watching trends elsewhere before changing (e.g. The same pattern of US then the UK followed by Europe and latterly Germany, happened with new manufacturing practices such as just in time (JIT) and quality management philosophies (TQM, benchmarking, six sigma, self-assessment techniques etc.).

VoC is an institutional approach. Institutions are not organisations, rather they are a set of man-made rules (North, 1990). All institutions are in turn created and changed or modified by man acting in the capacity of an agency; it therefore follows that organisations can be considered as players or groups of individuals who work towards a common goal or set of objectives.

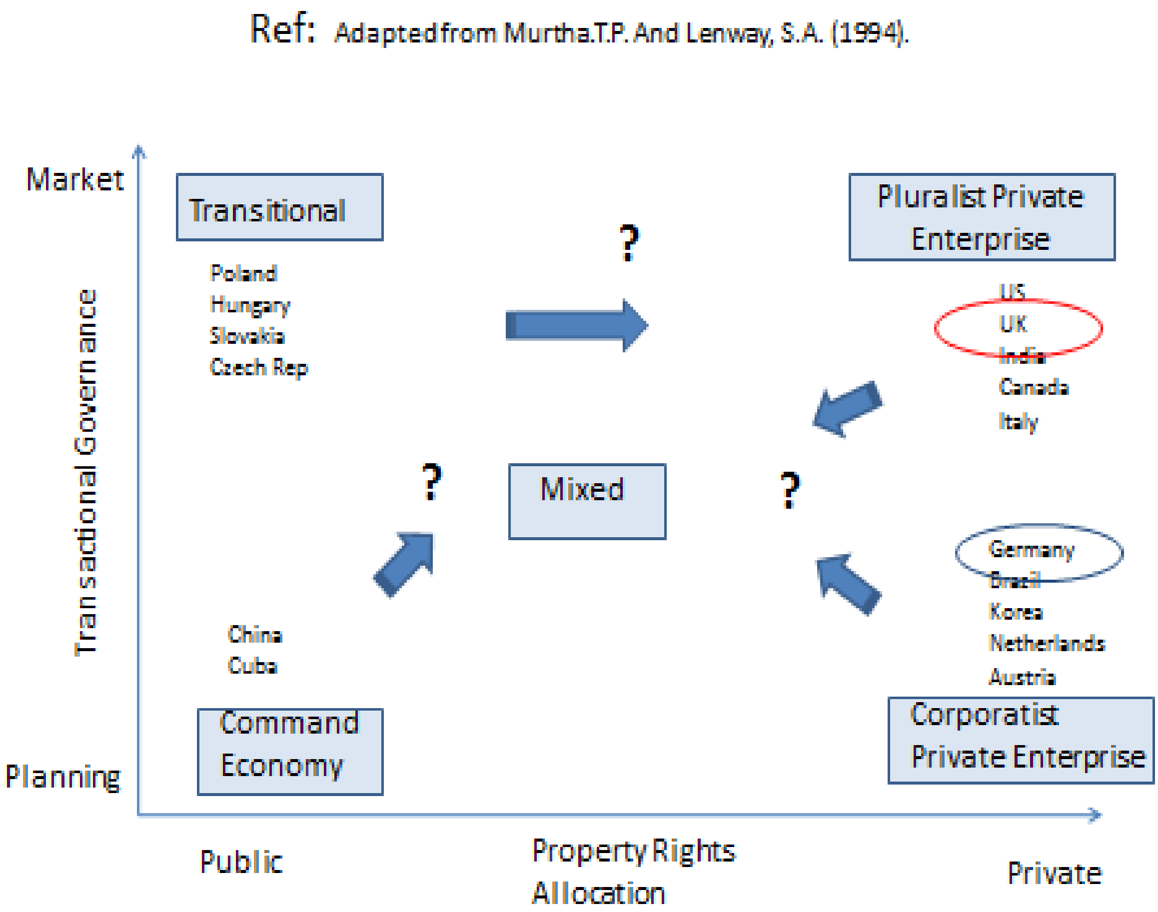

Figure 3-1 Systems of public / private political economic interest

It is the differences between the rules, the players and their interaction that shapes and creates institutions. The strength and weaknesses of transaction-cost and imperfect information approaches to the economic theory of institutions (Bardhan, 1989) and theories of institutions and their relative merits vary. The transaction cost school (Coase, North, Williamson et al) argue that institutions evolve to lower costs including those of information, negotiation and contracts.

When transaction costs are absent then assignment of property rights is immaterial (they are voluntary). However, when transaction costs are substantial then allocation of property rights is crucial as is usually the case. In spite of the above criticisms when comparing UK and German business rather more affirmation and insights from the VoC approach appear insightful and compelling.

3.5.1 VoC – comparing the UK and Germany

A useful comparison of firm strategies and corporate governance in the UK and Germany is offered by Vitols (2001) see Table 3-1 below. Also, another more detailed comparator is offered by Hall & Soskice (op cit.) see Table 3-2. Hall and Soskice further suggest that countries with a high profile stock market tend to offer less labour protection (e.g. LME) than CMEs (e.g. Germany) where the agencies and institutions will adapt differently to sudden changes or shock thus leading to different corporate strategies, levels of innovation, employment practices and income distribution. The comparisons below suggests a UK company is likely to be dominated by a CEO with strong performance incentives linked to share price. The UK model is largely shareholder driven and regulated by the equity market which has dispersed ownership. The labour relations system implies that bargaining is typically at the level of the firm, union membership is not compulsory and that a formal voice influencing corporate decision making would be unusual. Inter-firm relations are more likely to be competitive then collaborative. Employment is of general rather than specialist skills. Corporate policies will favour deregulation and seek to reduce tax. On the other hand, German companies are governed by non-market institutions, ownership is in the hands of long-term strategic actors with multiple links. There is a corporatist system of employee representation giving formal participation rights at both plant and company level. Also there is a dual company board system with the Vorstand reviewing day-to-day running of the business and the Aufsictsrat (supervisory) board addressing strategic decisions, capital investment, mergers and dividend policy. A German company is typically characterised by consensus decision making balanced by multiple goals, and strong representation of employees (through works council etc.) who could block, or moderate the pace of corporate change. Hence it is stakeholder driven. The emphasis is on strategic interplay, differentiated niche production and the acquisition of industry relevant skills through apprenticeships.

Table 3-1 A comparison of UK and German firm strategies and differing approaches to corporate governance

(Vitols, 2001)

Criteria	UK (LME)	Germany (CME)
Dominant ownership structure	Small shareholdings by portfolio investors	Large shareholdings by strategic investors
Employee representation institutions	Voluntarist	Corporatist (board-level co-determination)
Top management institutions	Single board dominated by CEO	Dual Board. Multiple power centres.
Primary corporate goal	Profitability	Multiple goals: profitability, market share and employment security.
Competitive strategy	Radical innovation in new sectors. Price competition in established sectors	Non-price competition through incremental innovation.

Table 3-2 A comparison of LME and CME criteria

(Hall & Soskice, 2001)

Criteria	UK (LME)	Germany (CME)
Mechanism	Competitive market arrangements	Non-market relations
Equilibrium	Demand/supply and Hierarchy	Strategic interaction among firms and other actors
Inter-firm relations	Competitive	Collaborative
Mode of Production	Direct product competition	Differentiated, niche production
Legal system	Complete and formal contracting	Incomplete and informal contracting
Institutions' function	Competitiveness. Freer movement of inputs	Monitoring sanctioning of defectors
Employment	Full-time, General skill. Short term. Fluid	Shorter hours. Specific skill Long term. Immobile
Wage bargain	Firm level	Industry level
Training and Education	Formal education from high schools and colleges	Apprenticeship imparting industry-specific skills
Unionization Rate	Low	High
Income Distribution	Unequal	Equal
Innovation	Radical	Incremental
Comparative Advantage	High-tech and service	Manufacturing
Policies	Deregulation, anti-trust, tax-break	Encourages information sharing and collaboration of firms

Hall and Soskice (op cit.) argue that the VoC approach challenges conventional assumptions on globalisation. Firstly, firms are not similar across nations and react differently to similar challenges. Secondly, firms do not always move offshore because of cheap labour – skill, productivity and inter-firm relationships may be important and a form of institutional arbitrage rather than labour arbitrage may take place. Some activities for example R&D might move to a LME to gain access to radical innovation and a CME when preferring incremental innovation. Thirdly, given more intense international competition LME might pressure government to deregulate further weakening organised labour.

Dore et al (1999) compared the twentieth century's history of the UK whose institutions and economic behaviour patterns most closely conform to, and those of Germany whose institutions most significantly deviate from, the prescriptions of neo-classical textbooks. They suggest that there is not an obvious story of a long and steady convergence-capitalist rationality that slowly dilutes differing cultural traditions. Rather both British and German have changed in key respects; finance and corporate control structures were arguably more similar in the 1920s than later. By the end of the post-war golden age, there were signs of convergence on similar forms of managerial capitalism.

The UK is further categorised by Lane (1998) as *Financier Dominated capitalism*. Activities are often voluntary, operated *at arm's length* and highly diversified (although conglomerates are less popular today than in the 1970-early 90s). There may be a loose association of lowly committed actors who operate in a socially isolated manner. Therefore it is difficult to share risk; and hence the typical stance is risk adverse, short term investments in relatively safe havens, with fixed capital, R&D, HR development resources. As a consequence local networks tend to be underdeveloped, institutional embeddedness shallow, and policy networks typically less pronounced. Hence, British companies are typically less able to mobilise external resources and share risks. This could be a challenge for the effective coordination and control of offshoring / outsourcing if the parent business is to influence success. Large British companies tend to rely upon the FTSE index, and are more likely to have a listing on foreign exchanges such as NYSE. Thus UK directors have a tendency to '*follow their share price'*, again reinforcing short-termism in terms of both behaviour and strategy[8].

On the other hand German companies tend to be more organised and referred to as '*Production Orientated Capitalism'* implying a greater concern with and for the integration of labour with management around specific productive tasks (Lane, 1998). There is a more communitarian approach towards group work and problem solving. Finance provision is long(er) term reinforced by education and a training system that is more robust than that of the UK, with skills development taken seriously at all levels. The institutional support system and network is highly embedded. This is illustrated by the CEO of a large German machine tool company sitting on the boards of Deutsche Bank, BMW, acting as President of the Trade Association and invited to join government round tables. Such examples are rare in Britain. Many large German companies are interrelated in terms of ownership and interlocking directorships; MNCs such as Merck KGaA and CompanyABC are still family controlled. That crucial controlling stake has been very evident at recent times of crucial strategic decisions on acquisition, divestment, restructuring and so forth (e.g. Merck-Serono) in 2012.

It could be argued that that we would expect CMEs (Germany) to constrain a firm's ability to outsource and offshore activity, while LMEs (UK) have greater degrees of freedom and latitude

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[8] Actions respond to the share price movements, e.g. share price falls, so cut costs and resources.

to restructure their processes, reallocate resources and choose a location in which to operate. Lane, (2008) for example suggests that British pharmaceuticals are not constrained by domestic institutions; the LME versus CME paradigm seemingly holding true for Britain and Germany. Lane and Probert (2009) also refer to LMEs and CMEs presented as polar extremes, while more plural typologies such as 'national business systems' by Whitley (1999) outline how institutions co-vary across international domains; recognising the governance of variety yet also the diversity within them. It is argued that LMEs rely on hierarchy and competition and tend to be better at radical innovation. Employees work long hours often with high income inequality between the top and bottom grades of staff. CMEs are rather better at incremental improvement and innovation. Their focus is improving the quality of existing products. Continuous improvement is regarded as on-going. The workforce work shorter hours and have a more equal income distribution.[9] Whitley also argues that *business systems* in this context should be regarded as a collection of institutions that shape economic transactions, cooperation and control, trade unions and government agencies (Whitley, 2002). Hence, there is an overlap with the 'varieties of capitalism' literature.

There is a debate as to whether CMEs and LMEs are converging, with CMEs moving closer to traditional LME characteristics. This does not necessarily mean that German companies will increasingly resemble Anglo Saxon LMEs, but there would be far reaching changes in institutional sub systems. Neither is the process irreversible (Lane, in Morgan, Whitley and

[9] There is always a danger of drawing too many erroneous insights from national characteristics. However, the above also has to be seen within a traditional focus on shareholder value, and the adoption of a short term view towards investment and expenditure in countries such as the UK. A rather different model is adopted by many German corporations towards multiple stakeholders (the shareholder is but one), and a more balanced approach to customers, employees and internal improvements; this is often teamed with a longer term view of investment – especially in the home market.

Moen 2006). With one of the institutional ‘spheres’ industrial relations (Hall & Soskice, 2001), it is argued that the gap between LMEs and CMEs is actually widening. The UK decentralised collective bargaining under the Thatcher conservative government reduced trade union power. Germany has tri-partite arrangements between the company, union and industry sector representatives; centralising discussion and negotiations. Thus CMEs exhibit resilience in their labour institutions not mirrored in LMEs. Questions remain as to whether a focus at national level exaggerates differences in culture (Trompenaars, 1997). The recent relative economic success enjoyed by Germany (compared with the rest of Europe) may well have slowed down the convergence of CME traits. That the UK (has for some years) been economically underperforming against Germany raises questions as to why Germany should wish to move towards the arguably less successful Anglo Saxon LME model. Other studies suggest that each of the German and UK systems remain distinctive (Vitols, 2001, see also Table 3-1) having examined the impact of differences on firm strategies deployed in financial services, chemical and pharmaceutical sectors (as noted in Hall & Soskice, 2001).

The more *corporatist* character of Germany compared with Britain (Ruigrok and van Tulder, 1995) suggests greater restraint with German FDI for MNC, and further comparisons between Germany and Britain imply that Germany has both higher exports and a lower FDI. Porter (1990) argues that Germany focus upon low volume, high value added segments, also delivering customer service. On the other hand, Craft and Thomas (1986), as well as Porter (1990) still consider that Britain favours standardised products, is more price orientated, labour intensive, and capital neutral; and focused upon commodities. Britain now has greater quality consciousness and Germany is more cost conscious. These two profiles play to popular assumptions of national characteristics; British companies are led by accountants and German by engineers. The internationalisation of board composition also shows differences between the UK and Germany. Siemens, BASF, Mercedes Benz have few non Germans on their management board, the Vorstand[10] are solidly German, Bank representation is normal. A significant number of British companies are moving in the direction of greater non-British board membership (Lane cited in Morgan et al 2006).

At the end of this chapter the key elements of the above literature will be synthesised to provide a conceptual framework and taxonomy.

3.6 Critique and synthesis

This section explores how the three strands of literature fit together and how their contributions can be drawn on to generate a novel taxonomy.

Offshoring and outsourcing could be analysed as global disaggregation of the value chain and as an attempt to combine comparative advantages of geographic location with an organisation's resources and competencies to maximise competitive advantage (Mudambi, 2010). The interplay of comparative and competitive advantages determines the optimal location of value chain components (offshoring decisions) as well as the boundaries of the firm and the control strategy (outsourcing decisions).

The lack of research on the interdependencies of geography and control is arguably underdeveloped, considering that firms operating in international markets face these decisions simultaneously (Dunning, 1996), and so while addressed in part by researchers of GPNs, the

[10] Top management team. There will also be a supervisory board.

field is contested. Making these decisions independently of each other may lead to short term, tactical sub-goal optimization. The strategic integration of these decisions can result in significant firm-level performance improvements (Banker *et al*., 1984). Most of the offshoring literature takes control decisions as a given. Similarly, the mainstream literature on outsourcing usually fails to explore the location decision.

Understanding the cost-benefit of offshoring and outsourcing is informed by RBV theory and concepts. This goes beyond the simple assumption of labour cost arbitrage towards the complexities of disaggregating home based processes and deciding what exactly to move offshore and where to locate it. Behaviour, whether rational or not, can be explored between buyers, suppliers and third parties in negotiating contracts and rents. If this can be combined with a better understanding of how to ensure that economic goals are embedded into social structures and the subsequent impact on behaviour then we have a compelling approach.

There are obvious limitations in clustering nation states, nevertheless broad comparisons seem possible. VoC can provide critical insights to the role of governments and institutions in juggling support and resources from the public to the private sector (and vice versa) also the extent to which institutions or the market influence prices, positioning, strategy and overall firm performance (see Fig 3-1). Whether coordinated versus liberal, production versus finance dominated, or corporatist versus pluralist private enterprise, most writers on VoC agree on distinct differences between UK and German systems of capitalism. The significant distinction is how German or UK MNCs then coordinate policy and whether they take their lead from the market or influential institutions to coordinate stakeholders. Further understanding of inter-firm linkages, power and competition is provided by the study of GPNs. The role of the lead firm is considered crucial in managing the impact of institutional policy on resource allocation decisions. Once offshore processes are sufficiently embedded that they add value back to the lead firm, further complex decisions are often required on (re)positioning (typically expensive) R&D and innovation resources, along with suppliers and customer markets.

The aforementioned insights, along with Tables 3-1 and 3-2 help to consider whether or not the CME approach in Germany is conducive to outsourcing and offshoring approaches, or possibly acts as a barrier when compared with LME competitors. There seem to be several issues that are nevertheless, underplayed by existing literature.

Firstly, institutional aspects of differing workplace environments and management groups largely responsible for decision making and policy setting of outsourcing and offshoring activity. If we consider the lead firm in a GPN, then there is an attractive argument that sustainable competitive advantage depends upon the firm's ability to manage the institutional context of its resource decisions (Oliver, 1997). Hence combining the resource based view with institutional perspectives from organisational theory overcomes both some of the criticism of VoC (Granovetter, 1992) and seems compelling in practice. Institutional theory assumes that individuals are motivated to respond to external pressures. The 'cultural clash' that arose from European post socialist transformation over the past seventeen years has attracted the attention of business partners from across the CEE. The body of organisational knowledge based on traditional, stable western market economies needs rethinking for sometimes unstable and ambiguous post- socialist environments (Soulsby and Clark, 2007). State Owned Enterprises (SOE's) tend to have functional hierarchies designed to have instructions and targets handed down through the various levels. A well connected MNC and the use of FDI could be critical in changing past practice and delivering demanding service level agreements (SLA's). This is clearly not easy, local managers will criticise the economic rationality of western values and practices such as financial control and downsizing while trying to defend local values such as a duty of care and the value of labour (Soulsby and Clark, op cit.).

Secondly, there are two contested issues with groups of labour and the impact on offshoring. One is whether CME firms are constrained from offshoring in the manner that a LME can. The other issue is related to the measurement problem (discussed in chapter 2) and the real impact on employment. It has been suggested that improvements in technology (that link tasks across distance and borders) lead to domestic job losses through offshoring but also create jobs from cost savings associated with enhanced trade. Employment takes time to adjust to improvements in offshoring technology (Kohler& Ward, 2010). In support, assume that an organisation relocates 500 jobs to India then this constitutes a relocation effect (Gorg, 2011). If however, offshoring these jobs results in an increase in business productivity and sales increase so overall employment also increases.

The third issue is that the dynamic and contradictory nature of relationships associated with re-shoring. The underlying reasons could be a mixture of changes in policy, costs, customer requirements, market and / or strategic plans. Either when poor decisions are taken at an early stage, or when institutional pressures change so work may be returned (or re-shored) to the home country. We need to better understand when re-shoring is simply the consequence of an over enthusiastic initial response to the competition, a response to a radical change in the cost and business model or the more recent political and institutional pressure in the ‘national interest’. Today, new institutional rules need to be defined that reflect the economic uncertainty and a lack of stability (Lane, 2008).

Helpful models for linking these concepts, also the aforementioned ideas, have been proposed by Dicken (2004) and by Murtha and Lenway (1994). Fig 3-2 below has been adapted suggesting that differing VoC models drive institutional policies and in turn lead firms exercise power with partners through GPNs. This may influence MNCs to adapt their local policies and decisions in the host country, possibly leading to re-shoring decisions.

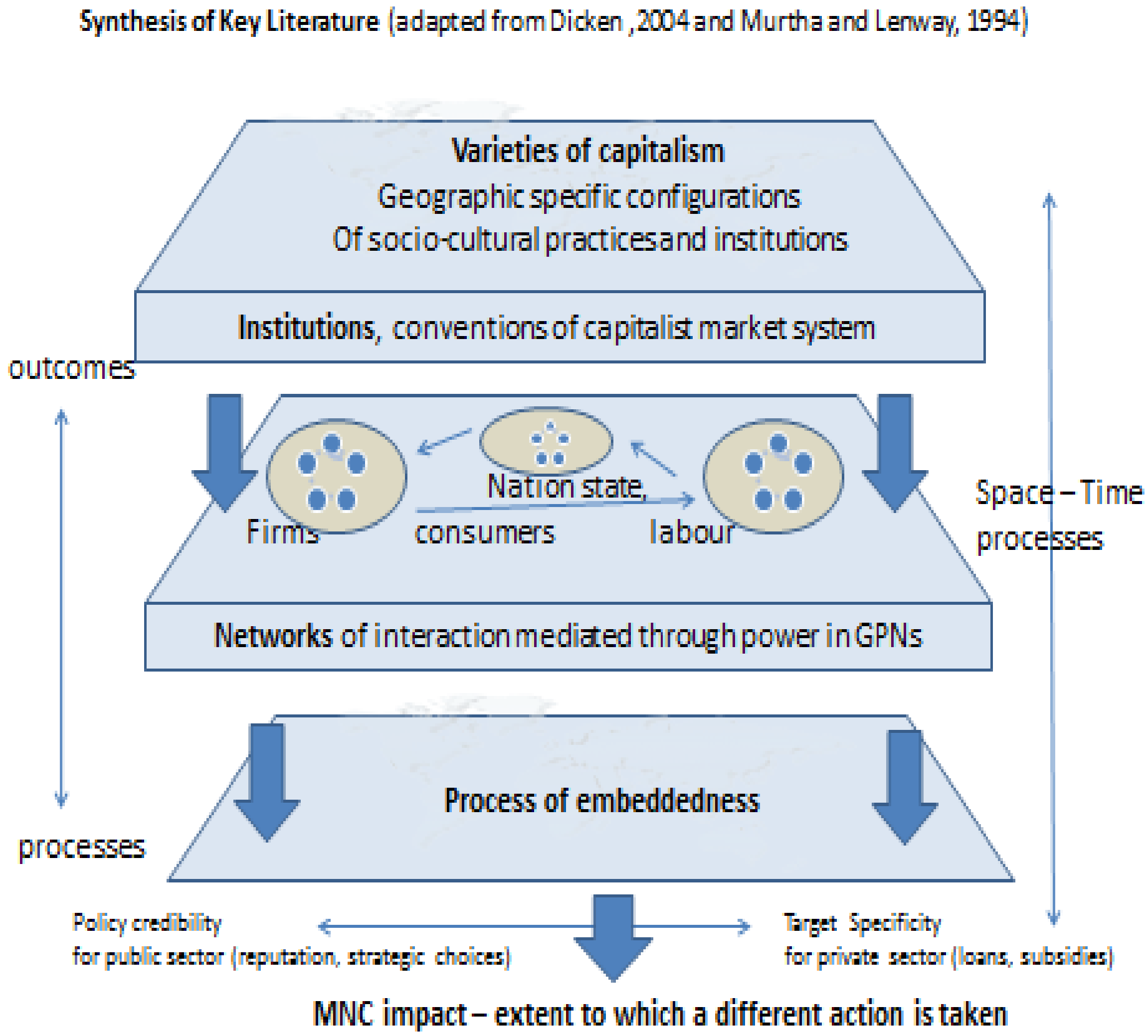

Figure 3-2 A heuristic framework for analysing the global economy

3.7 From Conceptual Framework to taxonomy

It has been suggested that a firm's decisions might evolve from initial cost saving through the outsourcing of support activities as a first stage of disaggregating the value chain, and then process improvement and further leveraging of labour cost savings through offshoring. Finally, if the economic circumstances in the home market change then politicians might in some manner influence MNCs to reverse their policy and restore work back into the home market – re-shoring or similar (McKinsey, 2010). While this appears logical at a generic level, it may be rather too simplistic, especially at the level of a firm. The intention here is to develop a more rigorous approach.

The research focus was outlined in section 1.2. Alongside the stated aim of this research it was suggested that specific sub-questions on *what, where, why and how* UK and German MNCs manage outsourcing and offshoring activity would be developed after undertaking a literature review. Chapters 2 and 3 have provided the basis for these questions which are now presented as a taxonomy within the novel conceptual framework shown in Table 3-3 below and set out in detail in Chapter 4 Methodology section 4.1. The six questions also evolved as a result of the initial or pilot interviews.

Having identified above a number of key theoretical strands used to explain the behaviours observed in the companies researched, it is now appropriate to clarify the links between the core focus of this thesis, how the literature will be combined and the relationship that this has with a taxonomy to predict answers to each of the research questions (Fig. 3-3 below). In addition, it can be seen from Fig. 3-3 that the thesis is focused on comparing German and UK MNCs approaches to outsourcing and offshoring. There is an assumption that differing VoC models will apply and may be observed through differing tactics, strategies and behaviour that is to be tested by comparative case studies and that the supporting and underlying theory is drawn from a range of academic disciplines. Furthermore, while VoC frames the conceptual framework and runs consistently through the taxonomy and each of the research questions, the theory of VoC may be necessary but is not considered to be sufficient. Different research questions will therefore also draw in support on theory from RBV, DC, GPN and embeddedness as appropriate to focus on competences, spatial dimensions and power. It is this collective approach that is considered to make a novel contribution.

The first column of Table 3-3 distils the key questions that have been identified towards outsourcing and offshoring. The second column attempts to separate differing criteria or dimensions that lead to fundamental choices of outsource, offshore, outsource and move offshore, or finally to re-shore. Column 3 lists what are considered to be the key dimensions to be explored through the research and subsequent analysis. These have been derived from the literature reviews. Columns 4 and 5 represent predictions of anticipated responses if the companies conform to the stereotypical national home LME model for the UK and CME for Germany.

It is intended that this conceptual framework and taxonomy will help in exploring case study differences of their rationale, success and lessons between the UK and Germany for each of the airline and engineering sectors as an empirical focus. In the Methodology (Chapter 4) abduction[11] is used as a research approach to bring together a number of innovative criteria. The

[11] Abduction (Wadham, 2009 and Reichertz, 2004) propose an approach that in conjunction with induction and deduction can be helpful in bringing together differing theories to develop a prediction or hypothesis. A three step process is outlined in 4.7.

variables or dimensions chosen include the choice of location for outsourcing and / or offshoring which is essentially the reason or motivation that the company has for making the change, the control and coordination mechanisms in place, the levels of involvement and participation and finally, an ability to cope with changes in circumstances. We compared earlier the UK and Germany using differing concepts of varieties of capital. The assumptions set out below and summarised in Tables 3-1, 3-2 and 3-3 are drawn from the literature (Vitols (2001), Hall and Soskice (2001), Lane, 1998; Lane and Probert, 2009; Whitley, 1999; and Trompenaars, 1997) in some instances reflecting a view that LMEs and CMEs are polar extremes, in other cases that over time there is some convergence and middle ground. Taking each dimension of column 3 (Fig 3-3) in turn:

It is predicted that the *motivation* for outsourcing and offshoring will differ in that an LME will focus on short term cost cutting, budget control and shareholder interests. This will have RBV implications. Initially, arbitrage of lower wages will be an inducement. If offshore they might also have a preference for English language speaking countries and traditional trading zones. On the other hand CMEs while also regarding low cost as a 'given' will focus on medium and longer term benefits in quality and performance and therefore a reluctance to outsource losing control and potentially intellectual property, if they offshore preferring central or European locations with a cultural or language similarity. This makes assumptions, such as all companies in a particular country will to at least some extent mirror and practice some of the characteristics associated with that classification of VoC. Also, the model can be regarded as rather static when in reality countries, sectors, markets and individual company approaches are dynamic and adapt to differing economic situations. So for countries such as Poland, Hungary or the Czech Republic the VoC positioning may be regarded by some as having shifted from a 'Transitional' positioning to a ‘Pluralist Private Enterprise’ (LME) or even to a ‘Mixed’ central position. Similarly, China has moved steadily with a mixture of state owned enterprises and publically quoted organisations. Again, RBV and Dynamic Capabilities (DC) theory help to understand how the case firms make their choices. For example, the three phases of DC (Teece, 2007) of how quickly a firm *sense* that a fundamental change is required, whether they then choose, or not, to *seize* that opportunity and how well they subsequently *manage and transform* the business.

Thus there is a link to the second dimension of ownership and related aspects such as *control and coordination and degrees of autonomy*. This draws on GPN theory to the extent that policy and practice become embedded in the supply chain, the network and the territory. The display of power by the lead firm might also be an issue. LMEs might be expected to be heavily focused upon the needs of the shareholder, strict cost and budget control as referred to above and an arm’s length approach towards strategy – do what you have to do to meet budget and hence a high level of autonomy, as long as the local business stays within budget. A CME however, might be expected to be more likely to follow a multiple stakeholder model with a balanced approach to the differing needs of customers, suppliers, employees as well as shareholders; this is often referred to as market driven and customer focused. A CME might also be predicted to retain tight control over strategy, policy setting and resource allocation, and hence comparatively low levels of local autonomy, with a more hierarchical structure and somewhat slow to change with major decisions to be ratified centrally. A CME is therefore more constrained by institutional factors that influence managerial decisions such as ‘what to offshore or outsource’ and ‘where to’?

The RBV and associated work on dynamic capabilities helps to inform us on how the lead company will manage core competences and resources, and hence the *division of labour*. In deciding to transfer work from in-house and the home market are there sufficient skilled resource to help the business transition work to either a third party or to an offshore subsidiary? With regard to managerial division of labour, LMEs might recruit local expertise with only a minimum of expatriate managers. Such individuals are often attracted to the lifestyle and financial benefits and choose to stay longer term.

In terms of *cultural proximity* LMEs are more likely to be flexible and opportunistic with a low(er) level of concern other than an ability to speak and work in English where possible. CMEs may be predicted to invest more initially in setting up offshore operations with a comparatively high level of expatriate managers to transfer processes, set-up operations and organise training of a local workforce. Gradually they might transfer expertise to local management. Compared with LMEs a higher level of priority would be given to cultural proximity in terms of behaviours and language. Each of these factors have implications for embeddedness and the extent to which the likelihood of long(er) term success is ensured.

