

# A framework for integrating process improvement into business process outsourcing

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## Abstract

Process improvement has become an important objective for organisations in business process outsourcing (BPO). Employing the organisational learning aspect of dynamic capability theory this paper develops a framework for understanding the capabilities required for process improvement in BPO. The research has identified a number of first order capabilities that are likely to positively impact process improvement in BPO, which share the same characteristics as ordinary capabilities in dynamic capability theory. Moreover, the framework includes a sourcing learning infrastructure level, which includes a number of elements that develop, integrate and renew the first order capabilities that support process improvement in BPO.

**Keywords:** business process outsourcing; process improvement; organisational learning and dynamic capability theory

## Introduction

Business process outsourcing (BPO) has grown as organisations have been transferring responsibility for entire functions such as human resources (HR), logistics, finance and accounting (F&A), and information technology (IT) services to both local and offshore vendors (Gerbl et al. 2016). BPO has been viewed as a strategy for achieving both efficiencies and improving service levels, as organisations have strived to reduce costs and enhance performance in back-office functions (Handley and Benton, 2013). Despite the growth of BPO there are few studies in the current literature that focus on the capabilities required for process improvement in BPO. Although some authors have considered the link between general capabilities and BPO (Lacity and Willcocks, 2012; Fersht et al. 2011), little attention has been given to understanding the capabilities required for process improvement in BPO. Moreover, many of these papers lack a theoretical basis, and are aimed primarily at a practitioner audience. A further shortcoming in the current literature is that little attempt has been made to fuse the process improvement and BPO literatures to understand this important phenomenon. Therefore, the aim of this study is to address this gap in the literature by developing a framework for understanding the capabilities required for process improvement in BPO. The study employed the organisational learning aspect of dynamic capability theory, and undertook case study analysis of a number of organisations that have been pursuing process improvement in BPO in order to develop the framework. As part of this analysis a number of propositions are developed. The paper makes a number of important contributions. The research has identified a number of first order capabilities that are likely to positively impact process improvement in BPO, and these share the same characteristics as ordinary capabilities in dynamic capability theory (Teece, 2014). Each of the case companies possessed first order capabilities in areas such as contracting, vendor management, process improvement techniques and change management. A number of studies in the literature have already highlighted the importance of capabilities such as contracting, governance and vendor management (Lacity and Willcocks, 2012; Fersht et al. 2011). However, through focusing on process

improvement and BPO this study has identified additional capabilities including those in process improvement techniques and change management.

Moreover, employing the organisational learning aspect of dynamic capability theory (Zollo and Winter, 2002) has allowed us to identify a sourcing learning infrastructure at the organisational level. The sourcing learning infrastructure includes a number of elements that develop, integrate and renew the first order capabilities that support process improvement in BPO, and highlights that the case companies exhibited some of the characteristics of organisational learning (Zollo and Winter, 2002).

### **Literature Review**

Organisations are increasingly expecting process improvement in BPO arrangements. Process improvement can be in the form of reductions in costs and/or improvements in service quality (Holweg and Pil, 2012; McIvor, 2010). Clients and vendors have been employing process improvement tools such as Six Sigma, benchmarking, process mapping, and lean thinking to reduce costs and deliver process improvements in BPO arrangements (Holweg and Pil, 2012). A number of authors have found that significant benefits can be obtained through the effective application of process improvement tools (Wullenweber et al. 2014; Holweg and Pil, 2012; Ray and John, 2011). Holweg and Pil (2012) have found that employing process improvement tools such as Six Sigma can lead to significant cost savings and improvements in service quality for the client.

A number of researchers have undertaken research to enhance our understanding of process improvement in BPO (Gerbl et al. 2016; Feeny et al. 2005). The importance of client capabilities has long been recognised as a key enabler of effective outsourcing (Feeny and Willcocks, 1998), and research has suggested that differences in the levels of outsourcing and returns from outsourcing can be influenced by managerial capabilities in the client (Perunovic et al. 2016; McIvor, 2009). A number of authors have identified capabilities required for effective BPO including contract negotiation and monitoring, and leadership and governance (Lacity and Willcocks, 2012; Lacity et al. 2011; Fersht et al. 2011; Feeny and Willcocks, 1998). Although this strand of literature on BPO capabilities makes an important contribution to enhance our understanding of the client capabilities required for effective outsourcing, none of these studies focus on how capabilities impact on process improvement in BPO, and also lack a theoretical basis. Moreover, current literature does not provide an understanding of the supporting infrastructure at the organisational level the client should have in place to ensure process improvement occurs in BPO.

