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**An Examination of Issues and Strategies in Global Outsourcing: Insights from the  
Canadian Retail Industry**

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## **1. Introduction**

Globalization has provided both opportunities and challenges and impacted how managers make sourcing decisions. Today, it has become increasingly popular to decrease operational costs by outsourcing parts of the supply chain that have traditionally been performed in-house. Developments in logistics and technology have increased the options available for managers to tailor the design and management of their supply chain to fit their business objectives. Recent literature on outsourcing indicates that managers use outsourcing as a “quick and easy fix” to their operational problems (McIvor, 2008; Min, 2004; Juras, 2008). However, incorrect decisions to outsource key operations may have negative impacts on the long-term capability of a firm to continue to compete in a competitive global business environment.

Typically, the decision to outsource operations is conventionally driven by cost and profit margin considerations (McKenna and Walker, 2008; Stauss and Jedrassczyk, 2008). Strategic decisions made by managers have been limited in scope to the bottom line of a company’s income statement. A modern approach to the decision making process is centered on the short and long term goals of an existing firm (Hormozi, 2003). It has been recognized that outsourcing is more than a quick fix to cutting costs within a company and should align with the overall strategy of the organization. With increasing volatility in the economic environment, some firms are considering spreading their risk by sourcing from multiple vendors (Pang, 2004). The advantages and risks associated with each decision will need to be weighed carefully. Modern indicators of

when the outsourcing of operations becomes advantageous have centered on: technology improvements that have recently outdated core business operations; changing value chains that have forced firms to respond to evolving consumer needs; emerging markets that are available to supply demand; and firms forced to catch-up to competitors (Badeen- Fuller et al. 2000).

The global clothing retail sector has undergone substantial change over the last decade. With the entrance of specialized and discount stores into the market this sector has become highly competitive (Freathy, 2003). The current retail clothing landscape has seen a shift in focus on their supply chain management process and many companies are focusing on sourcing as a strategic tool to maintain their competitive advantage. With the significant investments companies have placed in their supply chain management and information systems, clothing retailers are looking to successfully reduce their investment in inventory by faster replenishments and improving inventory turnover (Mannings, 2007; Tan et al. 2007).

In this paper, an outsourcing decision making matrix is proposed and discussed; viz., how might a firm effectively manage the decisions to source its products and/or services. The framework of the model will be supported by a case study of a Canadian retailer and the issues the retailer has faced in competing in the clothing industry over the past 35 years. The paper is presented in four parts. The first briefly describes the decision framework. The research methodology is outlined next. The third section presents the case of outsourcing practices of the Canadian retail firm. The

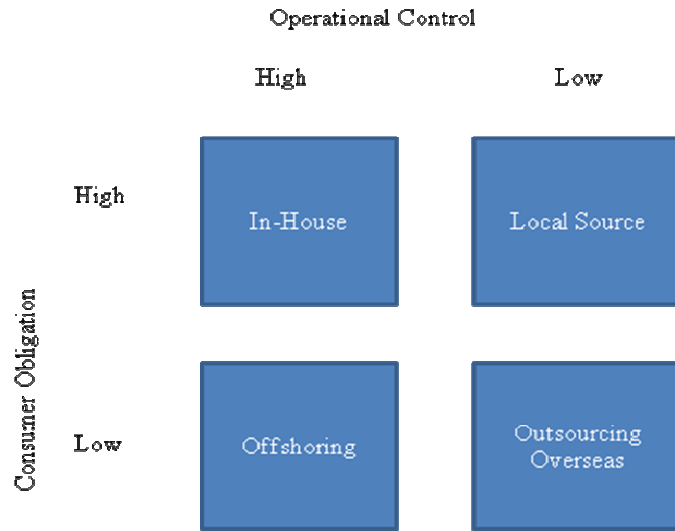
discussions and conclusions including an analysis of critical success and failure factors and examines important implications for managers involved in outsourcing is presented last.