One of the key institutional factors to be explored is the role played by the *trade unions* and works council; and the inter-relationships with employees and management. For LMEs it is assumed that the influence is often low or even non-existent, management will ‘push the boundaries’ once a decision has been taken within legal requirements and may be confrontational to enforce the decisions considered essential for the future of the business, especially at a time of poor economic prospects. CMEs on the other hand, will assume to be very much more consultative, actively avoiding confrontation and use times of growth to create jobs overseas and simultaneously move into key international markets. Negotiating strategies, tactics and timing and the outcome will clearly have resource and network (RBV and GPN) implications.

Finally, we address evidence of a reversal in policy and returning work to the home country. For LMEs this might be influenced by political pressure or economic incentives. With CMEs we are assuming that this may be more likely to be a result of a change in market focus and /or strategy or a loss of intellectual property rights. The re-shoring of extensive manufacturing processes in particular would have substantial RBV and GPN implications, service operations rather less so. Much would depend on how much of the original capacity and expertise remained in the home country.

So, a detailed taxonomy within a theoretically derived conceptual framework is shown below in Table 3-3 presenting a series of predictions on what we might expect from a MNC headquartered at home in either the UK (LME) or Germany (CME). We have explored some relevant theory in Chapter 3 to underpin and construct this conceptual framework. Chapter 4 follows with a focus on the empirical approach and methodology, with a review in particular of the 'case study method' as an approach to research two different business sectors. The case studies will provide a 'test' for the conceptual framework of the theory both in use and practice. The first case study comparison is for airlines (BA and Lufthansa) which will include passenger transport, cargo, maintenance and overhaul. The second case study is for engineering and manufacturing [12] (CompanyXYZ / UK-Engineering Plc with CompanyABC) this covers products such as pumps, valves and seals for the offshore oil and gas industry together with software / hardware for the automotive components market.

[12] Both companies requested that the corporate identity be disguised.

How do the literatures fit together?

- **VOC** differences in economic institutions between countries influence policy and hence company approaches to location, cooperation and stakeholder management
  Where / Why / What?
  Refs: Hall, Soskice, Murtha, Lenway, Whitley, Lane

- **RBV / Dynamic Capabilities (DC)** – Outsourcing - competitive advantage from leveraging key assets and agility with changing / developing markets
  Why / What?
  Refs: Penrose, Mahoney, Barney, Helfat, Teece

- **GPN** – Offshoring -complexities and interrelationships for connecting partners in delivering goods and services. The extent to which operations become embedded and are influenced by institutions
  How?
  Refs: Gereffi, Coe, Dicken, Hess

- **Institutional effects / embeddedness** the influence of actors, decisions and policies, social structures and resource scarcity acting as constraints
  Timescale, sustainable, contributing to local economy….?
  Refs: Swedberg and Smelser, Evans, Martin, Hess, Granovetter, Grabher, Dicken.

Core focus of Thesis

- Comparing German and UK approaches to outsourcing & offshoring
- Assumption that differing country VoC apply to MNCs
- Comparing MNC tactics and strategies by competitors / sectors
- Developing a novel conceptual framework / taxonomy that draws related stands of theory together
- Use of theory from economics, geography, sociology together with management of operations and strategy to explain behaviour in practice.
- Comparative case studies

Relationship between the literature and the taxonomy / table of prediction

			Literature	
			Core	**Supported by**
1.	Motivation	outsource or not	VoC,	RBV
2.	Ownership	‘ ’	VoC,	RBV / DC
	Control / Coordination	‘ ’	VoC,	GPN
	Autonomy	‘ ’	VoC,	GPN
3.	Division of labour	offshore or re-shore	VoC,	RBV
4.	Cultural Proximity	‘ ’	VoC,	GPN / Embeddedness
5.	TUs	‘ ’	VoC,	RBV /DC, GPN
6.	Reversal of policy	‘ ’	VoC,	RBV /DC, GPN

Figure 3-3 Linking literature and the taxonomy

Table 3-3 Taxonomy – theoretical projection (author)

Question (see 4.1.1 - 4.1.6)	Approach	Dimensions	Liberal Market Economy (LME) predictions	Coordinated Market Economy (CME) predictions
1. What are the differences in the geographical, functional and temporal patterns of outsourcing and offshoring?	Outsource	Motivation	• Cost cutting and employee reduction • English speaking countries • Traditional trading zones	• Quality and performance, cost control is 'a given'. • Central / Eastern Europe preferred
2. How far do mechanisms such as ownership, control, coordination and the degree of autonomy differ?		Ownership	• Shareholder driven	• Multiple stakeholder
		Control & Coordination	• Arm's length on strategy. Strict cost and budget control	• Tight HQ control of strategy, policy and resources
		Degree of autonomy	• High – if meet financial targets then local control	• Low • Hierarchical structure • Can be slow to respond to change
3. How is this reflected in divergent international divisions of labour regarding the employment of indigenous or ex-pat managers?	Offshore or	Managerial division of labour	• Low initial use of ex-pat managers who then stay on	• High initial use of ex-pat managers for set-up and training. Subsequently local management
4. To what extent do preferences for cultural proximity affect location?		Cultural Proximity	• Low, flexible, opportunistic	• High – language, behaviour

5. What is the influence of trade unions in the process of outsourcing and offshoring and how is this reflected in the structuring of the firms' labour markets?	Outsourced offshore or	Relationship with employees / Trade Unions	• None, limited to legal requirements • Push the limits • Can be confrontational to enforce desired changes	• Consult widely • Actively avoid confrontation • Opportunistic – use growth to create additional jobs elsewhere
6. What evidence is there, and why of a reversal in policy – re-shoring?	Reverse offshore (Backshore)	Change of policy	• Loss of initial cost-benefit. • Political pressure or economic incentives	• Loss of intellectual property • Change in market focus or strategy

See Table 5-2 (airlines) and Table 6-2 (engineering) for case study summaries that can be compared with these predictions; also further analysis in Chapter 7.

3.8 Synopsis

In Chapter 3 the underlying theory that supports outsourcing and offshoring decisions has been explored. The links between the focus for the thesis, the relevant literature and the proposed taxonomy is clarified. The theoretical approach and the contribution to knowledge from this research is therefore twofold. Firstly, a conceptual framework is posited by proposing a taxonomy to analyse the relationship between CME and LME varieties of capitalism and the components of the offshoring and/or outsourcing process. Secondly, the empirical novelty lies in the ‘rich data’ generated by insights from the senior executive interviewees to which the researcher was privileged to have access, as they were the prime decision and policy makers. The subsequent analysis deploying a process of abduction is essentially a search for a valid explanation that draws an inference, as distinct from the normal logical conclusion based upon either purely deduction or induction. This brings together ideas not previously associated with one another and results in a set of predictions or hypotheses.

Chapter 4 will explore a suitable methodology and options for the research, data collection and analysis. Aspects of validation and research limitation will also be explored.

CHAPTER 4

EMPIRICAL FOCUS AND METHODOLOGY

This chapter reviews the empirical approach, arguments and selected methodology for primary and further secondary data collection. The research sub-questions have been reviewed and minor revisions made as a result of the initial interviews. The final version has been repeated below, and the significance of using ‘What or Why or How’ in the questions is clarified.

4.1 Research Focus and Questions

The overall aim of the research is:

> **To examine the extent to which the offshoring and outsourcing strategies of German and UK based multinational corporations (MNCs) are embedded in the institutional contexts of their respective home countries, and in particular the extent to which this can be explained by the ‘varieties of capitalism’ perspective.**

This gives rise to a number of sub – questions:

Use of ‘What’ as opposed to ‘How’ or ‘Why’ helps to signpost the positivist as opposed to interpretivist nature of the question.

4.1.1 **What** are the differences between *German and UK* based MNCs in the geographical, functional and temporal patterns of outsourcing and offshoring?

4.1.2 **How** far do mechanisms such as ownership, control, coordination and the degree of autonomy differ between the *German and UK*?

4.1.3 **How** is this reflected in divergent international divisions of labour regarding the employment of indigenous or ex-pat managers from the home country?

4.1.4 To **what** extent do preferences for cultural proximity affect location choices?

4.1.5 **What** is the influence of trade unions in the process of outsourcing and offshoring and how is this reflected in the structuring of the firms' labour markets?

4.1.6 **What** evidence is there of a reversal in policy – re-shoring / reversed offshoring / outsourcing and **why** may it be occurring?

4.2 Philosophy and approach: From naivety to informed questioning

4.2.1 Personal journey

After graduating in 1973 in Industrial Engineering (University of Hertfordshire) I was invited to undertake PhD research in the then Engineering school. For personal reasons at the time I chose instead to take a one year MSc (now MBA) at Imperial College, University of London in Management Science and Operational Research. Again there was a chance for me at the end of the programme to undertake doctoral research, this time in Systems Dynamics at MIT, but the need to earn a salary won the day, and I shifted from engineering to consulting and an early career in industry. While the challenge of completing a PhD has always been an attractive and interesting proposition, it was not at that time at the forefront of my then ambitions for a career in industry rather than academia.

From 1967 to 1988 a mixture of experience was gained in engineering, tobacco and financial services sectors. This included a range of appointments from apprentice to R&D / design engineer at GEC-Marconi, to consultant at Touche Ross (now Deloitte), operational research analyst, productivity manager, business planner and HR manager at Gallaher Ltd (now JTI). After 13 years with Gallaher, married with two young children, and having experienced working on a major inter-company research project in conjunction with Lord McCarthy and Roger Undy at Templeton College (now Said Business School, Oxford) into the management of change, the opportunity arose to join Ashridge Business School in 1988. So having enjoyed an eclectic mixture of business, consultancy and academia I could now combine all three and spent a further twenty six years (from 1988 to date) at Ashridge with programme and client responsibility, including 8 years as one of the Executive MBA directors. As a senior member of the faculty since the 1990s my focus has been the teaching of Operations Management, Decision Science and Director of Projects for MBA and MSc Management students. In parallel my contract encouraged private work and I run a successful consulting company, Mitchell Palomares Ltd during my tenure at Ashridge.

As an institution, Ashridge back in the 1980/90s deliberately recruited ‘industry expertise’ rather than academics, and sadly discouraged academic research in favour of what was seen as more practical management and leadership topics. The advent of FT league tables, triple accreditation and the growing competition between business schools slowly led Ashridge to change its thinking in terms of faculty skills, focus and academic research. However, this was rather too late for me to pursue an academic career on the back of doctoral studies. I was, after all due to retire in the year 2010.

A turning point arose mid-summer 2010 when my beloved wife Cori became ill again and lost her ten year long battle with cancer. This was only a matter of weeks before our planned retirement and long intended move to our vacation home in Spain (Cori’s home country). I needed to re-evaluate my plans, decided and was grateful for, the opportunity to stay on at Ashridge, and also return part-time to my alma mater to complete the often contemplated and unachieved personal goal of a PhD. So, why choose this particular topic?

Having taught operations management and strategy for many years at Ashridge and other Business Schools (in New Zealand, Australia, France, China, Holland and Scotland), some of the controversy around globalisation, the role of MNCs and the various pros / cons of outsourcing and offshoring had become regular topics for healthy classroom debate and discussion. There was also a sense that outsourcing and offshoring decisions were widely regarded as predominantly short term, operational matters intended to achieve quick (primarily) labour cost savings. A debate was also developing about what happened when the outsourcing decision was found to be a mistake and how easy it would be to reverse if needs be? Some service functions for example human resources and accounting are rather easier and cheaper to transpose (back or forth) than complex manufacturing plants, especially when the buildings have been sold along with the plant and machinery and the skilled workforce have been redeployed. Therefore the question of

> *....to what extent should such decisions be strategic rather than operational in the first place?*

Given the advent of the economic recession and changing political priorities in the United States and Europe in particular – the whole notion of outsourcing and offshoring has suddenly taken on a new sense of urgency.

As a former Director of a German based European Partnership (or Consortium) Executive MBA I had some insights to the differences between how UK and German businesses were managed, and some of the arguments around economic policy and governance between UK and German firms. With an alumni base of some 250 graduates from the four German host companies some useful contacts were ‘potentially’ on offer, along with their senior management teams who were known through the researcher’s supervision of MBA projects and management of the Consortium programme over the period. It was therefore hoped to build a research agenda and protocol around this topic and focus.

4.2.2 Challenges

The first nine months of this part-time PhD programme resulted in mixed emotions. It was a difficult time wanting and needing to grieve the loss of my wife yet also trying to keep busy and occupied. Being a student once again and opening a 'Pandora's Box' of materials relevant to the Literature Review was fun. Academic articles and books from politics, geography, sociology as well as various fields of economics and business management were ferociously consumed in the spirit of learning and knowledge. To write in an acceptable academic manner proved more problematic, and considerably less enjoyable. It became necessary to 'unlearn' some forty years of writing business reports, various articles, case studies and even a management book and to adopt a rather different academic style and vocabulary.

The lack of connectivity across subjects was a surprise, although it had often been assumed that the world of academia – even in a business school, can be very compartmentalised and functional around both disciplines and preferred approaches. It is the nature of academics to critique and disagree on approaches within their field; an example in case is the battle over quantitative versus qualitative analysis that has raged for many years with a few brave souls sticking their heads over the wall and adopting a 'middle ground' for pragmatic reasons (in the instance of case studies). Yet outside academia and for much of the past twenty years most organisations have been trying to break down barriers between sales, marketing, operations, HR and finance to name a typical few. The identification of business processes has helped build cross discipline, multi skilled staff and replaced departmental functions in the name of being customer responsive, driven or market led (or some other management philosophy such as Total Quality Management, or

Value Engineering or Activity Based Costing). All of which had been at least in part, personally embraced, as well as by consulting clients and Ashridge Business School as common syntax; but not it would seem, in the university.

Multinational corporations have often been the first to adopt such new business ideas and also to publish the results, previously the preserve of academics. Furthermore, complex matrix organisational structures typically represent how the firm needs to function across markets and product or service ranges.

4.2.3 Ontology & epistemology

Ontology describes the researcher's position on the nature of the world he is engaged with, and what exists; it is generally considered that there are two forms (Blaikie, 2000, and 2007; Mason 2002) – *realist* where the researcher engages with a real external world, or *idealist* based upon human constructions. Epistemology is the researcher's belief about how knowledge is gained and deployed to share with others and whether knowledge is regarded as truth or as one of possibly several meanings. Again, there are two popular paradigms; positivism is often consistent with realist ontological perspectives; or interpretivism similarly congruent with idealist perspectives. How then should four key philosophical choices to the methodological thinking be developed (Remenyi and Bannister, 2012)?

A realist or social constructivist philosophy?
A theorist or empirical approach?
A positivist, interpretivist or mixed methods and strategies?
And does the author consider himself to be a pragmatist?

These questions are debated, critiqued and addressed further in 4.3 to 4.6 below. Also having collected the data how can that data be analysed to respond to the questions and what theoretical constructs' can be incorporated?

The chosen-epistemology would largely follow that of a pragmatic constructionist. This does not reject the existence of a reality and a wholly positivist approach but rather accepts that there is likely to be an interplay between reality and its construction as reflected in the discourses of social actors (Blaikie, 2007). Therefore mixed methods would be appropriate to the interpretation of the interviews combining a largely qualitative, interpretivist approach to ontology with a positivist assessment of data where it can be reliably obtained in terms of relative cost, quality, delivery and customer satisfaction etc.

This approach reflects a desire on the one hand, to not only reflect the real world which is the context of this research, but also to appreciate how the reality will constrain the manner in which respondents answer the questions. One perspective on mixed methods is a discussion paper that argues why this approach is becoming more popular with researchers (Brannen, 2005) and suggesting a test of 3P's – paradigms (competing philosophical perspectives), pragmatics (technical issues that influence the research questions) and politics (concerns around social and other inequalities).

The sub-questions (revised slightly after the initial phase of interviews) suggest that an interpretivist approach can be adapted to the 'HOW and WHY' aspects of specific questions and respondent's cognitive answers. Both interpretivist and positivist approaches are applicable to those questions that seek 'WHAT' was undertaken and may require content analysis to generate a meaning or the probing of responses by use of Likert scales. (See 4.8.1 Access and Respondents for a brief profile of the interviewees).

If a case study approach is to be considered then what are the various aspects that need to be considered?

4.3 The use of case study as a research methodology

As a key aspect of the intended methodology the case study method has been contested and deserves an extended discussion on what is meant by a case study for research as opposed to teaching purposes, the various pros and cons, design, validity and interpretation of the results. Examples of relevant case study research will also be presented before summarising the chosen approach.

Apart from their widespread use in teaching and learning, case studies have been increasing in popularity as a research strategy but are not without criticism. A case study may be regarded as an in depth study of a particular situation that can be used to narrow down a very broad field of research into a manageable topic. Case studies can test whether theories and models work in practice and are popular in social science, psychology, political science (Shuttleworth, 2012) and business studies. Theory building is via the recursive cycling among data, emerging theory and extant literature (Eisenhardt, 1989 and 2007), an often cited view. For multiple case studies the logic is reinforced through theoretical replication logic (Yin 2009), again an accepted view offering a holistic approach to research (Spagnolettti, 1995). A case study should include empirical enquiry that is based on primary or sense based data not solely secondary data (Remenyi, 2012). It should also be contemporary rather than historic, real life rather than experimental, where the researcher has no control over the outcome. The boundaries are unclear and so it is often messy, unlike a laboratory experiment. There will be multiple sources of evidence, multiple variables and complex questions. Multiple cases may be used in business and management studies to compare and contrast evidence and data serves to increase the learning. However, a second or third (or more) cases are NOT conducted to replicate the results of the first case as in experimental research. There is NO requirement to find either a random or representative sample.

A case study is exploratory in nature and can create new knowledge, either primary or secondary data may be used. It is constructive, able to solve problems and confirmatory to test a hypothesis. The case may be quantitative or qualitative in nature and still be useful if of a small sample size and can avoid problems of statistical power (Garger, 2010). A case study can evoke more realistic responses than a purely statistical survey. It is flexible, can introduce new unexpected results leading to further research and may have a strong impact on readers; whereas a detailed statistical method may be less accessible. A case study may be a good source of ideas on behaviour (Shuttleworth, op cit.). There is usually a good opportunity for innovation that enables the researcher to study rare phenomena and can challenge theoretical assumptions (Anon)

The challenges to this approach and the questions posed are typically around external versus internal validity, the researcher cannot control events. The findings may only be applicable to similar cases. This raises the question of whether the benefits of internal validity are offset by a lack of external validity. The researcher may be over reliant on interpretation to guide findings and recommendations and could lead subjects to the results (self-fulfilling or ‘Pygmalion’ effect) (Garger, op cit). A further criticism is that the researcher cannot extrapolate results to fit the question, and may therefore show only one narrow example (Shuttleworth, op cit.). It may be difficult to draw definite cause-effect conclusions, and hard to generalise from a single case so there is possible bias in data collection and interpretation (Remenyi, 2012).

The intention would be to isolate an interesting study group that is relevant thorough research and meticulous and systematic note taking, it is important to be a passive observer in the research (Shuttleworth, ibid). The research design should stress both the advantages of case study approach and also address alternative approaches and the reason why they were not chosen. In addition the methodology should state the philosophical orientation and how that links to the research design (Remenyi, ibid). Typical criteria would include choice of an appropriate industry sector of a suitable size, and be sufficiently complex to be of interest. It is important that the researcher can achieve adequate access and the host company will allow their story to be told in an academic dissertation. Further aspects are also that the chosen case is relevant to the research questions, significant in terms of having something to say, accessible in terms of geographic location and finally amenable to the research study in terms of staff cooperation. It also helps to locate a gatekeeper to gain access and an individual informant to interview. It may be important to challenge whether the unit of analysis is representative and embedded? Especially for Doctoral research Remenyi postulated that the researcher should be clear on the unit of research. For example, if the whole organisation is to be involved or specific divisions only. Multiple cases can compare and contrast e.g. policy implementation, and should have something in common. So for the airline sector, two competing airlines could be compared and in particular offshoring and outsourcing approaches to catering, shared services and repairs and overhaul.

The researcher might inadvertently violate the principle of falsification. It is important that the researcher should be a disinterested observer therefore has no vested interest in whether research turns out one way or another Popper (1959), (Guba & Lincoln, 1994). In comparative sociology, qualitative comparative analysis [13](QCA) has quantitative rigour, yet treats each case holistically preserving causal complexity. QCA does not disaggregate cases but treats configurations as different types of cases (Ragin 1987, and 2006). So while this is not an easy option as sometimes (mistakenly) assumed, it is as rigorous and complex as other empirical research designs and also suited to organisational design and other fields of management research.(Spagnoletti, 1995).

4.4 Analysis and interpretation of results?

Case studies are opinion based, they may be used to provoke reasoned debate, collate data and construct a narrative with examples, often to judge trends. Remenyi (op cit.) argues that cases are used to answer complex or challenging research questions through an empirical approach to the research questions that Involves many variables, not all of which are obvious. It may involve using qualitative, quantitative or mixed methods in either in a positivist or an interpretivist mode. The case study is presented as a narrative and a way of answering the question(s) with a clear cut focus on a unit of analysis. This should recognise the context in which the research question is put and the answer sought. The case should not be extended for a long period of time i.e. does not compete with historiography and is likely to be

[13] Qualitative Comparative Analysis (QCA) is an analytical technique that uses Boolean algebra to implement principles of comparison. It is used by scholars engaged in the qualitative study of macro social phenomena with a systematic way of studying configurations of cases. The data is analysed qualitatively while also looking at causality between the variables. Thus the two-stage approach to studying causality has a qualitative first stage and a systematic second stage using QCA. QCA is truly a mixed-methods approach to research.

enriched by multiple sources of data or evidence in order to offer a degree of triangulation.

Interpretation is likely to require the producing of lists of constructs and concepts with the objective of finding a construct and concepts that have a direct bearing on the answers to the research question(s). Concepts / constructs might include: Influence, Training, Market drivers, Critical Success Factors, Cost justification etc. The interview transcripts should then be carefully inspected for constructs and concepts that are: essential to understand the research results, and can be used in perceptual maps, tables and matrices to record how many frequency (content analysis), and to demonstrate the relationship (Correspondence Analysis). If it is intended to combine case studies with a grounded theory approach then a popular argument is to learn from the first case before progressing to the next Remenyi (ibid).

Statistical applications are not appropriate if the chosen technique is qualitative analysis. It is important to present both evidence in support and evidence to reject the hypothesis, then to weigh up and reach a judgement. Prospective case study design has been proposed (Bitektine, 2007) as an alternative to post-hoc case study research in deductive theory testing. Some limitations can be offset by formulating a hypothesis for an on-going process and then testing the hypothesis at a predetermined time in the future. Desired outcomes can be compared with pattern matching or similar techniques.

4.4.1 Example applications of case study research

An institutional approach is further supported by the significance of Global Production Networks (GPNs) that was considered as part of the literature review. Research into supply chain management, logistics and global operations is therefore relevant because multinational corporations (MNCs) by definition typically have long, complex chains that link their operations and markets around the globe. In total some 442 research papers were reviewed (Sachan and Datta, 2005) and more than 50 per cent found to have adopted quantitative methods only. Case studies while judged to be increasing in popularity still only account for 16 per cent of the total. The primarily positivist approach assumes that the whole is equal to the sum of the parts. See Table 4-1 below.

Yet GPNs make an implicit assumption that synergy effects will generally create additional value in excess of the sum of the parts. This is an underlying principle of 'Systems thinking' and a reason why organisations manipulate value chains through outsourcing and offshoring to improve customer service and quality while reducing cost. As an example of a case study approach addressing offshore outsourcing, and addressing the 'what' and the 'how' questions the following text is of interest:

> *Research on the offshore outsourcing of services has been conducted with six United States based Fortune 500 companies (Tate et al, 2009). The case study research method was deployed because of the complexities of inter-firm relationships, strategic alliances and the success (or failure) of a buyer-supplier relationship. Offshore outsourcing increases risk with both data and intellectual property becoming available to outsiders; employee turnover was also judged to be higher. All these factors combine to increase cost and the challenges of measuring the total cost in order to review transaction cost savings. Case study research was judged to be the most effective method of addressing both the 'what' and 'how' questions to stakeholders and coping with their mixed expectations in highly complex, uncertain, fast moving and risk environment. The companies chosen were in financial, technology and transportation sectors; each experienced*

different problems associated with offshoring, and the cases helped to highlight a range of different solutions at each company. The conceptual framework highlighted a list of barriers e.g. culture, resources, distance, infrastructure and then explored links to investment, benefits and functional roles. Semi-structured interview protocols were adopted to provide flexibility and fresh insights. Additional open ended questions were included as well as some structured questions for base data collection. Limitations included conducting the research from a western-centric perspective, and the fact that only 6 cases were developed.

Table 4-1 Truth & Object Reality

Truth and Object Reality (Based on Meredith et al)

natural ← Kind of information → artificial

Nature of truth: Rational ↔ existential

	Direct observation of object reality	People's perception of object reality	Artificial reconstruction of object reality
axiomatic			Reason, logic, theorems, normative and descriptive modelling
Logical positivist	Field studies and experiments	Structured interviews, survey research	Prototypes, laboratory experiments
Interpretive	Action research, case studies	Historical analysis, expert panels, Delphi interviews	Conceptual modelling
Critical theory		Introspective reflection	

Grounded theory can allow the researcher to adopt an inductive approach to developing theory while simultaneously taking account of empirical observations of data (Fernandez, 2004) through Information systems (IS) case studies. Fernandez argues that this achieves a balance of rigour and relevance. However, care must be exercised to ensure that the true emergence of theory is not distorted. Yin (2009) though states that theory development prior to collection of case study data is essential; and yet this contradicts one of the principles of grounded theory. The researcher must therefore be clear what the overarching methodology is to be.

Eisenhardt (1989) has proposed three strengths of using case study data to build theory. Firstly, the theory is likely to be novel because ‘creative insight often arises from a juxtaposition of contradictory or paradoxical evidence’. Secondly, emergent theory is testable with measurable constructs and hypothesis that can be proven false. Thirdly, resultant theory is empirically valid because of constant comparison, questioning data from the start so that the theory mirrors the reality; which is also consistent with Yin (ibid). Fernandez continues to explore how the substantive theory contributes to the extant literature which in turn enables the grounded theory to be further developed. Global case study research of family owned businesses (Kenyon-Rouvinez, 2001) chose a qualitative empirical approach to grounded research because of the connections with reality, real life cases offering testable, relevant and valid theory. Multiple cases are preferred to single case studies enabling comparison and incremental contributions. Care must be taken with the definition of the research questions and the unit of analysis to construct validity. Internal validity is through careful linking of data with the cases, external validity through cross analysis of replication in the cases.

Vries (2004) has studied 62 North American and European IS case studies in both the positivist (the world conforms to laws of causation that can be objectively tested) and the interpretivist tradition (the world is socially constructed and multiple realities exist). No difference was found between North American and European journals in the application of positivist case research. European journals published more interpretive studies, are open to other sciences and take a philosophical approach. Vries (ibid) concludes that case study research is a vivid part of qualitative tradition and is evolving. Interpretive research and how to carry out case studies from inception to publication warrants further research, argues Walsham (2006). Geertz (cited in Walsham, op cit.) suggested that:

> *.....what we call our data is really our own construction of other people's constructions of what they and their compatriots are up to*.

There are concerns that the researchers lose critical distance on the value of their own contribution. Tape recording may make the interviewee less open, and does not capture the tacit non-verbal reactions that might be critical. This and the time consuming task of transcribing a recording has to be balanced with a truer record of what was said rather than relying upon notes and memory.

4.5 Empirical Focus

Given the prime research question The UK and Germany are the selected nations and the empirical focus will initially target two sectors, each will comprise one German and one UK MNC.

The case study methodology is appropriate for a postgraduate researcher wanting to complete a thesis that blends rigour with relevance to the complex processes of global business (Perry, 1998). Furthermore for empirical inquiry, case study research is appropriate where the boundaries between the phenomenon and the context are unclear, and where multiple sources of evidence may apply (Yin, 1984 and 2009) as with outsourcing and offshoring for MNCs. It is therefore intended to develop two case studies in each of two sectors, around specific processes that have been outsourced, and / or moved offshore; thus building evidence of practice and experience over time. Checks will be made of validity and reliability. The debate around the use of case studies for research, and their respective pros and cons is discussed further in 4.3 above.

The cases considered would be sector based and selected from four possible groupings. Possible pairings under review were:

Airlines, Engineering, Banking and Pharmaceutical.

A decision was taken[14] in conjunction with the supervisory team to focus on airlines and engineering rather than four sectors. This was partly because the initial first phase of interviews revealed that these two sectors would provide sufficiently rich data, but also that gaining agreement from Banking and Pharmaceutical organisations proved to be both difficult to gain access to and expressed a concern that they were 'over-researched' (at the time of the financial collapse and recession. While the two airlines were eventually happy to be named the engineering companies asked that their identity be disguised. Hence the German partner is referred to as CompanyABC, and the UK partner as CompanyXYZ (a subsidiary of a large UK group that we shall call UK-Engineering Plc.) It was agreed that individuals who took part in interviews would remain anonymous.

Case Study 1: Lufthansa and BA (Airlines and Transport) and BA (Airlines and Transport).

Case Study 2: CompanyABC (GmbH) and CompanyXYZ (Ltd) (Engineering)

The reasons for selecting these organisations include:

Firstly, each has a number of international businesses within a large multinational corporation which have grown substantially since their inception through a variety of means, organically and through acquisition.

[14] It was subsequently felt that the data would be rich and sufficiently diverse from a mixture of airlines and engineering. This choice became compelling as it became increasingly difficult to gain access to the alternative Banking (recession) or Pharmaceutical companies (over researched).

Secondly, they are market leaders, well known and regarded within their sectors, and publically available secondary data should also be accessible. Because they are high profile organisations that often feature in the media, they are likely to be well aware of their role and responsibilities with a range of institutions and public bodies.

Thirdly, in each case personal contact could be made initially at a senior level in headquarters, and it would be hoped to then develop further contacts in local businesses with staff at various levels of seniority and representative of different interest groups. Even so, it still proved difficult to gain initial support. The organisations receive frequent requests to cooperate with research and so are forced to be selective. There were also some concerns with confidentiality – either to protect the company name and / or the individuals participating in the research. In each case the companies are well aware of their competitors and are already familiar in some detail with their strategy. Because the organisations are market leaders and high profile organisations it is difficult to disguise their corporate identity especially at a case study level.

Fourthly, although the market sectors in which they compete are broad, each organisation does have distinctive products or services, styles and expertise. This should still enable specific direct comparison as well as investigation of special or unique practices across different business units in air transport and similarly in the engineering sector.

