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# Chapter 1.20
# Strategies for Business Process Outsourcing:
## An Analysis of Alternatives, Opportunities, and Risks

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## ABSTRACT

This chapter provides a comprehensive overview of business process outsourcing (BPO) strategies and analyzes related issues. The discussions in this chapter can serve as an aid to decision makers who face the great dilemma of whether to insource or outsource a process, and additionally how to handle outsourcing to offshore locations. While business processes themselves are activities that need to be performed ef. ciently, outsourcing them is essentially a strategic decision that can ultimately impact the competitiveness of the client . rm. This chapter explores the risks and opportunities associated with the numerous strategies related to outsourcing and offshoring alternatives, business process migration, contracting and alliance building, the role of the vendor, the nature of the relationship, multiclient or multivendor relationships, infusing maturity and ushering transformations in business processes, locating required expertise and quantity of workers, and also utilizing on-demand software services from application service providers.

## INTRODUCTION

In *business process outsourcing* (BPO), a client's business process is performed by a vendor. Certain business processes of the client are transferred over to the vendor, and the vendor's of. ce then becomes the "back of. ce" for the client's outsourced business processes. The vendors are given the responsibility to manage the client's business processes, such as call centers, emergency hotlines, claims management, helpdesks, data management, document processing and storage, financial services (banks and insurance), payroll, auditing, accounting, travel management systems,

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various logistics and information systems services (Millar, 1994, as cited in Lacity & Hirschheim, 1995, pp. 4-5; Sparrow, 2003, p. 11). Hence, a BPO vendor needs to have the capability to provide consistent levels of customer service spanning across a range of services and businesses.

Though BPO has inherent risks, it also provides many benefits to the client. Apart from focusing on short-term cost savings and operational efficiencies, it is important that BPO be performed with a strategic mindset, whereby decisions are based on wider business context and help in gaining competitive advantages in the tough external environment (Sparrow, 2003, p. 8). For effective BPO, an organization should segregate its business processes into two broad categories: (1) the ones where its own core competencies are strong and which have strategic significance, and (2) those that can be performed better by a vendor (Adler, 2003, p.53). In most cases, business processes that represent the client's core competencies and have high strategic stakes are best performed in-house. In order to identify its *"core competencies,"* an organization needs to be very clear about where its own strengths lie and identify the processes that truly give the organization its business value. In order to identify processes that are "strategic," the organizations need to be able to identify processes that differentiate it from its competitors in the marketplace, or processes that gives it the competitive advantage (Porter, 1996).

Importantly, the market is dynamic where the demands and competition changes over time and, therefore, the core competencies or the strategic nature of associated business processes may accordingly change. Hence, organizations also need to have a clear vision of their goals and future strategy in the dynamic marketplace and, accordingly, identify its business processes for outsourcing. Failure to do so can make an organization overly dependent on the BPO vendors for its core or strategic business processes, and it would effectively be at the mercy of vendors. The key here is to have complete power and control over one's core and strategic business processes, while gaining maximum advantages out of the various vendors' strengths in noncore business processes. This chapter discusses the various alternative strategies that clients should consider while pursuing BPO.

## STRATEGIES: BASICS OF OUTSOURCING AND OFFSHORING

### Business Process Insourcing and Outsourcing

The two basic strategies in sourcing business processes are *insourcing* and *outsourcing*. While in *business process insourcing* a firm executes business processes on its own, in *business process outsourcing* (BPO) the client firm establishes a contractual relationship and hands over the responsibility of executing the business processes to a vendor. In other words, a company "insources" from within and "outsources" to an external company, that is, *outsourcing* is the sourcing of work across organizational boundaries.

- **Insourcing:** The business processes are performed by the client itself or a client entity (such as a subsidiary or an internal department).
- **Outsourcing:** The business processes are performed by a nonclient entity (such as a vendor/supplier).