## **2. Sourcing Decision Framework**

A globalized business marketplace presents opportunities for firms to realize the value of increased opportunities to source goods and services from around the world. The drivers of globalization (e.g., improved communication and more efficient transportation methods) have made it possible for firms to take advantage of international differences in cost, quality, and production methods (Crujssen, 2007; Srivastava et al. 2008). This in turn, has increased customer expectations in terms of higher performance levels and better service. The retail industry in particular, is extremely competitive and firms regularly seek a competitive advantage to separate them from the group. For example, there is no shortage of retailers providing innumerable quantities of basic blue-jean or classic white t-shirts in all styles and sizes. If a retailer can secure an advantage in a sourced product or material, it is typically a focus of their strategic marketing to exploit that advantage.

Implementing an effective outsourcing decision involves an analysis of various dimensions. This framework aims to link two of the major factors affecting the outsourcing decision in the retail industry. These two factors are customer obligation and operational control. The relationship between these two dimensions and strategies is shown in the matrix in Figure 1.

Customer obligation is broadly defined as fulfillment of clear specifications or requirements of the buyers or users of a particular firm (Koh et al. 2004). Within the highly competitive global marketplace, it is critical that the retail sector maintain a good relationship with customers to be successful. This relationship commitment can be viewed as the degree to which a firm feels pledged or obligated to fulfill customer requirements and also maintain a stable relationship with a supplier or vendor (Prahinski and Benton, 2004). An inability to fulfill such commitments may result in losing loyal customers and hence weakening a firm's competitive advantage (Youngdahl and Ramaswamy, 2008).



**Fig. 1. Sourcing Decision Framework**

Operational control relates to whether firm management chooses to keep production in-house or have it performed through an offshore arrangement. A firm must weigh the potentially short-term advantages offered by outsourcing against the firm’s longer term success. There are many examples in the literature where firms have lost their strategic control to a supplier and the supplier has become the major competitor (Earl, 1996; Shiu, 2004). Outsourcing the production of a competitive advantage to a third-party manufacturer exposes the firm to risk of losing that advantage (Lau and Zhang, 2006). In-house knowledge of the process usually erodes over time, or there is the risk that the process can be adopted by competitors. It is the decision of the firm whether to invest in their competitive advantage and keep it within their control, or to outsource it. Balancing the need for control over the necessity to provide a consumer obligated item is at the forefront of any business decision maker’s short and long-term goals for their firm. In order to maintain a healthy and successful relationship between customer and supplier, the firm needs to choose effective control mechanisms to prevent suppliers from taking selfish advantage of

circumstances but enable both firm and supplier the opportunity to improve their competitive advantage (Li et al. 2005). The control mechanisms are the organizational arrangements designed to influence what collaborating partners will do.

### **3. Research Methodology**

This study has been carried out as a part of an explanatory investigation of outsourcing practices of Canadian retailers. The case study method was selected as the appropriate technique since it has the capacity to investigate complex situations where the researcher's focus is 'how' and 'why' questions (Yin 2003). This focus of this case study was to explore the operations of a large Canadian retail firm. For many years, this firm has been engaged in the operations of strategically sourcing production of clothing merchandise. Multiple interviews were carried out over a time period covering September 2008- January 2009. The following interviews were conducted with management at the mid and senior level via face-to-face visits at facilities. Interviews lasted anywhere from 30 minutes up to 2.5 hours. The interviewer asked questions about each manager's experience and knowledge of the sourcing practices conducted within the company. Documents collected from the company during this research were classified into general company information and information related to the outsourcing activities studied. In advance of interviews, general company information was obtained from the company web-site and the public domain (e.g., newspaper-based business reports). This case study and analysis is

being presented to expand the current research of case studies focused on strategic sourcing. The information offered is judged by the authors to selectively illustrate the management decision criteria to source production of activities.