The case studies were written through the interpretation of semi-structured interview transcripts and publically available secondary data. The interviews were face to face or by telephone as appropriate, recorded and agreed with the interviewee. Although the researcher had rather good contacts in each of the nominated organisations, he found it extremely time consuming and difficult to set up the interviews. There were understandable concerns over confidentiality; also a general reluctance to participate in academic research. Major multinationals are heavily targeted by University research departments and so the organisations have learnt to be selective or already have chosen academic partners. This was particularly so for the banks and the pharmaceutical companies spoken to during the early research design phase. The interviews once agreed were set up well in advance, questions were circulated beforehand and the interview scheduled for up to one hour in duration. On a number of occasions interviews had to be rescheduled because of busy schedules for the host organisations. After the interview a transcript was prepared, edited and sent to the interviewee for approval. The subsequent case studies were also approved by the companies concerned.

With some interviews and one in particular (CompanyABC India) it was extremely difficult to fully understand a strong local dialect. The answers were also found to be rather obtuse and required patient interpretation.

Copies of the interview schedules are shown in Appendix A1 and selected narratives in Appendix A2 and A3. Other interview narratives are available on request. Secondary data is available as each MNC is publically quoted (or part of a publically quoted group).

This design suggests comparing direct competitors. Even though sector information is often shared, confidentiality issues exist. Gaining access is also complicated by virtue of multiple requests to such organisations for research purposes, the challenges and priority of the current economic situation and the fact that contact managers are moving on and are no longer available. Telephone and email requests were made by the researcher to alumni contacts to establish the initial interviews. Seven were held late 2011 across the four organisations representing corporate headquarters in either of Germany or the UK plus offshore businesses in Poland and India. These interviews were supplemented with follow-up questions in 2012-13 with offices in Czech Republic as well as in the UK and Germany. Seven further interviews took place during 2013-2014, also a further four in China with some additional research (see 8.5).

By pairing organisations it is intended to draw direct comparisons between UK and German centric approaches, also by using two different sectors some overarching insights to the impact of government and economic policy on company performance. Limitations are likely to include access to confidential data and key personnel, also idiosyncratic patterns between companies within a sector whether German or UK based; hence the extent to which findings are representative and capable of further extrapolation. These issues are also explored further in 4.3 above.

It can be argued that ‘Quantitative’ research is confirmatory and deductive in nature while ‘Qualitative’ research is exploratory and inductive in nature. This typical dichotomy however, is a contentious field amongst academics (McBride and Schostak, 2006) argue that combining both quantitative and qualitative methods in what is referred to as a "mixed methods" approach is good practice attempting to get the advantages from each. Similarly, while inductive versus deductive are seen as typical forms of logical conclusion, a third approach namely, abduction is becoming increasingly popular in social sciences.

4.6 Choice of approach

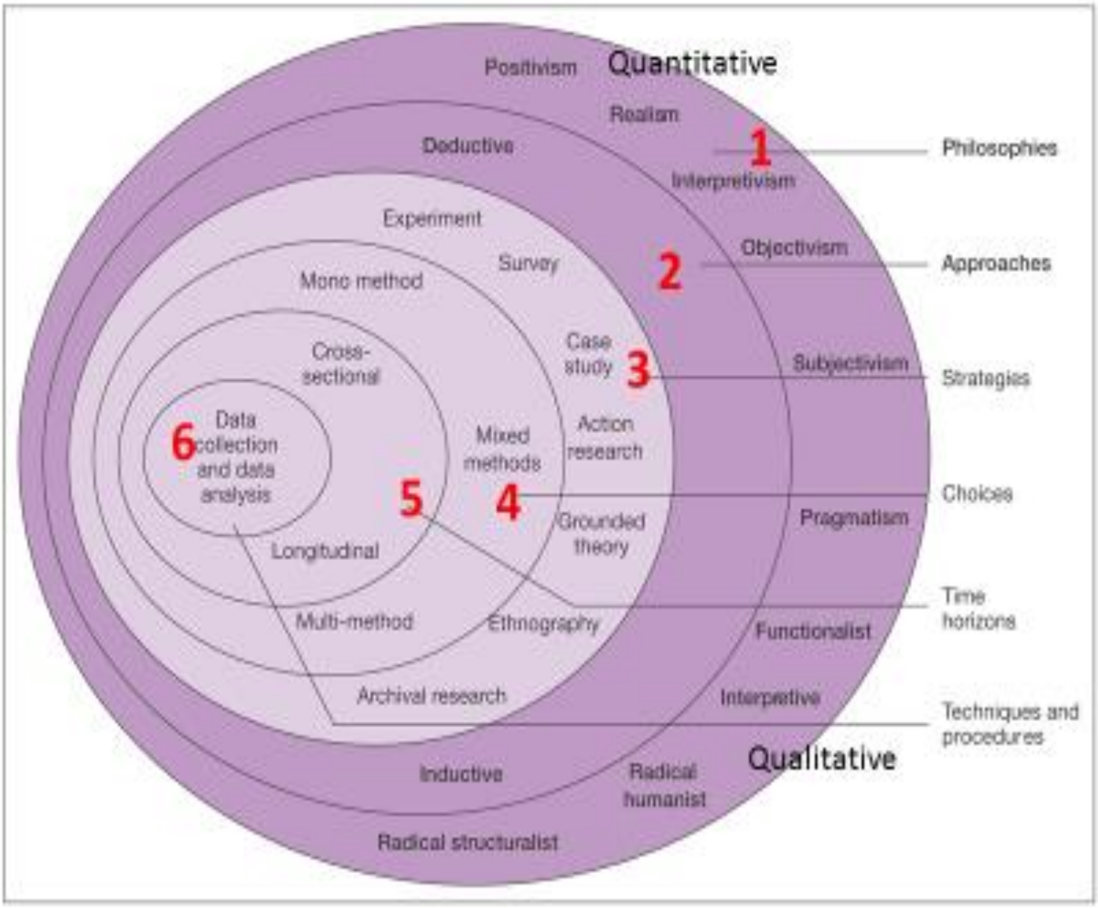

Figure 4-1 Research Onion **adapted from Saunders, Lewis and Thornhill (2006)**

Qualitative researchers are primarily interested in answering '*why?*' Quantitative research remains more interested in '*what people do?*'

Interview and secondary data will be critically assessed through a mixture of qualitative and where applicable quantitative analysis to overcome criticism of an over-reliance upon interviews with actors (Hess and Wai-Chung Yeung, 2006).

4.7 Selected methodology

Using Fig 4-1 above a combination of approaches has been selected for the first phase of the research, and these are summarised below in Table 4-2 below.

Table 4-2 Selected Combination of Approaches

Criteria	Selection
1. Philosophy	**Pragmatism** – combining positivism and interpretivism
2. Approach	A combination of deductive and inductive. **Abduction** will also be deployed.
3. Strategy	**Multiple case studies** that are paired by sector with multinational corporations MNCs who are significant market players. Ethnography – exploring customer needs, experiments and action research were not considered to be appropriate. To support the case studies some additional secondary data and / or research of archive material will be required to triangulate the findings.
4. Choice	**Qualitative**
5. Time horizon	**Cross sectional** with some historical perspective to current time.
6. Techniques & procedure	**Semi structured interviews**, recorded transcripts, analysis using qualitative techniques, supplemented with additional secondary data collection.

For criterion 2 above, (Wadham (2009), suggests that before any rational process may begin, there needs to be a guess or a lateral thought that can be tested. Reichertz (2004) has referred to abduction as a knowledge-extending means of drawing an inference, distinct from the normal logical conclusion based upon either purely deduction or induction. The idea of abduction can lead to rule governed and replicable knowledge that is both new and valid; and is increasingly popular in social science research. This approach has some links to grounded theory and was first popularised by Charles Sanders Peirce an American philosopher, logician, mathematician, and scientist, sometimes known as "the father of pragmatism". Reichertz (op cit.) suggests that there will be a risk that in bringing order to chaotic[15] data collected in interviews, and then fitting that data into a typology with predictions of likely outcomes for LME and CME firms, that we are bringing together ideas not previously associated with one another. Nevertheless, it is hoped to develop a series of propositions from the findings that in turn can help to develop conclusions. So abduction is essentially a search for some meaningful rules that will offer a valid explanation, while removing what is surprising about the facts. This results in a set of predictions (could also be regarded as a hypothesis). There are three steps that will be followed here:

> Step 1: Develop a novel conceptual framework based on a taxonomy of criteria that help to explain outsourcing and offshoring behaviour (Table 3-3 above). This '*abduction*' provides a focus, to commence research and testing and is a useable re-construction of the predicted outputs from the research (the hypothesis).
>
> Step 2: Derive predictions from the hypothesis (*deductions*) these are in Chapter 7 where the researcher reflects upon answers to the interview questions – see 7.2.2 for the airlines case study and 7.3.2 for the engineering case study
>
> Step 3: Search for evidence that will verify the assumptions (*inductions*) that are the propositions in Table 7-2 based on Tables 5-2 airlines and table

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[15] In this context, 'chaotic' reflects the assimilation of views from different interviewees, in different business units / companies that are expressed over time. Some order is given by targeting senior managers and following the same questions (see 4.8 Interview protocol).

6-2 engineering. These propositions are the further developed and lead to Conclusions (Chapter 8).

Does the author consider himself to be a pragmatist? Well over the past 25 years of teaching postgraduate students, setting and marking assignments, examinations and dissertations; the researcher has learnt not to dismiss theory in favour of a purely practical approach. The best policies, practices and strategies that are most capable of a successful implementation are also academically rigorous and conceptually sound. Furthermore, it is a mistake to assume that complex problems can be progressively simplified and resolved with simple pragmatic solutions. Complex problems deserve respect, careful definition, assessment and often detailed and complex analysis before resolution. From the selections given above in Table 4 it can be assumed that the researcher has adopted a rather cautious approach where it is deemed to be most appropriate.

4.8 Interview protocol

It is intended to develop comparative case studies that mix empirical data with pragmatism to critically compare and contrast the experiences of competitors in each of the UK and Germany. It is likely that interviews will be a prime source of data with senior executives in both headquarters and regional / divisional offices. It was originally hoped to visit and also meet managers and employees at differing levels, including trade union representatives at each of their home and overseas bases. Finally, it was decided to focus the research on a sample of senior management as they were the prime decision and policy makers. It was envisaged that the interview responses ought to be more insightful as a result.

Interviewees requested that they be anonymised. A 'snowball' sampling technique was used. This is a non-probability sampling technique used to identify potential interviewees through referral when subjects would otherwise be hard to locate.

4.8.1 Access and respondents

Contacts were initially made through the researcher's personal network who then recommended subsequent interviewees. The two engineering businesses in Germany and the UK had a specific headquarters, whereas the two airlines have a number of major offices representing different parts of the business. Candidates were selected to represent both strategy development and policy making as well as line management and implementation at a site level.

Given that the researcher was fortunate in being able to make use of personal contacts (either former mature students who are now senior executives, or their sponsors - see reference to the researcher's earlier role as MBA director for a German based consortium of companies (see 4.2.1)) or colleagues of the aforementioned, the interviewees accordingly displayed a level of trust and candour that benefits the resulting depth and detail of data obtained. This provided the researcher with an advantage given the sensitive and confidential nature associated with outsourcing and offshoring activities.

Comparative Case 1: Airline / Transport sector
Lufthansa (Germany)

- VP international Business Services, Cologne
- Director Engine Lease, Hamburg
- MD Airline Accounting Systems, Krakow

BA (UK)

- Manger of Procurement Strategy, Heathrow

- Operations Manager, Gatwick
- Head of Alliances, Heathrow
- Other
    - Academic (former National Officer, GMB Union acting for BA members)

Comparative Case 2: Engineering sector

CompanyABC (Germany)

- VP Global Manufacturing, Germany
- President & MD Engineering Solutions, India
- Director Engineering, Czech Republic

CompanyXYZ (UK)

- VP Operations EMEA, UK
- Operations Director, UK

Interviewees were matched in so far as possible in terms of seniority, experience (both in home and international markets) and length of service within the organisation. Fourteen interviews (including follow-up meetings) with senior executives, responsible for policy and strategic decisions were held over two phases with the case study companies. Full transcripts were analysed in depth and revealed 'rich' data. The interview data was supplemented with corporate annual reports, industry reports and other available secondary data. Related research undertaken in the same sectors in China was used to partly cross check and triangulate the findings and results.

The relatively small sample of interviews was not therefore considered to be a limitation as the questions asked were the same, the level of seniority similar as was the experience and involvement with outsourcing / offshoring policy. This avoided variability and inconsistency where possible. Furthermore, because these were high level and senior informants they were able to provide an overview of the strategic decisions of the firm.

The data therefore lends itself to a variety of analysis techniques and both SPSS / Excel for quantitative and NVivo9 software for qualitative data were considered. In the event, the largely qualitative data was interpreted through inspection and colour coding and also by taking different tabular perspectives. Both deductive and inductive situations would arise but not necessarily warranting a grounded theory approach which would normally require pursuing one case at a time. Abduction principles were also used as set out in 4.7 above with a three step process.

4.8.2 Research project stages

Table 4-3 Schedule

Part-time PhD year	Phase
1	Sept 2010 – Aug 2011 Literature review and complete Registration process. √
2	Sept 2011 – Aug 2012 Seek approval for case studies. Identify stakeholders, Draft questions and survey. Identify data requirements and unit of measurement. Gain ethics approval. √
3	Sept 2012 – Aug 2013 Undertake initial phase 1 interviews. Cross check data, analyse findings. Revise research questions. Start writing thesis. √
4	Sept 2013 – Aug 2014 Undertake further research phase 2 Europe and India. Develop case studies. Discuss findings. Doctoral review. Write papers, attend conferences – test findings. Further search undertaken in parallel while on business in China. √
5	Sept 2014 – January 2015 Draft, finalise and submit final thesis.* √

* (Written outputs will include a thesis, three conference papers during summer 2014, journal articles and hopefully a book to follow.)

4.9 Synopsis

In Chapter 4 the reasons for and the limitations of case study approaches were recognised; also that in this context case studies were found to offer a suitable approach to gain both an in-depth understanding of why various outsourcing and offshoring decisions are taken, as well as what strategies are preferred. Multiple cases can be developed that are paired and sufficiently similar to enable some assurance in projecting industry trends and lesson. Findings could be triangulated by reviewing other MNCs operating in similar industry sectors.

The first interviews with each company helped to test the questions and approach. Unanswered or partially addressed questions were then clarified in a second stage of follow-up interviews. The wording of the questions was gradually revised, while keeping to a common set of semi structured questions. This has provided insights on differences both at a national level – Germany versus UK; and an industry sector level. Differences in the responses has also helped to reveal either differences in policy or strategy or the extent to which the host company is embedded in the home country VoC.

Chapter 5 will set-out the first of two comparative case studies, the airlines and transport sector.

CHAPTER 5

COMPARATIVE CASE STUDY 1:

AIRLINES / TRANSPORT SECTOR

5.1 Context

In this chapter the first of two case studies is presented. The nature of the airline industry is such that large, historically state owned airlines were typically 'vertically integrated' comprising passenger, cargo, catering and engineering, maintenance, repair and overhaul divisions (MRO). The US and then Europe started to deregulate the sector (US Airline Regulation Act of 1978) , state-owned 'flag carriers' as they become known were privatised, and new entrants able to enter the market. The industry is often regarded as cyclical with the profitability of major carriers closely linked to national and global economic performance. This resulted in a conglomerate approach to a mixture of businesses in the organisation where for example, the fortunes of MRO or cargo might improve when passenger numbers were in decline.

New business models emerged with cheap or low cost airlines (Southwest Airlines 1971), as did partnerships, alliances and mergers as large(er) national airlines wished to become global players and connect routes through international 'hubs' and acquire landing slots – often requiring protracted institutional / government negotiations. At times of cost cutting, consolidation, disposal (e.g. of catering) and outsourcing / offshoring strategies started to become prevalent. In an attempt to be competitive, differences in employment terms and conditions were exposed between the traditional players in the market and the new, lean, agile entrants. Trade Unions became concerned over both job losses and changes in contracts e.g. short to long haul at British Airways (1976 when Concorde entered service).

5.1.1 Sector dynamics

From 2001 through to 2013 / 2014 it was difficult and challenging time for the airline industry. Macroeconomic performance around the world has been erratic with the external shock known as 9/11, a severe economic recession, continued threats of terrorism and the SARS virus (and now in 2015 Ebola), with strict security checks as a consequence have all resulted in dramatic negative effects on volumes and values of traffic (Jarach, 2004). A more recent issue for the European airline industry in 2013/2014 is dynamic pricing[16] (Siegert and Ulbricht, 2014). The dramatic growth of low cost carriers (LCC) has continued to challenge the traditional business models of major airlines leading to huge deficits, bankruptcy, acquisitions and mergers. While LCCs have been a reality in the United States market since early in the 1970s and traditional United States carriers have managed to fight back; the European situation seems to be different as Jarach (op cit.) also posits that the European industry is more fragmented, and alliances and partnerships have yet to result in sustainable cost savings and efficiencies.

In Europe the road to deregulation (or liberalisation) has been longer than that for the United States (Pender and Baum, 2000). The implications for new services and for changing the way in which fares are set are considerable. Any European Union airline can in theory, set up new domestic services in any member country without government interference. Low cost entrants are attracted to the UK by a flexible workforce, liberalised aviation sector and relatively low social security costs.

The global economic downturn in 2008 resulted in a crisis for the transport sector and the airline industry in particular. The implications have been more extreme than the 'double dip' economic crisis of 2001 and 2003 (Franke and John, 2011). Airlines reacted more quickly in the latter

[16] Dynamic pricing (also called real-time pricing), is an approach to setting the cost for a product or service that is highly flexible. This is now common when services are sold over the Internet to adjust prices in response to market demand.

recession to adjust capacity, cut costs and develop new organisational and operational structures. The competition from so called ‘low-cost operators’ has however, continued to be intense thus profits for major airlines have been slow to recover. Less successful business models have led to recent acquisition or mergers (for example Swiss, British Midland and Iberia in Europe; United and Continental in the US) as attempts have been made to change the rules for international long-haul operators, the big have grown bigger, gaining from alliance synergies and scale (Franke and John, op cit.). Non-cyclical trends such as deregulation or consolidation influence strategy and impact on carriers differently. European hub and spoke carriers have been in a favourable position to capture new markets for their networks; and major hubs such as Heathrow, Charles–de-Gaulle and Frankfurt continue to dominate. Competition for European airlines is high from North American and Asian carriers who benefit from rising incomes or an increased customer base in their home markets.

Downturn trends, since 2001 and market dynamics have included shifts in reduced passenger demand together with increased journey time, consolidation of carriers on routes with a blurring of differentiation through agreements on code (route) sharing, further deregulation, and technical innovation associated with ticketing and rising fuel prices and landing charges. If there is little differentiation between airlines; and business travellers are also required to be more prudent then the ticket price will become significant and those ‘Flag’ carriers that failed to respond had the poorest results when the market did start to improve (Franke and John, 2011).

The short haul operations for traditional airlines such as BA and Lufthansa have recently come under increasing pressure from the growth of low cost carriers (Dennis, 2007). Competitive responses have included multiple strategic initiatives with reductions in labour costs, use of regional aircraft, a reduction in secondary hubs and the progressive reduction of costs through either acquisition or divestment, third party sourcing as well as outsourcing and offshoring. The consequent realignment of pay and work grades is expensive in management time and gives rise to concerns for the trade unions as for example with British Midland; when Lufthansa bought the remaining 50 per cent in 2008 and subsequently sold to British Airways in 2011 (author).

The maintenance, repair and overhaul (MRO) business for airlines is a combination of technical capability, logistics integration of vertical supply chains and outsourcing practices (Al-Kaabi et al, 2007). The trend towards outsourcing has been increasing and was estimated to rise to 65 per cent of reporting airlines in the year 2010. Increasing levels of outsourcing present different internal and external challenges for the airlines, and perhaps demand a different approach for outsourcing MRO because of the labour skills required to that taken by the airlines towards business services and administrative processes.

Many multinationals have created shared service operations integrating a number of back office as well as traditional finance functions into one centre that can then be efficiently managed (Financial Times, 2013). Finance departments are taking a broader view of what needs to be delivered, and in relocating jobs are looking beyond labour arbitrage as a justification. Highly integrated companies may find it easier to outsource financial functions than companies that allow a greater degree of operational freedom to subsidiary companies and divisions. A consultant at PA Consulting Group suggested:

> *…the more difficult it would be to integrate systems the less you want an outsourcing provider to be involved because you are going to have to pay more money for complexity.*

Without minimum scale, clear differentiation, strong partners, and high efficiency a stand-alone airline seems unlikely to survive. Airlines increasingly need to manage a complex mix of operational platform, hubs and brands. Most legacy or traditional carriers have already responded to the short or mid-haul low cost challenge. Six strategic scenarios have been suggested (Jarach, 2004) that would require airlines to demonstrate internally consistent behaviour and clear market positioning to either resist, adapt, retrench, fight, join or to ally through an extensive contractual agreement between a traditional and a low cost carrier. Offshoring and outsourcing strategies might be the enabler to such approaches.

There are good reasons why change might be more important than continuity in MNCs (Lane, 2001) and so actively shaping change rather than reacting to the complex business environment is a challenge to be explored for the airline sector case study and for these two companies. It is in the context described above, that we seek to understand how two major European airlines can both compete, and at times collaborate through differing offshoring and outsourcing strategies. At the time of the '9/11 disaster' with the terrorist attacks on New York, and the resulting business slump and decline in air travel; existing internal cost cutting and efficiency drives were seen by both Lufthansa AB and BA Plc to be inadequate and further steps were required.

5.2 Background to case study companies: Lufthansa and British Airways

Lufthansa AB is a major German firm with a passenger transport division at its core supported by a range of other business units including cargo, engineering, IT and food services. Lufthansa who are market leaders in terms of size in Europe (fleet size, number of routes and passengers carried), have grown through several acquisitions and mergers but also have the largest network of formal non-equity partners with whom Lufthansa cooperate making them a significant global player (2011 Annual Report). As opposed to concentrating on growing the 'Star Alliance' with loose, non-equity code sharing agreements with other carriers, they recently acquired loss making Swiss (2005) and British Midland (selling the latter very quickly in 2011 to BA following substantial losses). Key financial measures in 2010 include: Revenue of EUR

27 billion, an operating profit of EUR 876 million and free cash flow of EUR 1600 million. There were 117,000 employees worldwide at the end of 2010 (Annual report).

British Airways Plc. (referred to as BA) a UK company, commenced trade 90 years ago. Shares are now traded on both the London and Spanish Stock Exchanges having 'merged' with another European operator (Iberia) in January 2011. The parent group is International Airlines Group (IAG) with operational offices in both London and Madrid. They are the world's sixth-largest transport company in their sector by annual revenue and the third largest by annual revenue in Europe (Annual Report). BA continues to seek further acquisitions and also has a network of partners that they cooperate with (One World Alliance). A key subsidiary of BA is its Cargo business. Prior to the merger with Iberia in 2009/10 BA earned £8 billion in revenue, down 11 per cent on the previous year. Passenger transport accounted for 87 per cent of this revenue, while 7 per cent came from cargo and 6 per cent from other activities. BA carried 760,000 tons of cargo to destinations in Europe, the Americas and throughout the world. There were 57,000 employees at the end of 2010 (Annual Report).

A helpful comparison of Lufthansa and British Airways has been reported by Doganis (2006). This further helps set a context for the case study in terms of their differing approaches to building alliances and also in the way management and the trade unions interact.

Lufthansa arguably has an aviation group strategy that may be constrained by company-based employment systems embedded in German industrial relations practice at a national level, also by the institutions of social partnership in Germany. BA does not have to deal with UK institutions that preclude innovative strategies. Hence, for BA, labour-driven, cost-cutting strategies become a more attractive proposition. (Doganis, op cit.), although the often adversarial relationships between management and unions creates tension.

An equally important contrast can be drawn between the Lufthansa's Star Alliance and the Oneworld Alliance of BA. Oneworld does not enjoy antitrust immunity or full transatlantic code sharing which allows carriers to share profits and revenue and more fully integrate their operations. It therefore focuses on 'passenger-friendly' activities such as frequent-flier programmes, branding, lounge access, easier connections, and customer support (Doganis, op cit.).

Over the period 2011 to 2013 there have been a number of challenges for Lufthansa with a 'cost cutting strategy which challenges employee demands for increased wages and benefit packages on the one hand, and a desire to reduce non-core activity on the other hand. There has been an increasing level of outsourcing activity, also moving work offshore and considerations of joint ventures or disposal of secondary activity. Former Lufthansa Group CEO Christoph Franz announced that the company had fallen behind 'in achieving the targets of its "Score" austerity program, which aims to boost company profits by €1.5 billion by the year 2014' (Lufthansa Group Report 2013). BA's competitive strategy has been based on a 'virtual airline' model, whereby the airline focuses on core competences (a network of air services) and outsources as many non-core activities as possible (including ticketing, in-flight catering, ground-handling, and some maintenance). BA's response to the changing organizational environment was therefore diametrically opposed to that of Lufthansa.

In terms of recent performance, airline fortunes vary dramatically. The global airline sector is currently in a cyclical upswing and this is helping to drive better profits for most. However, it does seem that IAG is currently achieving a structural improvement in its profitability as a result of strong discipline over capacity, capital and costs and a firm stance on labour productivity. More than its European legacy peers, the momentum is now with IAG. During the first 6 months of 2014 IAG (the holding company for BA and Iberia) outperformed

Lufthansa as well as the other ‘legacy’ air group of Air France - KLM. (CAPA, 2014 – see Table 7 below).

In November 2012, IAG whose subsidiary Iberia held a 46 per cent stake in Vueling (the second largest carrier in Spain by passenger numbers), offered to buy the remaining 54 per cent. IAG wanted to both stem losses in Spain and change the nature of short haul flights. It was in April 2013, that IAG finally acquired control of Vueling; which remains a standalone company within IAG. Some of the benefits of this acquisition are now evident. (CAPA, op cit.). IAG was also the only major European airline to record revenue growth in both periods. While this was assisted by the Vueling acquisition, the combined sales of BA and Iberia without Vueling were also up slightly. In addition, IAG had the best year on year increase in the first half year operating profit. Lufthansa stands out as the laggard on profit improvement. Adjusting for its change in depreciation policy, Lufthansa's operating profit declined year on year in both the second quarter and the first half of 2014. See Table 5-1 below.

For the Airline / Transport sector case study, the industry traditionally operates in a number business units which may be autonomous and stand-alone, or operate as subsidiary businesses .e.g. catering, cargo, engineering, ground operations, I.T. systems and so on. In this case when comparing Lufthansa and BA we will look at two main areas firstly, shared business services such as ticket processing, and secondly, maintenance repair and overhaul (MRO). It is also appropriate to weave considerations regarding strategic alliances and partnerships into the text as appropriate.

Table 5-1 IAG and Lufthansa revenues and operating profit

(EUR million) 2Q and 1H 2013 versus 2014 **(source CAPA Centre for Aviation and company reports 2014).**

	2Q 2013	2Q 2014	*Change*	1H 2013	1H 2014	*Change*
IAG (BA+)						
Revenue	4,768	5,086	***6.7%***	8,707	9,289	***6.7%***
Operating profit EUR million	245	380	**135**	-33	230	**263**
Operating margin (%)	5.1	7.5	**2.3ppts**	-0.4	2.5	**2.9ppts**
Lufthansa						
Revenue	7,836	7,704	***-1.7%***	14,464	14,166	***-2.1%***
Operating profit EUR million	439	409	**-30**	144	219	**75**
Profit change post change of depreciation policy			**-118**			**-99**
Operating margin (%)	5.6	5.3	**-0.3ppts**	1.0	1.5	**0.6ppts**

5.3 Motivation

The motivation for this decision to outsource or offshore, i.e. the choice of location, the source of focus for disintegrating the value chain, and the rate of transfer is the basis for the first research question (4.1.1).

Support and /or business services, such as ticket handing, cross charging of revenue, claims for lost baggage etc., are often regarded as non-core activities for an airline and hence one of the first areas to attract attention when it comes to cost cutting exercises and reviews of who does what, where and at what cost?

5.3.1 Business / Shared Services

In 2001 Lufthansa AB was driven by a combination of the 9/11 attack in New York and the economic recession to seek more radical improvements to quality, service and cost. This they did, in part, by further exploring the concept of 'shared services and service centres' (interview with VP International Business Services in Cologne). Small office administrative teams in countries spread across Europe and Africa were consolidated into Krakow, Poland which offered a so called 'nearshore' alternative for Lufthansa. In 2003 this restructuring enabled Lufthansa to initially reduce the labour force by 50per cent from the previous dispersed arrangement. Lufthansa has since further redesigned processes and extended the range of services provided by the Krakow office, hence increasing from 200 to 400+ employees.

Labour cost advantages and an emerging 'cluster' of skills and expertise were anticipated to be drawn from skilled staff in similar service centres (interview with

MD of Airline Accounting Centre in Krakow) and from other organisations such as Shell, Philipp Morris and Cap Gemini (the biggest in Krakow) who offer business process outsourcing (BPO) services for third parties such as IBM and Electrolux. Between 2003 and 2006 some fifty such centres have opened in Krakow, the largest is a call centre that has capacity for 700 persons. In 2003 the unemployment rate in Krakow was 18 per cent and so it was easy for Lufthansa to recruit locally; however, since 2012 the increased competition has encouraged attrition as trained people move elsewhere for higher wages. Thus the initial comparative advantage is diminished. This is a typical problem for call centres, although it is not clear how applicable this also is to ‘shared service’ centres that typically have more specific work and activities. This however, is not yet seen as a problem in Lufthansa (MD Airline Accounting Services).

