Managing institutional differences for international outsourcing success: the case of a small New Zealand manufacturing firm

Abstract

Purpose - Most of the research on international outsourcing of value chain activities focuses on larger firms. This study fills an important research gap by exploring how small firms manage institutional differences to enhance their international outsourcing success.

Design/methodology/approach – The paper uses data from interviews conducted with two managers of a small New Zealand apparel manufacturing firm who have over 35 years of combined experience with international outsourcing. The firm had both failed and successful experiences in its international outsourcing ventures. Findings are discussed in the context of the extant literature on international outsourcing.

Findings – Small firms overcome institutional constraints they face in offshore locations by leveraging from their entrepreneurial skills, learning from failures and using a relational governance mode. This results in achieving performance targets and sustaining long term relationships with suppliers, defined as international outsourcing success in this study.

Research limitations/implications – The findings may not be generalised as they are based on a single case and cover only the client perspective. The study contributes to the offshoring literature from the perspective of smaller firms and calls for quantitative investigations to generalise the findings.

Practical implications – The key implications include that small firms need to develop quality relationships and leverage from their unique entrepreneurial capabilities to enhance their success while outsourcing to relatively different institutional environments. Moreover, even a failed experience might help generate subsequent multiple successful ventures, if lessons are learned and behaviour adapted accordingly. Operating in emerging economies is much more challenging than managers from developed markets usually expect – thus the need for them to understand and prepare well before undertaking operations in these markets.

Originality/value – With the rise of international outsourcing of value chain activities, the findings are useful to small firms aiming to achieve success in their outsourcing ventures in offshore locations. This study is one of only a few studies investigating small firms' international outsourcing that examines both failure and success in an institutionally diverse context.

Key words – Outsourcing, Entrepreneurship, Organisational learning, Relational governance, Small firms, New Zealand, China, India

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1. Introduction

International outsourcing has become a norm in the current globalised business environment (Hätönen and Eriksson, 2009). International outsourcing occurs when some of the value chain activities are sourced from external suppliers located abroad (Chadee and Raman, 2009). Firms outsource to offshore locations to reduce costs, seek growth opportunities, address competitive pressures, access human resources and follow industry practices (Lewin and Peeters, 2006). With the increasing globalisation of business activity, international outsourcing allows firms to leverage disintegration, location and externalisation advantages (Kedia and Mukherjee, 2009). Disintegration advantages include increased focus on core competencies and modularity benefits. A focus on core competencies allows firms to develop superior capabilities by appropriate reallocation of resources. Modularity, on the other hand, allows flexibility, speed and cost savings. By outsourcing to offshore locations, firms leverage from infrastructure, government policies and human resources available in those locations. Externalisation adds value by providing opportunities for co-specialisation and co-learning. While attempting to reap benefits of international outsourcing, firms face certain challenges such as transportation and logistic costs, quality of logistics infrastructure, local logistics industry competence, quality and delivery performance, supplier capabilities, and host and home country institutional differences (Ruamsook *et al*., 2009). Given the perceived advantages and challenges of international outsourcing, the question arises as to how firms can gain from their international outsourcing ventures.

There is still limited research on the relationship between international outsourcing and firm performance, as well as mixed findings. International outsourcing is found to enhance the productivity of exporters (Görg *et al*., 2008). A reason for this is that outsourcing firms are able to focus on their core competencies and use outsourcing to gain access to globally competitive products in which they, themselves, are not competitive. On the other hand, Mol *et.al*. (2005) find no performance effects of international outsourcing. Gilley and Rasheed (2000) find no direct impact of outsourcing on the performance of multinational enterprises (MNEs), arguing that the relationship between outsourcing and firm performance is moderated by firm strategy and environmental dynamism. In other words, in their study, outsourcing contributed to the performance of firms that followed a cost leadership strategy and operated in relatively stable environments. In uncertain and dynamic environments, transaction costs become higher and may offset benefits of cheap factors of production available at those locations. Also, firms having an outsourcing strategy to guide their outsourcing decisions gain significant cost savings from international outsourcing than firms having no such strategy (Massini *et al*., 2010). The mixed findings on the outsourcing-performance relationship suggest the likelihood of the influence of contextual factors on firms undertaking international outsourcing. This paper focuses on the context of institutional differences between client and supplier countries in the outsourcing performance of small firms. As international outsourcing is a strategic decision not to produce at home, outsourcing failures are likely to have serious implications on a firm's performance. Outsourcing failures can be more drastic for small firms relative to larger firms, since they have limited knowledge and experience, and are usually resource-constrained. By drawing on an analysis of a failed and a successful international outsourcing experience of a small New Zealand manufacturing firm, this paper explores how small firms manage institutional challenges in order to succeed in international outsourcing ventures. In so doing, the study addresses an important research gap in the international outsourcing literature.

The rest of the paper is organised as follows. The next section discusses the relevant literature underpinning the theoretical rationale for the proposed conceptual model. The third section discusses the methodology. The next section presents the case results, followed by the discussion. Finally, conclusions, implications, limitations and future research areas are discussed.