A further limitation of the current literature is that little attempt has been made to link the process improvement and BPO literatures. Despite the well-developed literature on process improvement (Skrinjar and Trkman, 2013), limited research has considered process improvement in a BPO context. This is somewhat surprising as there are a number of complementary aspects of process improvement and BPO. A key aspect of BPO is standardisation as it has a direct impact on production costs, since economies of scale can be achieved more readily (Wullenweber et al. 2008). This paper seeks to address this gap in the literature by enhancing our understanding of how organisations achieve process improvement in BPO. Following this logic, the aim of this research is to develop a framework for understanding the capabilities required for process improvement in BPO.

### **Conceptual framework**

A conceptual framework was developed to address the aim of the research. This involved reviewing the literature to identify a suitable theory that could be used as a

theoretical basis to understand process improvement in BPO. Dynamic capability theory was viewed as the most appropriate theory for undertaking the research. A dynamic capability refers to a learned and stable pattern of collective activity through which an organisation generates and modifies its operating routines in the pursuit of improved performance (Zollo and Winter, 2002). The dynamic capabilities concept considers issues such as how resources are developed, how they are integrated, and how they are released.

Dynamic capability theory was chosen to undertake this study, as there is a strong emphasis on organisational learning. Organisational learning is already recognised in the BPO studies as contributing to the development of routines that enables clients to collaborate with a range of vendors (Whitaker et al. 2010). Clients with greater outsourcing experience are more likely to outsource as they have learned the administrative routines that allow them to collaborate successfully with vendors. Organisational learning is likely to be an important element of process improvement and BPO. For example, the client should create an environment where learning in process improvement is transferred to other BPO arrangements. Mechanisms should be in place to leverage the learning that vendors have gained from working with other clients in BPO arrangements. Moreover, the client has to put in place structures to further develop these skills through providing on-going training and development, facilitating employee transfers, and providing proper incentives for effective outsourcing (Handley and Benton, 2013). Such structures are likely to create knowledgeable employees who can transform internal performance.

### **Research methods**

A case study approach was chosen to undertake the research with the chosen organisations. Use of the case study approach allows an increase in the quality and quantity of data obtained and allows the researcher to analyse relationships and social processes that is not possible via a quantitative approach (Yin, 2003; Eisenhardt, 2007). In order to address the aim of the research an analysis of the process improvement and BPO literatures, and dynamic capability theory was undertaken. Following this theoretical development, empirical evidence was sought to develop a framework for process improvement in BPO. The stages in the research are set out below.

For purposes of confidentiality, the organizations are referred to as *Case 1*, *Case 2*, *Case 3* and *Case 4*. These organisations were chosen for a number of reasons.

Preliminary interviews with key personnel had revealed that these organisations had been involved in BPO arrangements where there was a significant emphasis on process improvement. These interviews had revealed that each of the case companies had achieved cost savings and improvements in process performance in BPO as a result of applying process improvement techniques. These interviews had also revealed some of the complexities and challenges of process improvement in BPO, and the research team believed that important insights and learning could be gained to enhance our understanding of the capabilities for process improvement in BPO in practice.

A number of sources were used for data collection. Archival data in the form of internal memoranda, annual reports, strategy documents, trade and internal company magazine articles were collated. In particular, a number of published internal and external audit reports of certain aspects of the BPO arrangements were important sources of data.

This documentation was useful for gathering data on the background to the case organisations, and the BPO arrangements studied.