#### **4. A Case Study from the Clothing Retail Sector in Canada: Rocky Mountain Retailers**

Rocky Mountain Retailers (RMR) specialize in designing, manufacturing and selling clothes for use in multiple work conditions. One of their most lucrative product segments is their industrial division that makes work clothes for industrial workers. The retailer designs, tests, and sources materials to make durable, long-lasting clothing. Starting from one retail outlet in western Canada, they have expanded to cover all of eastern and western Canada with over 350 stores nationwide. More recently, RMR has experienced explosive growth, doubling sales from 1992 to 1998 and then doubling again from 1998 to 2007. Effective management of growth become paramount for the long term survival of the firm. Developing everything in-house to cope with the changes was no longer feasible. RMR began to look towards outsourcing components of the business to stay competitive at a high level and be able to continue focusing on core competencies. They have outsourced parts of their distribution to a third party provider and are currently outsourcing the development of their Information Technology (IT). Outsourcing these segments is typical for a large firm; however, decisions on how to source RMR made products is based on a different criterion. RMR, like most other retailers, weighs their product sourcing

decision against the value of customer satisfaction. This is commonly referred to by RMR as consumer obligation. Decisions on product cost, quality and inventory levels all reflect this notion of having a consumer obligation.

### **Outsourcing Decision Making Criteria**

RMR has established criteria for the deciding to source production and manufacturing of their merchandise. These criteria allow them to make informed decisions on the making and production of their product lines. RMR, like many other retailers, looks toward outsourcing their production in order to lower their investment in the production of products. It has been noted that a goal of outsourcing for RMR is to manage the risk of having a large capital investment in owned plant and equipment. Reducing investment in plant and equipment helps RMR to maintain market mobility as a company. It gives them the ability to move where the trends are and scale production accordingly. Management at RMR firmly believe that by outsourcing to other firms operations in which those firms they are “good” at what they do, it will in turn, frees RMR to focus on what RMR does well (in this case, retail and market merchandise to consumers) or commonly referred to as, their core competencies.

Rocky Mountain Retailers selects vendors based on the following criteria;

- Quality

- Trustworthiness
- Financial stability

A quality vendor is transparent and will not hide what he or she does. Indicators of quality usually are their willingness to reveal that they are employing to standards set by them and not using any child labor, for example, or exposing workers to poor working conditions. Vendor trustworthiness centers on the vendor's commitment to negotiated terms. Do they have a proven track record, and do you believe they will keep the integrity of the process by not selling your products to the competition or otherwise take advantage of the sourcing circumstances. Financial stability of the vendor is required to ensure the vendor can continue to produce the product or service for short and long-term gain. Outsourcing control of a component RMR's operations is largely weighed on these three indicators. Under these three indicators, management can make the strategic decision to outsource their product. When there is stability in the vendor's quality, trustworthiness and financial position, relationships can be built on a firm foundation that can build a long lasting relationship with long-term benefits.

### **Types of Outsourcing**

The following section reviews reasons for outsourcing under different categories associated with varying levels of commitment. Each degree of offshore outsourcing of production or of moving traditionally in-house production to external manufacturers falls under RMRs commitment to uphold ethical sourcing. The making of clothes is a relatively complicated process. Skilled labour and specialized capabilities are in high demand, especially when dealing with garments of

multiple fabric blends and complicated design. The process and fabric manufacturing may entail weaving, knitting, dyeing and/or screening prints (Simchi et al. 2008). The sourced fabric can also incorporate factors that influence how well the fabric insulates and machine washes. RMR continuously researches and develops testing procedures to prove the best materials and products are being offered to their customers for every-day activities, in particular, industrial work conditions. The process of placing merchandise on the sales floor begins with procurement of materials and progresses to the preparation of designs (which may also include prototypes), the cutting of fabric, sewing and completing finishing touches. RMR has four basic divisions in which the company separates production:

- i) **Men's world:** a division that focuses on the manufacture of garments geared to everyday living both for recreational and business.
- ii) **Women's world:** a division centered on the creation of garments for everyday activities for women whether in or out of the office.
- iii) **Industrial wear:** a division that provides quality labels and clothes that can be used in the industrial sector. This division also includes the marketing of safety wear and accessories.