2. Relevant literature and conceptual model

Traditionally, the outsourcing literature has focused on the environmental and organizational antecedents of outsourcing, as well as the performance influences and consequences of outsourcing in relation to large MNEs, with little focus on small firms (Barrar and Gervais, 2006; Di Gregorio *et al*., 2009; Raman and Ahmad, 2013). However, small and medium enterprises (SMEs) are not smaller versions of large MNEs; they have distinct characteristics and capabilities as compared to MNEs (Brouthers & Hennart, 2007). For instance, SMEs face knowledge and resource constraints, but are considered more entrepreneurial than MNEs (Di Gregorio *et al*., 2009). SMEs are quicker in decision making, leveraging the benefits of small size and relatively flat organisational structures, where owners and managers are in direct contact with each other. SMEs face more complex problems compared to their larger counterparts, as their small size, structure and lack of resources, make it difficult for them to facilitate growth and remain competitive in the growing international economy (Coviello and Munro, 1995). In order to deal with these problems, SMEs are increasingly opting to cut costs and gain access to resources by outsourcing the manufacturing and service components of their businesses abroad (Di Gregorio *et al*., 2009). A recent study of New Zealand manufacturing SMEs finds that those that outsource their value chain activities internationally perform significantly better than non-outsourcing SMEs (Raman and Ahmad, 2013). The possible explanations include SMEs using international outsourcing as a tool to manage their scarce resources, enabling them to focus on their core competencies (Prahalad and Hamel, 1990; Raman and Ahmad, 2013) and leverage location specific advantages (Dunning, 2001). These include those relating to offshore suppliers, such as low labour costs, access to local markets, low costs of manufacturing abroad, and existence of production and supply networks in those countries. On the other hand, Solakivi *et al*. (2011) find no significant relationship between the performance of SMEs and outsourcing, but argue that it is the fit between the company context and outsourcing that enhances performance. This aligns with much of the outsourcing-performance research on MNEs.

SMEs also face the dilemma of sourcing supply chain activities from nearby locations (near-shoring) or distant locations (off-shoring). Antonio and Martines (2010) find that relatively larger and more internationalised SMEs and SMEs with institutional contacts outsource to develop value added activities from distant locations. Smaller SMEs, on the other hand, face challenges in establishing supply chain linkages in remote markets. This implies that SMEs with relatively larger resources and which have experience in operating in overseas countries are more comfortable outsourcing business activities from distant locations. This helps them leverage location specific advantages, such as the availability of relevant labour skills, raw materials and potential market size.

The mixed findings on the impact of outsourcing on firm performance suggest more complex influences and relationships between variables. These include relatively under-researched aspects, including contextual factors, such as the business environment, and firm's resources and capabilities that may influence outsourcing-performance relationships. Furthermore, there is scant research on the international outsourcing-performance relationship in the context of SMEs, since most of the research has tended to focus on MNEs and larger firms in general (Di Gregorio *et al.*, 2009; Raman and Ahmad, 2013). This research addresses this gap by examining how the business environment, in particular the institutional differences between the home and host countries, influences the international outsourcing success of small firms, and how these differences could be managed to enhance success.

Institutions are "humanly devised constraints that structure human interaction" (North, 1990 p. 3) and are commonly known as 'rules of the game' (Peng, 2009). Such 'rules of the game' can be classified into two broad categories: formal and informal. Formal 'rules of the game', or institutions, consist of laws, regulations and rules, while norms, cultures and ethics constitute informal institutions. As firms operate globally in different environments, they face different 'rules of the game', as regulations and cultures vary across countries. Firms outsourcing their business activities to offshore suppliers, with the aim of enhancing their business performance face challenges of environmental dynamism (Gilley and Rasheed, 2000) and cultural differences (Jia and Rutherford, 2010; Winkler *et al.*, 2008) associated with the institutional make-up in the offshore market.

Firms from Western developed economies generally enjoy strong formal institutions in their home countries. However, emerging economies from where these firms often outsource their supply chain activities are usually characterised as having weak institutions or institutional voids. Identifying institutional differences and voids and appropriately responding to them are essential for succeeding in emerging economies (Khanna and Palepu, 2011). Thus, the management of institutional differences between the home country clients and host country suppliers in an outsourcing arrangement is likely to play an important role in deciding the fate of the outsourcing venture. Accordingly, our base proposition is that well-managed institutional differences enhance the outsourcing venture success, while ineffective management of institutional differences is more likely to result in a failed outsourcing venture. But the question arises, if institutional differences exist, how do firms manage them? Based on the institutional–based view of strategy (Peng et al, 2009), we propose that small firms manage institutional differences by using a relational governance mode. The institutional based view of strategy proposes that managers are rational people and they make their decisions based on institutional constraints they face; and that when formal institutions are weak, informal institutions play a greater role in achieving outcomes (Peng et al., 2009). Therefore, the choice of relational governance makes sense when formal institutions are weak and informal institutions differ (see Figure 1).

Figure 1 about here

However, the question of whether the outsourcing venture should be governed through formal mechanisms (contractual governance) or informal mechanisms (relational governance) also depends upon other factors, such as the nature of the goods or services outsourced (Kedia and Lahiri, 2007) and firm characteristics, such as availability of resources and the entrepreneurial nature of small firms (Chetty and Holm, 2000). If the product being outsourced is of a 'commoditised' nature (e.g. standard garments), one can argue for more emphasis on contractual governance (Poppo and Zenger, 2002). As small firms are, naturally, small in size, and are resource and knowledge constrained, it might be difficult for them to engage in contractual enforcements in countries which are known for relatively weak regulatory institutions. Larger firms have been found to be successful in gaining benefits from international outsourcing because of their resources and synergy effects (Antonio and Martines, 2010; Gorg and Hanley, 2004). However, it might be too expensive for smaller firms to engage in contract enforcement mechanisms, which might cost a lot of time and money. At the same time, as small firms have relatively flat organisational structures and enjoy faster decision making, they are more likely to leverage their entrepreneurial capabilities to move to other suppliers or locations if they are let down by their existing suppliers. Enhanced competition in supplier markets and increased globalisation opens opportunities to outsourcing firms to move between suppliers or locations. Thus, small firms are likely to utilise their entrepreneurial skills in managing their scare resources and move to other suppliers or locations, if necessary. Thus, our second proposition is that a small firm's entrepreneurial nature enables its managers to make strategic decisions quickly, thus helping in the management of institutional differences.

