

IT'S A SMALL WORLD- SOCIAL IDENTITY AND TRUST IN OFFSHORE OUTSOURCING

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This paper argues that social ties that are made on a substrate of social identities are a source of the initial trust that is required for procuring services from geographically dispersed regions. The study is based on affiliation networks of the founder entrepreneur of 40 successful outsourcing firms based in India. The study finds that a significant number of these entrepreneurs had major North America affiliations prior to setting up their firms in India, a fact that assumes significance in a context in which over 60% of offshore outsourcing transactions takes place out of North America. Integrating social network with transaction cost economics also provides a better conceptual framework to explain the growth of offshore outsourcing that has traditionally been explained in terms of labour cost arbitrage. Looking at offshore outsourcing as transactions that are embedded in social ties can explain why such transactions have been limited only to certain geographic regions.

1. INTRODUCTION

Recent years have seen tremendous growth in outsourcing from geographically dispersed regions. This growth has been typically explained in terms of low labour cost in the countries from which the services are being procured. This offers only limited explanation as there are other issues that are left unexplained. For example it is not clear why there is a huge concentration of locations from where services are being procured (around 70% of services are procured from a single country which is India) and not from other locations where labour costs are equally low or sometimes even lower. A rather less obvious question is why the growth in offshore outsourcing, though exponential, is not even higher? Advances in telecommunication technologies have ensured that there are few technological barriers to firms sourcing services globally. As individuals we procure goods and services all over the world and communicate with our near and dear ones who are based on other side of the world with low cost and user friendly technologies like VOIP, internet auctions and online payment facilities. Yet firms show remarkable reluctance to procure services from geographically dispersed regions, even when few technological barriers remain and there is clear labour cost arbitrage.

One of the reason why firms may hesitate to procure services from offshore can be due to the greater level of uncertainty associated with the process. Intuitively, one senses that uncertainty is greater when services are procured offshore. But what leads to this heightened sense of uncertainty? From the new institutional economic perspective, one can say that the basis of the heightened sense of uncertainty lies in the different institutional norms that the buyer and seller faces in the case of offshore outsourcing. Institutions, following North's (1990) argument, are the *rules of the game*, both formal and informal. In the case of domestic outsourcing, the institutional setting in which the buyer and seller operates are the same, while in offshore outsourcing it is different. As pointed out by North, the primary purpose of institutions is to reduce uncertainty in transactions, but this of course implies a familiarity with the institutions of both the formal and informal types. Firms that are spatially located in geographical locations that are separated by large distance would have familiarity with local institutions but would have relatively less knowledge about institutions that its partner firm is embedded in. One can see how such information asymmetry about institutions lead to a heightened sense of uncertainty in offshore transactions.

The following discussion is divided into the following sections. In the first section, the issue of organizational trust and how it affects the governance decision is discussed. Inter-organizational trust and network governance are closely related concepts and this is highlighted in the discussion. In the second section, the small world phenomenon is discussed. More specifically it is highlighted in this section, how social small worlds are built on social ties, strong and weak. How these ties have different properties and how such ties makes offshore outsourcing possible. In the third section, findings are presented that are based on social network analysis of top ranking outsourcing firms, focusing on outsourcing firms that are based in India and looking at affiliation network of the founder entrepreneurs

3. THE SMALL WORLD OF OFFSHORE OUTSOURCING.

Economic action has been seen as something that is embedded in social relations (Granovetter 1985) that is contra-distinct from the neo classical economics view of economic action which is conceptualised as asocial and carried out by atomistic actors. While strong social ties have been found to engender trust (Putnam 2000), Granovetter (1985) pointed out that strong social ties though instrumental in engendering trust are not very efficient in search for new information. The argument is simple but insightful. The information that circulates within strong ties is often redundant and fresh information is often acquired through weak ties. Thus social networks perform two important but distinct functions, trust and search. As we have seen earlier, trust becomes even important in the offshore outsourcing context due to institutional uncertainties. But search would equally have an important role to play as search for suitable partners across geographical space would be of paramount importance.

Watts (2000) suggest that how people spatially locate themselves in relation to each other is often different to the actual physical distance between them. He invokes the concept of social identity here to make the point that people have multiple group identities that affect their sense of proximity to each other. Bourdieu (1985) makes a similar point, when he points that there exists a social space that is multi-dimensional and which is as real as geographical space and individual agents arrange themselves in this social space.

Watts (2003) makes the point that people make social ties on a *substrate* of social identities. Social identity forms the context in which individuals meet and interact with each other. Social identity forms out of group membership that an individual may have. The idea that people have affinity with other people with similar social identities has been put forward before (Hogg and Abrams 1988). Lewis and Weigert (1985) suggest that trust is essentially a cognitive process that discriminates among persons and institutions that are trustworthy, distrusted and unknown. In the context of offshore outsourcing, as mentioned before trust should play even a greater role in reducing uncertainty vis-à-vis domestic outsourcing. In a situation of where there is a sense of heightened uncertainty it should be the case that firms choose to interact with service providers that are trustworthy rather than with parties that are distrusted or are plain unknown. Simmel (1978) has suggested earlier that trust involves a degree of cognitive familiarity with the object of trust that lies somewhere between total knowledge and total ignorance. In a context, where the one party does not have any knowledge about the other, trust cannot arise, one can gamble in such situations but cannot trust. On the other hand if one has complete knowledge of the other, trust becomes redundant.