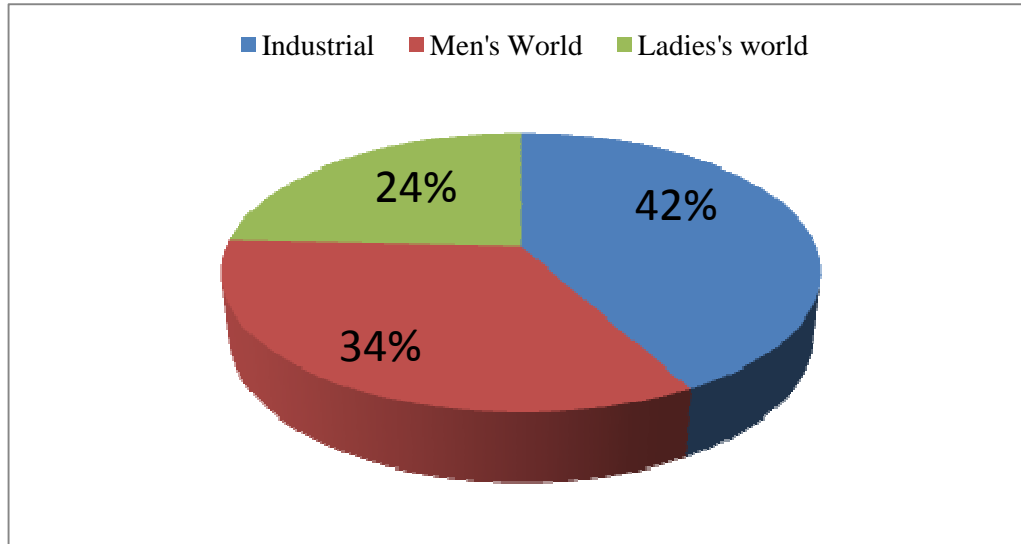


Figure 2: Divisional Sales as a percentage of Total Sales

### **Outsourcing strategies**

RMR focuses on developing strong customer loyalty and relationships are a major part of their strategic business plan. RMR believes their customers expect to find the products they are looking for, on the sales floor, on any given day. RMR management believes that the higher the consumer obligation to provide an item, the more likely that the product will be multi-sourced and sourced locally. This will give them the advantage of using vendor managed inventory, yet have increased response time for replenishment cycles. The lower the consumer obligation, the more likely the opportunity is to outsource and take advantage of large lot sizes and cost differences in production.

## **Outsourcing to vendors overseas**

There are many variables that contribute to the decision made to commit production of merchandise for the firm to outside manufacturers (McIvor, 2008). Outsourcing to overseas manufacturers, mostly in Asia, come with longer lead times, pressure to commit to larger production runs, loss of control over the product, and the interest in signing long-term “Relationship contracts” for mutual benefit. RMR observed that the commitment of production to overseas vendors is “best” worked through the maintenance and development of relational contracts. Long-term contractual agreements can prove to be beneficial in reducing the risk associated with overseas vendors. The assessment of risk when dealing with overseas vendors for the first time include i) the vendor not having a proven track record, and ii) the vendor failing to deliver goods that were contracted for (Metters, 2008). In addition, even if successful delivery has been made, the ability for the merchandise to perform to specified requirements of quality and condition is also a concern. Often encountered with sourcing from overseas manufacturers, is vendor reluctance to accept returned goods. When firms receive goods of inferior quality the returning process can be very costly and in most cases, the product contract agreement does not include refund provisions by the manufacturer. These risk factors are essential in the planning process of firms deciding to outsource overseas. In the case of RMR, 60% of their inventory is sourced from Asia. In most cases, the decision to outsource to Asian subcontractors is based on cost savings. RMR is currently in the process of increasing their Men’s shorts from being 30% outsourced to 80% outsourced overseas. The outsourcing process focuses on careful vendor selection and the establishment of a strong partnership to ensure successful conversion to outsourcing.

## **Offshore Operations**

Offshoring presents a different set of challenges and opportunities from traditional outsourcing for a retailing firm. Immediate consequences are the decreased control over operations and the direct influence the vendor can have on the firm's off-shore operations (Metters, 2008). One major barrier to the success of offshoring operations is the politics that can arise from a firm's presence in a foreign country that has opposing interest groups. The country of outsourcing may have political agendas that look unfavorably on the firm's ongoing success (Metters, 2008). In recent offshoring projects of RMR, expropriation has been a risk in some South American countries such as Argentina. In particular, as offshoring requires a great deal of capital investment and in an industry which is as dynamic as fashion, it can become a risky venture. Other concerns are the apparent physical distance, communication and personnel movement that can be quite cumbersome. Personnel have to travel longer distances to actually "see" operations and personnel may be reluctant to seek permanent employment in a foreign country. Specific to the fashion industry, offshoring of operations as part of a company's strategy often does not have enough favorable factors to make the decision beneficial. At times there may be little support for the high capital investment necessary to progress an offshore venture. The venture may also reduce the mobility of a company to move with market trends and a changing global economy.