Overall, we propose that the impact of institutional differences on international outsourcing success is moderated by a relational governance mode and entrepreneurial skills of the small firm (Figure 1). International outsourcing success from the client perspective implies the realisation of expected cost savings with respect to the quality of the products/services being outsourced, satisfaction with the outsourcing venture, and longevity of the outsourcing relationship.

3. Methodology

The main research question this paper investigates is how small firms manage institutional differences in achieving success, while outsourcing to locations with strikingly different institutional environments relative to their home country. A qualitative approach was adopted for this study because empirical research to date on the management of institutional differences by small firms engaged in international outsourcing is lacking. This approach enables access to exploratory data, which may not be accessible in quantitative research (Cavana *et al*., 2001), and is "appropriate for studying phenomena that are not well understood" (Edmondson and McManus, 2007).

Qualitative methodology is relevant also because the intent of the exploratory research question is to provide input into theory-building relevant to the topic (Eisenhardt, 1989). The approach allows us to gain deep insights from the empirical data, providing the opportunity to assess and advance the conceptual framework developed. Our study follows an inductivist/qualitative stance, where we start with some a priori constructs in the form of a conceptual framework, which allows us to focus on specific phenomena of interest (Haider and Birley, 1999). The approach also allows for fresh insights to emerge from the data, and potential emergence of relationships and patterns not previously identified (Daniels and Cannice, 2004).

Rather than adopting a case study methodology, our research is an interview study, since we were concerned with exploring particular phenomena, rather than seeking to understand the organisation as whole. According to Daniels and Cannice (2004), an interview study is "one where the data and findings are based on direct researcher-to-respondent conversations (in person or by phone)." (p185). As such, an interview study allows researchers to illustrate how a firm may respond to a specific situation or topic of interest.

The interview study was conducted on an Auckland based New Zealand apparel firm that has outsourcing operations in the offshore locations of Indonesia, China and Thailand, and previously in India. Thus, the unit of analysis is the firm. The firm in question is a small firm with 30 employees and 25 years of experience in international manufacturing outsourcing. The definition of micro, small, and medium firms varies across countries. NZSMERC (2012) defines small firms in the New Zealand context as firms having 6 to 49 employees. This is to adjust to the fact that larger New Zealand firms are smaller than their global counterparts. The firm was selected on the basis of its long experience in offshore outsourcing, and its different outsourcing performance outcomes – both failure and success. Contact was established with the firm via phone, and subsequent email relays resulted in a meeting being arranged between one of the researchers and two senior executives at their Head Office in Auckland, New Zealand.

By definition, interviews provide unique insights into a situation, depending on, among other things, the nature of the questions asked and the respondent's interpretation of the situation (Stokes and Bergin, 2006). Our interview guide (Table 1) consisted of a range of semi-structured and open-ended questions relating to both the decision and implementation phases of the offshore outsourcing projects, as well as an evaluation of the success of the projects to date. The interviewees were also given the opportunity to discuss specific issues and provide examples of instances where they had to handle institutional differences.

Table 1 about here

A single face-to-face, semi-structured interview was conducted by one of the researchers with the two senior executives from the firm, both of the latter being present for the duration of the interview. The interview lasted approximately two hours. By interviewing two respondents from the same firm concurrently, we were able to cross-check and validate information and opinions given by each interviewee, as well as benefit from their collective experience and range of perspectives, given their respective responsibilities and roles in the firm (Daniels and Cannice, 2004).

Executive One had been working for the firm for thirty years, in a variety of roles, and was present during the transition from local manufacturing to offshore manufacturing via an outsourcing vendor. Executive Two had been at the firm for over ten years and was the project manager for their offshoring projects. With their combined outsourcing experience of over 35 years with the firm, the two Executives were able to provide substantial insights into both the history of offshore outsourcing of the firm, and into the outsourcing projects that the firm is currently undertaking.

In order to ensure verification of the information obtained and subsequent accurate reporting, researcher-subject corroboration was undertaken, where the meaning of the data gathered was cross-checked with the executives during the interview (Cavana *et al*., 2001). This accords with the need to ensure that qualitative research is trustworthy, having credibility, dependability, transferability and conformability (Sinkovics *et al*., 2009). The interview was conducted in English. It was tape-recorded, and the audio files were subsequently transcribed.

Following Miles and Huberman (1994), the transcript was then manually coded, according to broad themes which arose from the literature review, notably those presented in the conceptual framework (project success, relationship management and other governance mechanisms, cultural differences and institutional factors). The coding process underwent a number of iterations resulting in sub-coding, recoding and clustering into these themes before the analysis was considered to be complete, as suggested by Bazely (2007). The analysis revealed some rich insights into the factors and relationships proposed in the conceptual model.