The affinity that individuals share with people with similar social identities can be a source of the initial trust that is essential to launch a partnership onto a 'cycle of trust' (Vangen and Huxham 2003). Once there is history of trustworthy behaviour exhibited by both the parties, it allows for taking more risks as partners becomes increasingly confident that one of them will not behave in an opportunistic fashion.

Granovetter (1985) points out that new institutional economics largely ignores the role social ties play in reducing uncertainty thus affecting governance choice by firms. Social ties are often made when people with similar social identities meet each other. Social identities are thus often the substrate on which social ties are made (Watts 2004). Social identity is a process of self categorization that is borne out of perception of oneness with a group of persons (Ashforth and Mael 1989). Individuals can possess multiple social identities e.g. organizational membership and religious affiliations. Watts (2004) suggest that individuals don't simply belong to groups, but have a way of arranging them in a social space to measure their similarity or difference to others. The way this is achieved is constructing a mental hierarchy of a particular group. At the bottom level of hierarchy is the closest possible affiliation of this particular group thus the strength of the affiliation is highest at this level. As one goes up higher up in the hierarchy, the strength of the affiliation reduces. As a thought experiment, if you consider that there is only one type of affiliation possible in the world which is geographical proximity, then the people who stay in your home and in your street will have the highest degree of affiliation with you on this social dimension. As you go higher up in the hierarchy, you will share this social identity with people in your city, then county, country, continent and eventually you will share this social identity with all the people inhabiting the planet earth.

As highlighted before, individual possesses multiple social identities and Watts (2004) suggest one's perception of proximity to another is affected by a) social identities they share and b) where they share these affiliations in the hierarchy of the social identities.

For example, if we consider three actors, Amar, Akbar and Anthony, two of them Amar and Akbar share a common social identity arising out of going to the same Ivy League Business School in the USA and also share a common social

India. The affiliation pattern of these founder entrepreneurs becomes significant in the context of offshore outsourcing where over 60% of the business transactions happen out of North America. Although it is difficult to establish empirically that the social identity the founder entrepreneurs played a pivotal role in establishing the initial trust between the firms in North America and that in India, several anecdotal account of these founder entrepreneurs on their success, further confirms this idea.

Offshore outsourcing has been generally looked upon as firms in low cost nations like India serving spatially distant countries like USA or Britain (D'Costa). The assumption here is that transactions are carried out at arms length distance with minimum interaction between inter organizational actors. It is shown here that the reality is that these relationships are often built upon a substrate of social ties that serves the purpose of building the initial trust and also facilitates search for suitable partners. Also emphasis is given on the socialisation aspect. Firms will often depute personnel in client site without any specific duties but to increase face to face interaction between inter-organizational actors.

Sense of proximity is relatively easier to generate when inter-organizational actors share physical proximity, however that is not the only way sense of proximity can be achieved. As discussed, sense of proximity also comes from sharing similar social spaces. Profiles of founder entrepreneurs of the successful outsourcing firms from India show certain patterns. Most of them have studied abroad mainly in Ivy League business and engineering schools in North America. Many of them worked for several years with MNCs based in North America and Europe before setting up their own firm in India. In other words these entrepreneurs had a set of social ties that they acquired prior to setting up their businesses that would be invaluable in generating a sense of proximity that is critical in a business model where transactions are carried out in real time yet are separated by great geographical space.

Social identity of the founder entrepreneurs and the role it plays in fostering the initial trust building can also perhaps explain why offshore outsourcing has been limited only to certain geographical regions. In the case of India, one witnessed emigration of skilled individuals through 1960 till late 1990s (there is still emigration of skilled individuals, but the pace since have slowed down). Many of these skilled workers formed group memberships (for example Ivy League business and engineering schools, MNCs etc) that would have resulted in a set of social ties that would be invaluable to those who would later set up businesses in India. In the absence of such ties, it would be perhaps very difficult to establish the kind of network governance currently being witnessed across large geographical distance.

4. SPATIALLY DISPERSED NETWORK GOVERNANCE

Late 20th Century and early stages of 21st Century has seen an increasing propensity amongst firms in OECD countries in general, and North America in particular, to procure services from spatially dispersed locations that are often at great geographical distance to them. Low labour cost has been cited as the main reason why firms are increasingly choosing offshore service providers. However, the fact that such transactions are restricted only to relatively few geographical locations, suggest that lower cost can only offer at best a partial explanation of the phenomenon.