When a firm decides to insource its business processes, there are two basic strategies: (1) the "OK as is" strategy where the client feels that it is running its business processes efficiently and satisfactorily, and hence the strategy is to simply continue with the status quo, and (2) the "fix and keep in-house" strategy where the client might be a bit unsatisfied with the efficiency of its in-house business processes, but believes that insourcing

is still the best option, and decides to invest in the adoption of better practices to identify and fix the deficiencies (Wibbelsman & Maiero, 1994, as cited in Dibbern, Goles, Hirschheim, & Jayatilaka, 2004, p. 11). Here, firms target the highest efficiency levels (achieved by competitors or vendors), set them as the benchmarks, and are self driven and motivated to achieve those high efficiencies in their business processes.

When a firm decides to outsource its business processes, two basic strategies are (1) the "option to reverse" strategy where business processes are outsourced to a vendor, but it also takes into account the possibility of bringing the outsourced business processes back in-house whenever needed, and (2) the "divest completely" strategy where business processes that are perceived to be best managed by a vendor are outsourced permanently (Wibbelsman & Maiero, 1994, as cited in Dibbern et al., 2004, p. 11). Additionally, it is also important to note that a client's option is not limited to outsourcing to just one vendor, and it can potentially outsource to multiple vendors. Similarly, vendors often provide services to multiple clients. The strategic aspects related to multiple clients and multiple vendors will be discussed later in the chapter.

## Making the Insourcing vs. Outsourcing Choice

To evaluate the experiences of organizations with outsourcing, 14 case studies were carried out by Hirschheim and Lacity (2000). The case studies show that when departments executing in-house business processes get the required support from the upper management, they too can improve performance and imitate the various cost-reducing and efficiency-enhancing tactics adopted by the vendors, and thus provide a strong alternative to outsourcing. Furthermore, they highlight the risk of lesser control and lower–than-expected service levels that may result from large-scale outsourcing. Moreover, they report that some organizations were considering the discontinuation of outsourcing, which involved getting the outsourced work back in-house by either waiting for the contract period to end or by simply renegotiating/terminating the contract. Outsourcing is not easy, and a great amount of planning along with immaculate execution is needed for it to be completely successful. Based on an extensive review of the academic literature, some of the salient advantages of insourcing and outsourcing are compiled (Ang & Straub, 1998; Aubert, Rivard, & Patry, 1996; Chakrabarty, 2006b; Currie & Willcocks, 1998; Earl, 1996; Jurison, 1995; Loh & Venkatraman, 1992; Loh & Venkatraman, 1995; Nam, Rajagopalan, Rao, & Chaudhury, 1996; Nelson, Richmond, & Seidmann, 1996; Poppo & Zenger, 1998):

**Advantages of business process insourcing:**

- Insourcing allows greater *control* over the strategic assets and resources that are used in the business processes.
- Possibility of *opportunistic behavior* of a vendor is a major hassle, and insourcing safeguards against this risk.
- Insourcing is best when high *uncertainty* is associated with the business process
- Many business processes require very high amounts of *. rm speci. c knowledge* (business/technical) for their effective execution. Transferring such knowledge to a vendor not only takes time and effort, but may also compromise the confidentiality of the firm-specific knowledge.
- Negotiating *intellectual property* rights associated with business processes (with a vendor) are always a tricky issue, and insourcing reduces the risk of IP rights violations.
- Not all business processes can be effectively carried out by vendors (no matter what the

sales/marketing representatives of the vendors say). Hence, insourcing is sometimes the only option when *competent vendors are absent*.