Subsequent expansion in the design and scope of the work has led to two similar centres being established as *global hubs* in Mexico for North and South America, and Bangkok for the Asian market; (the activities comprise *back office* non-core processes, and revenue accounting activities such as where passengers travel with partner airlines in the Star Alliance) each moved offshore but all are kept within the Lufthansa group. Some other work such as claims by customers for lost baggage or cancelled flights, customer complaints and call centres are outsourced and offshored to a third party provider (not disclosed) in Cape Town and Dublin, but kept under close review. Part of the revenue accounting is also outsourced and moved to India, but again kept under close review. A senior VP in Cologne continued:

> *In the very first phase we of course tried to adopt the existing processes but since then there have been tremendous changes with a lot of projects and process improvements. We did some auditing on travel agency sales at three points in the world and this was only possible by the parallel introduction of a new IT platform and system.*

Again according to the Senior VP in Cologne, the motivation for Lufthansa has been the consolidation of administrative services, centralisation at three global ‘hubs’, and a redesign typically referred to as ‘re-engineering’ of processes and systems all resulting in quality and service enhancements at lower cost. The Systems Division of Lufthansa retains responsibility for corporate and group systems, much of which is also now developed outside Germany (in 2014 it was announced that Lufthansa Systems would be outsourced to IBM). It was further suggested that when shared service centres were first tried within Germany the experience was disappointing. To keep the costs manageable relatively low skilled labour was appointed, resulting in a poor reputation for Lufthansa in terms of service delivery, with high error rates and delays.

At BA Plc., to reduce costs, employee numbers and to improve productivity the focus has been the offshoring and outsourcing of business processes to India (interview with procurement manager responsible for strategy). World Network Services (WNS) was initially created in Mumbai as a wholly owned subsidiary of BA in 1996; this was a pioneer venture for the outsourcing of back-office operations with (at the time) less than 300 employees. In October 2011 WNS announced a 20-month extension to the existing outsourcing contract with BA Plc. WNS had approximately 1,000 employees at the time dedicated to the BA account in Mumbai and also Pune in India (Moneycontrol, 2011); the contract included all back office processing of revenue accounting, invoicing, bookings, amendments and staff travel. Each BA directorate manages their own offshore – outsourcing contract with WNS.

However, a significant development is that WNS is no longer wholly owned by BA. From 2011 WNS offers business services to 200+ global clients through so called operational excellence[17] to clients including travel, insurance, banking and financial services, manufacturing, retail and consumer packaged goods, shipping and logistics, healthcare and utilities (ibid).

In July 2006 BA disposed of its 14.6 per cent stake in WNS Holdings, the Indian business services group, for $96m (£52m). The intention was to repay debt and report a gain of £48m in second-quarter earnings (Done, FT 2006). The business established in Mumbai by BA was ranked as India's third largest business process outsourcing company. Warburg Pincus, one of the largest United States private equity firms, bought a controlling stake in WNS in 2000 and raised it to 70 per cent in 2002 (ibid).

So in corporate 'parenting terms' BA Plc., divested WNS, which quickly grew and added value to a range of services and clients as an independent concern. WNS provides a full range of business process outsourcing (BPO) services such as finance and accounting, customer care, technology solutions, research and analytics and industry specific back office and front office processes. WNS has over 21,000 employees across 23 delivery centres worldwide including Costa Rica, India, Philippines, Romania, Sri Lanka and United Kingdom.

Under the renewed service agreement, WNS aim to focus on further strengthening the back-office operations delivering a range of transport operations, including customer relations, fares and passenger name record (PNR) servicing requests, passenger and cargo revenue accounting, finance and accounting, research and

[17] Operational excellence is a term widely used to denote a management style that epitomises efficiency, close management control, tight financial targets and budgets that promote short term profit maximisation and shareholder returns.

analytics, revenue and yield management and HR shared services to BA. A senior director at BA commented (Moneycontrol, op cit.):

> *We are delighted to extend our partnership with WNS. The company has a highly professional and experienced delivery team, which clearly understands our project goals and requirements. This has enabled us to realise significant cost efficiency and business value operationally, over the years.*

… Group CEO, WNS Global Services replied.

> *This is an extremely proud moment for us; we are delighted to take this fifteen-year-old relationship with BA to the next level of growth. BA continues to be one of our most important and exciting clients and with the new service agreement we aim to provide strategic benefits to both parties, and drive further innovation for BA Plc.*

The contract extension through to January 2014 is intended to align the BA-WNS relationship with Business Process Outsourcing (BPO) services (Moneycontrol, ibid). The intention is to increase the focus on process improvement as well as to achieve a cultural change towards effective innovation and partnership. Under the renewed contract, WNS aim to introduce a new service quality scheme, along with identifiable best practice partly from other WNS clients. The partnership committed to invest in technology and process improvement[18] involving lean, kaizen and six sigma performance improvement reviews. This would hopefully yield increased operational efficiency, access to management and innovative employee control (Moneycontrol, ibid).

Lufthansa and BA were once public sector, nationalised industry players. Since privatisation both organisations have grown and formed large non-equity alliances

[18] In this case operational best practice will include ideas drawn from practices such as ‘lean’ (minimum manpower, movement, waste, inventory etc.), ‘kaizen’ (Japanese for lots of small continuous improvements) and ‘Six Sigma’ (a process improvement approach that enhances capability by reducing variability in performance. The name refers to control of up to six standard deviations i.e. equivalent to 3.4 parts per million).

as well as grown through acquisition. There is some evidence that the German company Lufthansa follow a mid-long term coordinated capitalist model with central control through wholly owned subsidiaries, local involvement with institutions supporting selected clusters. There is also a sense that the UK case, BA is prompted by the need for short term cost cutting measures as well as trying to develop longer term partnerships. The nature of that relationship is then much more flexible in terms of an appropriate business model.

5.3.2 Maintenance, Repair & Overhaul

Within Lufthansa and BA differing approaches may also be found in their approaches to engineering works, and use of flexible labour contracts. The search for efficiency improvements at Lufthansa was not driven by external consultants but with internal reviews. A director explained:

> *I would say that it originated from within the organisation at the point in time we recognised that the cost structures were simply not competitive any more. So there could be market pressure, yes, but I would say the idea would originate within the company, maybe to implement some of the changes we would need external help, consultants etc. Are close competitors following a similar path? Yes everybody is doing this.*

Lufthansa were asked ‘What was their driver for offshoring MRO work to China?’ Also to clarify whether this was driven by cost reduction, the need for different expertise, competences / skills, innovation, or part of a plan for regional or market expansion. The Director for Engine Lease responded:

> *In any case cost is involved, I don’t think it is a question of competencies and skills. It is cost and the German labour regulations that make it impossible to quickly lay people off and encourages the use of temporary employment. Regarding the aircraft overhaul it is only cost. We are not going to China because they have higher skills of overhauling the aircraft, it is simply because the man hour rate is cheaper there.*

When pressed on what difference it made in total for an annual maintenance or major overhaul on a Boeing 747 or a 777, e.g. if there was a 50 per cent difference or 20 or 10 per cent difference in cost. The reply was:

> *I would say 50%, just on the man hour rate. The material can be a significant portion of the bill and this is similar wherever we work but the man hour rate I would say is in the area of 50%. In China we also have other costs. You have to set up the structure there, you have to have your people there as well, and you have to have your inspectors. Sometimes you even have to make a flight there. We try to make it a revenue earning flight but sometimes that doesn't work. It can happen that you have to make a ferry flight which costs money but I would say 50% on the personnel side and then maybe we end up with 30-40% overall benefit.*

A helpful further comparison would be if Lufthansa undertook the maintenance overhaul in Hungary.

> *Yes. Maybe more 10 than 20 per cent I would say, because these countries are growing as well and wages are growing.*

In an interview with the Engineering Director at BA (Birchell, 2009) it became clear that the BA approach also included radical restructuring that began before 9/11 in 1995, when a maintenance division was established in Cardiff, South Wales. Significantly, the restructuring was in parallel with a continuous improvement philosophy developing 'local lean' activities to increase efficiency and deliver significant cost and performance benefits. The key is to challenge significant costs and look for new ways to do things. The commonly held view is that the U.K. is too expensive. The Engineering Director commented:

> *Yet we discovered that the most competitive facility, when we looked at cost and downtime, was our own. Labour rates are certainly cheaper elsewhere, but when we looked at the labour content and downtime that other MROs*

> *proposed for those checks, it forced us to reconsider what BA could do in-house.*

BA outsource tactically where necessary. The two things that tend to drive outsourcing are: (a) BA cannot do it efficiently in terms of resource and or time, or (b) the cost of doing it in-house is simply too high. A BA purchasing executive suggested that the key issue is then:

> *….can BA be the most competitive place to do the work for BA Plc.? If we can, then there are some powerful drivers to make it happen, particularly where facilities are available with skilled staff. That said, they wouldn't be the sole drivers.*

Some outsourcing has been reversed and brought back in-house to BA where an internal market can now operate, the BA executive added:

> *Wheels and brakes are a good example. Our long-term contract with Honeywell was due for renewal, and our own component overhaul facility quoted for the tender. Our facility won the bid and has done the work for more than a year' (BA Procurement).*

Significantly, this is possible in the high-cost Euro zone because labour rates are not necessarily a predominant factor in the transport sector. In the majority of cases, material costs dominate while labour rates represent a relatively small proportion of the total. In return for some latitude on labour costs, it is possible to save the costs of holding additional inventory.

At BA the Manager of Procurement Development plays a key role in developing contract agreements, including third party outsourcing and offshore work. He added that now the Engineering division have successfully adopted lean practices to reduce waste then that has effectively generated some excess capacity which can be used to serve customers rather than needing to reduce the workforce.

The issues raised at BA suggest that successful productivity improvements, can free up crucial capacity so that initial decisions to outsource can subsequently be reversed if and when appropriate. The driving force is to achieve the best value for shareholders, perhaps through internal competition and to have effective control over the cost of that service. Furthermore, that cost is not necessarily labour cost. In a number of specialist engineering and maintenance activities, materials are a significant proportion of the cost. Other factors may therefore determine the best location. So while maintaining control remains crucial, suppliers are encouraged to add value through a mixture of 'loose and tight' policies to balance meeting targets and encourage innovation. At BA these initiatives are often procurement led with specialist legal, and then HR or Finance support as and when required. The procurement executive commented:

> *….so if I take the example of facilities management, which is a rather classic example of outsourcing, we need to keep a certain level of expertise within the business to manage effectively that supplier and achieve the specification that we seek. We are absolutely mindful of the need to be able to maintain control of these contracts and if we have overstepped the mark then that reduces our ability to make a switch, or understand that we are indeed getting value for money. An example of where we might need substantial legal support is in any area where there are Transfer of Undertakings Protection of Employment (TUPE) obligations. This is mainly in the UK although rules similar to TUPE do also exist in other parts of Europe.*

The second research question explores mechanisms such as ownership, control, coordination and autonomy (4.1.2)

5.4 Ownership, control and coordination

A senior VP from Lufthansa commented that there are a few 'modest' examples of 'real outsourcing' in the German airline shifting parts of revenue accounting to India. However, where possible the preferred approach is to retain a wholly owned legal entity with selective choice of countries and preferred cultures that Lufthansa wish to work alongside.

In a highly competitive sector, both Lufthansa and BA, have specialist offshore 'shared business service centres' to reduce costs and improve efficiencies. At BA a need to reduce pressure on the Pension Fund sharpens a focus on reducing employees and perhaps outsourcing (author). This could help to explain the BA decision to divest WNS after a satisfactory period of offshore activity in India. Today they source an extended service contract from WNS.

Lufthansa and BA, both employ large numbers of people – some 170,000 in total. If you include alliance partners and those affected through the production network then many more jobs are reliant upon the success of these enterprises. The sector is high profile, the companies are all household names and business is derived from both corporate and individual consumer traffic. Lufthansa has a residential 'School for Business', essentially a corporate business school which has provided a range of skills, knowledge, qualification and other programmes for many years. BA also has specialist apprentice schemes, and accredited training programmes for a whole range of employee groups – including senior management. There are concerns at BA over numbers of full time employees and pension commitments given that the very attractive scheme has a substantial deficit.

In 2011 there was a change of Chief Executive at Lufthansa with a desire to strengthen corporate governance and to create transparency of operations across the Group for the board. The interviewee based in Cologne suggested that:

> *….. during the course of the year 2011, there has been a tremendous change in attitude from the Lufthansa Board towards (the value of) 'Shared*

> *Services' and towards the partnering of functions. Before that it was clearly prohibited to speak about it at all.*

Ideas for improvement have come from extensive communication and cooperation with other shared service providers – especially in Krakow. While there are initiatives to encourage staff to initiate improvement ideas through self-managed groups, there is apparently still some distance to go. The Managing Director for Lufthansa in Poland commented:

> *.....besides informal contact, there is an Association of Shared Service Centres in Krakow called Aspire. While I am not an official member, I am regularly invited to events. It is an exchange platform where they propose events, and where 'shared service' centre leaders are invited to visit a centre, and present what they think they have been doing well, so there is an exchange of experiences from the other MNCs in Krakow.*

Lufthansa has had advice on the use of 'shared service centres, call centres and BPO' from McKinsey, Deloitte and currently Accenture consultants. The Lufthansa plan is still to retain an individual office and keep staff numbers in Krakow relatively small – this helps to avoid issues with the Works Council in Germany and also access to local grants, taxes and local regulations in Poland that draw a fiscal distinction between IT centres and shared service centres. The MD explained:

> *....in Poland there are such possibilities but you need to compromise. You need to prepare well in advance and there are certain conditions which in the case of IT centres are easy to comply with but for Shared Service Centres the conditions are strict as the investment is not so high. You need to guarantee building up more than 200 jobs and be able to guarantee them for several years. We have had growth but it is not predictable to an extent that would have qualified us for such grants.*

In 2012 Lufthansa undertook a preliminary study to create global service lines with more complex work and local responsibility in the market for service delivery. It is hoped that this will offer more career prospects, also opportunities for higher skilled and grade employment.

Krakow has recently been assessed as the most successful 'magnet' in the region for Business Process Outsourcing[19] (BPO) centres, and 11th in the world (Financial Times, April 2012). The demands of clients for sophisticated IT connections are very high. As investment has grown so the vacancy rates are falling; in Krakow they are expected to fall from 8 to 6per cent by the end of 2012. The figure in Warsaw is only 4per cent. Rents are far lower in Sofia, Bucharest and Budapest. Central Europe continues to face fierce competition from China and India but also enjoys proximity to Western Europe which should allow shared service centres for BPO activities to continue to grow and prosper. From interviews with senior executives in both Cologne and Krakow it is apparent that while Lufthansa HQ was initially reluctant they were persuaded to develop 'shared service' centres in Poland. This allowed the consolidation of lots of small administrative offices and teams across Africa and Europe. These centres have gradually extended their range of activities and continue as wholly owned subsidiaries of the parent company Lufthansa AB. There is some outsourcing to third parties but it remains small and is closely monitored (detail not available).

With the comparison case BA Plc. a number of trade-offs between risk, quality and cost become evident. The BA approach is internally driven, with the procurement function taking a lead role on outsourcing, efficiency improvement and cost cutting (Procurement executive with responsibility for strategy). BA was willing to further develop and then eventually spin off the WNS business – an early experiment in

[19] Business Processes is a widely used term to describe cross functional activities that are undertaken by an organisation to focus outputs on customer requirements. They may be considered core or secondary to the organisation's purpose and the customer may be internal or external. BPO is a recently popular term to describe the policy of outsourcing certain processes, typically secondary, (in this context) administrative processes that might be undertaken elsewhere at lower cost. This allows the business to refocus its deployment of resources and priorities upon core activities. Over time, the definition of what is core may change.

offshoring as well as the domestic outsourced catering arrangements. Procurement was also very much involved with restructuring following post-acquisition deals as in the cases of both Iberia and British Midland. While the activities outsourced and moved offshore to India by BA may be considered as secondary rather than primary activities in the value chain, they still represent key support activities with a high level of customer contact and risk exposure.

Lessons about a lack of control over outsourcing may have been learnt from past experience of catering contracts such as in 2005 when working with Gate Gourmet. BA now not only keeps more control over outsourced work through service level agreements[20] but also consider it to be prudent to spread the risk with different providers.

From the BA Board and shareholder's perspective there is a long standing concern over spiralling pension costs and hence the number of full time employees on the payroll. In July 2011 the BA pension deficit stood at £3Billion, having been reduced by £770m with the Chancellor's switch from RPI to CPI (Griffiths, Observer 10 July 2011). Conflicts with BA staff continue over cuts in prospective pension payments. This could go some way towards explaining a preference at BA in comparison to Lufthansa for spinning–off a successful and sizable business unit, rather than retaining control as a wholly owned subsidiary. This has been exacerbated by the aforementioned acquisitions as issues arise with the integration of key employee groups between new and existing companies. To reduce pension costs, and a mounting deficit, the final salary scheme at BA closed to new members

[20] A service level agreement is a contract signed by both parties that documents how the organisations intend to work together and typically specifies in considerable detail the appropriate targets by which performance will measured. It is not unusual for payment terms to then be linked to these targets along with the necessary conditions for payment of bonus or incentives.

in 2004. This has helped BA to reduce costs. However, there remains a need to control full time equivalent (FTE) employee numbers and retention levels by key role category. To further leverage productivity enhancements the use of open book accounting[21] is widespread and there is a desire to exploit tax incentives where available.

5.4.1 Outsourcing versus Alliances, Partnerships and M&A

A recent interview with the Head of Alliances at British Airways provided a number of insights on how outsourcing and offshoring fit into a spectrum of collaborative forms of working that include Mergers and Acquisition (M & A) as well as joint ventures, alliances and partnerships.

> *I am responsible for our relationships with our airline partners and that covers a number of different types of relationship, it covers our joint business relationships, our franchise relationships, our co-shares and frequent flier relationships, our alliance relationships where we are part of an alliance group and to an extent our normal interactions with airlines, interline relationships and such like.*

BA's One World Alliance and Lufthansa's Star Alliance are well known and often used as examples of strategic partnership, collaboration and alliances. So what are the essential differences? He went on to elaborate:

> *There are a few big differences. There are obvious differences in terms of size and scale, so Star are bigger, historically quite a bit bigger than One World and we like to think we are focused on quality rather than quantity and Star is focused on covering the globe and that's kind of how we look at it and I am sure they look at it slightly differently to that but that's the One World perspective. There are some other differences in the nature of our business and Lufthansa's business in particular as we are not exclusively but still very focused on traffic to and from London. So London is a huge global centre in a way that Frankfurt is not. We concentrate on traffic*

[21] Open book accounting is a principle whereby both parties – the supplier and the customer reveal all accounting data and records that are relevant to the contract. The intention is to ensure that performance is mutually transparent. Costs are controlled on the one hand but also that there is adequate margin for the provider to ensure a good service over the length of the contract.

> *coming into London with BA whereas Lufthansa's business is principally built around flowing traffic through their Frankfurt hub connecting it to their services on to the rest of the network. So that's a flow hub whereas London is a hub, 40% of traffic connects in London so it's not without connections hence it is important but it's not an entire rationale.*

A recent development for BA and One World was the acquisition of Air Iberia and the formation of IAG as a holding group in 2011. The Head of Alliances continued:

> *BA has merged with Iberia and Flybe now under IAG but we still exist as a British company and Iberia still exists as a Spanish company, even though we are wholly owned by a holding company IAG. And the reason for that is if we were not British we would lose our ability to fly to many parts of the world because the relationship is between the government, so the permission for us to fly from the UK to India is just that, it is based on the relationship between the UK and India or the UK and Japan or, in Iberia's case, Spain to Brazil.*

Hence the institutional approach to economics is interesting in this respect with the importance of negotiating entry and exit from new routes / air space and the required gates and slots at airports etc. BA see an alliance as a *'marketing wrapper'* an endorser brand which enables BA customers through One World to gain BA benefits on Cathay or Qantas or JAL because it is an extension through the endorser brand for the alliance. This is seen as a joint business, in fact a *'quasi merger'*. The senior BA executive continued;

> *BA have two substantial joint businesses – one with American Airlines, which also includes Iberia and Finnair which is between Europe and North America and we have a joint business with JAL and Finnair which is between Europe and Japan where we pool our revenues, we make collective decisions and we take collective risks and we share the rewards from taking those risks. BA (a) gain access to more markets where we are not allowed to actually merge; and (b) gain access to local expertise.*

The policies, rules and regulations in Europe as opposed to the US / North American air space are different. The Head of Alliances added:

> *… North America comprises three countries – Mexico, US and Canada. Europe has 28 countries in the EU plus non EU countries. Air space is a good example, so if you look at the continent of North America there are 8 air space blocks and in Europe there 22 or so, because Governments own*

> *air traffic control and there is a national interest in maintaining control of your own air space, there is a great deal of reluctance to consolidate that space into meaningful size blocks.*

Customers may get confused by the different brand and flight code systems in use – he continued:

> *There are alliances, joint businesses, BA also franchise. BA has a company in South Africa called ComAir operating as British Airways and a company in Denmark called SunAir who also operate as British Airways. ComAir are, by passengers, the fourth largest airline in Africa so they are not small, they have an extensive domestic network as ComAir but are branded British Airways, so if you went to Cape Town you would just see British Airways aircraft flying to Durban and Johannesburg and Port Elizabeth and hence it would just look like BA. And then BA also extend our relationship network, through co-sharing we simply put our code on somebody else's flight, and brand it differently – this helps us distribute our fares, and provides a one-stop shop for onward connections for customers to get to their destination. There is also something called 'interline' where you simply sell your partner's service but without the co-share.*

Yes, there is still a place in BA for outsourcing and offshoring, alongside the other forms of collaboration, especially in reducing duplication and delivering synergy savings from M&A. The Head of Alliance clarified:

> *….having merged with Iberia there is a whole raft of synergies that we are looking to achieve. Firstly, let's take revenue synergies. Our networks are complementary; the BA network is principally to North America, while Iberia is to South America. We can access their service to South America cheaply and efficiently and therefore we add more choice for customers coming from the UK and Iberia has the same opportunity with us to North America.*
>
> *Secondly, cost synergies are about how do we do things more cheaply and have a greater buying power as a larger entity and can secure better deals. You can standardise your specifications, take some simplification costs and equally you can do things with less people. So previously we were two companies with two people doing the same job, now one person. We have also started to move things into a global business services centre. There is support activity that could be almost like in-house out-sourcing, Procurement has moved to central servicing, IT have moved to central global business services, elements of finance, have been centralised. So initially IAG started off with consolidating the really large corporate functions, treasury, investor relations, external PR, the stuff that sits directly around the Chief Executive, but now we are starting to move some of the*

more transactional activity into global business services – but still based in the UK.

In the context of alliances, there has been a deal of concern by the unions about the scope of work and therefore loss of jobs. Not a net loss of jobs but moving work from BA to America say, so total jobs might actually increase but they would be American rather than British jobs. The American unions have exactly the same concerns. So actually our joint business does not incentivise that kind of transfer of work. You are motivated to swap work if that's most efficient, so BA and America have swapped some services around. We have been trying to integrate our sales forces efficiently and that has resulted in change, certainly in change to roles and in some cases fewer jobs but those type of reorganisation occur regularly and it doesn't seem to be quite the same emotional experience.

BA are obliged to carefully plan potential alliances because the authorities treat a joint business as a quasi-merger and so close cooperation with regulatory institutions is necessary, he added:

The Atlantic joint business is Mexico, Canada and the US, each national state has its own regulator. With Europe, BA do have one regulator, which is the EU Commission. BA has to talk, consult and inform the Department for Trade and the Office of Competition Authorities in the UK. However, the authority the responsibility is with the EU Commission rather than a national government. In Japan it is the MMIT, which is the Ministry of Infrastructure and Transport, but they also have to consult with the Japanese Trade Authorities, who require economic analysis, an assessment of the benefits for the customer and whether they outweigh the losses from reduced competition. This is an awful lot of work taking many months.

Although it is still 'early days for IAG' there are substantive benefits………..

Our declared synergies over 3 years are something like £350 million a year and we have a total target of half a billion by 2015 which is a combination of incremental revenue and cost saving. BA made £700 million operating profit last year, IAG made a bit less than that because Iberia lost money. In terms of the joint businesses, to North America we have started routes that are successful, that are profitable and create value for all partners that we have been unsuccessful in operating in the past, so San Diego in California is a classic example. BA has tried twice before to operate that route because while there is clearly a market we couldn't operate that on our own, we needed the strength of the American point of sale to help support the route; and as a result the European consumer (because no-one else operates from there from Europe), gains a direct service from Europe to the US.

Unfortunately it was not possible to interview the Lufthansa director responsible for strategy and alliances. The Lufthansa Star Alliance is largely regarded as one of most respected networks of non-equity partnerships. As at April 2014 there are some 26 member airlines (in addition to Lufthansa) with in excess of 2000 departures per day, serving 235 airports in 78 countries.

5.4.2 Influence and autonomy

Research question 4.1.2 (continued). In this industry sector the major competitors are largely grouped into several alliances. These tend to start, and in the case of Lufthansa mostly remain as non-equity partnerships that enable cooperation for global transport services via selected hubs. In the case of BA after a sensible period of courtship, acquisitions and restructuring of corporate governance tends to prevail. There is a sense that with Lufthansa when acquisition does arise (e.g. both Swiss and British Midland) it is somewhat contradictory to the typical CME VoC model and rather more as a short term spoiling tactic to prevent, or at least delay their major competitor who happens to be BA. An idiosyncratic pattern evidenced by these cases is that a major competitor can also be a collaborator when there is commercial sense and a practical solution on offer as at Lufthansa providing catering and MRO services to BA.

Now in terms of the division of labour and use of local compared with expatriate workforce.

5.5 Managerial and other divisions of labour.

The approach to cost reduction at Lufthansa in Engineering and Maintenance Services is to look for lower cost employees to undertake the work (4.1.3). For example when Lufthansa moved certain operations to China; the whole management team, (also the inspectors and the team leaders needed to control the work) required for a complete overhaul were German; and only the workers were Chinese. There are substantial cost savings in the order of 50 per cent, just on the man hour rate. The cost of material is significant and remains unaffected. The Engineering Director commented on some of the tensions that can arise:

> *Today we even have controllers, engineers and people working in the personnel department who are external, which can cause problems especially with a controller who from my point of view has to be a part of the company to challenge the management and propose decisions etc. In my view there are certain jobs where this shouldn't be done.*

Substantial engineering overhaul work has been offshored but not to external companies. In this case Lufthansa set up their own companies, for example in China and Malta, also in Eastern Europe – Hungary and Romania. Here the labour cost savings are in the order of 10-20 per cent when compared with Germany. There is then also a joint venture with a Chinese partner but all the other examples are subsidiaries of Lufthansa. There is some, but not much evidence of taking advantage of grants and subsidies. The Director said:

> *I don't know about Eastern Europe, I do know that in Ireland there is some transport maintenance which is tax advantageous in Dublin and also in Shannon. There is also a facility in Malta and lots of leasing and asset management work taking place in Malta.*

While clarifying the need for specialist skills and competences; Lufthansa seek opportunities to reduce permanent employee numbers with an increased in flexible temporary employees. Some 10 - 20 per cent, subject to the specific engineering department are now external employees on contract; and five per cent of administrative roles (Engineering Business Unit Director, interview) commented:

> *We call it zeitarbeit (temporary employment) or staffing services so that we try to have a certain proportion of our personnel being from external companies, especially where the capacity needs to be adjusted to meet either more or less demand. In Germany it is very difficult to lay off people and therefore the solution is that we keep our own people to the extent that we need them all of the time and any additional peak demand is covered by external staff.*

At BA there seems to be little change in terms of division of labour. Discussions are also closely tied – in with trade union negotiations especially on jobs lost to the US. BA Engineering IAG have had work that is already outsourced to a third party and when the contract has come to an end Iberia have been successful and won the bid, so work has moved back into the group – a form of re-shoring.

5.6 Cultural Proximity

It is significant that both Lufthansa and British Airways were once state owned and are today often referred to as legacy carriers. While size has its virtues, it also makes it harder and slower to change. Both airlines have a reputation for having deeply entrenched working practices throughout the business operations, higher manning levels when compared with new(er) airlines such as Virgin, as well of course as with the so called low cost airlines. This typically results in a high cost base and fragmented infrastructure with institutional practices that are deeply embedded.

The approach adopted by Lufthansa to establishing shared service centres for back office operations has essentially been to 'near-shore'. Duplicating core and secondary processes but also taking advantage of cultural and language affinity for different regions in the world (4.1.4). The VP for international Business Services commented:

> *When we founded our shared service centres, we established one in Bangkok for Asia Pacific, one in Mexico for the Americas and one in Poland which for Europe and Africa. We found having the comparison between the three centres helpful, and indeed it is easier for us in Germany to discuss issues with the team in Poland than with the guys in Bangkok.*

In terms of choice of country for the service centre, the senior manager added:

> *I think the British public doesn't have the problem with having certain kinds of services being done in India. For the German public that is a different story. It is not only a question about how the unions are gearing up or the Works Council, it is also a question of reputation and Lufthansa's experience has not been positive when outsourcing to India.*

For the Americas region:

> *……what we do see, and this is indeed interesting, is that Mexicans have a different way of working to in Europe. When we do psychological testing with the team in the Americas the results are significantly different to Europe. The school systems in those countries are completely different and as a German company this becomes an issue if we want to transfer somebody who did a terrific job in Mexico to Germany but then fails the diagnostic tests, it is not so easy.*

The managing director of the Lufthansa service centre in Krakow added:

> *…..in some countries there are very strong bonds between the employees because they have worked together for over thirty years and it is very difficult to take even one person out, as cannot count on the support of the others. I can see the differences of operating a centre in Thailand compared to Poland because I have had both experiences, but this was not during the transfer phase from Germany. I see the differences in how the people in the service centre act.*

The Head of Alliances at BA commented on how cultural and behavioural differences influenced such aspects as decision making when establishing partnerships:

> *What we haven't yet talked about is how we set up and run the joint businesses, so obviously you have gone from making the individual decision,*

which is always hard enough in a big organisation, to having to make decisions with your partners to do things and change things, though you are having to work within a collective framework, so getting the governance right with the right level of authorised people managing the business with the correct governance and escalation to resolve disputes is really important – we spend a lot of time setting that up. And you need to recognise, certainly I have learned that there are big cultural differences, Americans are not like Japanese, and yet we have got joint businesses with both. Neither are the Spanish. So people you have in the room tend to be fairly diplomatic otherwise ... with the day to day stuff but actually when you get down to the issues of dispute then you often need to have frank discussions to get them resolved.

When prompted on examples of the differences:

Yes, interestingly the Japanese, guys go on special courses on how to be more assertive. We deal with JAL and you see Japanese corporate culture but through the lens of one company. I hear that ANA are quite different, another big Japanese airline, with a more western approach because JAL are nationalistic. Lovely people but it is collective decision making, collective responsibility. One of the big things we have been grappling with together with JAL is targeting, so our sales force down to the individual have targets that they need to achieve in terms of sales. The Japanese don't, it is an anathema the concept of individual accountability and culturally individual targets is not how they operate.