The primary source of data collection was via semi-structured interviews. An interview protocol based on the literature was designed prior to data collection, and this served as

an interview guide. This interview guide included questions on a number of issues including the motives for outsourcing; process improvement objectives; contracting; the application of process improvement tools; change management implications; vendor management; and enablers and barriers to process improvement in BPO.

The data collected was analysed using Eisenhardt's (2007) guidelines on case study analysis. The research team analysed the data to determine common factors and themes. Case studies were developed from the archival data and interviews undertaken with the personnel involved in the arrangements. Using Eisenhardt's (2007) guidelines on case study analysis, within case analysis and cross-case analysis was carried out to determine how the logic of dynamic capability theory could be employed to develop a framework for understanding the capabilities required for process improvement in BPO.

### A framework for process improvement in BPO

The framework includes a number of levels as shown in Figure 1. The first level includes first order capabilities that are likely to positively impact process improvement in BPO. In dynamic capability theory these first order capabilities share the same characteristics as ordinary capabilities (Teece, 2014). Although ordinary capabilities can improve process performance it is possible for competitors to replicate these through internal development, acquisition or recruitment. The second level in Figure 1 includes the sourcing learning infrastructure level, which is influenced by the organisational learning aspect of dynamic capability theory (Zollo and Winter, 2002). Sourcing learning infrastructure includes a number of elements that develop, integrate and renew the first order capabilities that drive process improvement in BPO. Moreover, sourcing learning infrastructure shares some of the logic of higher-order capabilities associated with dynamic capabilities that emphasise an organisation's constant pursuit of the renewal, reconfiguration and recreation of resources and capabilities in order to achieve competitive advantage (Teece, 2007).

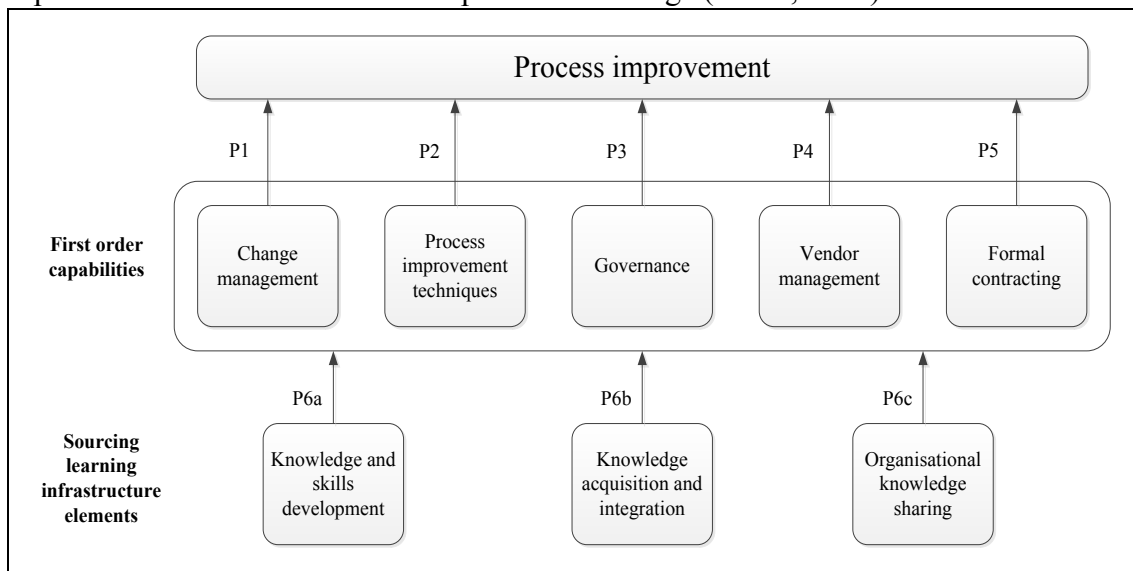


Figure 1. A framework for process improvement in BPO

Table 1 summarises each of the first order capabilities along with supporting evidence from the case companies. The associated propositions are set out below.

P1. A change management capability is likely to support process improvement in BPO.

P2. Process improvement techniques capability is likely to support process improvement in BPO.

