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WHY ARE DIFFERENT SERVICES OUTSOURCED TO DIFFERENT COUNTRIES?

ABSTRACT

The "tradability revolution" in services has led to a dramatic expansion of offshore outsourcing of services, allowing firms to take advantage of lower production costs in foreign countries. However, production costs alone cannot explain the location determinants of offshore outsourcing of services. In this paper, we argue that minimizing transaction costs is also an important determinant of the location of offshore outsourcing of services. We empirically analyze characteristics of services and characteristics of foreign countries that may impact on transaction costs in an outsourcing relationship and hence determine where services will be outsourced offshore. We derive measures of service characteristics - routineness, complexity and interactiveness - based on the tasks required to provide them. Further, we posit that there are interaction effects between service and country characteristics. Using Bureau of Economic Analysis data on US service outsourcing across 11 types of services to 31 countries between 1992 and 2005, we find that: (1) services that are more routine, less complex or less interactive are outsourced more to foreign countries; (2) services are outsourced more to countries with higher institutional quality and greater cultural proximity; (3) non-routine, complex and interactive services are outsourced relatively more to countries with a better institutional quality. *Journal of International Business Studies* (2011) 42, 558-571. doi:10.1057/jibs.2010.61

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