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Bridging what we know: The effect of cognitive distance on knowledge-intensive business services produced offshore[☆]

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ABSTRACT

The rise of offshoring of knowledge-intensive business services (KIBS), causing a physical separation between clients and service providers in co-created services, is a major trend in practice but challenges existing theories. International business literature has addressed many types of distance that may affect (service) offshoring, such as cultural or geographic distance. However, limited emphasis has been placed on the implications of differing cognitions of individuals that produce a *cognitive distance* (CD). We address this gap and ask how increased CD through offshoring affects KIBS production processes. This conceptual paper focuses on how CD interacts with the modularity of different process stages in service production and what effect CD has on repeated production processes. In order to do so we first predict what stages of KIBS production processes can be offshored and what implications offshoring has on these services. We contribute to literature by deepening the understanding of CD and providing a process perspective on KIBS offshoring that looks at modularity within services, rather than firms as bundles of modular production, and on the impact repeated production processes have on service characteristics.

1. Introduction

Knowledge-intensive business services are a major and increasing contributor to economic activity, particularly in advanced economies, and have therefore been studied widely in recent decades (e.g. Kipping & Kirkpatrick, 2013; Murray, Kotabe & Westjohn, 2009; Starbuck, 1992). For example, it has been conservatively estimated that these services made up 5.3% of U.S. economic activity in 2012 (US Census Bureau, 2013). We define knowledge-intensive business services (KIBS) as “value added activities [that] consist of the accumulation, creation, or dissemination of knowledge for the purpose of developing a customized service [...] to satisfy the client's needs” (Bettencourt, Ostrom, Brown, & Roundtree, 2002: 100–101), i.e. services that are co-produced by knowledgeable experts of service providers and clients (Schein, 1990; Starbuck, 1992) due to their embeddedness in the client's context. Thus, KIBS have various characteristics that distinguish them from less knowledge-intensive services and manufacturing (Murray et al., 2009).

Undoubtedly the most important change affecting KIBS over the past decade has been the previously unimaginable rise in offshoring of

KIBS (Larsen, 2016; Metters & Verma, 2008; Mudambi & Tallman, 2010), such as the offshoring of legal services (Harmon, 2008), research and development (Bertrand & Mol, 2013), and financial services (Jensen, 2011). Offshoring is viewed here as the sourcing of activities, either within a firm (captive) or from an outsider firm (outsourcing), from another geographic location, to support a firm's domestic or global operations (Manning, Massini, & Lewin, 2008). This geographic relocation of services can be seen as a drastic case of decoupling the service production process, i.e. separating services production and consumption, which should significantly affect these services and their characteristics. Decisions to source services across country borders are often driven by the dual aims of capitalizing on cost advantages, similar to manufacturing, but also and maybe even more importantly by the desire to access skilled and knowledgeable labor (Manning et al., 2008; Maskell, Pedersen, Petersen, & Dick-Nielsen, 2007), which in turn increases the capacity to create new knowledge.

Thus, offshoring and perhaps any physical separation of production and consumption of high value activities, challenges traditional theories of international business (IB), which have assumed that high value activities ought to be undertaken at home or are only offshored for

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efficiency seeking purposes (e.g., Dunning, 1993).

Moreover, IB theory has paid much attention to the impact of distance on cross-border activities, but the types of distance discussed most commonly, such as cultural distance (see Kogut & Singh, 1988 and in a service context Peeters, Dehon, & Garcia-Prieto, 2015), or geographic distance, do not directly address knowledge creation. Even knowledge distance is a type of distance most commonly measured through patents (Berry, Guillen, & Zhou, 2010), i.e. it addresses knowledge outputs, not inputs. A small literature (e.g., Bertrand & Mol, 2013; Ceci & Prencipe, 2013; Fainshmidt, White, & Gangioni, 2014; Xu & Shenkar, 2002) has used another type of distance called cognitive distance (CD). As we explain in more detail below, CD focuses on knowledge creation at an individual level, which stands in contrast to cultural distance that remains on the collective level. This characteristic makes CD highly relevant for our study of KIBS, as services are dependent on knowledgeable individuals (Starbuck, 1992), and are co-produced by individuals of the client and service provider (Schein, 1990).

Specifically, we draw from cognitive and behavioral theory, which focuses on how individuals create knowledge (Gavetti, Greve, Levinthal, & Ocasio, 2012; Levinthal, 2011; Nooteboom, 2009) and propose that offshoring induces an increase in CD among the individuals producing knowledge. Our focus is predominantly on trying to understand KIBS, not on the firms producing and/or consuming these services, and we compare offshoring to the default option of domestic (onshore) production. We focus on location as the driver of distance, only briefly addressing questions of ownership (outsourcing), which literature has already tackled (e.g., Bals, Jensen, Larsen, & Pedersen, 2013; Jahns, Hartmann, & Bals, 2006; Murray & Kotabe, 1999).