The Iberia acquisition is also an attempt to bring together two management teams that again are culturally different:

Yes, to some extent we work very closely with them but we are not wholly integrated, so we are still a management team running BA and they have a management team running Iberia but where we do have to work together there are inevitably differences of opinion, as well as agreement. You have to work through that. Iberia have been going through an awful lot of change so I think most recently BA went through a lot of change in the '90's and again in the early 2000's, a lot of change, a lot of modernisation, rationalisation, simplification of management structures, people leaving, slimming down. Iberia hadn't gone through that at all so now they have to go through an accelerated change programme to modernise and that's pretty tough. The folks at BA have been through that over 10 years and Iberia are having to go through it in two years – I have a lot of sympathy. But they have changed a lot and they have got some very good people that we deal with now.

A senior engineering manager at Lufthansa also commented on difficulties in China at Ameco a joint venture between Air China and Lufthansa:

> *What I have heard is that with Ameco in Beijing, each of the management positions were staffed with two people, one Chinese and one German. I would say especially in China it is very difficult for both sides, not only for us but for them as well.*

The above examples suggest that while Lufthansa has a greater global reach, it has struggled to fully replicate its *German model* elsewhere in the world. We also now know that Lufthansa's acquisition of British Midland proved to be a disaster and of the airline Swiss troublesome and expensive. BA on the other hand, seem to have been more agile, adaptive and flexible in recent years when dealing with cultural challenges in Iberia, Vueling and JAL (current negotiations with Aer Lingus are close to acceptance, subject to a golden share held by the Irish government). A key factor in such negotiations are the control of landing slots at Heathrow which are subject to strict regulatory control. And the influence of the trade unions in British Airways is demonstrated by the following incidents:

5.7 Trade Unions

One early approach to outsourcing of 'non-core' activity by BA Plc., in 2005 was for catering services in the UK. A major supplier Gate Gourmet was chosen and all went well until there was an unresolved dispute at the contract suppliers over pay and work practices (our fifth research question 4.1.5). The strike became serious and halted supplies to BA for several weeks. The dispute then continued, and spread to other work groups, including at BA who acted in sympathy with the supplier over a period of several months. 700 employees at the supplier were dismissed. Delays and cancellations disrupted the travel plans of 100,000 passengers. This was very damaging to BA, especially for premium customers. The brand and reputation of BA suffered with serious implications for loss of revenue and market share in the region of £45m. Today considerably more control is exercised over key contracts and multiple suppliers are in place for different market channels. Another interesting characteristic of this market sector is that today some services are contracted in from a competitor who happens to be Lufthansa (London City Airport). These are seen as commercial contracts that are awarded on merit and value for money.

The trade unions at BA are strong, well organised and some would suggest militant. Over the recent years there have been a number of disputes which tend to be high profile and capable of splitting public opinion. However, this does not seem to have deterred management from seeking radical change and if necessary confronting the unions. Whereas at Lufthansa there is a different management style, confrontation is generally avoided wherever possible. Changes have been deliberately designed to involve small groups in different regions and sites seemingly to diffuse attention from the Works Council.

A preliminary study in 2005 said that Lufthansa could combine the accounting of two operating divisions and that would save a substantial amount of money but only if located in Poland. The HR business director said:

> *I don't go into war with the Unions for merely eleven million Euro per year, so forget about it, the idea is dead.*

Whenever there are implications for substantial job changes in Germany, Lufthansa believe that they must talk with the Works Council about the Social Plan (Engineering Business Unit Director). Lufthansa need to demonstrate how they will offset the risks that for employees, how to help employees to find new jobs and what offers can be made. Specialist work tends to be retained in Germany while more routine service or maintenance is increasingly performed in Eastern Europe, or in China. While Lufthansa continues to grow, finding alternative work has not been a major problem. Lufthansa may also perform work for alliance partners outside of Lufthansa but normal market forces will then apply. Work is put out to tender and Lufthansa will supply if they can offer the best quality at the lowest cost. Lufthansa has several joint venture relationships with specialist suppliers, partly for regulatory reasons; also to spread the risk. There is also a preference to nearshore in Central / Eastern Europe (rather than locations such as India) where cost savings may be realised but there are also cultural similarities in terms of language, proximity to key markets and Lufthansa routes for access. The HR Business Director at Lufthansa added:

> *You have to understand that Lufthansa AB and India are not always on the best terms when it comes to legal entities and technical issues. To date, joint ventures with India were disasters, and so we try to avoid India when it comes to founding legal entities and to find alternative low cost locations.*

At BA Plc. recent productivity improvements have enabled a shift to another business model with a recent trend to start in-sourcing with engineering works. There is arguably a greater emphasis on realising short term cost savings and productivity improvements where a business case has been made. Britain and India traditionally have had stronger cultural, educational and colonial ties, this may have helped ease the way for BA to forge a successful working relationship with its now partner WNS. The procurement executive at BA commented:

> *.....it would have been difficult to envisage a situation where we could effectively tackle our internal costs with such a large unionised part of the workforce. Now we can look back at the history of BA Plc. and see some progress in terms of changing relationships with big labour groups. I think the best way of expressing innovation and competence and skills is given when we outsource, and particularly when we outsourced the company whose purpose is to operate in that particular market.*

A recent interview with the Operations Manager at Gatwick (Appendix A 2.5.3) provides insights on how outsourcing work in the UK became the preferred approach for cost cutting and securing future capital investment in a new fleet. Following the acquisition of Iberia and the establishment of IAG, as corporate parent of British Airways, decisions about re-equipping the fleet at Gatwick became the responsibility of IAG. British Airways struggled to make a profit on its short haul operations and lost money at Gatwick. Discussions took place in 2011 with BA TUs on reducing costs and how best to meet the challenge. The trade union representatives from Unite and GMB were very aware of the options that typically include different manning levels, ways of working, terms and conditions, or wage rates, or changes to paid leave. Management explored a number of ideas and the consequent cost-savings arriving at a target figure; and the trade unions were non-committal because they have to sell the concept to their members. Initially, two areas were scrutinised first, ground operations with the ramp and secondly, customer services teams. The operations manager explained:

> *Part way through those conversations the TUs asked us a crucial question, which was how do we know that the 120 people is the right figure to get BA to a market rate? How did the TUs know that we weren't really bumping it up effectively? So, we offered to do an exercise of tendering with the various ground handling agents to understand the size of the gap, so we were no longer 'shooting in the dark'. Ultimately, I guess they probably wished they had never done that because when we got the quotes back even we were surprised at the size of the saving, which was almost double what we were looking for. The difference for customer services wasn't quite so great, about a 50-60% differential.*

BA management and the trade unions accepted that the only option was to outsource the ramp operation. It was a different outcome for customer services. Customer services accepted the challenge of reducing headcount by 15 per cent and management talked to the representatives about how that might be done in practice. The process had several steps that were all covered in-house, part was the loading and unloading and general baggage handling, a second part was aircraft pushbacks and towing and a third used to drive buses to where aircraft were on remote stands.

There was also a separate activity for de-icing of aircraft in the winter. BA outsourced the majority of the ramp operation, the loading, unloading, baggage handling, 'push-back' and towing to Swissport, BA outsourced driving the buses to Airlinks. The de-icing, was outsourced to a specialist company called Airline Services who supply a large part of the Gatwick airfield. The BA Operations Manager added:

> *Of the 450 BA Gatwick staff made redundant 100 transferred to Heathrow cargo. BA paid differential travel expenses for one or two years, and then they become Heathrow members of staff. BA reached a TUPE agreement with Swissport but subsequently only one person decided to accept, which is interesting. The redundancy deal agreed was generous at 75 weeks' pay.*

The annual savings are estimated at £12m, and in 2013 Gatwick operations were profitable just one year into the new outsourced contracts. IAG have now agreed to re-equip the Gatwick fleet of 20+ airbuses before summer 2015 at a cost of £500m.

An interview with a former National Officer for the GMB (now an academic) who once represented some 90 per cent of employees affected by the restructuring at BA suggested:

> *There were regular meetings at BA on cost cutting and outsourcing. These lasted many years. Also that the tone of the negotiations changed and reflected rather different leadership styles from several CEOs over the period. Multiple sourcing (e.g. catering) became the result of previous disputes and major disruptive action. Furthermore, job losses would continue as work moved to overseas suppliers.*
>
> *A tiny number of jobs in IT have returned to BA in the UK'.*
>
> (Former GMB National Officer)

IAG and BA also have European based employees that are represented by a works council and that is regarded in a positive manner. The Operations Manager added:

> *IAG / BA has a call centre in Bremen, and other stations that we operate in Germany. It enables us to have a dialogue with the employees rather than*

dealing directly with a multiplicity of unions so there is an efficiency of conversations.

5.8 Re-shoring – a change in policy

The Head of Alliances at BA stressed the importance of institutional negotiations and added that there were examples of reverse outsourcing in BA:

> *…….we bought avionics back into the workshop at Blackwood which is the seat overhaul workshop and a subsidiary of BA. They are in the Welsh Valleys and avionics is in Abergavenny, also we do all our heavy maintenance or a big chunk of it in Cardiff. There are a number of businesses re-locating in or to Wales, where there is good regional support from the authorities, the Welsh government and the UK government to support that type of work.*
>
> *Much of the engineering and highly skilled work (avionics and seats) has been reorganised into production line work, but even then it is still skilled labour. BA are offering skilled jobs in an area of historically deprivation (because of the loss of the mining and steelwork industries), while many of our competitors outsource their heavy maintenance completely overseas e.g. Singapore Airlines do a lot in China,*
>
> *In the aviation press there has been discussion in Australia about outsourcing Qantas engineering work but our preference, is for a combination of cost, quality and speed, because it is not very far to Cardiff but it is a long way to fly an aircraft to China. Aircrafts on the ground cost money, and all the analysis we have done is that BA are now extremely competitive'.*

Reference is also made to work having previously been outsourced by BA, then won by Iberia at the time of contract renewal and thus returned with IAG. This is essentially a form of re-shoring.

Both transport sector case companies have undertaken extensive investment and clearly regard engineering work such as maintenance, repair and overhaul as important. Lufthansa though has deployed flexible labour policies using contract employees in preference to outsourcing. BA preferred a form of near-shoring moving from London to South Wales. Further reviews showed that material costs were more significant than labour especially when productivity improvements had been realised and an internal market created. This served to return or keep work in-house at BA. Speed was also considered important by BA. This area of activity further emphasises some of the difficult trade-offs between a need to control cost yet also a desire to continuously improve quality; furthermore there is a need to retain organisational and management control while improving quality.

A recent change in policy towards outsourcing has also occurred at Lufthansa. In October 2014, Lufthansa announced their intention to outsource all of the Group's IT infrastructure services to IBM. The IT group is also expected to take over the Infrastructure division of the current Lufthansa Systems AG. The outsourcing agreement is to have a term of 7 years. It will enable Lufthansa to benefit from a permanent reduction of IT infrastructure costs by approximately 70 million EUR annually. Lufthansa will incur 240 million EUR in one-time charges due to restructuring and effects from the purchase price in the financial year 2014.

(http://www.lufthansagroup.com/en/press/news-releases/singleview/archive/2014/october/22/article/3322.html)

Table 5-2 below takes key findings from the case study above also the detailed interview narratives in Appendix A2.1, A2.2 and A2.3 using the format developed in Table 3-3 (Conceptual Framework) to 'test' the initial hypotheses. The implications are further discussed in Chapter 7 Findings.

5.9 Airline case summary

Table 5-2 British Airways and Lufthansa Compared

(see also Appendices A2.1, A2.2 and A2.3)

Question (Refer to chapter 4)	**Approach**	**Dimensions**	**Liberal Market Economy (LME)** **British Airways**	**Coordinated Market Economy (CME)** **Lufthansa**
What are the differences in the geographical, functional and temporal patterns of outsourcing and offshoring? (4.1.1)	Outsource	Motivation (see 5.3)	Outsource back office services to India and RMO to South Wales. Cost and improved productivity -reduced employees numbers. Catering, administrative and revenue accounting, engineering, maintenance, repair and overhaul. Ramp, buses and de-icing. Speed of response.	Offshore shared services to Poland, Thailand, Mexico. Quality, performance and cost. Shared services, ticket booking, invoicing. Offshore RMO to China (JV) and Hungary.
How far do mechanisms such as ownership, control, coordination and the degree of autonomy differ? (4.1.2)		Ownership (see 5.4)	Outsource: Shareholder value	Retained offshore subsidiary
		Control & Coordination (See 5.4 and 5.4.1)	Offshore and outsourced. Arm's length, market driven. Open book, service level agreements. Procurement led/ contract driven. More recently strategic collaborative ventures ('One World') have become more important	Tight HQ organisational control. The Star Alliance – not wholly but largely non-equity based has become a benchmark in code sharing. New CEO resulted in fresh policies and priorities.

		Degree of autonomy (see 5.4.2)	Generally high. Maintenance retained at an internal subsidiary. Allowed to source from competitor if a business case.	Low, but increasing, based offshore or nearshore. Acquisition used as a short term ‘spoiling’ technique.
How is this reflected in divergent international divisions of labour regarding the employment of indigenous or ex-pat managers? (4.1.3)	Offshore or	Managerial division of labour (see 5.5)	Local staffs. No ex-pats. Concern over JV in the US with potential loss of UK jobs.	Run by ex HQ managers At start-up managerial level withdraw at operative level as soon as possible and recruit locals. Duplication with JV in China.
To what extent do preferences for cultural proximity affect location? (4.1.4)	Outsourced offshore or	Cultural Proximity (see 5.6)	Unimportant. Global reach. Cope with afterwards - gain experience through diverse partnerships.	Important – language & culture. Focus on regions Europe, SE Asia, S America.
What is the influence of trade unions in the process of outsourcing and offshoring and how is this reflected in the structuring of the firms’ labour markets? (4.1.5)		Relationship with employees / Trade Unions (see 5.7)	Sometimes adversarial, often regarded as non co-operative, but there exceptions e.g. Gatwick ground staff. Regular meetings – tone set by different CEOs.	Cooperative, aversion to conflict. Resolution often rather quick leaving employees frustrated with the union rather than management.
What evidence is there and why, of a reversal in policy – re-shoring / reversed offshoring / outsourcing? (4.1.6)	Reverse offshore (Backshore)	Change of policy (5.8)	MRO work retained / returned in-house and within the UK. Work previously outsourced now back within IAG.	Not so far

5.10 Synopsis

Chapter 5 sets out the first case study comparing and contrasting the outsourcing and offshoring practices of two competing airlines Lufthansa and BA. Both airlines include passenger, cargo, maintenance, repair and overhaul (MRO). This section summarises the themes developed in the chapter.

First with regard to cost, while cost reduction is a target for both airlines there are some differences in approach that can be identified. The primary motivation has been cost in BA with a focus on either outsourcing support or the offshoring of back-office and secondary processes. There is evidence that over time, as trust develops, further increasingly higher added value work may also be moved. Early successes and substantive cost savings, often of 30 per cent plus, build confidence for the longer term. In Lufthansa, while cost is a significant factor, it has not in the past been given the same over-riding priority as with BA; there has been more concern instead with the central coordination of shared activities that can then be replicated around the world. In the case of maintenance, repair and overhaul work for Lufthansa in China, this seems more problematic when working as part of a joint venture partnership; however, the savings are again substantial at 50 per cent in China and less at 30 per cent for Central Europe. BA have recently outsourced a number of ground operations activities at Gatwick and have returned maintenance work in-house to Wales following specific productivity improvements. Lufthansa are now finding it hard to achieve planned cost savings without increased outsourcing. They have recently announced a very significant outsourcing initiative as part of the overall cost reduction and restructuring plan.

Second, with regard to ownership of the source of supply, BA demonstrated that there is a willingness to offshore and outsource, but a reluctance by Lufthansa to outsource (this is now showing signs of changing– see above) and a wish to retain ownership, but at a lower cost. Similarly, with control and coordination, BA outsource and move non-core work offshore from the UK and a significant role has been played by procurement and contract management in managing that business. In Germany, tight control is exerted from Lufthansa HQ with a distinct preference for captive offshoring.

Third, different attitudes to autonomy were displayed. BA show a high degree of relatively loose and flexible autonomy. Whereas with Lufthansa in Germany the autonomy offered captive offshore business, relaxes over time as trust is earned, although there is a preference to near-shore.

Four, similarly, there were differences in the use of ex-patriates. Following outsourcing moves by BA there was minimal involvement from the UK by BA staff. With Lufthansa, the initial set-up involved German ex patriates, and then local managers were recruited. In China with MRO there was an initial set up for Lufthansa with the overlap and duplication of Chinese and German management, with contract employees covering controller (financial reporting) roles.

Fifth, language and cultural affinity was regarded by Lufthansa as more important than was the case with BA in in the UK.

Sixth, there were differences in the relationship between management, employees and trade unions. In BA these had been adversarial, with management regarded as confrontational, however, in practice, more recent negotiations were consultative, and eased by attractive redundancy terms. In the case of Lufthansa, and in line with the German VoC characteristics, there is an aversion to conflict and a desire to work with the Works Council in Germany. To date Lufthansa have avoided major job losses at home as they have grown and remained profitable, however, there are signs that this is now changing. It is worth noting that changes every five years on average, of the CEO at both BA and Lufthansa have also resulted in different relationships between management and trade unions regarding outsourcing, shared service centres, and the priority given to cost cutting and manning levels.

Finally, turning to reshoring and changes in company policy, BA showed that they could be to be flexible with outsourced MRO work that was returned in-house once improved productivity was demonstrated. There was no substantive evidence of re-shoring in the German companies although poor quality or complexity were cited as reasons for work moving back to Germany.

Chapter 6 develops the second case study for the engineering sector.

CHAPTER 6

COMPARATIVE CASE STUDY 2:

ENGINEERING SECTOR

6.1 Context

For the second case study a similar approach is followed to that in Chapter 5 but by examining the Engineering sector it is necessary to focus on a more diverse and fragmented sector. Hence, in choosing two large MNCs, one UK and one German headquartered while they have many common features, they are not necessarily direct competitors. Also, both the case companies have diverse divisions and profit centres.

6.1.1 Sector dynamics

Engineering is typically associated with design, R&D and maintenance or refurbishment. Manufacturing implies the production or assembly of goods. Many businesses in this sector increasingly also offer a broad range of associated business services, e.g. after sales support, or sales engineering and so rarely manufacture on an exclusive basis. There is a system for standard industrial classification (SIC) which includes over 30 (mainly product) types. Large MNCs such as those studied here tend to have a number of divisions and a broad range of products that fall into different SIC categories. McKinsey (2012) argue that in such a diverse sector it is useful to have a broader classification system that varies in respect of where factories are built, where R&D is undertaken and where growth markets exist. Energy, labour costs, proximity to talent and suppliers all depend upon the industry segment and carry different weight. McKinsey (ibid) suggest that it is helpful in this context to consider five broad segments. See Table 6-1 below:

Table 6-1 Types of engineering and manufacturing (McKinsey)

Type	Label	Description
1	GLOBAL INNOVATION ***The German engineering case study with CompanyABC fits into this sector.***	Global innovation for local markets (including chemicals, motor vehicles, transport equipment and appliances) estimated at 34 per cent of global manufacturing value added.
2	REGIONAL PROCESSING ***The second engineering case study company with CompanyXYZ (part of UK-Engineering Plc.) fits into this sector.***	Regional processing (fabricated metal products, rubber and plastic products, food, drink and tobacco) are estimated at 28 per cent of global manufacturing value added.
3	Energy resource	Energy resource – intensive commodities (wood, refined petroleum, paper, basic metals) estimated at 22 per cent of global manufacturing value added.
4	Global technologies	Global technologies/ innovators (computers, office machinery, semiconductors, and optics) estimated at 9 per cent of global manufacturing value added.
5	Labour intensive	Labour intensive trades (textiles, leather, furniture, jewellery, toys etc.) estimated at 7 per cent of global manufacturing value added.

However, the distinction between manufacturing and services has also blurred over time where manufacturing companies increase activities such as R&D, marketing, sales and customer support. Telecom and travel services connect workers in global production networks, logistics providers, banks and IT services all play an increasing role. By including outsourced services, McKinsey (ibid) report that service jobs in manufacturing employment now exceed ‘pure’ production jobs.

Among the five largest EU Member States, Germany stands out as its manufacturing sector contributed more than one quarter (28.7 per cent) of the EU-27's value added in 2010, well above its 21.9 per cent share of value added in the EU-27's non-financial business economy as a whole. In value added terms, Germany was the largest EU Member State in 18 of the 24 manufacturing subsectors in 2010; the United Kingdom was the largest for the manufacture of beverages and for the manufacture of tobacco products. (Data from April 2013 http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Manufacturing_statistics_-_NACE_Rev._2#Country_analysis).

Engineering then is typically synonymous with the development of processes and products. As such economic measures, for example the import and export of material, equipment, information, talent and the balance of payments are subject to laws, regulation and government policy; and all have a major impact on engineering and manufacturing (Nathan, 2013). The UK government(s) has traditionally interfered as little as possible, this approach coupled with the lack of a coherent industrial policy perhaps contributed to a decline in UK manufacturing, and a disproportionate level of corresponding reliance upon services. This in turn helped to over-expose the UK economy to the United States led global financial crisis of 2008. One of the (then) government responses in 2010 was to establish a Technology Strategy Board and so called 'Catapult Centres' to accelerate development in strategically selected areas of technology – biotechnology, automotive etc., and thus refocus the UK on high-value-added engineering to offset high labour costs when compared with emerging economies (Nathan, ibid). £200 million was then invested by the government in UK manufacturing. A specialist UK merchant bank, Turquoise International, provides second stage funding to move a technology or product out of the laboratory and into an industrial development phase. Prof Geoff Callow is managing director of engineering consultancy at Turquoise and he has suggested (Nathan, ibid):

.....the automotive companies while keen to acquire new technologies struggle to integrate the concept into their structures. More R&D orientated industry such as pharmaceutical are better prepared. Large scale production can take 25 years yet investors look for a return in only five or seven years' (ibid).

Tom Lawton, manufacturing partner at accountant BDO[22], suggests that Germany has been the inspiration for a revised UK industrial policy. The aforementioned Catapult Centres are a direct copy of the Fraunhofer Institutes. Germany has specialised in value-added sectors such as chemicals, automotive and aerospace, and most significantly has a level of continuity that outlives the term of a single government. With a long serving coalition, whoever is in power understands that the underlying structure will remain as it is fundamental to the German economy (Nathan, ibid). This is perhaps best demonstrated by the mid-sized Mittelstand enterprises, known as the 'sweet spot' of corporate Germany accounting for 30 per cent plus share of total German exports (Venohr, 2008).

Also in Germany the system of local banks makes it easier for smaller companies to gain access to funding. A BDO survey of funding establishments found that German owners of local businesses regarding themselves as also having a responsibility for the local community. Yes profitable growth was a priority, but a target that is also blended with accountability for local job creation.

Engineering and manufacturing businesses have been at the forefront of restructuring involving outsourcing and offshoring practices. Recent research by KPMG has revealed that in 2012 some 70 per cent of decision makers suggested that the reason for outsourcing was still lower cost, but down from 83 per cent in 2010; claims Karl Findus at Computer Weekly (Financial Times, 2012b). This survey further revealed that access to skills (51 per cent), improved quality (48

[22] BDO is the fifth largest accountancy network in the world. The corporate name changed from BDO Stoy Hayward in 2009.

per cent) and business transformation (21 per cent) had all increased in 2012 compared with the previous survey of 2010. Prof Ilan Oshri at Loughborough University suggests that the shift in outsourcing from functions to processes and critical shared services will often make it harder to reverse the original outsourcing decision. However, he acknowledges that GM in the automotive sector is one such example of determined re-shoring. At GM 90 per cent of IT is carried out by third parties (they started early with acquiring IT services firm EDS from Ross Perot, back in 1984 only to later 'spin it off' as an independent company while remaining a customer). Today at GM they are recruiting IT specialists to reduce the proportion of outsourcing from ninety to ten per cent. By offloading multiple outsourcing contracts GM believe that they can be more efficient and innovative (ibid).

Challenges then remain though for MNCs, for triad economies and the regions that host engineering development and manufacturing. Lynn and Salzman (2009) further suggest that scholars need to adapt old theories and develop new ideas on core competences, the stickiness of technology on a geographical basis and the use of strategic alliances.

It is intended that the following two cases studies will provide insights in this regard.

6.1.2 Background to case study companies: CompanyABC and XYZ

CompanyABC GmbH Group is headquartered in Germany and is a leading global supplier of technology and services. The organisation recorded a significant anniversary in 2011 having traded for well over 100 years. 92 per cent of the share capital is held by a foundation and the majority of voting rights by a charitable industrial trust. The remaining shares continue to be controlled by the family. There is a Board of Management and a Supervisory Council as is traditional for large corporations in Germany (Annual Report).The business comprises more than 350 subsidiaries and regional companies in over sixty countries. CompanyABC GmbH develops innovative engineering solutions through a broad range of products and services. They operate in business sectors that include automotive, industrial, consumer goods and building technology. Sales for the year 2014 were Euro 48 billion. Employees (called associates) total 281,381 (as of December 31, 2013) persons and some 60 per cent are based outside Germany (Annual Report).

CompanyXYZ Ltd is a wholly owned subsidiary division of UK-Engineering Plc. a large UK diversified publically quoted engineering group. The group employs 23,000 people in fifty countries with global customers including governments, petrochemical industries, hospitals, telecommunications and manufacturers. The group is structured along divisional lines each operating in competitive markets, with strong technology positions in growth sectors. 2014 group sales were £2.95 billion with operating profit of £504 million (18 per cent) (Annual Report). CompanyXYZ Ltd supply products and services to process industries including petrochemical, oil, gas, power generation, pharmaceutical, pulp & paper and mining. CompanyXYZ is the market leader in their field and achieved 2014 sales of £941 million with a 25 per cent profit margin. CompanyXYZ has 6850 employees and contributes in excess of 30 per cent of group sales and 43 per cent of operating profit (Annual Report).

6.2 Motivation

6.2.1 Outsourcing and offshoring

The issue of motivation, or focus, cannot at least in this instance, be separated from the decision on location (4.1.1). The focus for CompanyABC GmbH has been twofold, commented a senior engineering executive based in Stuttgart. Firstly, in 1996 a captive specialist business was established offshore (in India) for developing embedded software which is now a key factor in technology for automotive components. A senior executive commented (Interview, Stuttgart October 2011):

> *….. When we talk about embedded software then I know the competitors are following in the same way. They are also located in India, and also have their offshore centres in terms of business accounting. For non-product related offshore services this is decided by headquarters, for the product related ones this is more often decided by the CompanyABC division who also have autonomy to decide on scale.*

Secondly, the interviewee added that between 2001 and 2006 a range of significant but ‘supporting rather than core’ activities such as accounting processes, IT services and call centres were also moved offshore.

There are very few instances of ‘true’ outsourcing in Company ABC one being internal travel services. Previously this was a department (of approx. 20 persons) now the work is handled on a SAP system via a Travel Agency covering all staff travel. A second instance is call centres for IT support that were outsourced and moved offshore to Slovakia, Romania and Thailand. The central support department responsible is in Bangalore, India. Catering is kept in-house with kitchens at all larger sites (more than 2000 employees). Pre-cooked and delivered to smaller locations within a 20km distance. If the site is more remote then catering is outsourced.

Business Services (accounting, invoicing etc.) are handled in India alongside the embedded software business (largely set up as a replica of Infosys). Another senior executive in CompanyABC is currently investigating a change in policy which would result in more platform responsibility with added-value design work etc.

The CompanyABC approach is cost driven (a senior engineering executive in Stuttgart) but will vary by operating division. Where appropriate there is detailed institutional involvement with local authorities, and federal or state governments on tax and other fiscal arrangements. The embedded software business now supports some 10,000 employees in a wholly owned subsidiary. Another key factor is that the work undertaken from India is progressively becoming more innovative with further added value as more design and R&D responsibility is released from headquarters in Germany. They have close collaboration with universities in India for specialist recruitment needs. Also, the Indian operation has introduced in-house training in cultural sensitivity to improve communication and influence with group and divisional headquarters; and now find that they can compete with organisations such as Infosys and other major IT providers for the best associates. Recruitment is very difficult, and remains highly competitive. The senior executive, now back in Stuttgart, who for the past five years has been responsible as the country manager for India, now has responsibility for coordinating global manufacturing stressed a further two points:

> *… that we have now reached a certain number of employees in India that we would not like to go beyond, I think it is 10,000 people; we want to mitigate our risk and also have other locations available for cost protection.*

Secondly, the senior executive then added:

> *Diesel systems, power tools and embedded software, are located in one road in two buildings with a separate legal entity, different management, a different reporting structure, and they have a different DNA. In the one you will smell fuel and you will see machines; and in the other, there are clean rooms, meeting rooms and different facilities.*

Jobs in Germany have been largely unaffected as the moves overseas have coincided with global growth in demand and market expansion. Customers are also demanding lower costs and request local supply which is now a business to business requirement. Hence offshoring initiatives for CompanyABC have evolved globally. The same executive added:

> *…..the global customer clearly understands, and is actually asking and pushing us for cost reduction and localisation of supply within their region.*

> *……..the fixed cost was the same and the growth for own product was driven over the past years mainly by China and India (not Europe). We always refer to a particular original equipment manufacturer (OEM) platform. There is one department and they have a complete overview while still located in Germany. Then the work which was*

> *lower in competency terms was executed offshore. Slowly, it changes and we are just in the process where the direction of this work, especially software for new projects is also transferred to the region.*

In discussions with the senior executive responsible for the Indian 'embedded software' operation, it became clear that more of the product range of software for automotive components is now highly customised, again supporting the trend towards greater innovation. OEM's demand different platforms helping to fuel demand. Growth has been especially rapid in years 2008 to 2011 with sales reaching $10M and a 20 per cent market share for the parent business. This operation has also allowed the parent to retain work within the CompanyABC group that it was reluctant to outsource to third parties. A considerable number of patents are held, and product development grows as the business becomes more aware of the market in India and deliberately positions itself further up the value chain. All of the jobs created are additional, none replacing work in Germany; and the business is now expanding into Vietnam. This centre provides further access into Asia, some contingency against risk in India and an additional 100 jobs. The plan is to keep the Vietnam operation comparatively small. The Indian executive explained (Interview, President & Managing Director of the business unit in India, December 2012):

> *The idea is to do the whole thing that we do now in Bangalore in Vietnam but on a very small scale (100 persons). Vietnam will not be able to give us as many prospective associates as in Bangalore or in India, just from the sheer number point of view, we are looking at Vietnam from two dimensions, one is de-risking India where we need to have a ten per cent capacity by maybe 2020 and the other dimension is basically to look at serving local or near markets, Japan, China and so on.*

CompanyABC also undertake more traditional R&D, engineering and manufacture of automotive platforms in the Czech Republic. The Budweis (Budejovice) plant (150 km from Prague) has a production area of 52000 square metres, a turnover of 400 million euro and function as the lead plant in CompanyABC for a number of products with 2500 associates. They have their own development, engineering and testing centre with 356 associates. Customers include GM, Volvo, Daimler, Fiat, Suzuki, Honda, BMW, VW-Audi, PSA.