**Advantages of business process outsourcing (BPO):**

- BPO can lead to considerable *cost advantages*:
  - º The client does not have to invest in the infrastructure or the technology required to execute the business processes and hence saves on capital expenditure.
  - º The vendor's economies of scale and economies of scope help in reducing the costs of running the business processes.
  - º The very process of bidding for and negotiating the outsourcing contract makes the respective vendors give estimates on the costs involved in executing the business processes, which in turn makes the costs more predictable for the client.
- BPO allows organizations to focus its *core business,* and outsource the noncore business that take up a considerable amount of management time and resources.
- BPO makes a client's transition to newer business processes easier, wherein the legacy or current business processes are outsourced to a vendor during the transition period.
- BPO gives more flexibility in managing labor:
  - º Any upsurge or downswing in the volume of business process work would entail variations in the required manpower. The client does not need to worry about this because the recruitment and staffing for outsourced business processes would be the vendor's responsibility. A vendor organization can more easily manage variations in manpower needs since it would be executing a huge number of business processes (for various clients) that involve a large number of vendor employees working on similar tasks. The vendor can easily balance out variations in staffing needs across its various BPO projects.
  - º BPO frees up a client's in-house resources (infrastructure, manpower, etc.) from noncore activities, and they can instead be utilized in the development of core competencies and processes that could give the client a competitive edge in the market.
  - º BPO gives the client access to the process and technical expertise of the vendor personnel, which can have a positive impact on the way the client's business processes are executed.
- To stay competitive, most vendors strive to adopt the best *business process maturity* models that can guarantee better quality and service. Hence, clients can benefit from the quality provided by the best-in-class vendors.

Apte and Mason (1995, p. 1258; see also Dibbern et al., 2004, p. 33) proposed that the choice between insourcing and outsourcing can be ascertained by the "strategic importance" and the client's "relative efficiency" in carrying out an activity in-house. Insourcing of business processes is suitable when both the *strategic importance* and the *relative ef. ciency* of performing the business processes in-house are high. However, if both these factors are low, the BPO is favorable. But what if the s*trategic importance* is *high* but the client's *relative ef. ciency* is *low*? In this case the client has the following options: (1) invest time, money, and effort into increasing the efficiency of these strategic or core competency business processes, (2) ask external consultants or vendors to come to

the client site and suggest the necessary changes to infuse efficiency, and (3) consider building a *strategic-alliance* with a vendor who is an expert in executing the relevant business processes. Options (2) and (3) would need the imposition of strict controls that would prevent any compromise on the strategic importance or confidentiality associated with the business processes. And finally, it is suggested that if the business processes are *not of strategic importance* but the organization has *extremely high efficiency* in executing them, then the organization should consider setting up a subsidiary or spin-off that offers its expertise to other organizations in the external market.

It should be noted that firms rarely outsource "everything," and instead adopt a cautious and sensible approach of selectively picking out the business processes that it feels can be best performed by the vendors. This is discussed in the next section.

## Strategy for Selective BPO

Is it a good strategy to outsource all business processes? Or is it better if they are all retained in-house? Well, it would be nice if the answers were as simplistic as the questions posed. The outsourcing decision is rarely an all-or-nothing approach. As discussed earlier, an optimum balance is reached between the number of business processes to be outsourced and the ones to be retained in-house. *Selective BPO* is the practice of outsourcing carefully selected business processes to vendors, while retaining the others in-house (Lacity, Willcocks, & Feeny, 1996, pp. 13-14). Clients often *outsource* the business processes that they feel can be better performed by a vendor, but prefer to keep select business processes in-house based on their own strengths and capabilities. This selective approach is based on an analysis of costs and benefits, technology/infrastructure availability, and human resource availability. *Selective BPO* shuns the all-or-nothing approach in favor of a smarter way of outsourcing that involves careful judgment and discernment, and that meets the customer's needs while minimizing risks associated with total outsourcing approaches (Lacity et al., 1996, pp. 13-14). This widely recommended selective approach capitalizes on the strengths of both the client and the vendors.