4. Findings

The focal firm did not succeed in its initial international outsourcing venture, but had a series of successful ventures afterwards. The international outsourcing journey from failure to success is summarised in Figure 2 and the explanation follows. The failed experience happened in India in the early 1990s and that was the firm's first outsourcing venture. As a result of this failure, the firm terminated its outsourcing arrangement in India and moved to a supplier in China where it was successful. Both China and India have different and weaker formal institutions as compared to New Zealand. Thus, it is interesting to explore how the firm failed in one environment and succeeded in another environment of similar institutional distance.

4.1 International outsourcing to institutionally different countries

The firm first outsourced to India and then later to China. Both China and India have strikingly different formal and informal institutions as compared to New Zealand (Table 2). It is evident from Table 2 that formal institutions are stronger in New Zealand and weaker in the other two countries. For example, contract enforcement is very hard in India and easy in New Zealand; China ranks in between New Zealand and India. Similarly, the ease of doing business index and global corruption indices indicate that New Zealand firms are likely to face significantly adverse regulatory environments in China and India.

Table 2 about here

The literature generally uses Hofstede's cultural dimensions and Hall's cultural factors to operationalize informal institutions (Hall, 1976; Hofstede, 1980), on the basis that these are largely reflected by the culture of the surrounding society. New Zealand differs substantially from China and India on Hofstede's cultural dimensions (Table 2). While China and India are similar on a number of these dimensions, New Zealand is in contrast. It is a relatively individualistic society with more risk taking propensity, less power distance, and more short term orientation, as compared to China and India. This implies that New Zealand firms operating in India and China need to consider and manage these cultural differences in order to succeed. Existence of cultural differences creates higher risk in managing supply chains and needs some risk mitigation strategies (Jia and Rutherford, 2010). Given these kinds of institutional differences, relational governance makes sense, as firms from collectivist countries with weak institutions tend to rely more on relationships to achieve their business outcomes (Peng et al, 2009).

4.2 The failed experience: lack of experience and appropriate governance mode

The firm's outsourcing venture into India occurred early in its experience of internationally outsourcing its manufacturing. The Indian economy was just opening during the early 1990s and the decision by the firm to outsource to India could be considered as an entrepreneurial decision to seek early mover advantages. However, the project failed within a year, causing the company to take the decision to terminate its contract with the outsourcing supplier in India. The firm had not envisaged that the challenges of moving out to an institutionally different country would be much more than originally anticipated.

4.2.1 Cultural differences poorly managed. The main reason for the failure highlighted by Executive Two was poor management of the cultural differences with their supplier. Executive Two stated that *"a lot of it probably was, in that instance, a cultural thing."* However, both Executives were unable to identify exactly what cultural aspects may have led to the breakdown of the relationship. Executive Two suggested that the failed Indian project resulted from the Indians' tendency to produce high-quality samples, yet produce low-quality bulk products for the contract:

> *... [We had a bad] experience in opening a container from India with regard to the quality of the goods. We went into India thinking that it wasn't business shirts, it was leisure shirts and various types of things that they could do out of India. And when you opened a container it smelt as if there was kerosene or petrol. What was the smell?*

This occurrence may be explained by the differences between India and New Zealand that led to a failure in communication and expectations - namely context, activity/passivity, power distance and individualism/collectivism (Table 2). Specifically, the differing contexts in which the two societies operate may explain the behaviour experienced; New Zealand is a low-context society, where people explicitly expresses their expectations, whereas India is a high-context nation where people tend to send implicit signals. The focal firm did not pick up on these implicit signals, and, as a result, had unrealistic expectations as to what the Indian vendor was able or willing to provide them.

The contextual differences between the New Zealand and Indian cultures appears to have also resulted in inappropriate governance being undertaken by the firm, as Indian culture places a great deal of emphasis on building strong business relationships (Winkler *et al*., 2008). The New Zealand firm, being from a country which relies predominantly on hard contracts when conducting business, seems not to have recognised this. The concept of activity/passivity could also be used to explain this behaviour, as India is generally found to be a relatively passive culture, while New Zealand is generally considered to be an active culture. Furthermore, differences in power distance may also be a contributing factor to this failed project, as India's high level of power distance means that employees may feel unable to voice a lack of understanding to their superiors; consequently the products manufactured were not as required. Finally, the cultural value of individualism /collectivism may also have influenced the firm and been a factor in the failed Indian project. New Zealand is a highly individualist culture, whereas India is a collectivist culture. The data suggest that the firm did not take this into account when conducting negotiations with the Indian vendor, and as a result, may have offered inappropriate incentives to the Indian vendor.

4.2.2 Regulatory environment and entrepreneurial decision. The early 1990s was a period of transition for India, moving from a relatively closed, to a relatively open economy. The firm endeavoured to leverage the more open economic environment but the Executives realised that the vendor did not respect the contract. As it takes time and resources to pursue legal cases, and the regulatory environment in India was relatively weak, the firm opted to terminate the outsourcing arrangement in India, rather than try to pursue legal proceedings. This aligns with the entrepreneurial nature of small firms, characterised by a less formal structure and faster decision-making.

4.3 The successful experience: learning and relational governance

For the focal firm, trust in its Indian supplier was broken because the goods supplied were different from the approved samples. Lack of trust, poor communication, and limited cooperation were factors in the fallout between the firm and the Indian vendor, which led to the firm moving away from India to China. The immediate cancellation of the Indian contract that occurred when the apparel was not manufactured according to agreed expectations indicates that the firm did not have measures in place to rectify and improve the relationship; instead, it simply contracted with offshore vendors elsewhere. However, the firm was able to manage its next outsourcing deal with a Chinese vendor more effectively. This proved to be a successful venture and was still in place at the time that the interviews took place.