## **Local sourcing**

Local sourcing becomes more advantageous to a retailer with higher consumer obligation. The fashion industry relies heavily on providing consumers with the product they are searching for at that very moment they are looking for that product (Nebahat, 2008). In such a competitive industry, consumers can take their business elsewhere and support the competition when you fail to provide service expectations. RMR believes the impact of a “non-sale” affects their bottom-line more than the sale of an item at a reduced price. Management makes their decisions through a combination of analysis of historical sales data and marketing to determine their consumer obligated items. The higher the obligation to provide the customer with what he/she is expecting the retailer to provide, the more sources the retailer must have for production. Multi-sourcing for various products helps to diversify the risk of being unable to supply certain items. However, extent of multi-sourcing must be guided by reasonableness and discretion. Benefits with local sourcing of merchandise for a fashion retailer includes: i) quicker turnaround (vendor managed inventory), ii) shorter inventory holding time, and iii) shorter lead-times. Firms often pay more in North America to have skilled labour perform the production process required of the retailer; however, they also take advantage of the close proximity of service. Managing lead-times for inventory becomes significantly shorter, thereby reducing the safety-stock required as well as reduced costs of storage. In most cases where there is a local manufacturer, the vendor will make and hold the inventory to be shipped, thereby providing a storage cost saving to the local retailer.

RMR have had successful business ventures through long standing relationships with their local casual pant and jean manufacturers. These products that RMR offer carry a higher obligation on their account to provide to their target customer. In turn, sourcing locally, they have lower profit

margins on these items. Understanding the mutual benefits of having a trusting relationship with their local provider has enabled RMR to better forecast decisions with their supplier. The sharing of information has helped the purchase and sales forecasting for each company and has given them more opportunity to make strategic decisions for their operations. For example, the purchasing department of RMR

### **In-house Operations**

Many retailers, especially those at the medium to large enterprise level have kept few operations in-house. The design and replenishment logistics of products are traditionally kept in-house, while the manufacture and production of garments are sourced elsewhere. Firms that have a competitive advantage in their specific area benefit from keeping the competitive advantage in-house. Once a firm decides to maneuver an operation outside to a third-party, they risk losing control of that operation. Much of the advantage a retailer has is its ability to provide merchandise to their target customer base. It is more common with smaller retailers or even other industries to have more in-house operations when they are a smaller and/or newer operation. Whether through rapid growth, or through attempting to play catch-up in an industry, the process of outsourcing operations previously kept in-house can facilitate the process of managing that growth (Badeen- Fuller et al. 2000). RMR provides their own private labels for retail and also offers their own specialty clothing. Their competitive advantage lies in offering targeted customers products with unique specifications. To do this successfully, RMR has their own

product design teams and testing of products is done in-house. RMR testers run their products through a variety of testing procedures such as shrinkage, wash testing, checking color fastness and garment shape holding ability, in order to qualify them for use. RMR keeps these functions in-house to maintain greater control over the process. Control over the process is important to the success of having their own private label which distinguishes them from their competition.

In the company's early days, RMR began with their marketing operations in-house. As the company grew and became more competitive on a national level with other retailers, they noticed they were being limited by their marketing failing to keep up with the creativity of their competitors. RMR's marketing department failed to keep up with industry trends and often failed to bring successful strategies from other industries into their own. To remedy this situation, RMR contracted out their marketing to a third-party. RMR now focuses on what they do best, and gives the opportunity for their contracted marketing firm to focus on marketing RMR products. This relationship has proven to be a successful strategy for the long-term development of RMR's continuing success of providing quality products to their target customers. Building a long term business relationship with their marketing firm also has provided more efficient communication of expectations and strategies for long term company development.