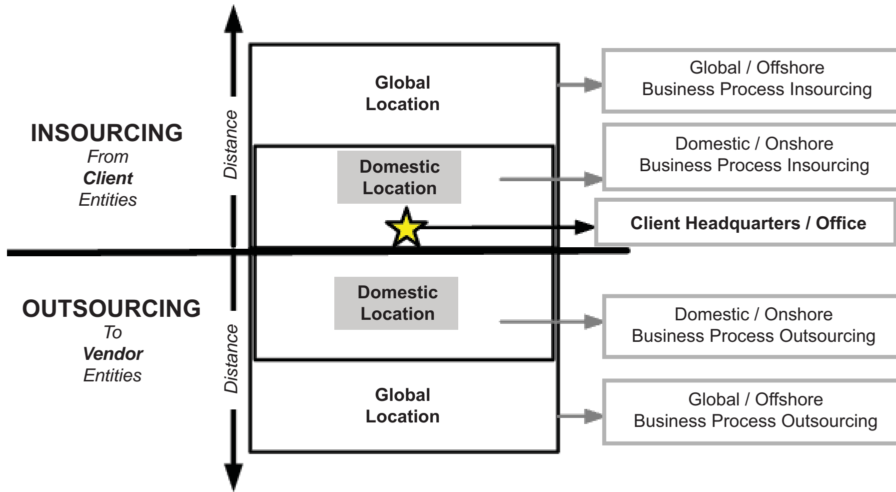
## Strategy for Offshore BPO: Going Global

### Offshoring and Outsourcing Classi.cations

As described earlier, the client's business processes can be executed or managed by entities that are either internal (its own department, subsidiary, or captive center) or external (a vendor). In this world where globalization is having astounding effects on the way business is conducted, where exactly is the location where the client's business processes are being executed? When the client's business processes are being executed in the same country as that of the client, it is known as *onshore sourcing, domestic sourcing,* or simply *onshoring* (Chakrabarty, 2006b). On the other hand, if the business processes are being executed in a country that is different from the client's country it is known as *offshore sourcing* or *global sourcing* (Chakrabarty, 2006b). Hence, offshoring is the transfer of work across geographical boundaries. But then, the question arises whether the business processes are being executed by a client entity (such as a subsidiary or department) or a nonclient entity (a vendor)? Hence, the following possibilities arise (see figure-1):

- **Onshore-insourcing of business processes:** When both the client and the client-entity that executes the business processes (such as its own subsidiary or internal department) are located in the same country it is known as *onshore BPI* (business process insourcing) or *domestic BPI.*

*Figure 1. Outsourcing and offshoring*




- **Offshore-insourcing of business processes:** When the client entity (such as a subsidiary, department, or captive center) that executes the business processes is located in a country that is different from the client's country it is known as *offshore BPI* or *global BPI.*
- **Onshore-outsourcing of business processes:** When both the client and the vendor that is executing the client's business processes are located in the same country it is known as *onshore BPO* (business process outsourcing) or *domestic BPO.*
- **Offshore-outsourcing of business processes:** When the vendor that is executing the client's business processes is located in a country that is different from the client's country it is known as *offshore BPO* or *global BPO.*

## Why offshore Outsourcing is Gaining Prevalence

There are many reasons that are attributed to the growth of offshore BPO, and the major ones can be summarized as follows:

1. **Business processes can be executed round the clock:** By distributing the work globally across multiple time zones, business processes can be run 24×7. This can lead to a faster execution time in completing any business process cycle (Apte & Mason, 1995, p. 1252; Sinha & Terdiman, 2002) and also allow 24×7 management and supervising that is crucial for business processes. 24×7 services can be a competitive strategy for any client in today's global market.
2. **Cost savings due to high availability of cheap skilled labor:** The predominant cause for the offshoring trend is certainly the cost advantage derived out of the lower pay scales of skilled professionals and the lower cost of living in some developing countries such as India and China. The high supply of skilled labor in such countries boosts the low-cost advantage (Apte & Mason, 1995,

p. 1252; Carmel & Agarwal, 2002; Sinha & Terdiman, 2002; Sobol & Apte, 1995).