The level of satisfaction of the firm with outsourcing to China indicates that the outsourcing projects in this location have been successful. After learning from the failed experience, it appears that the firm utilised a number of strategies and control and coordination mechanisms to successfully manage its outsourcing relationship. The firm's satisfaction with the China outsourcing project was evident from the Executive's responses when questioned about whether or not they were satisfied with the quality and performance of their vendors in China:

Absolutely! [We] wouldn't be with the same suppliers if the quality wasn't up to scratch. (Executive One)

We probably originally went offshore say nearly 25 years ago. And we are still using that same factory. So that's quite an achievement in itself. (Executive Two)

With respect to vendor performance and their satisfaction with the final product, the two Executives indicated that their initial expectations were met. Furthermore, they felt that their long-term relationship with their suppliers was strong and highly satisfactory. Furthermore, Executive Two stated that the cost savings met their expectations:

We wouldn't have been here if we didn't get them [cost savings]and there are some companies by reason of greater volumes who can perhaps have greater buying power but in the end we are happy with our level, and that we are getting the best out of it that we can.

4.3.1 Institutional differences and relational governance. Notwithstanding some differences, China and India have similar cultural and regulatory differences with New Zealand (Table 2). With respect to cultural differences, Executive Two asserted that cultural differences did not have a significant impact on their operations with their current outsourcing vendors, and joked that the only time he experienced cultural or language barriers was when he was *"…ordering food sometimes!"* This implies that the executives have been able to manage cultural differences in China well. They have used a relational governance mode effectively, developing good relations with their suppliers by using appropriate mechanisms. The literature also provides evidence that good partnership quality between client and vendor contributes to achieving organisational outcomes (Lee 2001; Chadee *et al., 2*011).

In regard to the mechanisms used to manage the outsourcing project with the Chinese vendor, Executive One stated that the business transactions with their outsourcing vendors are primarily based on trust. The Executives indicated that more emphasis is placed on informal 'soft' aspects reflecting relational governance, than formal 'hard' mechanisms associated with contractual governance:

Because it's trust related, at the end of the day it's going to work….We don't actually have formal contracts with the garment factories. We have our own order sheet so that's the way we do it. (Executive Two)

We've had such a good relationship with these factories so that it has worked…. I don't think a formal contract would have made any difference at all. It is just a case of the size of our business and if it *hadn't been for the good relationship I think we would've been further down the train. Contracts don't mean a lot in these situations. (Executive One)*

Executive One further identified one of the problems associated with 'hard mechanisms', such as formal contracts, as being a lack of legal ramifications, as *"you virtually have no recourse at all with regard to quality"*. Both Executive One and Executive Two indicated that their relationships with their outsourcing vendors were of high quality. They identified an exceptionally high level of trust as one of the main factors underpinning their successful relationships. When asked to identify on a scale of 1-10 (10 being excellent) the level of trust prevalent in their relationship with their offshore vendors, Executive Two stated that *"purely based on longevity it would have to be right up to 8 or 9 out of 10".* Furthermore, the Executives indicated that the high level of trust in the relationship meant that cooperation between the focal firm and its vendors was largely problem-free, and that minimal conflict had occurred between themselves and their outsourcing vendors. However, Executive One identified one situation where trust in their outsourcing vendors was questionable. He noted the increasing tendency for outsourcing vendors to sub-contract manufacturing work without consulting with the firm, because they were unable to cope with demand:

I think they subcontract the [garments] out. I know they did with some [garments], they subcontracted them out,...you think you might be dealing with XXX up there, but it might be another company who actually does the work for them.

However, since the firm was happy with the outsourcing outcomes, this did not concern them too much. Rather, the focus was on strengthening good relationships. Executive One stated that recently, due to the economic downturn and subsequent closing of manufacturing plants in Asia, the firm has dropped down the priority list of some of their outsourcing vendors, due to their small size; as Executive One noted, *"... and it's only our good relationship with them that's holding us in"*.

In respect to language barriers, Executive Two stated that no problems had occurred as a result of language differences because their Chinese outsourcing vendor contacts either spoke English, or had access to competent translators who were able to relay information between the client and vendor:

I was lucky that the contact that I have got in China...was quite young, so she had a good university education so her English was good... If someone's not there that speaks English, they've always got an option of bringing someone along that can translate.

However, the Executives brought to attention an instance where language differences could possibly be associated with some specific problems that arose. The instance was in regards to an order that was sent from the client to the vendor being misinterpreted, resulting in apparel being manufactured according to an incorrect design. Words used on the order form may have been misunderstood or misinterpreted by the Chinese vendor, and the resulting outcome could be explained by the power distance associated with Chinese culture. More specifically, employees working for the outsourcing vendor may not have fully understood instructions from their superiors, but felt they were unable to ask superiors to clarify the specifications of the design.

Both Executive One and Executive Two stated that they have encountered very few problems in respect to communication or information sharing to date, as they communicate with their outsourcing vendor frequently via telephone and email, and they visit their offshore vendors' site four times a year. The few instances when the Executives identified communication as being impeded and tasks being performed incorrectly by the offshore vendors, suggests that the firm benefitted from using a greater array of communication media. Using a variety of media meant that the client was able to reiterate its messages through different communication avenues to ensure that the message was correctly interpreted, as opposed to relying on one or two avenues (i.e. phone or email) where the message can be lost or misinterpreted as a result of cultural noise.