### **Problems and Challenges in Outsourcing**

RMR experienced unexpected challenges due to the recent shift in the economic conditions in North America. For many years the Canadian dollar had been valued significantly less than the

American dollar. This favored manufacturing companies that would make products and goods and then sell them in the US market. Many Canadian manufacturers relied heavy on sales into the US market. In 2006-2007, when the price of the Canadian dollar suddenly increased and was at par with the US dollar, many Canadian manufacturing companies saw their profit margins disappear and struggled to earn profits on their long-term contracts.

In particular, RMR found themselves in a difficult situation with one of their local suppliers because of this market shift. Their underwear segment was sourced to multiple local vendors because they had a high consumer obligation to provide those items. At any given moment, the retail firm would have about 250,000 units of safety stock on hand. Product was sourced approximately 60% from Asia, 30% from local vendors and the remaining 10% from European sources (Figure 3). The total make-up of inventory sourced produces about 40,000 different styles and over 450,000 different SKU's to be tracked.

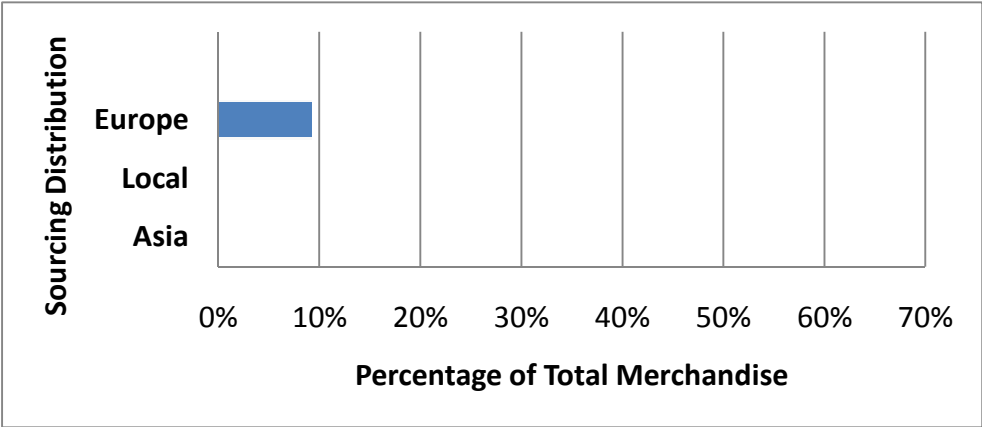


Figure 3: Outsourcing Distribution

Another outsourcing problem occurred when an RMR vendor went out of business, the company lost a significant portion of their product supply and had to quickly find a new source to supply their merchandise. Turning to any available supplier, they found themselves in Turkey trying to complete a contract. When the decision was finally made, the next obstacle to overcome was getting the product to the stores as quickly as possible. They chose to use air freight as it was the fastest of the modes of transportation available to them. This did get the initial production batch to the stores; nevertheless, it was only one shipment. Choosing air freight only allowed a small capacity to be used each time, thus, delaying the delivery of the entire shipment. Not only were they constrained by the smaller capacity for shipping, they were paying much higher premiums every time a decision was made to ship with air freight. Their alternatives were limited because of their obligation to provide the garments to their consumers in a timely fashion. Attempts to use the common ocean container shipping presented its own challenges. At that time there were high fuel prices and long lead-times due to high demand for ocean container shipping. It has been observed that lead times from ocean vessels increased when the price of fuel increased. Ocean vessels transporting containers for destination in the western ports of North America were travelling at more conservative speeds to save on fuel consumption. RMR saw their average lead-time for all overseas shipments increase over the 60-day average they were used to.

Since, 2007, RMR has spent numerous resources trying to supplement their supply for the sudden disappearance of production in their under garment segment. Since the disruption to their supply base on their under garment segment, they have added to their local sourcing base of manufactures to spread the risk of losing suppliers and product.