Automotive products include fuel pumps, pressure regulators, fuel rails / return lines, cylinder head covers, wire harnesses. A new production hall is under construction to more than double capacity. Development partners within CompanyABC worldwide include sites in the US, Mexico, Brazil, Russia, India, Korea, Japan, China, Australia and of course Germany. R&D activities include fuel supply, air management, fuel injection, sensors and ignition. The Test centre has 97 employees has a capital budget of 13m Euro per year and test capabilities for structural / dynamic work, climate, noise, endurance, corrosion and simulation testing. The Engineering Director, a German who at the time was based in Budweis, commented that the cost advantage comparing Czech Republic with Germany is:

> *The Czech Republic is about one third the cost of in Germany. But Romania is something like one tenth. As you can imagine Europe is a saturated market and if you look where the growth will be in the next years it is a question of does it make sense to transfer all stuff or parts continually to the East. Money is not everything and we recognise that CompanyABC is a very technically driven company, that it is also very important to have the technical skills and experience as I said. And my understanding is that it takes something like 10 years to build up the expertise.*

With regard to the approach to offshoring, outsourcing and supplier partnerships, there are some limited examples, but the main approach is keep work within the CompanyABC group and gain cost advantage via cheaper, but in-house sources where possible. The Engineering Director added:

> *Yes. We are stretched in our organisation to avoid the "not invented here" syndrome and as you can imagine the CompanyABC engineers are very proud that they understand their products and think that their solutions are the best ones of course. Honestly speaking, we know that other companies have specific know-how and we try to use them. For example we have a co-operation here with an external engineering office, a provider who does specific designs and calculations of a component for our product because we think they can do it better than we. So this is also on-going but at the end we have the responsibilities that we have to understand it as well.*

Let us now draw comparisons with the UK, as this organisation follows a rather different path. The initial focus for CompanyXYZ Ltd, also around the same time in 1996 was to outsource non-core activities: including security, canteen and maintenance activities to third parties. This was followed with more ambitious offshoring projects of seals, filters, pumps to India, China and to the Czech Republic. Associated direct and overhead cost reduction was achieved with a number of UK factory closures and restructuring of operations in the UK. The combination of these moves, and further help from Bain consultants improved Return on Sales (ROS) from 15 to nearly 20 per cent over a 1-2 year period. The parent group (UK-Engineering) target for CompanyXYZ is 18 per cent.

CompanyXYZ had three UK factories in Reading and decided to close all three sites. This was to achieve a mix between outsourcing, domestically in the UK, with the transfer of work to another CompanyXYZ site in Slough and a small amount of offshore-outsourcing of assembly operations into the Czech Republic. To then outsource a high volume of products and to do so quickly, CompanyXYZ used a third party (name undisclosed). CompanyXYZ also had what was then a JV in the Czech Republic. The outsourced work was gradually transferred from the third party to the JV partner company which has subsequently become a 100 per cent subsidiary now CompanyXYZ in Lutín, Czech Republic. If the order or customer lead time is sufficiently long then CompanyXYZ prefer to use China. That choice is reinforced if it is a product that is suitable to hold in stock. If the product has a short lead time or is heavy, or bulky and less suitable to keep in stock then that would cause CompanyXYZ to rethink its policy and look at near-shoring to the Czech Republic; however, the VP Operations does not think CompanyXYZ are at that stage yet.

We can see how the initiative has evolved (interviews in the UK with VP Operations EMEA and also the UK Operations Director, December, 2011).

> *CompanyXYZ owned a Chinese factory in Xiang Jin, south of Beijing; which was relatively small in the mid -1990s when CompanyXYZ moved a selected product range there for local manufacture. Although this product is still produced in China it is has subsequently been outsourced to a local Chinese supplier. Quite a lot of the machining has relatively high labour content compared to the material cost. The move to near Beijing was really about keeping the final sales price as low as possible through direct cost reduction. Another local Chinese company was then discovered to be copying a high technology version of CompanyXYZ's product range; they had reverse engineered the design and technology to create their 'own' product. In response, CompanyXYZ*

> *bought the competitor, acquired a new building and then put both companies onto the one site. The early days were quite difficult because of working with and trying to understand a very different culture; but bringing them together into the new building and moving people around is now considered by CompanyXYZ management to be a success story in terms of both operational and financial performance.*

Hence, to summarise the motivation to outsource or offshore, CompanyXYZ was under pressure from the group head office to achieve higher return on sales and hence shareholder returns. The German case CompanyABC again supports the need to achieve lower cost but there are more indications that a long(er) term view is taken from the outset, control via the German divisional headquarters virtually eliminates the option of outsourcing in favour of wholly owned (captive) subsidiaries that are geographically offshore. Labour is then specifically recruited and it would often seem to be on different terms and conditions. Further cost ‘reduction’ is then achieved by offsetting labour rate increases by recruiting younger, cheaper employees who then need extensive training. This of course might have other implications for example, on quality or lead times.

The CompanyABC foundation supports a wide range of social projects including exchange programmes for young European government administrators, school and other educational awards and programmes; and meetings between German and Russian entrepreneurs. The remaining shares (eight per cent) are controlled by the CompanyABC family.

At CompanyXYZ Ltd care is taken with the choice of organisation and location for relative ease of working and cultural fit – especially for offshore activity. Current preference is to work in Eastern Europe (Czech Republic) where the cultural challenges are considered to be rather less demanding than in India. The VP Operations commented:

> *It is obviously different if you take something out of Germany and move it to the Czech Republic than it is moving work from the UK; so understanding the cultural differences and how you need to operate with different approaches is key. We would broadly follow the same pattern, but in terms of the ‘touch’ that we would use and the politics that we would play and all those type of things would be very different and I think we have learned a lot from that.*

With CompanyABC in the Czech Republic cost reduction, is the first motivation, typically 30 per cent compared with Germany. The delegation of a global 'lead' role from Germany to Czech Republic for design, engineering and manufacturing work is an incentive for plant management and the workforce. Expansion of the site with a new plant under construction to increase capacity is part of the continued pattern of investment and growth.

So CompanyABC has taken advantage of an offshore location to gain labour cost advantages and gradually to build up local specialist knowledge and expertise with embedded software. This has coincided with an industry trend reflecting the growing importance of electronic control systems as opposed to engineering components in automotive control systems. There is today an established CompanyABC business embedded in India, demonstrating a model that is so successful that it can evolve as further 'satellite operations' are being developed in Vietnam to serve growing markets in China and South East Asia. CompanyABC has not outsourced but retained control. Neither has there been a negative impact on jobs in Germany. In many respects the risks have been minimal in this case.

6.3 Ownership, control and coordination

It is interesting to note that for CompanyABC India there is little networking and collaboration with other suppliers in India, most of the communication is directly between the OEM's and the parent company in Germany (4.1.2). In close proximity there are 'software development parks' with competitors. Tax breaks that were initially negotiated ceased in 2010. Furthermore, the Indian government announced reforms to reduce taxation disputes (Financial Times, 2013c) that have caused problems for MNCs with outsourced / offshore operations. The regulations relate to the amount of tax an international business should pay when offering services via an Indian subsidiary (transfer pricing). Problems e.g. litigation by Nokia, Royal Dutch Shell and

Vodafone compound an image of India as an unwelcoming and troublesome investment destination. The regulations will also apply to 'captive service centres' in India e.g. substantial back off / IT operations.

The ownership and transformation of CompanyABC in Czech Republic has changed slowly over a number of years of progressive investment, development of plant, machinery and human resources. A major expansion of manufacturing capacity is currently underway. The Engineering director explained:

> *CompanyABC Budejovice has existed for some 25 years. When we started with production here and a small engineering unit I joined the division and worked in Germany. It was then decided to transfer engineering work from Germany to Budejovice for the development of this new platform. This was in something like 2004. After the platform was launched into the market in 2008 the lead development stayed here in Budejovice. This is one product, it is a complex product. Other activities were then transferred and this means that the training programme of the engineers in Germany is half a year or sometimes for a year; then transfer the task to here with support out of Germany, for example with German experts or expats here and after 2 or 3 years the Germans go back to Germany, the expats, and the Czech guys here are then fully responsible.*

The next stage for CompanyXYZ was to concentrate on higher added-value work. Work initially offshored to China is today already outsourced within China (as outlined above). A detailed global operations strategy was developed several years ago and today progress is being made with integrating IT systems and implementing a common SAP platform across newly acquired businesses. In terms of organisation, CompanyXYZ has moved (explained VP Operations EMEA):

> *…… to a global setup. So we have a CompanyXYZ Ltd President because firstly that makes more sense on efficiencies and secondly because that's what our customers expect.*

Improving customer service and on-time delivery are amongst current short term business priorities at CompanyXYZ.

According to the two interviewees, VP Operations EMEA and the UK Operations Director:

…. the process of offshoring / outsourcing has now evolved further up the value chain e.g. from low skill to special skills. Another example of offshoring projects from the UK to the Czech Republic was with gas turbo machinery (the manufacture of which has a very tight design tolerance, is non-repeating and requires considerable planning and scheduling).

In the past, CompanyXYZ had considered this too difficult to outsource or offshore. CompanyXYZ started to move the product offshore in 2005 and finally achieved a successful transfer of the high end products in 2008. The quality and performance is now considered comparable with similar ranges still produced in the UK. Transfer costs and pricing data are scrutinised with regular reviews of actual versus target data. Minor concessions on employment conditions have been made to trade unions at CompanyXYZ when discussing the transfer of operations and job losses to date are relatively modest with a reduction in employees of 250 employees. CompanyXYZ is often faced with comments from the sales force and from some customers concerning the origin of production location. The VP Operations for EMEA paraphrased:

"I don't want product coming out of India". This concern is based on past experience of radioactive material used for lift buttons, or compressors manufactured from the wrong type of material which was sourced in India. There is nervousness from a quality control point of view. Similarly, in the Asia Pacific region Japan does not want China sourcing their product. However, to my knowledge, we have had nothing from shareholders saying "you shouldn't be working in this country or that".

Political, local state policies and fiscal 'breaks' or concessions, all play an important part – although the latter is typically found to be time limited. Comparative costs are all significant with savings of 30, 35 and 40 per cent respectively in each of Czech Republic, India and China. The specific saving at CompanyXYZ is subject to product design. In the Middle East there are detailed constraints with the use of expatriates and localisation policies. Russia and Latin America has offered tax breaks on joint venture arrangements with local organisations.

Regarding training and partnerships with educational institutions, apprenticeships and training schemes have now been established in the UK by CompanyXYZ; although it still remains a challenge to recruit good people even in a recession and at a time of high unemployment. The facility in the Czech Republic is adjacent to a technical college. This site has grown quickly and led to the recruitment of a number of apprentices.

In China some senior CompanyXYZ engineers work in collaboration with Tsinghua University, however, there is considerable concern over the protection of intellectual property. Given the importance of supporting the after sales market for CompanyXYZ (two thirds of CompanyXYZ sales – see section 5.1.2) there is a real risk of misappropriation and finding that they are essentially competing with their own product.

CompanyXYZ Ltd is a wholly owned subsidiary of a large British engineering plc. The group board sees its role as one of approving process rather than initiating or defining it. This has similarities with the 'Financial Control' style of corporate strategy (Goold, 1994), often part of the liberal market economy style of capitalism. Having improved financial performance and the key parent measure of ROS, current business performance is focused on service delivery and customer order fulfilment metrics. This is consistent with the current thinking by McKinsey consultants and others, that a large companies' core operations have typically become so complex to manage in a rapidly changing business environment; that cost efficiency is no longer sufficient. Increasing flexibility, agility and customer satisfaction capability are also necessary. Hence outsourcing and offshoring become more transformational not just a route to cost savings (Lagutaine and Daub, 2012).

Control comes across as an essential requirement in the case of the German company, this is at two levels. Firstly avoiding any risks of third party involvement through suppliers or outsourcing contracts, secondly through group or divisional headquarters in Germany retaining contact with OEMs and by managing the channel for work to be exported from India, rather than any product sales within India. This is somewhat consistent with the German corporatist / coordinated market economy model. For the UK case study, CompanyXYZ there is an impression of a much 'looser' style of control, which is largely coordinated within the relevant operating division.

6.4 Influence and autonomy

While Headquarters for CompanyABC in Stuttgart have delegated 'lead' responsibility for supply through the global production network of automotive platforms to plants in Asia, Europe and North America (special customised specifications are supplied top Brazil); budget control, strategy approval and product monitoring remain in Germany. The Engineering Director confirmed that significant capital expenditure plans are referred to Headquarters:

> *No, we have to go through Germany, because once a year we have a planning process where we have to go through budgets for machines and so on for the next year and this is signed-off and then we can follow this plan, as long as we meet the targets and as long as there are no additional cuts. When we want to apply for additional things or if we have deviations from the plan we have to (re)apply to Germany.*

In contrast the approach by CompanyXYZ has varied but is typified by a joint venture or partnership / alliance with a carefully selected organisation. If successful progress is achieved then the business is acquired and an integration process commences with further cost saving and continuous improvement benefits envisaged. Another such international site is in Bangalore, India. External consulting help has been of benefit, with Bain, KPMG, ATOS all playing a part. An MBA student project also made a contribution to company planning and scheduling of operations.

Partnerships at CompanyXYZ are grown over time by carefully selecting key suppliers only once trust has been established for the subsequent outsourcing and offshoring. These companies may then be acquired and integrated if proven successful over time. The only reference to group headquarters is for approval of acquisitions and the monitoring of financial performance against target. Again this is a classical 'Financial Control' style of corporate parenting (Goold, op cit.) and one that is consistent with liberal market economy variety of capitalism. M&A plans and major decisions on offshoring are approved by the main group board.

Hence, regarding the influence of ownership some further clarification is required on employment levels; but initial indications are that overall employee numbers have continued to increase over time in both the UK and German case studies largely through volume growth but also with consequent productivity and efficiency gains. This goes someway to avoiding conflict with Trade unions. At CompanyABC GmbH employees (called associates) total some 275,000 persons. CompanyXYZ Ltd Group employs 23,000 people in 50 countries.

6.5 Managerial and other divisions of labour

The VP Global Operations in Germany at the German based Company ABC was asked whether the policy was to transfer experienced staff from Germany to the operation in India (4.1.3):

> *No, basically what they do is recruit, they have a 'campus style' recruitment programme, where they recruit large batches, sometimes of people, who then receive special training programmes where they get up to speed in a very short time frame. There are some expats but very few. Amongst the 10,000 people in total in India there are not more than 5 expats.*

The Indian based then MD added:

> *If you look at 5 years back we were maybe 5,000 people, now we are 10,000 people, so we have just doubled in the last 5 years. In the last 2 years we have added more*

than 3,000 people actually – there was a downturn in that 5 years in 2008 and 2009. If you leave the downturn aside, this year alone we have added 3,000 people.

………the people at my office are really very young, the average age is 27 years something, and in Germany it is 43 years. So the average age is low, experience and industry knowledge are also low.

It later arose that given the increased labour costs in India, headcount targets could be met with recruits at a lower grade (and hence cost0 who would then be given further training over time. He added:

….. typically with attrition you cannot replace the person with the same years of experience. Most likely you will not find someone because we are very unique in the automotive world. So we end up taking someone who is junior, much more junior than what we lost and the salary is lower, so attrition helps to reduce the cost.

The Engineering manager for the German CompanyABC suggested that (4.1.3):

The site at Budejovice has existed for some 25 years. When we started production, a small engineering unit was established and has grown steadily since. It was decided to transfer engineering work from Germany to Budejovice for the development of a new platform. This was in something like 2004. After the platform was launched into the market in 2008 the lead development stayed here in Budejovice. This is one product, it is a complex product. Other activities were then transferred and this means that the training programme of the engineers in Germany is half a year or for a year; then transfer the task to here with support out of Germany, for example with German experts or expats here and after 2 or 3 years the Germans go back to Germany, the expats, and the Czech guys here are then fully responsible.

In the Czech Republic at CompanyABC workforce planning for the recruitment and training of local engineers may require 2 years, involving German engineers and ex-pats. Routine capital expenditure budgeting and monitoring is agreed with Headquarters in Stuttgart.

The UK CompanyXYZ also established European operations in the Czech Republic, some seven years ago with the main operational plants now reporting into the VP Operations EMEA:

….the latest transfers we have done have been very much more successful we sent machinists over there to train and it has been a pretty good process.

We recognised that it was a two way thing as we have learned culturally that if you

> *send production to the Czech Republic it is very different to sending the same work to India or to China. So understanding the cultural differences and how you operate with different approaches is key. Although we would broadly follow a similar pattern; the style or touch that we would use and the politics that we confront are rather different. I think we have learned a lot from that.*

The above experience brings us to the next question on cultural proximity.

6.6 Cultural Proximity

There is a substantial portfolio of cultural awareness, sensitivity and language programmes available for all associates at CompanyABC in India (4.1.4). The workforce is relatively young (average age of 27), and the average profile is getting younger. This is deliberate, because as the company is expanding they are partially offsetting the cost of higher wage rates in India by recruiting younger and less experienced entrants who start at a lower (or the same) rate. At current rates it is estimated that that the comparative costs are some 30 per cent lower than in Germany, and this includes additional management, coordination and travel costs etc., from the parent and group staffs. There is a very sophisticated system in place for monitoring and reporting these costs. The executive further suggested that:

> *We have a German based estimation of the tasks, and then we know how much was actually incurred in India. Initially it was only a gut feel but now we have accurate ways of calculating comparative cost efficiency. So when we add all of this back onto what we call the total cost of offshoring our aim is 30 per cent of the German cost. The good news is that we have reached 34 per cent and that is a phenomenally attractive proposition. This is done transparently with the German department heads. They are aware that it becomes extremely lucrative to regard India from a total cost of offshoring point of view.*

Similarly, in Central Europe the German executive in Prague for CompanyABC commented:

> *……for example with me as a German in the Czech Republic, I received cultural training and then distributed and shared the cultural profiles to the Czech guys so that they had a better understanding of how the Germans are working and what our philosophy is so that one can better understand each other.*

Now there are more formal systems in place, he added:

There is a standard programme for the guys being sent from Germany…….a couple of training programmes, and cultural information material available on our CompanyABC internet to all. We now have Mexican and North American, Brazilian, French, German, English and Polish employees, a lot of different cultures.

CompanyABC also train local Czech engineers in how to communicate with German colleagues:

I mentor a couple of Czech guys abroad and talk to them about the cultural material and have regular telecoms with them. For me it is essential in this global company that everybody is aware of what others could think and what they say.

In the UK, CompanyXYZ experience was that in India there was a propensity to say “yes” to a request even when not fully understood, which was only appreciated when it was apparent that nothing had started. Whereas in China there was almost the opposite. The VP Operations explained:

We are finding it probably easier with the Chinese, because we are getting action, whereas in India it was taking an awful long time to actually get things moving and changed but we have to be careful; we put mechanisms in place now to just check that they are doing as we thought they were going to do.

6.7 Trade Unions

Company ABC have had to involve the works council in its restructuring, but the offshoring and outsourcing never led to any substantial layoffs (4.1.5). A senior engineering executive in Stuttgart commented:

It led to restructuring but it never to layoffs. In general I would say whenever issues are considered, they are discussed with the Works Council and at least informed.

The implication of restructuring, is that the employees who did the embedded software design and development before in Germany were given other work to do of a different type. The engineering executive added:

CompanyABC managed the growth so that the existing workforce and the fixed cost was stable and the growth driven over the last years mainly by China, India, and emerging markets was supplied from India.

In the first phase the control of all this was through a common platform design still located in Germany. It changes slowly now, as new projects are also transferred to India. The innovation is controlled by Germany.

In the Czech Republic Company ABC-have a different system to in Germany. The Engineering Manager commented:

The commercial head of the plant deals with the union; we have a local union and they do the negotiations with the plant and when compared to Germany quite easy with good co-operation, it is a growing market and so it is easier than a market that is more difficult, labour and so on. We have not had any problems with having to reduce the workforce or transferring jobs to cheaper countries and so on. I don't know, if Ukraine or Romania have problems then it could be that they negotiate and fight for the rights of the employees but in the Czech Republic actually it seems as if it is easy to find jobs.

In the UK with CompanyXYZ, each stage of work to be transferred was discussed with the trade unions, Some adjustments were subsequently agreed and made to programmes plans – typically a modest reduction in the planned job losses, but that hasn't resulted in CompanyXYZ fundamentally changing the capital investment case. Across Europe there has been 'some interesting discussions' with the Works Councils'. Furthermore, in the UK there is a sense of working with the Trade Unions as and when required and trying to avoid substantial conflicts and job losses. With the German case, the Works Council are consulted as and when required but strategies may be devised to coincide with volume growth at home and new market entry. This offsets what are recognised as very difficult conversations around job losses at home and work being transferred elsewhere.

At CompanyABC GmbH there is now encouragement to nearshore some of the work to Eastern Europe so that it is both closer to Germany, and more services can be offered locally within Europe. However, it is left to the business sectors to decide what is appropriate for their market and to manage the costs associated with supply chains. In the Czech Republic CompanyABC work with local government on flexibility of working hours and conditions. They also seek to influence a local university to recruit faculty and run relevant engineering degree courses to support local skills and recruitment policy. There are weak trade unions in comparison with Germany. The Engineering manager commented that there was 'A compliant workforce in return for the promise of steady growth and expansion'.

6.8 Re-shoring – a change in policy

While work has so far not been re-shored by CompanyABC to Germany from the Czech Republic, examples were alluded to of over complex assignments referred to India and then returning to Germany (4.1.6). The Engineering Director suggested that:

> *Indian colleagues are quite good at routine work and if you describe the work very, very precisely and if you then follow up tightly, that is the strength of India. You can then gain the cost benefit. The idea was that a couple of my colleague's departments send their simulation stuff or design stuff but if you don't know the product, or if you don't know failure modes, the bond conditions in the vehicle and so on; you can make a number of mistakes and then you have to re-work it in Germany. So I know of a couple of examples of work that was transferred from India back to Germany. But as I said routine work, work packages that you can describe very precisely you could do in India or in other locations in the world.*

The VP Operations at CompanyXYZ could not identify examples of work to date that have been outsourced to the Czech Republic and then the policy reversed back into the UK. However, there has been an example of re-shoring where work was returned to Chicago from Mexico. Again the VP Operations:

Yes, the Americas did reverse a decision. This was in 2006 they had an exercise of shifting work into San Fernando. They tried to move too much product to Mexico and then brought a big chunk of it back again to Chicago. They virtually closed one of their factories and then had to open it all back up again.

Table 6-2 below takes key findings from the case study above also the detailed interview narratives in Appendix A3.1 and A3.2 and uses the format developed in Table 3-3 (Conceptual Framework) to 'test' the initial hypotheses. The implications are further discussed in Chapter 7 Findings.

6.9 Engineering Case Summary

Table 6-2 CompanyXYZ and CompanyABC compared

(see also Appendices A3.1 & A3.2)

Question **(see 4.1)**	**Approach**	**Dimensions**	**Liberal Market Economy (LME) CompanyXYZ**	**Coordinated Market Economy (CME) CompanyABC**
What are the differences in the geographical, functional and temporal patterns of outsourcing and offshoring? (4.1.1)	Outsource	Motivation (see 6.2)	UK, Czech republic, China outsource and offshore manufacturing destinations. Less keen on India. Acquire and integrate business when appropriate. Catering, administrative and revenue accounting, engineering, maintenance, repair and overhaul outsourced locally. Cost	Offshore India, Vietnam, Czech Republic – 'lead' global roles in Asia, Europe and North / South America. Embedded software applications, IT systems, accounting, call centres. In Czech Republic – the development of new automotive platforms; R&D, Engineering and Manufacturing. Local expertise and cost.
How far do mechanisms such as ownership, control, coordination and the degree of autonomy differ?		Ownership (see 6.3)	Offshore through Joint Venture then wholly owned acquisition. Financial control via HQ, but freedom to run business locally.	Now wholly owned, offshore subsidiaries, budget control and OEM contact through HQ.

(4.1.2)		Control & Coordination (see 6.3)	Global operations via HQ And regional (EMEA) control	HQ with OEM, divisional control and global coordination from HQ
		Degree of autonomy (see 6.4)	Relatively high – unless a problem e.g. loss of IP	Relatively high in terms of design and delivery. Close budget and resource planning and monitoring from HQ.
How is this reflected in divergent international divisions of labour regarding the employment of indigenous or ex-pat managers? (4.1.3)	Offshore or Outsourced offshore or Reverse offshore (Backshore)	Managerial Division of labour (see 6.5)	Kept to a minimum. Initial training on site in Czech Rep.	Ex-pat initially as senior manager. Replaced with local after 5 years, maybe 5 ex pats out of 10,000 local employees. In Czech Republic initial training of engineers in Germany then on-site over 2 years. Ex pats may stay.
To what extent do preferences for cultural proximity affect location? (4.1.4)		Cultural Proximity (see 6.6)	Significant preferences through experience. Try it, see what happens and learn. Manage each location differently.	Less important – although with the Czech Republic there are advantages of proximity, similar markets, some ease of language and cultural affinity.
What is the influence of trade unions in the process of outsourcing and offshoring and how is this reflected in the structuring of the firms' labour markets? (4.1.5)		Relationship with employees / Trade Unions (see 6.7)	Redundancies where required	Avoid conflict, timed to coincide with growth to avoid job losses in Germany. Few issues in Czech republic – weak union but also free labour market and plant growth offering security.

What evidence is there, and why, of a reversal in policy – re-shoring / reversed offshoring / outsourcing? (4.1.6)		Change of policy (see 6.8)	Mexico back to the US	Stories of complex work being returned from India to Germany for rework.

6.10 Synopsis

Chapter 6 sets out the second case study, comparing and contrasting the outsourcing and offshoring practices of two engineering companies ABC (Germany) and (XYZ) in the UK. The two companies are not direct competitors, but do share similar work processes, technologies, employee skill requirements and capital investment requirements.

First, with regard to cost, the initial motivation for local outsourcing of non-core activity was cost reduction for Company XYZ; and to offshore to China and India. return on sales improved from 15 to 20 per cent, meeting the UK group target. In the case of the German company ABC they moved offshore, but retained ownership (captive) in a range of key international markets. However, the long term development of embedded software products (in India) and new platform development (in Czech Republic) were moves driven by local expertise as well as cost.

Second, in relation to ownership, Company XYZ were flexible with an initial willingness to both offshore and outsource, taking defensive action and retaining control following a loss of intellectual property in China. There was a reluctance to outsource by the German Company ABC, preferring captive offshoring with customer contact (with OEM) directed through HQ in Stuttgart.

Third, attitudes to and strategies in relation to control and coordination differed. Shareholder value was a clear priority for control in the UK, whereas retaining control over an offshore subsidiary, and communication with the OEMs' is important in firm ABC with coordination via group or divisional headquarters in Germany. As a result, there were differences in the degree of autonomy. This was a 'light touch', relatively loose in UK as long as budget targets were met. However, for Company ABC there was tight central control of design in Germany, in addition to close budget monitoring and implementation of strategy.

Fourth, turning to the managerial division of labour, there was minimal involvement from the UK managers evident in Company XYZ; whereas with ABC the initial set-up was undertaken by German ex patriates who then had the choice to stay for a limited time in the Czech Republic. There was little presence of expatriates in India by ABC.

Fifth, it is worth noting that there were different strategies that emerged in the UK by Company XYZ, who exhibited a pragmatic approach which resulted in a mixture of near and offshoring in the UK, CEE and China. There was also contradictory evidence with a part of Company ABC favouring India as a location, and others not. UK Company XYZ were not in favour of India (despite colonial links).

Sixth, there was a 'working' relationship with employees and trade unions in both ABC and XYZ. Redundancies were negotiated when necessary in the UK, while the approach varied in

Germany, and was dependent upon current relationships and issues across the group of companies in ABC. Recently, the situation in China was described by CompanyABC as ‘problematic and getting more difficult’, but it was not clear whether this was resistance towards further job moves to China, or a deterioration of management and union working relationships at the operating companies in China.

Finally, with regard to re-shoring and changes of policy, there was more flexibility with the UK Company XYZ, reflected in work being re-shored from Mexico to the US mainland. In Germany work was re-shored that was seen as too complex for India when key skills were lacking.

Chapter 7 will explore in further detail the findings from the two main case studies, in the two different sectors that are central to this thesis. Similarities as well as differences between the sectors and the comparative organisations will be assessed.

CHAPTER 7

ANALYSIS AND DISCUSSION OF DATA

7.1 Introduction

In this chapter the findings from the two case studies are explored, searching for evidence to verify the assumptions by interpreting and analysing the data to draw out the differences, contradictions, and also unintended outcomes. A predictive taxonomy for relating varieties of capitalism (VoC) with dimensions of offshoring and outsourcing strategies, was set out as a hypothesis in Table 3-3 this can be compared with the findings from each of the two comparative case studies summarised and shown below in Table 7-1.

The structure of this chapter is as follows: Firstly, the key themes arising from the two case studies in airline transport and engineering are explored separately, with responses to the six exploratory research questions. Secondly, some propositions are derived from the overall findings and the two firms in the two sectors are compared and discussed through the theoretical lenses of varieties of capitalism, the resource based view/dynamic capabilities, global production networks and embeddedness. The discussion forms the basis for conclusions presented in Chapter 8.