Although the focal firm's outsourcing experiences in China have been largely positive, the company has been reluctant to undertake formal contracts because of problems associated with getting contracts enforced in weaker institutional environments. To compensate, the firm executed a relational governance mode to manage its China outsourcing venture. It focussed on enhancing communication quality by using multiple communication tools and translators, establishing trust, enhancing cooperation and avoiding conflict (e.g. vendor sub-contracting without permission) with the vendor. This has resulted in longevity in their outsourcing relationships in China.

4.3.2 Learning and entrepreneurship. It appears that the firm has learned from its previous failed outsourcing venture in India and put in place the mechanisms the literature suggests to succeed in institutionally different countries. Turning outsourcing failure to success supports the assertion that learning from failures is effective and long lasting (Madsen and Desai, 2010). To quote Executive Two, *"we are very conscious of the things that can go wrong"*. The company recognised the need to display a high level of sensitivity to institutional differences and a commitment to succeed in their outsourcing venture. The firm has also been undertaking additional successful outsourcing ventures in other Asian countries.

5. Discussion

The focal firm experienced an initial failure in international outsourcing followed by a successful experience. Both the failed experience and successful experience are summarised in Figure 3. As shown, the findings support our propositions that institutional differences impact outsourcing success and small firms leverage from their entrepreneurial capabilities and use relational governance modes for enhancing success. In addition, we find that learning from failures is critical in enhancing success, as it enables small firms to use appropriate outsourcing governance mechanisms.

Figure 3 about here

The firm outsourced its supply chain activities to locations with relatively weak regulatory environments – but failed at one location and succeeded at the other. Both the outsourcing countries are similar in a number of Hofstede's cultural dimensions, but differ markedly from New Zealand. The failed experience occurred primarily because trust was broken, when the goods supplied did not match the samples provided. The firm did not find it worth engaging in contractual enforcements, considering its own scarce resources and the weak regulatory environment of India. Its decision to move to India during the early 1990s was a deliberate entrepreneurial act, as the country was opening at that time and the firm saw India as offering potential advantages compared to China. Termination of the outsourcing relationship in India can also be seen as a deliberate entrepreneurial act on the part of the firm.

In its China experience, the firm managed the regulatory and cultural differences through a relational mode of governance, incorporating cooperation, coordination and communication mechanisms, and development of personal relationships. The firm learnt from the failed experience in India, using a difference governance mode to manage its next outsourcing venture. The Executives were satisfied with the outsourcing venture in China, as it delivered cost savings, appropriate quality, and overall outsourcing satisfaction, which have resulted in longevity in their outsourcing arrangement.

While interpreting the findings, it is important to note that India was opening its economy to foreign business during the early 1990s, so the firm's decision to outsource manufacturing to India at that time was unquestionably entrepreneurial. India is now well regarded in manufacturing outsourcing and is ranked just after China in terms of manufacturing location attractiveness, based on a number of parameters (see Deloitte, 2010).

This case illustrates how choosing an appropriate governance mechanism and applying a combination of entrepreneurial skills and organisational learning helps small firms manage their resource constraints and institutional challenges in international outsourcing ventures. If not managed well, institutional differences are likely to have an adverse impact on organisational outcomes (Peng *et al*., 2009). The regulatory environment of most developing economies is relatively weak, and this poses difficulties in establishing productive outsourcing relationships from the perspective of a firm from a developed economy. Cultural differences also exist between Western advanced economies and their outsourcing providers from developing and emerging Asian economies. Such cultural differences have been found to adversely impact international outsourcing outcomes (Jia and Rutherford, 2010; Winkler *et al.*, 2008). This can be explained by the greater role played by informal institutions when formal institutions are weak or fail. The use of relational governance by the firm in managing institutional challenges aligns with the institution based view of strategy (Peng *et al*., 2009), and with the importance of cultural adaptation in reducing risks in global supply chains (Jia and Rutherford, 2010).

Small firms face resource and knowledge constraints because of their size. Despite their scare resources, small firms engage in outsourcing in order to focus on their core competencies and leverage from the cheaper factors of production available in other locations (Prahalad and Hamel, 1990; Raman and Ahmad, 2013). Small firms tend to be entrepreneurial in nature, and are quick in decision-making; thus, they are likely to move from one vendor to another, if not happy with the outsourcing performance. The literature cautions that supplier selection has a critical impact on outsourcing outcomes, and suppliers must be selected carefully on the basis of their quality and capabilities (Hsu *et al*., 2006). It is unclear from the current study whether or not an appropriate supplier selection process was followed. It is more likely that the focal firm followed a random approach in the selection of its suppliers. However, the firm moved quickly to another supplier when its performance expectations were not met by the Indian company. The firm learned from the failed experience and managed its next supplier relationship successfully. Thus, in the process of moving to another vendor, the firm learnt from failure as to how an outsourcing relationship could be managed more effectively. Learning from failures is more effective and depreciates more slowly than learning from successes (Madsen and Desai, 2010). That the focal firm had many successes in its international outsourcing ventures following its earlier failure illustrates this point.