## **Ethics in Outsourcing**

There has been increasing interest world-wide to hold multi-national enterprises accountable for their business practices in other countries (Prestious and Love, 2006). An example is the recent outcry from North Americans against the ethical operations Nike had conducted in their offshore production of goods sold in America. RMR only distributes in Canada, however, the company is continually establishing their own track record for standards and guidelines in ethical sourcing. At their own cost they will, with their outsourced vendors, conduct operational reviews of offshore factories through a mixture of third-party audits, internal assessments and even factory self-assessments. Since 2004, RMR has established a supplier code of business conduct implemented through their parent company. This entails a set of standards that includes compliance with local and foreign laws, wages, appropriate working conditions, the use of child labour, and human rights. Their program is in accordance with the International Labour Organization (ILO). Also, they have seen the benefits of being a member of the Canadian Retailers Advancing Responsible Trade, an organization focused on responsible trade and the ending of unacceptable conditions for workers around the world. RMR believes in continuing to work with vendors in helping to manage their working relations and this will only improve their supplier relations as well as those who are directly impacted by their decisions. By taking an initiative with ethical sourcing, RMR can promote their image and ensure political activist groups that they are taking the steps necessary to make ensure the company is acting responsibly and in the best interests of those they employ. Under the umbrella of their decision making is their responsibility to source ethically and always uses ethics as a superseding factor in their strategic sourcing decisions.

## **5. Discussion and Concluding Remarks**

With more firms moving operations to be sourced outside their in-house operations, the process of outsourcing is becoming more complex. Through the discussion of strategies to source manufacturing, it should be evident that a one-size fits all strategy does not work (McIvor, 2008). Customizing the needs or applying the right mix of strategic sourcing to an organization's long and short-term planning is a current focus of many companies looking to move production from in-house to external parties. On the one hand, managers should be making decisions in today's increasing competitive environment that should be considered more comprehensively to determine the manner in which they impact the long and short-term goals and strategies of the organization. On the other hand, keeping the decisions simplified and processes basic, helps shorten the supply chain. A balance must be found among management of the company to implement the "best fit" sourcing. Moving operations from in-house to external entities always complicates the communication chain to operations. Managing that chain will add value to the company and improve performance. Looking at the strategic goals in the retail industry, it is the responsibility of the company to provide the opportunities for success. More specifically, there are certain steps a firm can take to ensure successful operations of strategic sourcing outside the firm's in-house operations. Some of those steps follow the process of simplifying operations to contain more standardized components in the process. For example, a firm should take advantage of outsourcing common designs. By using the common design, changes and alterations to a dynamic business environment can be easily modified and adapted. Sourcing in a globalized

business environment also provides opportunities to source common materials. Strategically taking advantage of common materials can help improve the lead-times and reduce complications in the fabrication process.

In a globalized supply chain, most problems occur when there is a break-down in communication. This is a common problem with moving operations away from in-house to outside distant third parties. The channels of communication become more complex and critical to the successful operations of a firm. Improving the channels of communication through simplification of processes and implementing common design, can help ease the anxiety of miscommunications on a firm's operational success. Moving in-house operations to offshore or other outsourced vendors adds complexity to the supply chain and the supply process. Obviously there will now be more channels of communication and risk of more disruptions in the supply chain. As firms begin to strategically source their operations to multiple outside sources, management must make informed decisions to strengthen the communication channels. The best way that RMR found to improve their communication channels was through the establishment of strong relational partnerships with their third-party partners. When each of the companies has a vested interest in the other's success, communication flow becomes easier and more productive. Focusing on the cost driver, typically had RMR switching to whichever supplier provide the lowest price. The constant threat of losing business over price never created loyalty with third-party vendors. The cost of re-establishing relationships with new vendors slowed the flow of the supply chain. When price ceased to be a driver of business decision-making for management, long-term relationships were formed and long-term visions shared

which clarified long-term contracts and agreements. RMR had found that with the decision to source strategically, the most beneficial drivers were not cost and price, but were characteristics of the company willing to collaborate on the long term goals of RMR.

This case study shows the complex nature of an outsourcing decision faced by the managers involved in the outsourcing. At present, this company appears to have reasonable control of their outsourcing operations. However, changes in the external environment and the financial sector in particular, continuously poses challenges to their outsourcing strategy. The authors are currently in the process of analyzing several other cases in Canada and US and it is hoped that the findings will lead to further insights into the effective management of outsourcing strategies.

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