Capability	Overview	Case evidence
<i>Change management</i>	This refers to the ability to manage the organisational change issues that arise from driving process improvement in BPO. Top management should have the ability to display leadership to ensure resistance to change is dealt with effectively. The client should have the ability to implement a stakeholder engagement strategy. This involves understanding the power and influence of stakeholders affected by change; communicating early and frequently with stakeholders to win support for redesigned processes; and involving key stakeholders in the redesign of processes. Through communicating early and frequently, stakeholders will more fully understand the potential process improvement benefits, and therefore provide support whenever necessary.	Elements of the change management capability were present in all of the case companies when pursuing process improvement in BPO. <i>Case 1's</i> capabilities in change management were employed to deal with the change management issues associated with improving HR service delivery performance through outsourcing. In applying Six Sigma tools, <i>Case 4</i> gave significant attention to engaging with internal and external stakeholders to address problems in the BPO arrangement. <i>Case 2</i> gave significant attention to change management issues when making the BPO decision. Despite the case companies possessing change management capabilities difficulties still arose when pursuing process improvement. <i>Case 1</i> encountered resistance to change, and members of the project team admitted that they should have been stronger in their approach to making corporate policies more robust prior to standardisation. Resistance to change amongst internal employees in the client was also an issue for <i>Case 3</i> when attempting to standardise processes.
<i>Process improvement</i>	This refers to the internal capability of the client in process improvement. This capability can assist in understanding the causes of internal performance problems, and highlight potential ways of achieving efficiencies by redesigning processes internally rather than outsourcing. Benchmarking can help to understand any performance gap internally and vendors, and provide an indication of the vendor capabilities required for process improvement. This analysis can assist with understanding whether the internal function can deliver the required process improvement, or whether outsourcing is the most appropriate improvement option. Applying these techniques should assist with understanding the processes involved, and determine requirements from BPO.	Each of the case companies had internal capabilities in process improvement, which had a positive impact on process improvement in BPO. Through applying process mapping and carrying out focus groups with internal staff, <i>Case 2</i> developed an understanding of the causes of poor internal performance, and vendor capabilities in mortgage processing in making the BPO decision. <i>Case 1's</i> capabilities in benchmarking allowed it to enter into a dialogue and consultation with vendors, which was an important means of identifying better service delivery models in the decision stage. Both <i>Case 3</i> and <i>Case 4</i> employed process improvement tools in the BPO process. Some of the case companies encountered difficulties with applying process improvement techniques. <i>Case 2</i> encountered a number of difficulties with deploying its capabilities in process improvement techniques in the BPO process.
<i>Governance</i>	This refers to the ability of the client to control and manage the BPO arrangement to ensure the process improvement objectives are achieved. The client should have the ability to put place mechanisms for deciding what areas process improvement initiatives should focus on; how process improvement initiatives should be implemented; and how the client and vendor should share any of the benefits of process improvement. A project implementation team should be established and composed of staff with the required skills from both the client and vendor, and should have the capability to review and track the progress of improvement initiatives to ensure the objectives are achieved.	<i>Case 1</i> and <i>Case 3</i> displayed evidence of having a well-developed governance capability. <i>Case 3</i> had significant experience of operating a number of complex, large-scale BPO arrangements with other vendors. Through possessing these capabilities it recognised the importance of having effective governance structures to develop a collaborative relationship with the vendor for process improvement. <i>Case 1</i> had also put in place governance arrangements in place to drive process improvement. <i>Case 4</i> had the least well-developed governance capability of the case companies. Governance arrangements tended to focus on monitoring vendor performance as part of the contract rather than having a formal approach to driving process improvement. Once <i>Case 4</i> had addressed these performance problems it recognised the importance of introducing governance mechanisms to proactively address performance problems rather than only monitoring vendor performance in the contract.
<i>Vendor management</i>	The client should have the ability to identify and determine whether	<i>Case 4</i> did not place significant emphasis on the improvement capabilities of vendor in the vendor