6. Conclusion

The main objective of the study was to explore how smaller firms manage institutional differences in order to succeed in their international outsourcing ventures. Small firms are normally characterised by having resource and knowledge constraints and entrepreneurial skills. The key findings include that smaller firms address institutional and resource challenges by adopting relational governance, leveraging their entrepreneurial skills, and through organisational learning. Firms from developed economies operating in emerging economies face strikingly different institutions: relatively weaker formal institutions and stronger informal institutions. As formal institutions are weaker and smaller firms have resource and knowledge constraints, using relational governance mode helps firms address institutional challenges and utilise their scare resources at the same time. For instance, it may not be wise for smaller firms to engage in lengthy legal battles in emerging economies with weaker legal institutions as it is likely to take a lot of time and resources with uncertain outcomes. The entrepreneurial nature of smaller firms enables them to make quick decisions and shift to other vendors, if needed. If the vendors know this, they are more likely to behave and perform as agreed. The study also demonstrates that learning from a failure and implementing relevant practices results in enduring future successes.

The current literature on international outsourcing highlights the role of relational governance in international outsourcing success, but most of the studies relate to large multinationals (Chadee *et al.*, 2011; Di Gregorio *et al.*, 2009; Lahiri and Kedia, 2009; Lee, 2001; Raman and Ahmad, 2013). We contribute to the international outsourcing literature by examining the relationship between institutional differences and international outsourcing success from the perspective of smaller firms. In particular, our study casts light on the mechanisms that smaller firms use, particularly relational governance and entrepreneurial skills, to manage this relationship. The study is also one of few that examine both failure and success, following calls for such research (Peng, 2004.) As such, we provide insights into failure and success of international outsourcing ventures within the same organisation, and the role that learning from failure plays in subsequent outcomes.

Our study has allowed us to explore how a small firm achieved both success and failure in its outsourcing ventures, and provided some insights into how and why these outcomes arose. Given that many small firms increasingly confront similar outsourcing decisions as their international businesses grow, there are important learnings for small firms to gain from this study. First, the study highlights the importance of developing a high quality relationship when conducting outsourcing arrangements in countries with relatively weak regulatory environments. Relationships also help to overcome cultural barriers between Western individualistic and collectivist societies like China and India. Relational governance is particularly important for small firms, as they face resource constraints and thus rely on relationships to access vital resources. Managers need to use control and coordination mechanisms, such as multiple communication channels (e.g. phones, emails, personal visits) to avoid potential interpretation issues associated with single communication channels, to enhance mutual trust and strengthen relationships. Second, small firms can leverage from their unique entrepreneurial capabilities to recognise failures quickly and move to other vendors, thus reducing dependency. Third, learning from failures is very important. A failed experience might help generate subsequent multiple successful ventures, if lessons are learned and behaviour adapted accordingly, as evidenced in the focal firm. Next, it is critical to understand institutional differences such as regulatory and cultural differences of outsourcing vendor countries, and adopt appropriate governance measures for the proposed outsourcing ventures. Emerging markets are generally more challenging than managers from developed markets expect, and thus there is a need for managers to understand and be prepared to meet the challenges. Lastly, having appropriate processes in place to select vendors is likely to enhance outsourcing venture success.

However, care should be taken in interpreting the findings as they may not be generalizable because of limitations of this study. The main limitation is arguably the use of a single firm, whereby the findings relate solely to this firm and cannot be generalised to other firms. While such an approach is well-accepted in case study research (Sinkovics *et al*., 2009), and can, in fact, provide deeper insights into the phenomenon being investigated, a multi-case, or multi-firm, approach would widen the application of the findings. In addition, a survey-based quantitative study would enable a better understanding of the relationships proposed in the conceptual model, and provide statistical generalisability. Further, the findings are based only on the clients' perspectives, rather than on the relationship dyads, which is a recommended approach where possible (Styles *et al*., 2008). It would, therefore, be valuable to explore both the client and vendor perspectives to generate a more robust understanding of the phenomenon. Future research should test and erudite the nature of the relationships between the impact of identified variables - namely, relational governance, entrepreneurship, and organisational learning - on the international outsourcing success of smaller firms. In addition, a more broadly-based qualitative study would provide the opportunity for deeper reflection on the drivers of outsourcing success in small firms and their responses to failure. This will fill up a noticeable gap in research on international outsourcing from the perspective of smaller firms. Despite its limitations, the study contributes to knowledge on the international outsourcing success of small firms. By exploring both failure and success of a small firm's international outsourcing ventures, insights are gained on how small firms can engage successfully in this rapidly expanding aspect of global supply chains. The study contributes by enhancing understanding of how smaller firms can manage institutional differences while outsourcing to countries with strikingly different institutional environments to their own: by leveraging their unique entrepreneurial capabilities and establishing quality relationships with their vendors. Thus the study contributes to understanding international outsourcing from the perspective of smaller firms.

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Figure 1: Institutional differences and international outsourcing success: a conceptual model

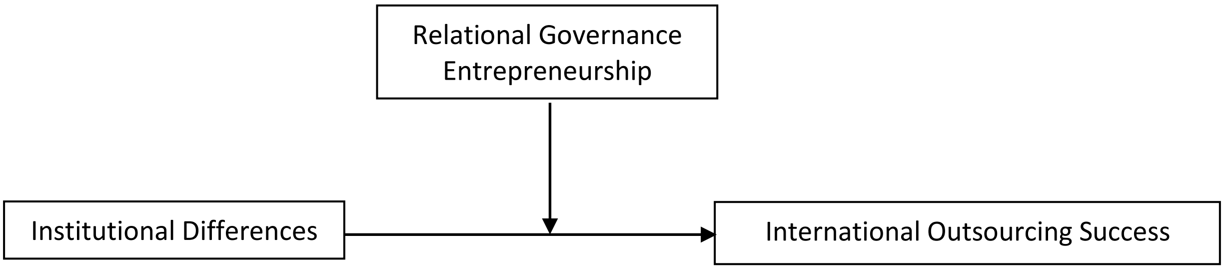

Table 1: Interview guide

Tell us briefly about your international outsourcing experiences

Discussion Stimulators: Type of activities outsourcing, Size and duration of the outsourcing venture, Supplier country selection - reasons, Satisfaction with the outcome, Key reasons for be satisfied/dissatisfied.