3. **Modern communication and collaboration technologies:** The Internet has surely promoted the growth of offshoring by providing a platform for the latest communication and collaboration technologies at reasonably low costs (e-mailing, teleconferencing, videoconferencing, instant messengers with text messaging, voice chat and Web cams, etc.). Thanks to these latest technologies, geographical distance is becoming less of a barrier for collaboration and coordination among globally distributed teams, also known as "global virtual teams" (Carmel & Agarwal, 2002, p. 66; Chakrabarty, 2006d).
4. **Business process discipline, maturity and quality improvement:** When a business process is outsourced to a vendor in a different country, the vendor personnel are obliged to understand and adopt the business process completely to make it operationally effective. The vendor personnel would attempt to understand the business process from a "fresh" perspective without any baggage of past or local experiences in the particular business process (Aron & Singh, n.d.). This would throw open the business process to questioning, and possible avenues for improvement. It is important to note that most vendors strive to adopt the best *business process maturity* models that can guarantee better quality and service, and hence attract more clients. Offshore outsourcing of business processes can therefore bring into it the much needed "process discipline" that makes: (1) *the process globally understood*—through removal of any ambiguity and improperly synthesized information, and enforcement of universally understood standards and procedures, and (2) *the tasks in the process optimally sequenced*—through elimination of redundant tasks and modification of defective tasks (Aron & Singh, n.d.). This evaluation of the outsourced business processes from the unadulterated third-party perspective of the offshore personnel, if well utilized (by requesting and acting upon the feedback), can lead to improvements in the business process in terms of discipline, maturity, and quality. Hence, the remoteness of the vendor or offshore personnel can also turn out to be an advantage.

## Why Offshore Outsourcing is a Risk

Offshore outsourcing brings in various risks that need to be addressed by the clients and the vendors (Apte & Mason, 1995, pp. 1252-1253; Carmel & Agarwal, 2002, p. 68; Chakrabarty, 2006d; Sinha & Terdiman, 2002; Sobol & Apte, 1995, p. 271), and these risks include:

- **Behavioral risks:** These risks include lack of trust, cultural differences, communication, and coordination issues.
- **Risks due to global laws, norms, and environments:** Getting visas/work-permits for global travel has become difficult and time consuming due to various factors (such as fears of job loss, and terrorist threats), laws and norms in various nations on cross-border data flow and services are sometimes unclear, and finally there is always a possibility of unstable economic, political, or social environments in any nation (in varying degrees).
- **Information and knowledge related risks:** There is sometimes a risk due to possible violations of intellectual property rights and privacy, since many business processes deal with sensitive data (such as credit card numbers). There is also the difficulty in knowledge transfer from the client to the vendor. The offshore vendor would lack domain knowledge about the client's industry, market, customers, organizational culture,

and the nitty-gritty about the way the client operates. How much should the client reveal? How much should be kept confidential? Also, how much time and effort will go into ensuring effective knowledge transfer?

- **Business process management risks:** It might be difficult to control quality and schedule unless proper mechanisms to ensure the same are in place. Also, how quickly, accurately, and efficiently can changes in business processes be affected?

## Distributed Consulting and Global Delivery

Offshore BPO is not always "purely offshore." An offshore BPO can have a minor onshore component along with a major offshore component. Often, a need arises to have a small vendor team at onshore in addition to the large number of vendor personnel at offshore executing who are executing the business processes (see Figure 2). While the offshore vendor personnel have the responsibility of carrying out the bulk of the work, the onshore vendor team has the role of coordinating face-to-face with client. This is known as *distributed consulting* (Kobyashi-Hillary, 2004, p. 153). This method is a widely accepted practice to ensure effective coordination between onshore-based clients and offshore-based vendors.