	potential vendors have the capability to redesign and implement changes to processes to meet the required process improvement objectives. The client should have the ability to leverage the specialist knowledge of the vendor to meet its process improvement objectives during the outsourcing relationship. This involves developing a number of relational facilitators of process improvement in the BPO arrangement including trust, knowledge-sharing, and high mutual dependency.	evaluation process. The primary aim of <i>Case 4</i> was to ensure that the vendor had the capability to meet the required standards of performance throughout the contract. However, both <i>Case 1</i> and <i>Case 3</i> gave significant attention to evaluating the capabilities it required from the vendor necessary for process improvement when making the vendor selection decision. All the case companies gave significant attention to managing the relationship with the vendor to drive process improvement. Relational contracting helped <i>Case 3</i> to resolve the performance difficulties that arose in the early phases of the relationship, and for <i>Case 4</i> the process improvement effort had the positive impact of strengthening the relationship with the vendor.
<i>Formal contracting</i>	This refers to the ability of the client to develop and implement a formal contract to drive process improvement. The client should have the ability to develop performance measures that are as complete and detailed as possible. The ability of the client to measure performance via SLAs is an important element of driving performance improvement via the formal contract. Performance measures should be expressed in meaningful terms and therefore, be fully understood and agreed with the vendor. Measuring service levels during the contract should allow the client and vendor to assess where improvement efforts should be targeted, and allow them to monitor the costs and benefits of any process improvements.	The case companies recognised the need to possess contracting expertise and the importance of including provisions for process improvement in the formal contract. However, there were differing levels of expertise in the case companies in this area. <i>Case 3</i> possessed some legal expertise internally as a result of operating a number of BPO arrangements with other vendors. <i>Case 1</i> lacked contracting expertise and sought advice in this area through employing consultants to develop KPIs and SLAs for use in the formal contract. <i>Case 4</i> employed the formal contract management process to measure service levels and assess where process improvement efforts should be targeted.

*Table 1. First order capabilities and case evidence summary*

P3. *Governance capability is likely to support process improvement in BPO.*

P4. *Vendor management capability is likely to support process improvement in BPO.*

P5. *Formal contracting capability is likely to support process improvement in BPO.*

### ***Sourcing learning infrastructure***

Employing the organisational learning aspect of dynamic capability theory, sourcing learning infrastructure includes a number of elements that allow the client to develop, integrate and renew the first order capabilities that support process improvement in BPO. Table 2 summarises each of the elements of the sourcing learning infrastructure level along with supporting evidence from the case companies. Each of these will elements now be discussed. The associated propositions with the sourcing learning infrastructure are presented below.

P6a. *The sourcing learning infrastructure element of knowledge and skills development is likely to support the development, integration and renewal of the first order capabilities that support process improvement in BPO.*

P6b. *The sourcing learning infrastructure element of knowledge acquisition and integration is likely to support the development, integration and renewal of the first order capabilities that support process improvement in BPO.*

Sourcing learning infrastructure elements	Overview	Case evidence
<i>Knowledge and skills development</i>	There should be on-going practices in place to ensure that personnel can further develop their skill sets over time in the first order capabilities. Continuous learning can low barriers to adopting new management techniques and practices, and made it more possible to realise the benefits of process improvement in BPO. Well-developed career paths that should provide a strong motivation for retained personnel to further develop their skill sets.	For example, <i>Case 3</i> had a formal training and development plan for personnel to ensure they kept abreast of contemporary management techniques and practices related to BPO. Moreover, <i>Case 1</i> encouraged its management personnel to enrol on executive development programmes that had a strong emphasis on change management and process improvement.
<i>Knowledge acquisition and integration</i>	This includes the organisational or individual practices to acquire and integrate external knowledge that can drive process improvement in BPO. Where appropriate this involves supplementing external knowledge in order to strengthen the first order capabilities. This practice encompasses the ability to recognise when it is more prudent to use external capabilities.	All the case companies recognised the value of using external expertise to bridge any internal skills deficits. Where appropriate the organisations recruited new people with skills in areas such as Six Sigma, knowledge management, process mapping, and benchmarking.
<i>Internal knowledge sharing</i>	The client must create a culture at the organisational level where learning and sharing ideas is encouraged amongst personnel involved in BPO contracts and process improvement across the organisation. There should be incentives in place to encourage personnel to share ideas and participate in BPO projects.	A number of the case companies attempted to create a culture where learning and sharing ideas from BPO contracts was encouraged. <i>Case 3</i> encouraged personnel to transfer between BPO projects to develop their knowledge base, and also share learning with other personnel. <i>Case 1</i> populated the BPO team with specialists from areas such as change management, contracting, procurement and process improvement to facilitate knowledge sharing from a range of different disciplines. Moreover, at corporate level a strategic review board was created with one of its key aims to share knowledge and learning on BPO across the organisation.