Table 7-1 Actual Taxonomy – Summary of Findings

(Based on Table 5-2 and 6-2 and Chapters 5 and 6, compare with Table 3-3 in Chapter 3 which posits the expected behaviour)

Question (Refer to chapter 4)	**Approach**	**Dimensions**	**Liberal Market Economy (UK)**		**Coordinated market Economy (Germany)**	
			British Airways	**CompanyXYZ**	**Lufthansa**	**CompanyABC**
What are the differences in the geographical, functional and temporal patterns of outsourcing and offshoring? (4.1.1)	Outsource	Motivation (see 5.3 and 6.2)	Offshore-outsource back office services to India and outsource RMO to South Wales. Outsource catering, administrative and revenue accounting, engineering, maintenance, repair and overhaul. Ramp, buses and de-icing. Cost and improved productivity - reduced employee numbers. Speed of response.	Outsource UK, Czech republic, China outsource and offshore manufacturing destinations. Less keen on India. Acquire and integrate business when appropriate. Outsource catering, administrative and revenue accounting, Offshore engineering, maintenance, repair and overhaul outsourced locally. Cost	Captive offshore shared services to Poland, Thailand and Mexico. . Shared services, ticket booking, invoicing. Offshore RMO to China (JV) and Hungary. All offshore work retained in-house. Recent outsourcing of IT systems to IBM. Quality, performance and cost	Captive offshore subsidiaries India, Vietnam, Czech Republic, Hungary. 'Lead' global roles in Asia, Europe and North / South America. Embedded software applications, IT systems, accounting, call centres. In Czech Republic – the development of new automotive platforms; R&D, Engineering and Manufacturing. Local expertise and cost.
Control & Coordination (4.1.2)		Ownership (see 5.4 and 6.3)	Outsource: Shareholder value	Offshore through Joint Venture then wholly owned acquisition. Financial control via	Retained offshore subsidiary	Now wholly owned, offshore subsidiaries, budget control and

				HQ, but freedom to run business locally.		OEM contact through HQ.
		Control & coordination (see 5.4 and 6.3)	Offshore and outsourced. Arm's length, market driven. Open book, service level agreements. Procurement led/ contract driven. More recently strategic collaborative ventures ('One World') have become more important	Global operations via HQ and regional (EMEA) control	Tight HQ organisational control. The Star Alliance – not wholly but largely non-equity based has become a benchmark in code sharing. New CEO resulted in fresh policies and priorities.	HQ with OEM, divisional control and global coordination from HQ.
		Degree of autonomy (see 5.4.2 and 6.4)	Generally high. Maintenance retained at an internal subsidiary. Allowed to source from competitor if a business case.	Relatively high – unless a problem e.g. loss of IP	Low, but increasing, based offshore or nearshore. Acquisition used as a short term 'spoiling' technique.	Relatively high in terms of design and delivery. Close budget and resource planning and monitoring from HQ.
How is this reflected in divergent international divisions of labour regarding the employment of indigenous or ex-pat managers? (4.1.3)	Offshore or Outsourced offshore	Managerial Division of labour (see 5.5 and 6.5)	Local staffs. No ex-pats. Concern over JV in the US with potential loss of UK jobs.	Kept to a minimum. Initial training on site in Czech Rep.	Run by ex HQ managers At start-up managerial level withdraw at operative level as soon as possible and recruit locals. Duplication with JV in China.	Ex-pat initially as senior manager. Replaced with local after 5 years, maybe 5 ex pats out of 10,000 local employees. In Czech Republic initial training of engineers in Germany then on-site over 2 years. Ex pats may stay.
To what extent do preferences for cultural	or	Cultural Proximity	Unimportant. Global reach. Cope with afterwards - gain	Significant preferences through experience. Try it, see what	Important – language & culture. Focus on	Less important – although with the Czech Republic there

proximity affect location? (4.1.4)		(see 5.6 and 6.6)	experience through diverse partnerships.	happens and learn. Manage each location differently.	regions Europe, SE Asia, S America.	are advantages of proximity, similar markets, some ease of language and cultural affinity.
What is the influence of trade unions in the process of outsourcing and offshoring and how is this reflected in the structuring of the firms' labour markets? (4.1.5)		Relationship with employees / Trade Unions (see 5.7 and 6.7)	Sometimes adversarial, often regarded as non co-operative, but there exceptions e.g. Gatwick ground staff. Regular meetings – tone set by different CEOs.	Redundancies where required	Cooperative, aversion to conflict. Resolution often rather quick leaving employees frustrated with the union rather than management.	Avoid conflict, timed to coincide with growth to avoid job losses in Germany. Few issues in Czech republic – weak union but also free labour market and plant growth offering security.
What evidence is there and why, of a reversal in policy – re-shoring / reversed offshoring / outsourcing? (4.1.6)	Reverse offshore (Backshore)	Change of policy (5.8 and 6.8)	MRO work retained / returned in-house and within the UK. Work previously outsourced now back within IAG.	Mexico back to the US	Not so far	Stories of complex work being returned from India to Germany for rework.

7.2 Reflecting on findings in the transport sector

7.2.1 Summary of findings

Key themes for the transport sector are:

First, that the airline industry is highly competitive. There are also overlapping segments in the market e.g. low cost passenger travel, and price competition for long haul passengers in premium class travel. Whether to remain focused or broad in terms of portfolio and where to compete continue to be challenges.

Second, the major airlines operate extensive networks of partner and alliance companies for global coverage. So outsourcing and offshoring are regarded as legitimate strategies competing with an array of collaborative or integrative forms of working including mergers, acquisitions, joint ventures, and non-equity alliances. The labour costs associated with Maintenance Repair Overhaul (MRO) activity may be low when compared with material costs and this restricts the benefits that would otherwise come from offshoring to China and Hungary. Hence BA's preference to re-shore following improvements in productivity.

Third, passenger transport and airline engineering (MRO) businesses can be counter cyclical. BA and Lufthansa essentially are conglomerates in that they are spreading the risk across the group especially when catering, cargo, and IT systems are included as profit centres as is the case at Lufthansa.

Fourth, profitability is sensitive to fuel costs, airport landing charges and taxes, economic conditions and competition. BA and Lufthansa are both reliant upon business class/premium price custom for profitable growth in the passenger business. Given that pricing is dynamic (changes constantly in response to demand) cost control, if not reduction is paramount.

Fifth, customer loyalty is a key factor in a high profile customer service business. Strikes or other critical incidents are very disruptive and lost customers notoriously hard to win back.

Further interpretation of the responses to the research questions are explored in the next section. Note that Appendix A2.4 provides an additional the focus, approach and issues for each of the UK and German airlines.

7.2.2 Reflecting on the research questions

To what extent are UK and German multinational companies displaying different varieties of capitalism and how does that effect decisions and strategies related to the deployment of outsourcing and offshoring?

Both BA and Lufthansa have reacted to an industry need to cut costs, responding to low cost competition and customer needs. Both have deployed a mixture of outsourcing and offshoring tactics to vary degrees. In Lufthansa these factors have developed and grown as a contributor to long term strategy, and the need for tight governance that has been acknowledged by successive new CEOs. Control is exercised through keeping units captive as subsidiary businesses within the group. The BA model is not purely cost driven, there is a determination to seek value for money and a willingness to reverse earlier decisions by in-shoring or insourcing when productivity improvements have been realised. This demonstrates a degree of pragmatism and flexibility at BA.

What is distinctive about the governance of UK and German multinational firms?

For the German airline Lufthansa, power and key decisions are centralised and taken at a high level in the organisation. It is assumed that the head office in Germany create and then add value by offering the business units and divisions specialised expertise, opportunities to develop synergies or the investment to develop new business. Shared services are replicated and monitored around the world in Lufthansa whereas in BA they are outsourced to a single provider. For the UK business BA, there is more evidence of devolution and the autonomy of sub-units as the contracts (or procurement) department have considerable power, working in close conjunction with the legal department. Together these departments take responsibility for outsourcing and offshore contracts, also the integration of acquisitions and new alliance partners. If outsourced providers meet the delivery targets they are left alone. Work is generally offered to competitive tender on a periodic basis and any exception must then be approved by the main board at BA Plc. Substantial outsourcing at Gatwick has generated cost savings and gained support for investment in new aircraft.

How is the above reflected in idiosyncratic patterns of outsourcing and offshoring at both a national and sector level?

For German Lufthansa, there has been a very careful selection of preferred countries, with a reluctance to engage with India. Lufthansa search for cities where similar work is clustered for example as in Krakow. For the UK there is a willingness by BA to use Skychefs and Lufthansa Technic (both subsidiaries of Lufthansa) the main competitor (in the core business) when the contract is competitive and not a direct conflict of interest. Lufthansa do not buy any services from BA.

In what ways does the embeddedness of firms influence the motives, control and strategy of the parent multinational company?

Lufthansa GmbH has concentrated shared service centres at several locations around the world to serve key global markets. As Lufthansa grow so the significance increases of these sites in Krakow, Bangkok and Mexico. BA in contrast have a global service centre sourced from WNS in India. As part of the restructuring of BA the new holding company board retain responsibility for overall strategic direction at group level. In both airlines there is varying levels of evidence that outsourcing and offshoring are strategic alternatives to franchise, alliance, merger and other collaborative ventures. Lufthansa's involvement with merger and acquisitions has been less than in BA – recent examples were Swiss and British Midland, the latter was subsequently sold on to BA anyway. Offshoring and outsourcing in BA also continue to play a role in substantive cost cutting when operational and productivity improvements are required. Lufthansa recently announced the outsourcing of their Systems business division to IBM. Tight parental control is evident over the embedded operating companies. There is also evidence of adopting best practice at BA, rather than duplicating common systems and standardising processes at Lufthansa.

To what extent are outsourcing and offshoring policies reversible, and what has been the experience?

To date there is no evidence of reversing offshoring policies at Lufthansa. However, BA has reversed and insourced work, that was previously given to third party contractors. This followed internal productivity improvements to both free capacity and render the operations cost effective.

7.2.3 Discussion

The two competitors selected in the transport sector show some differences in approach. Both have moved back office support services and administration offshore, but the German organisation has set up wholly owned (captive) shared service centres nearshore; while the UK company moved processes to India, then as the business unit developed it was demerged and contracts are now in place to buy increasing levels of service back into BA from the offshore and outsourced provider (WNS).

With engineering, repair and maintenance work also catering, the approaches are again different. The German company retains control and manages cost by leveraging labour costs offshore and using agency employees where necessary although this can raise issues around loss of control. The UK business however works through its procurement and contracts team to place work either offshore or outsourced or both to keep costs down. BA have now learnt to manage these contracts more effectively and even buy in catering and engineering services from the competitor Lufthansa when appropriate in best value terms. Where labour costs are less of a concern they have improved processes now to such an extent they are prepared to reverse a previous policy and bring work back into BA where it is now cheaper following efficiency savings. BA aim for flexibility and an ability to react to market changes. The yield and volume of seat tickets sold at BA are carefully monitored with metrics such as unit costs for an available seat per km. With price reductions and discount promotions, again the cost base is carefully monitored. Outsourcing and offshoring are critical for the productivity improvements that have to fund pay awards; efficiency improvements are regarded as important with large volume activity such as ticket processing and baggage handling. Outsourcing agreements have been a key to recent productivity improvements for BA at Gatwick and in securing future fleet investment. Outsourcing at Lufthansa now seems inevitable if they are to achieve their cost cutting targets. The interviews (Appendix A2) highlighted the effect of changes in Chief Executive, at both BA and Lufthansa, in terms of setting the policy (e.g. support for shared service centres, and more recently for a change in Lufthansa to support outsourcing as a means of cost reduction), overall direction and the relationships between management and the trade unions.

Outsourcing and offshore are not just operational tactics but a rearrangement of the value chain that contributes to business performance and strategy. While Lufthansa is larger than BA in terms of fleet size, passengers carried and market share, and has a loyalty and rewards scheme widely acknowledged as very successful; it is interesting to note that recent profitability and growth at BA has surpassed Lufthansa (Table 5-1). This increases the pressure on Lufthansa to reduce their cost base. There is also a sense that more recently, BA – now as part of IAG are less risk adverse, have greater agility, resilience and flexibility in adapting to the constant changes in the market. BA seem to have overcome many of the historical criticisms of poor management versus trade union relationships. At the time of writing (January 2015) a widely reported intention by BA to acquire Aer Lingus is close to being agreed. This also reinforces the recent policy of growth through targeted acquisition rather than by non-equity alliances (still the preference at Lufthansa).

The use of resources

The development and deployment of capabilities require a consistent long term vision and has long term performance at its heart (Wang and Ahmed, op cit.). This may represent a challenge for firms located in countries such as the UK and US which are typically Liberal Market Economies (in Varieties of Capital terms) and hence short term in their horizon and essentially shareholder driven (see also 3.5). Recent Ashridge research supports this hypothesis with a review of the entrance of low-cost carrier (LCC) passenger airlines into the market; and applying dynamic capabilities as a strategic framework to explain the actions of different airlines. (Collins et al, 2013). British Airways, Air France / KLM were judged to be less successful (having launched and then sold off a LCC over a four year period), while Lufthansa in particular and also Qantas were found to be the most successful at creating better value (combination of price and perceived quality) for those customers purchasing its products and services, as well as for shareholders in the business who are interested in financial returns.

Lufthansa regarded itself as six distinct businesses (Cargo, Engineering/Maintenance & Overhaul, Catering, Systems, Low Cost (Germanwings carried 7.5m passengers in 2011) and not just as a ‘flag flying’ national airline. This is in contrast to BA who retained a unified organisational structure, and closed their low-cost airline (GO) having lost eight per cent in shareholder value (Collins et al, ibid). Lufthansa’s structure allowed it to capitalise on the entrance of LCCs (e.g. easyJet and Ryanair) by both supplying and supporting them with catering and maintenance while competing in the passenger market. Lufthansa used the value chain network to identify and capitalise on opportunities by integrating back or forth along the chain, hence the section on global production networks (7.4.3) which introduces a spatial element to decisions on where to outsource or offshore activity and how it ought to be organised.

Both Lufthansa and BA have been careful to redefine resources and key competences with a view to reallocating work in a more cost effective and efficient manner. Outsourcing and offshoring have featured in both organisations and been sustained now for over a decade. Issues of control have been important in terms of how best to manage the resource and ensure value for money. The German approach has been to keep control through wholly owned subsidiaries and divisions with an emphasis upon alliances and a few select strategic partnerships for specialist sourcing. The UK model seems to have been more flexible encouraging a business to relocate, develop a new operating model, divest, and encourage third party trading by the supplier. There has also been evidence of work being returned and insourced once significant improvements of productivity have been achieved.

In a sector which is competitive and changing quickly, decisions on the strategic deployment of resources, for example whether or not to have a low cost airline, enabling internal as well as external partnerships and how much autonomy to give cost and profit centres are crucial factors in creating advantage.

The influence of ownership

Both case study organisations moved from the public to the private sector some years ago through privatisation initiatives. It might therefore be expected that differences are embedded in institutional factors, which are still at the heart of 'flag carrier' airlines. As is common in Germany, there is a two tier executive board management structure for the Lufthansa business who works closely with a supervisory board. The group is controlled through twelve operating company management teams in four divisions. There are some 400 subsidiaries and associated companies in total. While operations are global the home market is regarded as Europe. Detailed targets and corresponding achievements are included in a comprehensive annual report. Lufthansa AB shares have been traded since 1966. There are certain business cycles that are counter cyclical e.g. passenger as opposed to engineering and maintenance work. The UK business BA Plc. was a separately quoted UK company until January 2011. Following a £31M merger with another European operator Iberia (with whom they had worked in partnership for a number of years), an international holding group was formed to manage the group who are responsible for overall direction and strategy. Individual businesses retain their own board of directors and management teams. For BA Plc., shares are now traded on the London and Madrid stock exchanges. This follows agreement by shareholders and regulators late in 2010 to establish a significant merger and operate under the guidance of a holding company (IAG).

Work at Lufthansa is largely (but not exclusively) kept in-house and controlled through divisional and / or central office. With MRO activity some flexibility with headcount is achieved through the use of contract staff. Conflict with the Works Council and its representatives is avoided where possible, sometimes at the expense of potential cost savings in reducing permanent staff. A preference is given to nearshore shared service centres on a regional basis while retaining HQ control by retaining centres in-house as part of the group structure. The choice of location seems to emphasise a nearshore cultural affinity.

At BA Plc., procurement and contracts management play a key role in establishing new contracts, also new acquisitions and then monitoring performance and delivery of services. Bad experiences with an early outsourcing catering contract at BA (with provider Gate Gourmet) demonstrated the need for greater control. There is some inevitable confusion with cost centres as opposed to profit centres, and more research could be undertaken to understand the role played by some of the business units. The situation is fluid and changes frequently. There is a sense that BA are less risk adverse, more inclined to decentralise and devolve work; also more prepared to be confrontational with the Trades Unions where they feel it is necessary and also in the interests of shareholders, the company as a whole and the customers.

At BA there has been evidence of returning work in terms of maintenance, repair and overhaul (MRO); improved productivity and efficiency has enabled this specialist engineering work to stay in-house when otherwise it would have been outsourced even though labour costs are a small proportion of the full costs.

Shifts from the public to private sector for both airlines have resulted in rather different governance structures, attitudes to risk, apparent flexibility in decision making and actions that can be traced to institutional practices embedded in the UK and Germany.

The same procedure will now be adopted for the second case study – engineering.

7.3 Reflecting on findings in the engineering sector.

7.3.1 Summary of findings

Key themes for the engineering sector are:

First, that cost control is key, especially in the UK case where the approach is shareholder driven and more short term with a focus on year end budgets. With the

German case while costs and budgets are tightly controlled from the centre there is a greater sense of more mid to longer term financial planning and the provision of FDI.

Second, customers of both Companies ask for, and expect lower prices and local supply. This has an impact on location decisions, not only whether labour rates are appropriate but also if there is an adequate choice of local suppliers and infrastructure. It is particularly important for the German CompanyABC when they claim that the choice of location is also for market development reasons. Further, there are implications for shareholders as to whether a long(er) term presence in a host country, sustainability and the distribution of wealth locally (as opposed to returning shareholder profits to the home country) is part of the Company's goals. .For CompanyXYZ the CEE region is not a market that they sell to, but is a convenient and efficient source for producing products that are then sold elsewhere in the world.

Third, there is high competitor pressure within the market and industry sector, margins are often low and customers may switch to alternative suppliers easily.

Fourth, the data supports a preferred tendency for CompanyABC to engage in captive offshoring and for CompanyXYZ to try a joint venture and then outsource or acquisition, integration and / or restructure to gain longer term rewards.

Note that Appendix A3.3 summarises the focus, approach and issues for each of the UK and German engineering businesses Companies ABC and XYZ.

7.3.2 Reflecting on the research questions

To what extent are UK and German multinational companies displaying different varieties of capitalism and how does that effect decisions and strategies related to the deployment of outsourcing and offshoring?

The differences here are nuanced. There is some evidence of traits of CME behaviour by CompanyABC GmbH while CompanyXYZ Ltd displays features of a LME. A reluctance to outsource anything other than travel services or other ‘peripheral’ activity by CompanyABC GmbH is apparent. The similarities are common – both employ high quality engineers and other specialists, both are keen to cut cost and improve efficiencies. Both have grown and are successful. There is a sense that CompanyABC in Germany is more institutionally constrained – not only by the German dual board structure but also family controlled with Trusts for which they have responsibility. The evidence from CompanyABC displays: a low risk threshold hence a reliance upon captive-offshoring, with very limited outsourcing, drivers other than just low cost include for example skills availability. The contradictions with CompanyABC would include a lack of communications with the customer, strict budget control and planning from headquarters in Germany, rather limited use of ex-pat managers from headquarters. CompanyXYZ is more affirmative to a LME model, they have deployed the full spectrum of outsourcing, offshoring, collaborative partnerships and acquisition, the driver is lower cost with approval from Headquarters but then high levels of autonomy as long as budgets are met.

What is distinctive about the governance of UK and German multinational firms?

The role of the MNC in transferring technology is an aspect of offshoring and outsourcing (Jensen, 2003). Both firms share the same characteristics with high R&D, a large share of professional and technical workers, complex technical products, and high levels of differentiation. Advantages come from ownership, location and internalisation (Dunning, 1981); and democratic countries such as India and Czech Republic tend to attract more FDI with lower country risk, debt risk. What is unusual with the German firm here is that not only is there is little communication by the supplier, even though they are willing, with the customer – this is left to headquarters; but neither is internal collaboration encouraged (by headquarters) across the group, only between headquarters and a specific subsidiary. An interview in India revealed this to be the case with automotive software product development. This would suggest that HQ in Stuttgart and the subsidiary in India have a differing attitude to risk and are inclined to prefer different approaches. Elsewhere in the same German group, but with a different division, CompanyABC has deliberately relocated R&D and manufacturing plants in Hungary so that they operate in close proximity to encourage collaboration and market focus. A similar relocation by the same German CompanyABC is reported in the literature (Sass and Hunya, 2014).

How is the above reflected in idiosyncratic patterns of outsourcing and offshoring at both a national and sector level?

The UK firm CompanyXYZ Ltd is more pragmatic and flexible in terms of their approach; while CompanyABC GmbH avoid outsourcing in favour of controlled captive offshoring. This suggests that the UK CompanyXYZ is less institutionally constrained than its German counterpart, also less risk adverse, more agile and flexible.

Which functions or processes are moved offshore, where to and why?

With CompanyXYZ the work initially moved offshore was solely manufacturing to both China and Czech Republic, other support functions such as sales and marketing or finance stayed in the UK. The approach in Germany is to make the subsidiary where possible self- sufficient with core and relevant support functions in place and offshore. Both firms showed similarities in that simple processes when possible were moved initially and then more complex, higher added value processes follow once trust has been gained and skills levels are in place. This was the case with CompanyXYZ initially moving work to China and the also with Czech Republic. In the case of CompanyABC the driver in moving software to India was cost but in particular access to software development (acquisition of a former Infosys business). Over time more complex work would also have evolved because of innovation and technological advances especially with automotive software.

In what ways does the embeddedness of firms influence the motives, control and strategy of the parent multinational company?

In the case of CompanyABC GmbH long term development with substantial inward investment in both India and Czech Republic has resulted in considerable growth and employment. The size of the business in India is now at 10,000 employees and that is considered by CompanyABC to have reached an optimum level and has now led to the establishment of a second, smaller clone in Vietnam as a further captive-offshore business. This is not as a result of increasing costs in India although it is also the case that a number of early tax breaks and other advantages in India have been progressively reduced.

CompanyXYZ Ltd are pleased with the progress they have achieved in Asia and the CEE and have recently restructured the manner in which they now coordinate regional operations. A current priority is to implement common IT platforms across the sites which is intended to improve routine monitoring and reporting back to HQ.

To what extent are outsourcing and offshoring policies reversible, and what is the experience in The UK and Germany?

None observed here within Europe, but in the United States division of CompanyXYZ Ltd they have reversed a policy to move work from the United States to Mexico. Given the size of the case study companies, and the twenty years or so that outsourcing and offshore practices have been commonplace in BA and Lufthansa, this is a surprise. More evidence might have been expected, and of course might well have been the case.

7.3.3 Discussion

These two engineering case studies therefore provides insights into some differences in approach with respect to competences, technology transfer around the world and the development of key alliances; as postulated by Lynn and Salzman (op cit.) in section 2.3 and 6.1.1.

There are similarities in focus for both UK and German companies – to initially cut costs, keep prices down and then to improve efficiencies, processes and customers service. The method of delivery however, is different. The UK company CompanyXYZ states that it takes a long term view but with short term deliberate steps towards partnership and then integration and acquisition utilising outsourcing and offshoring where appropriate. The German company CompanyABC however, prefers to retain centralised control by establishing a subsidiary (captive) business offshore from the outset, with no or little consideration of outsourcing. There is also little evidence of synergies across the German group. Both UK and German companies have grown and employment has been largely protected, although the United States division of CompanyXYZ has reversed a policy to move work from Mexico back to the United States. It would also seem that complex work initially offshored to India by CompanyABC has subsequently had to be returned to Germany and reworked.

Key challenges for the engineering businesses include on-going cost control, especially in the UK company which is shareholder driven. There is competitor pressure within the market and industry sector. The preferred tendency of CompanyXYZ is to try a joint venture and then acquisition, integrate and restructure to reap rewards. There is more control if it is a wholly owned subsidiary of CompanyABC, can then avoid issues of IP with a third party. Complex global production networks and supply chains which require careful coordination from headquarters and represent potential risk of supply failures.

The use of resources

From a resource based view (RBV) of the firm, both case studies CompanyABC GmbH and CompanyXYZ Ltd have experienced steady growth in recent years and started a mixture of outsourcing and offshoring strategies as part of their global expansion. The appropriate allocation or reallocation of resources is fundamental as is finding an appropriate combination of assets – both tangible and intangible as evidenced here by the outsourcing and offshoring strategies of these firms (Mahoney, 1992).

Such developments require an assessment of both current and projected competences for key parts of the workforce. The (re)designing of jobs to then enable the generation of added value processes with different skill sets (Ramanujam, 1989) are again highly relevant to the RBV. In recent years it has become apparent that as the demand for offshore and outsourced work has increased dramatically, so have the notional labour costs. This has been especially true in both China and India. The need to track costs and develop increasingly more sophisticated monitoring systems that will include associated resource from Head office and other specialist staff support are again further evidence of the need to have accurate transaction costs (Williamson, 1979).

CompanyABC GmbH has a clear preference to focus on building their internal resource capability within a captive subsidiary. This is particularly the case in India where recruitment involves large numbers of candidates to be interviewed and partnerships with universities. However, the now higher rates of pay in India have resulted in a policy of recruiting younger, less experienced staff who then follow an internal training programme or apprenticeship. This keeps the cost of labour in check. Outsourcing as stated before is rare and the only examples given were of corporate travel services, and catering arrangements at smaller plants in Germany.

Determining strategic choices that are valuable, rare, inimitable, non-substitutable (VRIN) is again an important aspect of the RBV. However, the knowledge that competitors have a similar approach to embedded software in the case of CompanyABC GmbH suggests that the inimitable aspect might not be straightforward (Barney, 1991). Whereas the UK case with CompanyXYZ Ltd does suggest a more flexible, perhaps shorter time frame perspective towards restructuring and achieving demanding financial targets, but again they have experienced problems with a loss of IP at one plant in China.

There are also indications that both organisations try to establish strategies that will have a minimum negative affect on industrial and employee relations. For many years CompanyABC GmbH has enjoyed substantial overseas growth to 'conveniently' mitigate job losses or difficult conversations with the Works Council on transferring work. CompanyXYZ Ltd has also managed to limit the extent of job losses while achieving big savings in overheads. It is the case that huge investments in recruitment, training and development in India as well as in the Czech Republic have helped CompanyABC GmbH with the embeddedness of social structures and economic goals (Granovetter, 1992). CompanyXYZ Ltd are also working on this area at home in the UK, although it is less clear what happens overseas, further research is required.

Choice of location and institutional effects

With regard to varieties of capitalism (VoC) theory while both companies are well known in their home countries and abroad, they are not necessarily wholly typical of MNCs. The German company is still partly family owned (as with some large German pharma and automotive companies). The UK group has shifted direction in terms of market focus over the years and grown largely through acquisition, mergers and divestments as it switched the mix of business in the portfolio. Such differences in economic and political institutions across countries (Hall and Soskice, 2001) is at the heart of the VoC theory; along with questions on location, structure and strategy at the level of the firm and whether one country can coordinate these policies better than another in the search for advantage. Comparing the two companies in this sector, it is the parent group of CompanyXYZ that has changed more dramatically and in a shorter period of time.

The two cases under review have both successfully moved selected operations offshore to China (traditionally regarded as a command economy, but today increasingly in transition and mixed) also to CEE (transition) economies (Murtha and Lenway, 1994). Indeed CompanyXYZ Ltd has an affinity with the Czech Republic and found that both culturally and because of institutional factors this is an easier source of supply than India. CompanyABC GmbH is now getting closer to the Czech Republic (since 2004) having embedded their operations in India since 1996 (Senior CompanyABC executive, Stuttgart). Other German companies, for example (Lufthansa) avoid the complexities of an ‘ex British colonial’, nation such as India and prefer to near-shore in Eastern Europe from both a geographic distance and cultural aspect. It is too early to deduce clear arguments for corporatist (Germany) private enterprise or coordinated market economy versus ‘pluralist (UK, US, India) private enterprise or liberal market economy (Lane, 1998). Furthermore, the extent to which central government or regional policy influences MNC strategy is difficult to judge. More research is required. At CompanyABC, there is evidence of long term strategy and expansion, short term budget and product monitoring, global coordination within the business unit from headquarters with delegated responsibility for the design, engineering and manufacturing (both from India and the Czech Republic). Close cooperation with key customers, suppliers and extensive employee training and development is also embedded.

An important debate is whether or not CMEs and LMEs are showing signs of converging. The recent global recession is one reason to suggest that Germany has in fact done well to avoid Anglo-Saxon approaches. Examples at Gatwick of recent outsourcing agreements suggest that BA can hold satisfactory negotiations in reaching a settlement that achieves substantive cost savings, suggesting that UK labour relations have in some cases become more consensual.

Interconnectivity and influence

Global production network (GPN) theory helps us to address a key question of whether governance depends upon the complexities of the transactions and the capabilities of the supply base. In this respect CompanyABC GmbH keep firm control through the divisional, country and head office management policies. The focus on inter firm linkages and power between suppliers and buyers (Dicken, 2007), is also limited with sales trade via headquarters and original equipment manufacturer (OEMs), rather than directly into the country of origin. On the other hand, it would seem that CompanyXYZ Ltd enjoy rather more trading autonomy and operational control. The UK Group board is involved in agreeing M&A activity, major strategic changes and of course monitoring return on sales (ROS) and other key financial indicators. In the case of CompanyABC GmbH the organisation has a number of separate subsidiaries in the same street in Bangalore. To explore clustering dynamics is one of the aspects of GPNs. More research is required on the balance of power between actors, knowledge of regional assets, policy interventions, institutional arrangements, cultural awareness and value creation. At CompanyABC in the Czech Republic there is extensive coordination of intra company supply chains around the world for the delivery of automotive platforms, components and customised products.

With regard to tensions between cooperation and collaboration on the one hand and competition and conflict on the other (Coe, 2008); it would seem that the latter win for the German CompanyABC. The business in India is denied the input of direct customer contact as part of the product development process and subsequent operational delivery, possibly because headquarters wishes to restrict leaks to competitors. There is surprisingly little collaboration between business units in the same division, tending to operate on a 1:1 basis with headquarters. Trade and communications are between India and headquarters in Germany. This contrasts with the UK case where there are indications of effective cooperation and coordination between CompanyXYZ Ltd and its chosen partners in China and the Czech Republic.