Tell us about main challenges you faced in your outsourcing ventures

Discussion Stimulators: Main challenges, Environmental differences in between New Zealand and China/India, Impact on outsourcing venture, How did you manage them – litigations, trust, personal visits, communication, training to staff.

Do you prefer contractual or relational governance to manage outsourcing venture

Discussion Stimulators: Reasons for choosing relational governance mode, Mechanisms adopted to make relational governance effective.

How you rate your relationships with your suppliers?

Discussion Stimulators: Any conflict situations you faced with your suppliers – examples, How conflicts were managed? Were they resolved? Your reactions to the outcomes.

How you perceive your outsourcing success rate?

Discussion Stimulators: Met your expectations – cost, quality, supplier capabilities, relationship quality, Overall satisfaction with the outsourcing venture, Planning to continue with the supplier or move somewhere else.

Would you like to share any related thoughts which I may have missed in the interview?

Table 2: New Zealand, India, China institutional differences

	New Zealand	India	China
Ease of Doing Business Index (Global ranking)[1]	3	134	79
Contract Enforcements (Global Ranking)[1]	9	182	15
Corruption Perception Rank[2]	1	87	78
Corruption Perception Index[2]	9.3	3.3	3.5
Power Distance Index[3]	22	77	80
Individualism[3]	79	48	20
Masculinity[3]	58	56	68
Uncertainty avoidance Index[3]	49	40	30
Context[4]	Low	High	High

Sources:

[1]Ease of doing business and contract enforcements http://www.doingbusiness.org/rankings

[2] Global corruption indexes

[3]Hofstede cultural dimensions http://www.geert-hofstede.com/

[4] Halls cultural dimension (Hall, 1976) and http://en.wikipedia.org/wiki/High_context_culture

Figure 2: International outsourcing Journey: from failure to success

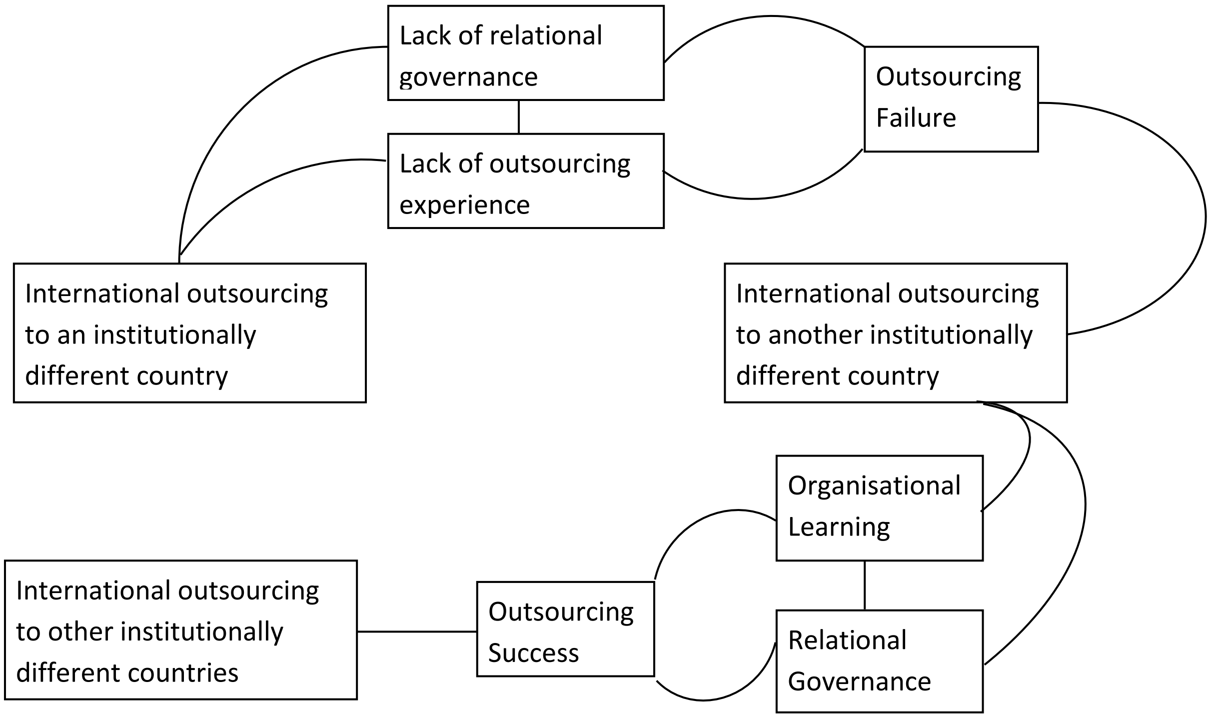

Figure3: Summary of the case findings