Firms that have outsourced offshore are not only the large MNCs but also small and medium sized (SME) firms in OECD countries (Coward). For SMEs going to a distant locale poses a challenge that is qualitatively different from that faced by a MNC. Relative to MNCs, SMEs have less knowledge about different work cultures, customs specific to geographical regions, and in general suffer from a lack of knowledge about institution and norms of the country of procurement. These are real issues that often deter SMEs from global procurement despite the real saving potential that exist. For SMEs in North America that have taken the step of procuring services from India, a country that is not only separated by geographical distance but also differs in culture and societal norms, the decision raises the issue of trust that has to exist to lubricate such spatially distanced relationships.

As this study follows Granovetter's (1985) argument that economic action should not be seen as something undertaken by a rational atomistic actor but rather as something that is embedded in social ties, the following section tries to illustrate how such social ties have developed between SME firms in North America and India.

1970 and 1980 saw large emigration of highly skilled people from India to mainly North America prompting fears of brain drain in India. Kapur (2003) estimates young (under the age of 25 years) India born immigrants in USA increased from 304,000 in 1990 to 836,000 in 2000, 80% of whom had a higher education in India before emigrating to USA. Now of course, as India is reaping benefits from these social ties that allows for economic transactions such as offshore

sector, it can lend credence to the suggestion that these ties are essential for offshore transactions to take place.

From the three surveys mentioned above, 40 firms were identified that either in the second or third category.

Obviously for this purpose, the founder entrepreneur of these firms needs to be identified. Most of the firms in the surveys have an account of their organizational history in their website which would include a profile of their founders. In some cases where this cannot be found, the details are gathered by doing some search in the internet. What is of interest to us are the social ties of the founder entrepreneur that existed prior to setting up of their businesses. Following from Watts (2004) suggestion, that social ties are made on a substrate of social identities, the focus here is to identify the affiliation network of the founders. Affiliation networks and social identity are closely related concepts. Social identity would arise out of membership to different affiliations. The affiliation network of the founders in consideration would reflect the nature of social ties these actors have been endowed with.

As over 70% of the offshore outsourcing transactions take place out of the USA, a main point of interest would be to identify if the founders share any major USA affiliation. If they do, it would follow that they also would have been endowed with social ties arising out of these affiliations and these ties would be invaluable in generating the initial trust, which is suggested as of vital importance in offshore outsourcing in this research. On the other hand, if it turns out that the founders do not share any major USA affiliation, it would suggest that formation of initial trust is not of vital importance and arms length contracting that takes care of opportunism has been the reason for the growth in offshore outsourcing.

What can be considered as major USA affiliation? Affiliations that are characterised by emotional intensity, reciprocity, frequent face to face interactions can engender strong ties (Granovetter 1973). For India born immigrants to USA such ties can arise out of educational and or organizational affiliations. This is not to say that social ties cannot be developed through other affiliations but education and jobs are the two main reasons why Indians migrate to North America. For this study, if the founders have pursued education in USA for a substantial period of time (for example, time required to acquire a bachelor or master degree) and or have worked for more than 2 years in USA prior to setting up their own businesses in India, he or she is considered having an USA affiliation.

Another interesting affiliation to look into would be that with Europe especially with UK as India and Britain shares many similar institutions including the language. Despite sharing many institutional similarities as a result of the legacy of the British rule in India, relative to North America, offshore outsourcing has been slow to take off in Britain.

It was decided that affiliation network of the founders would be investigated with the objective to specifically look for affiliation to USA and Europe. At the same time an inductive approach was adopted to find whether there exists other pattern of affiliations amongst these founder entrepreneurs.

Information on the founders was retrieved from secondary sources such as websites of the companies they have founded, personal homepages, annual reports, SEC filings, social network websites and other archival data.

After collecting the data and doing a search for patterns, it was decided to include two additional categories of affiliation as it was found that a significant number of the founders had these affiliations. These are affiliation to the main engineering and business management higher education institutions in India- IIT and IIM. Both these educational institutes enjoy a reputation of being amongst the top tier premier engineering and management institutions worldwide. From the analysis, it emerges that the majority of the founders share USA affiliation prior to setting up business in India. Majority of the founders are engineering graduates either from India, in most cases from IIT, or from USA. A significant number of them have prior working experience in the USA and in some cases their firm's present clients include their previous employers.

Following table shows the percentage of founders in each of the affiliation categories

Affiliation	Percentage of founders having the affiliation
USA Affiliation	75%
Europe Affiliation	13%
IIT	38%
IIM	11%

The findings illustrates the suggestion made earlier that trust, which has to be of vital importance in the outsourcing

or absence of relevant social ties within these regions.

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¹ see also Dunning, 1997; Gray, 1998; Hirst and Thompson, 1999; Prakash and Hart, 2000; Strange, 1998 Farnham, 1994; Williamson, 1996; Moore and Lewis, 1999; Rugman's, 2001 for sceptical views on globalisation

² An analysis examining just the flexible working practices elements of HRM, using a longitudinal sub-set of this data, found that country differences persist over time (Tregaskis and Brewster, 2006).