*Table 2. Sourcing learning infrastructure elements and case evidence summary*

*P6c. The sourcing learning infrastructure element of organisational knowledge sharing is likely to support the development, integration and renewal of the first order capabilities that support process improvement in BPO.*

## **Conclusion**

The findings have highlighted the value of employing the organisational learning aspect of dynamic capability theory to develop a framework for understanding the capabilities required for process improvement in BPO. The analysis of the case companies found evidence of the companies possessing first order capabilities (Teece, 2014). These capabilities lead to improved performance when an organisation demonstrates the ability to deploy resources to achieve a desired goal, which in the context of this research is process improvement. Each of the case companies possessed first order capabilities in areas such as contracting, vendor management, process improvement techniques and change management. A number of studies in the literature have already highlighted the importance of capabilities such as contracting, governance and vendor management (Lacity and Willcocks, 2012; Fersht et al. 2011). However, through

focusing on process improvement and BPO this study has identified additional capabilities including process improvement techniques and change management. Through possessing and developing internal capabilities in process improvement techniques the findings have shown that the client can develop its knowledge of the supply market, and also learn from vendors of potential options for process improvement. The framework has highlighted the importance of a change management capability throughout the BPO process including the contracting and relationship management stages. Although the case companies made efforts in this area, resistance to change still arose and hindered the ability of the vendor to deliver process improvement. The findings in this study have shown that the onus is not just on the client, but on the vendor to deal with change management issues. Process improvement and change management have an important role to play in re-designing processes and embedding process improvement in the retained function after outsourcing, as was illustrated by *Case 1*. It should be stressed that much of the current BPO literature ignores the performance impact of outsourcing on the retained function, and focuses primarily on the performance of the vendor (Handley and Benton, 2013). Through employing dynamic capability theory this study has extended existing literature by highlighting the importance of organisational learning. The sourcing learning infrastructure level of the framework highlighted that the case companies exhibited some of the characteristics of organisational learning (Zollo and Winter, 2002). There was some evidence of the case companies making deliberate strategic decisions in relation to the development, renewal and integration of the first order capabilities that drive process improvement in BPO. Sourcing learning infrastructure shares some of the logic of dynamic capability theory and the concept of higher order capabilities where an organisation's renews, reconfigures and re-creates resources and capabilities to achieve advantage (Teece, 2007). The findings have highlighted a number of important areas for further research. Although the case companies had some of the elements associated with the sourcing learning infrastructure level no one company had the full range of elements. Further research is required to gain a fuller understanding of how organisations can create the sourcing learning infrastructure to develop and renew the first order capabilities identified in this study. Employing the organisational learning aspect of dynamic capability theory has the potential to provide further insights into how organisations can develop the capability to re-configure and integrate internal capabilities with those of vendors to continuously drive process improvement in BPO (Teece, 2007; Winter, 2003). In addition, further research is required to understand the stages in the evolution of developing the capabilities identified in this research. Such research would provide important insights into the learning and development processes that organisations have to go through. The client should have mechanisms in place to ensure that it possesses the necessary internal skill sets across a range of areas such as process improvement, contracting, and change management in order to achieve process improvement in BPO. There should be formal structures in place to ensure that these skills are developed, and recognition that such skills cannot be developed overnight. The client should recruit external expertise where there are internal skills deficits, in order to supplement and develop current internal capabilities. Indeed, for some organisations with limited experience of BPO a gradual and incremental approach should be adopted to developing the capabilities identified in this study.



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