Section 2.3.1.refers to research data based upon an ORN (Offshore Research Network) survey launched at Duke University in 2004 (Roza, 2011). Further related research (Massini, 2012) suggested that the initial wave of outsourcing and offshoring of manufacturing (as depicted by the UK engineering company in the case study (Chapter 6), has been succeeded by a 'new wave' of offshoring business services and this has been found to be the case with the transport / airline case study (Chapter 5) with both the UK and German companies. Massini also reported that administrative processes, call centres, IT processes, procurement and product development were being offshored to less developed countries – and this has been the case with the UK airline using India and the German airline Poland, South America and the Far East. Another key point is that the technological integration and coordination remains largely in the advanced economies (Massini, ibid).

7.4 Overall findings and link to underpinning theory

This section brings together the four case study firms to reflect on how the findings relate to the theories and the literature; varieties of capitalism (VoC); resource based view / dynamic capability (RBV/DC) and embeddedness.

7.4.1 Linking Findings to propositions and to draft Conclusions.

From the findings, a process of abduction is used to derive eight propositions in column three of Table 7-2 below. The propositions are mental constructs (Reichertz, 2004 considers as usable re-constructions) and will be used to develop conclusions in Chapter 8.

Table 7-2 Development of propositions

Airlines (Table 5-2)	Engineering (Table 6-2)	Proposition (see conclusion Chapter 8)
1. **Motivation** – is primarily cost in UK with a focus on outsourcing support or back-office processes (5.2.2 and 5.3.2. also Appendix A2.3). In Germany while cost is significant it is not given the same over-riding priority; more concerned with central coordination of shared activities (e.g. Krakow) that can then be then be replicated around the world (5.2.1 and 5.3.1 and Appendix A2.2).	1. **Motivation** – outsource non-core activity locally in the UK, offshore to China and India (less keen) – all primarily cost driven Appendix A3.2). For German company offshore but retain ownership in a range of key international markets. Long term development of embedded software products (India) and new platforms (Czech Rep). Driven by local expertise as well as cost Appendix A3.1.1 to A3.1.3).	1. Cost control is a key consideration in both sectors with UK and German companies. Coordination from HQ and a replication of shared services is important for both the German airline and the engineering company. Market development and local expertise is also important for the German engineering business. Both sectors seem to be consistent with the country VoC hypothesis.
2. **Ownership** – willingness to offshore and outsource in UK (e.g. business processes to WNS in India Appendix A2.3), reluctance to outsource by the German company who wish to retain ownership but at a lower cost.	2. **Ownership** – UK flexible with an initial willingness to offshore and outsource, only retaining control following a loss of IP. Reluctance to outsource in Germany contact with OEM through HQ.	2. In both sector cases, the UK companies were open to outsourcing and progressive offshoring; they were also flexible and prepared to divest, start joint ventures or acquire when circumstances changed. Reluctance to outsource from both German companies but willing to take lower costs from moving offshore if control is retained. Outsourcing in Germany however, remains on the agenda as further productivity improvements are demanded. Recent evidence of outsourcing IT systems at Lufthansa to IBM.

3. **Control & Coordination** – both outsource and move offshore from UK a significant role played by Procurement and contract management. In Germany tight control from HQ.	3. **Control & Coordination –** shareholder value a priority in UK, retaining control as an offshore subsidiary is important in Germany.	3. Procurement and Contracts drive the operational changes in the UK airline. Performance measures and SLAs are regarded as part of achieving budget in UK but the business is left alone to meet targets. German operations, are more constrained and have fewer ‘degrees of freedom’ they must consult with HQ on delivery.
4. **Degree of autonomy** – relatively loose in UK, high autonomy and flexible, tight in Germany but relaxes with trust over time and preference to near-shore.	4. **Degree of autonomy** – relatively loose in UK. Tight central control of design in Germany also close budget monitoring.	4. As suggested above – consistent with LME (loose) and CME (tight) styles for the UK and Germany respectively.
5. **Managerial Division of labour** – minimal involvement from UK, initial set-up covered by German ex pats, then local recruits.	5. **Managerial Division of labour** – minimal involvement from UK, initial set-up covered by German ex pats who may choose to stay.	5. Very similar for both sectors. This does contrast with some ‘other’ transnational companies (e.g. ABB) that wish to develop an international cadre of experienced managers.
6. **Cultural Proximity** – language and culture are seen as more important for German company.	6. **Cultural Proximity** –‘Try and see’ attitude in UK leading to a mixture of near shoring and offshoring in both UK and Germany.	6. English is regarded as an international language that is widely spoken around the world. Although some reservations were expressed by the UK companies there was generally a higher level of concern by the German companies of working somewhere that was sympathetic to the German language and culture.

7. **Relationship with employees / Trade Unions** – adversarial in UK, management force issues and change. Aversion to conflict work with the Works Council in Germany. The UK airline also exhibited a high degree of institutional awareness in terms of regional government incentives, skills availability and political treaties for air routes where the UK is a ‘brand’.	7. **Relationship with employees / Trade Unions** – adversarial in UK, variable in the German company dependent upon current relationships and issues.	7. Perhaps one of the biggest differences was revealed in the airline case study. In Germany disputes seem to be settled more quickly and the Works council are inclined to agree with management. The attitude of members is different as a result – supportive of the TU in the UK less so of the works council in Germany.
8. **Change of policy** – more flexible in UK work returned when improved productivity demonstrated. No evidence of re-shoring in German company.	8. **Change of policy** – more flexible in UK, work re-shored from Mexico to US mainland by UK Company. In Germany work has been re-shored that was seen as too complex for India when key skills were lacking.	8. Few examples in the companies studied but generally a more flexible attitude by the UK airline and engineering company where there was a willingness to change earlier decisions and policy when judged appropriate.

7.4.2 Varieties of Capitalism

So where did the case study companies choose to offshore or outsource, why and what work was moved? The German case study firms displayed similarities irrespective of sector, with very limited outsourcing and a clear preference for captive offshoring. The motivation to move work included lower cost – but not exclusively so. Quality, performance and local skills / expertise were also reasons. Central European destinations provided the opportunity to near shore with other benefits of language, and cultural empathy in Poland, Hungary and the Czech Republic. This is consistent with findings reported by Sass and Fifekova (2011) also Hardy and Hollinshead (2011). Lufthansa and CompanyABC displayed a preference to both replicate and then coordinate services (Lufthansa – from Krakow to Thailand and Mexico, similarly with maintenance, repair and overhaul (MRO) from Germany to Hungary and China; CompanyABC for IT / software applications from India to Vietnam, and for engineering from Germany to Czech Republic). Strategic direction, budget control and communication with original equipment manufacturer (OEM) customers all within the remit of headquarters in Germany. Brand identity and IP are also preserved at the corporate centre. Recent evidence (Reuters Nov 18th 2014) suggests that selected outsourcing of the Lufthansa Systems business will now occur with a $1.25 billion deal (IT systems to IBM see also 5.10). Whereas in the UK, back-office systems were outsourced to India, they were moved to captive offshore centres by the German case study companies along with software engineering and engineering platforms.

On the other hand for both UK companies BA and CompanyXYZ, cost seems to have been the principal driving force to initially outsource non-core support and

/or back office processing; BA to India, Company XYZ initially consolidation locally and then outsource to Czech Republic and later China. Shareholder value is the focus, productivity and speed of response are also regarded as benefits by BA. Catering, routine maintenance and administration were all target areas for outsourcing.

A difference arises in terms of ownership, control and autonomy. Whereas in Germany there is a distinct preference to retain control through ownership, but also to coordinate via headquarters, in the UK there is a willingness to divest ownership, in both BA and Company XYZ, to build trust through a joint venture, sell and buy back an increasing proportion of business. A form of re-shoring was also apparent at BA when improved productivity in the home country the UK, led to work being returned in-house to BA. For Company ABC it was interesting to note that even though a wholly owned subsidiary was well established (10 years plus) in India they were still unable to communicate directly with their external customer, contact was retained though headquarters in Stuttgart. BA operate open book accounting systems, together with detailed service level agreements with their outsourced supplier WNS in India. It is also interesting that BA are prepared to outsource work to Lufthansa when they have successfully bid for competitive contracts (for example catering at London City airport and some maintenance (MRO) work. The two airlines both make extensive use of alliances and partnerships, with Lufthansa regarded as the benchmark. Both UK and German airline case studies revealed that changes in CEO led to policy changes for example fresh support for shared service centres, the introduction of a major cost cutting programme, the use of outsourcing – all at Lufthansa. For BA, the introduction and subsequent sale of a low cost airline (LCC), changes in relationships with the trade unions (Appendix A2.3), the acquisition of British Midland, Iberia and. Vueling. At CompanyABC and XYZ in the past 2 years there has not been a major shift in direction or policy evident from the research. The two engineering cases both had established systems for coordinating global operations and regional / divisional control of budgets and performance and this continues as before.

Regarding divisions of labour the UK cases suggested a minimum of ex-pat staff would be involved in coordinating day to day business in offshored or outsourced contracts. Lessons were learnt from an initially too laissez faire approach (Gate Gourmet) and now Procurement ensure that service level agreements and tight performance contracts are in place. At CompanyXYZ they prefer to focus on the recruitment and training of local managers in the offshored destinations. The German cases reported more involvement of ex-pat managers - from HQ in the case of Lufthansa, and then gradual withdrawal and handover. Some concern over job losses and duplication of managerial roles was expressed by both Lufthansa and BA with alliances in China and the US respectively.

In Germany, cultural affinity with employees and customers in similar markets is important, more so than language for CompanyABC. For the UK this is regarded as less important but with the engineering CompanyXYZ they did state that they have learnt through experience and tend to favour some regions e.g. Czech Republic, over those countries where one might expect there to be more of an affinity e.g. India.

UK and German involvement with trade unions was revealed by the two case studies to be different and largely in-line with VoC and stereotypical expectations. The main difference is that in the UK union members are often left frustrated with management whereas in Germany the members are left frustrated with the Works Council / trade union for seemingly settling disputes too quickly (interview Lufthansa Appendix A2.1). In BA it is interesting to note that negotiations have more recently (Interview BA June 2014 Appendix A2.2.3 referring to year 2012) been less adversarial and most job transfers from Gatwick to Heathrow airports have been amicably agreed. Economic growth in Germany for much of the past ten years may well have made it easier to offshore without job losses in the home market.

There were a few examples of re-shoring in the companies chosen as case studies CompanyABC from India to Germany, for CompanyXYZ from Mexico to the US, and BA with MRO work. However, there is growing evidence that this rate is now increasing in both UK and Germany (Economist, 2014).

Hence from a VoC perspective the characteristics shown in Tables 3-1, 3-2 and the taxonomy in 3-3 are largely upheld. Now to review the other theoretical strands, firstly the resource based and dynamic capability viewpoint.

7.4.3 Resource Based View / Dynamic Capabilities

The why and what aspects (of) are mainly covered above through the VoC lens. So what was the impact on resource capability and the ability to innovate in a changing environment? If we consider resources and assets from a capability viewpoint in the engineering sector, CompanyABC in Germany clearly found that India provided a substantial source of highly skilled software engineers and analysts (Table 7-1). Also, in the past five years as demand for these skills has grown and so have the costs of supplying those skills. To maintain the cost-benefit of offshoring

CompanyABC has had to recruit younger, less experienced staff and provide additional training. The British engineering company (XYZ) has been quick to divest and then source from an offshore provider. The contract costs are then kept under close review. In terms of the Barney's (1991) VRIN criteria. The German CompanyABC provides a good example of developing new products from scratch with high added value software that is difficult to copy and substitute. Meanwhile when Company XYZ initially outsourced products that were 'easier' to copy they quickly lost their IP and had to resort to acquiring and controlling the Chinese business more closely. Lufthansa have reported concerns that with MRO work in China there are additional costs of duplicating inspectors.

From a dynamic capability perspective a temporal viewpoint is offered. This is reflected in the three stages of adapt, absorb and innovate; and each of the case study companies have displayed a tenacity in changing who does what work, the main difference seems to be in respect of timescale with both the UK companies taking decisions, on outsourcing and offshoring and being prepared to adapt the approach and consolidate activity relatively quickly. The German companies having made a decision (to offshore) then take time to consolidate and stay with the initial approach. The evidence points to the two UK case study firms as being more agile, pragmatic and flexible in comparison with their German counterparts, and thus able to adapt more quickly. Again levels of innovation are hard to measure and compare in this instance. The Lufthansa Star Alliance is certainly bigger and offers more benefits then do the BA One World scheme but much of the underlying reasons for this is explained by differences between European and transatlantic government regulation of air space (5.4.1) rather than dynamic capability or innovation. In terms of the use of airline shared services , BA have been innovative in terms of relinquishing control of back office services and then sourcing a greater variety of work packages back into BA over time, whilst Lufthansa choose to expand but then duplicate the work between geographical hubs.

7.4.4 Global Production Networks

In each of the case study companies reviewed, the way in which the MNCs managed, controlled, coordinated and allocated resources was significant in terms of ensuring business continuity and meeting budgetary targets. So how did they manage the transition? Power is clearly exercised by the German headquarters at both Lufthansa and CompanyABC through the control of overseas subsidiaries. In some cases even communication with customer is sequenced through headquarters. The UK practice is more hands-off, rather greater levels of autonomy are enjoyed by outsourced third party suppliers as long as budget targets and other service level agreements are met. The level of inter-connectedness is arguably more pronounced by the German companies because of retaining ownership but in practice there also seems to be higher demands on management for travel, meetings and delivery of targets. German engineering CompanyABC has built up an extensive network of business relationships in India to support its growth, but also recognises the importance of having reserve capacity and contingency in Asia. Changes in tax incentive, coupled with increasing labour costs and sometimes difficult government relationships have reduced the attraction of India as a supply region. The closer proximity of central and eastern European countries has clearly been important for Germany. Both Lufthansa and Company ABC have benefitted from nearshore arrangements in Czech Republic, Hungary and Poland. So too have Company XYZ who have expressed a preference to work with the Czech Republic and now have sizable manufacturing operations located there in preference to India. Likewise BA make use of MRO facilities in Hungary.

7.4.5 Embeddedness

After initial issues with transferring work from the home nation to the host country each of the case study companies have now demonstrated long term stability (over 10 years plus); this benefits the local economy in each case through employment, business growth and the payment of taxes. As the factories, the shared business / service centres and the engineering plants have expanded so as the inward capital investment. More FDI from Germany than the UK in terms of the companies studied here (figures not available).In the case of Lufthansa and CompanyABC the capital investment is tightly monitored by headquarters in Germany. For each of the four companies reviewed there is very limited demand for the product and/or service locally in the host nation, this is then exported around the world. To that extent it can be argued that the offshore location is convenient and cost effective as opposed to being part of a market entry strategy. Financial returns are largely to headquarters and to institutional and individual shareholders. Given the longevity of the operations in chosen locations there is some evidence of 'spatial lock-in' (Henderson, op cit.).This is further supported by a lack of evidence of re-shoring. At Gatwick BA were able to secure further capital investment and long term security through successfully negotiating a series of productivity and outsourcing arrangements for ground operations. In this instance there was full support and cooperation from the trade unions.

7.5 Synopsis

The case study organisations are faced with multiple choices on how best to reorganise their value chains, where to locate and how best to manage the new entity. This chapter explored the extent to which the differing responses between the case-study companies reflected the deeply embedded practices rooted in the practices of the VoC of the home country and the institutional responses that entailed. Some of the interesting and unexpected findings included:

For airlines, it was significant that BA were willing to use competitor (Lufthansa) subsidiaries as outsourced suppliers for catering and MRO activity. The importance of agency was emphasised in that frequent changes in CEO at both BA and Lufthansa accounted for significant differences in outsourcing policy and also management and union relationships.

For the engineering sector, some of the differences were nuanced. There was evidence of different CME and LME behaviour by the German and UK companies respectively, but there were also similarities. CompanyABC was more institutionally constrained (than Company XYZ) by the combination of its dual board, family ownership and family trusts. XYZ was able to display the full spectrum of choices in practice with outsourcing, offshoring, partnerships, and acquisition as long as cost was reduced and budget targets met.

CompanyABC, as the principal supplier of automotive software products in India were unable to communicate directly with the OEM, that being a headquarters responsibility in Germany. Further expansion in India was also moved to Thailand because of the cessation of tax breaks.

There was little substantive evidence of reshoring in either of the two sectors studied by the four case-study organisations. Rather a lot of anecdotal incidence was proffered but also a reluctance from those interviewed to provide detail; given that these were large organisations with over twenty years of experience of outsourcing and offshoring this was a surprise.

With regard to the underlying theory, it was felt that from a VoC viewpoint the taxonomy developed was largely upheld. Resource capability and an ability to innovate in a changing environment was reviewed through RBV and dynamic capability (DC) frameworks. While both sectors displayed tenacity it was the two UK organisations that were able to take decisions on changes in policy and adapt more quickly. GPNs were helpful in reviewing the differences in control, coordination and communication between the German and UK organisations. The two German companies were much more inter-connected with their partners and institutions, but they were also more constrained in terms of choice of location, lower autonomy and higher control.

The key findings are used to develop eight propositions reaching across the two case studies. These propositions are then further developed into Conclusions in Chapter 8.

CHAPTER 8

CONCLUSION

8.1 Contribution of the research

The combination of different strands of theory has helped to explore the motivation for why and how MNCs embark upon, and implement outsourcing and offshoring practices. In particular, it enables the consideration of the main research question which is the extent to which the outsourcing and offshoring behaviour of firms from Germany and the UK are constrained by their varieties of capitalism and is embedded in the institutional contexts of their respective home countries.

The novel contribution of the thesis is twofold.

First, a conceptual framework is posited by proposing a taxonomy to analyse the relationship between CME and LME varieties of capitalism and the components of the offshoring and/or outsourcing process. The similarities between the two UK companies (BA and CompanyXYZ) and the two German companies (Lufthansa and CompanyABC) confirms the usefulness of the taxonomy and allows for its extension to other firms and sectors. Further, the trends and implications identified might well be extended forward over time.

Second, the empirical novelty lies in the ‘rich data’ generated by valuable insights from the senior executive interviewees to which the researcher was privileged to have access to. This is despite holding a relatively small sample of 14 interviews with the chosen case study companies. The responses to the same questions provided a consistent data set.

8.2 Overarching finding

The main aim of this research was to establish the extent to which the outsourcing and offshoring practices for the chosen case companies were embedded in the institutional contexts of their home countries, as seen from a 'varieties of capitalism' perspective.

> To a significant degree the policies and practices in use in India, Czech Republic, Poland and China do largely followed the characteristics anticipated for each of the German and UK headquartered MNCs studied. This applied both to transport / airlines and also to engineering sectors as reported in the case studies.

8.3 Ambiguities

Although many aspects of the hypothesis developed in the conceptual framework are supported, there are also some aspects that are disputed or lack clarity:

The ambiguities noted include:

The policy towards outsourcing and offshoring at least with the airline cases, is very dependent upon the CEO. Frequent changes (five years on average) in leadership over the past twenty years, has now resulted in the use of substantive outsourcing at Lufthansa, rather than relying upon captive offshoring. For BA, better relationships with trade unions then either history or the VoC characteristics alone might have predicted, have also been observed.

The German businesses (in particular CompanyABC) regard their overseas presence as necessary for market development and making good use of local skills (e.g. software development) which also just happens to be at a lower cost than the same skills in Germany. Thus the issue here is whether market development really is the justification for moving or relocating work offshore and retaining control, or is it just rhetoric for saving cost? Separating suspicion and fact prove troublesome in this instance.

For the German case there was very limited communication channels between the operating business and with the customer (OEM) when we might have assumed a higher level of interconnectedness and interrelationship.

Considering attitude to risk, with the UK cases autonomy seems to be evidenced by a hands off, stand-alone approach as long as targets are met. In Germany the processes are standardised and closely monitored in operational terms, and are not keen on taking a third party risk. A higher level of interconnectedness and institutional support might have been expected.

The German company would have been expected to deploy and retained a stronger presence, especially of skilled operatives or of senior management in establishing new captive offshoring locations. Involvement was largely short term and modest.

With regard to cultural proximity, the German engineering company developed a long established, sizable and now firmly embedded business in India, while the German airline had no wish to locate in India (following a bad previous experience). CompanyXYZ also had no wish to relocate in India and yet that is where a UK company might have been expected to be comfortable.

With the UK management and trade union relationship, at BA a number of employees were successfully relocated from Gatwick to Heathrow. This might not have been anticipated by the stereotype VoC for UK trade union and management relations, or indeed by the history at BA. Company XYZ had also made radical changes without adverse relationships developing.

Finally, regarding a change in policy such as re-shoring. To this extent the case study companies are not typical of the average levels reported for re-shoring in the UK and Germany (14-20 per cent see 2.3.1) nor of a recent increasing rate or a response to political pressures.

8.4 From propositions to conclusions

The propositions were identified in table 7-2. Here each proposition is summarised and extended as a conclusion:

The first proposition is that in terms of motivation for outsourcing and/or offshoring then cost reduction is a key, but not the only driver. Coordination and control, and a low cost skilled workforce are also key considerations in both airline / transport and in the engineering sectors with UK and also German companies.

Coordination of captive offshore subsidiaries from HQ and a replication of shared services is important for the German engineering company and the German airline. Market development, product quality and local expertise is also important for the German engineering business. Further cost reduction is now inevitable for the German airline and additional outsourcing initiatives are anticipated as the route to achieving the targets. The British

> airline and engineering companies have already undergone significant outsourcing leading to improved productivity and enabling the case for further capital investment and growth.

The second proposition with regard to ownership, is that in both sector cases the UK Corporation was open to outsourcing at an early stage and then to progressive levels of offshoring. There was a reluctance to outsource evident from both German companies (although there is very recent evidence that this is changing for the German airline as above).

> The term offshore is not necessarily recognised or widely used in the working language of either of the German cases studied. Captive offshoring was reframed as market development especially in the case of CompanyABC. At Lufthansa, the lower cost base and efficiencies of shared services was acknowledged and importance placed on duplicating the model to other regions for a consistent global offering.

The third proposition regards control and coordination and notes that the Procurement and Contracts department controlled and coordinated a number of the initial operational changes via outsourcing in the UK airline. Performance measures and SLAs are regarded as part of achieving budget but WNS who supply BA are left alone to meet targets. In the German cases the line management team is in situ (captive offshoring) and has to work closely with headquarters in agreeing targets, budgets and plans.

> More recent examples of outsourcing in the UK airline have come from ground operations and helped to secure future investment in new aircraft. Strategic initiatives as part of collaborative ventures at BA also generate

substantive savings. In the German organisations there appear to be fewer 'degrees of freedom' from institutional pressures and business units must consult with HQ on delivery, changes in strategy and policy. Their ability to outsource and offshore is constrained by institutional pressures.

The fourth proposition and conclusion regarding autonomy is largely consistent with LME stereotypes (comparatively high as long as budget is met) and for CME (comparatively low, with coordination and control from headquarters on policy) styles for the UK and Germany respectively.

The role of the parent group board was found to be significant for both UK and German companies not only in terms of policy and direction but also in terms of support for outsourcing and offshoring decisions. This emphasises the strategic nature of outsourcing and offshoring rather than the traditional view that business units treat this as a sourcing issue which is largely cost driven and ordinarily dealt with at an operational level.

The fifth proposition is that divisions of labour were very similar for both sectors. The German companies studied were inclined to utilise ex-pats from Germany for initial start-up. There was minimal involvement from the two UK companies.

This does contrast with some 'other' transnational companies that aim to develop a mobile, international cadre of experienced managers (such as ABB see 8.5 further research) and readily relocate experienced international executives to help establish and transition new business anywhere in the world.

The sixth proposition is that English is regarded as a widely spoken international language and hence for UK companies the location choice is easier, also there is a historical tendency to use former colonial and Commonwealth nations such as India as a location for offshoring work. There was generally a higher level of concern by the German companies for needing to work somewhere more sympathetic to the German language and to the home culture, as in Central or Eastern Europe.

> However, the findings are to the contrary, with the German engineering company developing a long established, sizable and now firmly embedded business in India and more recently in Asia for automotive software based products. Whereas CompanyXYZ decline to offshore to India.

The seventh proposition is that managerial and trade union relationships present one of the biggest differences between the UK and Germany.

> In Germany, disputes in general seem to be settled more quickly with the management trying hard to be consultative and / or avoid conflict in the first place with the Works Council. The attitude of members is different as a result, while supportive of the TU in the UK they are rather less so of the works council in Germany.

The eighth proposition is that there were surprisingly few examples of re-shoring identified in the companies studied. A flexible attitude by the UK airline and engineering company was evident with a willingness to change earlier decisions and policy when judged appropriate and demonstrated by lower cost and improved productivity. There were suggestions that in the German engineering business, work had been brought back from India and similarly in the British engineering business work had moved from Mexico back to the US. In each case specific details were not available (only suggestions of poor quality and insufficient skills in the case of CompanyABC).

8.5 Further research

In Chapter 7 several gaps were identified that deserve further research including: whether the real level of re-shoring in the four companies was actually greater than that reported; and secondly what recruitment, training and development plans were actually in place at CompanyXYZ. Thirdly, in the case of CompanyABC, why do they have a number of separate subsidiaries working independently of each other in the same street in Bangalore? More research is also required to understand clustering dynamics as one of the aspects of GPNs with the balance of power between actors, knowledge of regional assets, policy interventions, institutional arrangements, cultural awareness and value creation.

Over the period 2013-2014 the researcher undertook some related research in Shanghai and Beijing, China. It was not possible to gain access to the original four case study organisations which operate in this region, as hoped; however, four other multinational corporations (Mitchell, 2014c) also in the transport and engineering sectors were identified. This is of interest because the HQ base can once again be linked to a Variety of Capitalism (VoC) model thus providing a useful comparison with the case studies presented (See Appendix A4.1).

That these companies sit in similar industry sectors is compelling, as is the fact that the same research questions were used again with senior executives. The four MNCs therefore offer a form of triangulating the findings from Lufthansa and BA in Case Study-1, and CompanyABC and CompanyXYZ in Case Study-2. These MNCs are not German or UK based, however, it is significant that they are headquartered either in the US or Europe and share similar country based VoC models that are either LME or CME.

Key messages derived from the interviews (for detail see Appendix A4.1) include:

Firstly, a number of these organisations have separate profit centres / business units with regional headquarters located in different countries. This is a result of mergers, acquisition and subsequent restructuring. In terms of designating a variety of capitalism (Hall & Soskice, 2001) it is the original home country that is assumed to be dominant when interpreting the implication VoC has on the company’s approach to outsourcing and offshoring.

Secondly, transport and engineering sectors were again found to be reasonably homogeneous. Sub sectors e.g. transport: automotive, rail, were found to display similar characteristics as did Engineering: power, automation, building products.

Thirdly, captive offshoring was preferred by a major robotics company, and outsourcing was limited to the supply of components but was expected to move quickly towards sub-assemblies that would offer greater savings potential also the consolidation of complex supply chains. Higher skills and different capabilities however, would then also be needed in the workforce.

Fourthly, consideration would soon be given by a US parent company to reduce manufacture in Asia and especially in China as US local market labour rates have become very competitive. More consideration is given now to total costs including material and transport. This supports the case for further re-shoring to the US.

Finally, the management teams observed were very international, mixed nationalities with wide experience. Culture, language skills and geography were all considered to be important in decisions on outsourcing, location, and how to coordinate and control.

It would be interesting for further research to:

Test 'the robustness of the design' for differing classifications of VoC and different industry sectors. The recent further research by the author presented at a Cambridge conference (Mitchell, 2014c op cit.) is a start, and the early findings from this are referred to above and in Appendix A4.1

Return to each of the main thesis case study companies in say, five years and see what has changed. Further outsourcing is planned for the German airline Lufthansa. CompanyABC is also facing some difficult times in some markets such as China, and the German economy is showing signs of slowing. The UK is starting to see improvements in manufacturing and also with growth rates this may well impact on the dynamic manner in which outsourcing and offshoring decisions continue to be taken. The RBV and dynamic capabilities theory are particularly relevant in this respect.

Check whether earlier suggestions that Germany might move towards a LME model indeed happens (See 3.5.1).

This research has had the benefit of gaining insights from senior executives involved with policy making and decision making. They spoke with candour and authority. However, it would be of interest to expand the interview base (as originally intended) with a greater cross section of employee groups (rather than mainly senior executives) and interested stakeholders.

8.6 Usefulness of the research

The findings are of practical use to managers in MNCs developing and implementing their strategy, also in understanding why their own organisation as opposed to an international competitor follow rather different paths given similar industry challenges. This serves as a reminder that a cost-benefit review on its own may be necessary but is not sufficient. The taxonomy in the conceptual framework, together with an understanding of the relevant theoretical constructs will provide enhanced insights, and increase the likelihood of success.

The recent manner in which the German economy has been managed, and the resulting form of capitalism (CME), has becomes a guideline for many German organisations to follow and indeed has a number of advantages. Notably, the access to capital, a medium to longer term planning horizon, multiple stakeholders and / or institutions which appear to be closely coordinated in support. However, there is now also evidence that compared to their UK sector counterparts, German organisations such as Lufthansa and CompanyABC are more risk adverse, less flexible, slower to react to change and rather unsuited to outsourcing and perhaps traditional offshoring. There was little evidence until very recently of classic outsourcing in the German companies studied – although there are ongoing ‘threats’ to meet future cost saving targets. Offshoring in the German cases is captive and is heavily disguised under a ‘market focus’ label possibly because of fear of alienating the works council over losing jobs at home in favour of cheaper labour elsewhere. Indeed it is the case that from an institutional perspective CME’s are not able to deploy outsourcing and offshoring strategies with similar degrees of freedom to that that LMEs and their organisations typically enjoy. CMEs are constrained by their policies, the interconnectedness and style of working. Financial success and internal growth in Germany (until the recent period) has also conveniently allowed overseas growth without fear of substantive job losses at home. This has not been the case for the UK and other so called LME models of capitalism for example in the US.

For students, researchers and academics the conceptual framework and taxonomy developed during this research has proved to be a useful template for predicting how the organisations might operate in practice, and pulls together differing theoretical constructs.

8.7 Synopsis

This final chapter has clarified the contribution to research, the overall findings, a number of ambiguities and how propositions were considered to lead to the reported conclusions. Further research is proposed together with an assessment of the usefulness of the research.

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