Therefore, the central objective of this paper is to explain what CD is and investigate how various stages of a KIBS production process are more or less likely to be offshored (in propositions 1a-e below). Then we study the indirect impact of CD on the modularity of different production stages (propositions 2a and b) and the repetition of service production processes (proposition 3). We argue that a) stages of production processes differ in their likelihood of offshoring due to CD; b) where production processes are modular, CD encourages offshoring of production stages; c) repetition of a production process in an offshoring relationship can help to bridge CD between individuals.

Our research produces two main contributions that provide insights going beyond existing theory. First, we present CD as a separate form of distance, at the level of individuals, which is crucial in KIBS contexts that involve co-production of knowledge by the client and service provider. CD has potential implications for a wider variety of IB phenomena. We show how CD changes the production process of services and as a result also service characteristics. These insights are novel to the international service management literature. Second, we help progress theory in offshoring and global operations management by providing a process view of KIBS production, which examines modularity of service production and repeated interactions between service providers and users while taking a cognition perspective. This approach creates a detailed picture of the phenomenon and provides stronger theoretical underpinnings.

Next, we discuss KIBS and the concept of CD, to lay out the mechanism driving our later analysis. Then we dissect the KIBS production process into five stages, to allow us to discuss each of these stages and the impact of CD on the propensity of offshoring this stage. Then, we are able to study the interrelationship between the stages within the production process and the repetition of the process. The key contribution of the paper comes from propositions that use the CD mechanism to investigate two key aspects of KIBS production processes, namely modularity and repeated relationships (McDermott, Mudambi, & Parente, 2013; Miozzo & Grimshaw, 2005; Tiwana, 2008). Finally, we develop the implications of our work and conclude the paper.

2. Kibs and cognition

2.1. Characteristics of knowledge-intensive business services

There has been some work describing the design and characteristics of KIBS as well as their production process (Den Hertog, 2000), although research efforts have mainly focused on the design of services in general (c.f. Goldstein, Johnson, Duffy, & Rao, 2002). Goldstein et al. (2002) emphasize the service concept in the production and design of services and produce a service design-planning model with three consecutive stages including inputs and outputs. Den Hertog (2000) emphasizes service innovations and client interaction, service delivery and technological dimensions of services design. However, this work does not incorporate the idea that a service production process consists of multiple stages (Stabell & Fjeldstad, 1998), nor does it examine physical separation of clients and providers as evident in KIBS offshoring. A further point from IB studies is that use of KIBS is associated with export intensive firms, although this seems to be driven by the innovativeness of these firms than by their export behavior as such (Shearmura, Doloreux, & Laperrière, 2015).

Before discussing the production process of KIBS further, the unique characteristics of the services need to be understood as they play a major role in the process. KIBS are often deeply embedded in client contexts through organizational processes and are used for the production of value, which is not always easy to decipher (Bowman & Swart, 2007) but is primarily derived from the creation of new knowledge. This knowledge is co-produced by experts from the client and service provider (Schein, 1990) and involves a high degree of tacitness, which is difficult to transfer effectively across locations and organizations (Szulanski, 1996). We follow Grant (1996) in arguing that knowledge is primarily an individual-level attribute, due to their strong reliance on these individual experts (Bowman & Swart, 2007). Moreover, the tightness of the link and co-production intensity can vary between different services (Bettencourt et al., 2002). There can even be variation between different stages of the production process of a single service; KIBS consist of multiple stages that are required to turn an initial customer signal into a finalized service (Stabell & Fjeldstad, 1998).

As a result of KIBS characteristics, the services are socially constructed, context specific, and ambiguous, based on personal judgments. These characteristics, taken together with the difficulties of standardizing activities that arise from the need for service customization (Bettencourt et al., 2002; Löwendahl, 1997), imply that KIBS offshoring was long seen as impossible (Stabell & Fjeldstad, 1998). Moreover, traditional IB theories have also predicted difficulties in offshoring of knowledge-intensive activities, due to the specific assets of KIBS that are impossible or costly to transfer across borders (Buckley & Casson, 1976) and that KIBS were argued to relate to client core competencies (Prahalad & Hamel, 1990). However, recent practical developments have severely put this conclusion into question.

We see KIBS offshoring as an ideal setting for understanding why these traditional theories no longer seem to provide correct predictions and suggest that the study of CD between individuals is the best place to start theorizing about new mechanisms. A summary of several existing perspectives on offshoring can be found in Table 1. We suggest that as firms increasingly consider different production stages separately (as modules), it has become possible to offshore some of these modules while retaining others onshore, instead of keeping everything onshore. This choice is evidenced by the observed increases in offshoring. Furthermore, we believe that experience generated from repeated interactions between providers and clients may be helpful, as it potentially bridges CD and supports firms' offshoring activities.

2.2. Cognitive distance

Given that knowledge production in KIBS is dependent on

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