Companies such as TCS, Infosys (whose BPO arm is called Progeon), and Wipro, all large software service providers (primarily based in India), are now aggressively providing BPO services, and have for long incorporated the concept of distributed consulting into what they call the "*global delivery model*," whereby these large vendors execute the business processes from various global locations for their clients situated at various other global locations (Chakrabarty, 2006b). Table 1 gives some of the BPO services being aggressively offered by these companies. Though India is one of the predominant players in the market, it is mentioned here only as an example, and it is important to realize that numerous organizations from various other countries are also competitively providing BPO services (Kempf, Scholl, & Sinha, 2001).

*Figure 2. Distributed consulting & global delivery*

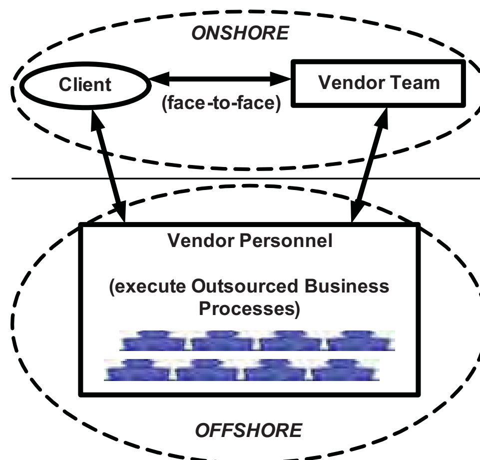


*Table 1. BPO services*

| TCS (http://www.tcs.com/bpo/offerings.htm) | Infosys (Progeon) (http://www.infosys.com/bpo/services.asp, http://www.progeon.com/) | Wipro (http://www.wipro.com/bpo/index.htm) |
|---|---|---|
| **Banking and Financial Services**<br>Payment Processing, Loans Processing, Securities Back-office Processing<br><br>**Telecom**<br>Revenue Assurance, Order Management, Digitization of Network Data, Network Service Provisioning<br><br>**Healthcare**<br>Clinical Data Management, Statistical Analysis<br><br>**Travel and Hospitality**<br>Revenue Accounting and Fare Audit, Fare Filing and Distribution, Ticketing & Reservation, Loyalty Program Administration<br><br>**Insurance**<br>New Business Acquisition support, Policy servicing, Claims Management, Distribution Administration | **Banking**<br>Credit cards, retail lending, mortgage processing, retail banking and account management, cash management, trade services, lease and loan processing, investment banking<br><br>**Securities Industry**<br>Custody and Fund Administration, Brokerage, Asset Management, Investment Research<br><br>**Insurance**<br>Life & Pensions, General<br><br>**Enterprise Services**<br>Accounts payable, accounts receivable, GL and fixed asset accounting, Financial reporting, Sales order management and administration, Procurement Services, HR services<br><br>**Telecom**<br>Billing, Service Provisioning<br><br>**Knowledge Services**<br>Equity Research, Credit Analysis, Fixed Income Research, Bond Analysis, Economic Analysis, Industry analysis and Company analysis | **Customer Interaction Services**<br>Customer Services,<br>Telemarketing Services,<br>Technical Support Services,<br>IT Help Desk Services<br><br>**Industry Administration Services**<br>Insurance Processing,<br>Mortgage Processing<br><br>**Business Optimization Services**<br>HR Processing Services,<br>Finance & Accounting Solutions,<br>Procurement Solutions<br><br>**Knowledge Services** |

The vendor's offices, where the client's business processes are executed, are located worldwide (based on various factors such as availability of skilled manpower at low costs), and there is comprehensive networking with the latest telecommunications and collaborative technologies that allow seamless integration of business processes delivered from multiple locations and thereby providing economies of scale and scope. Hence, the "*global delivery model*" is an offshore BPO model that takes advantage of the global talent pool to give the best value to the client in terms of cost and quality.

This section focused exclusively on offshore BPO. However, the strategies discussed throughout the remaining chapter apply to both domestic/onshore BPO and global/offshore BPO.

## STRATEGIES FOR BUSINESS PROCESS MIGRATION

### Strategy for Migration of Business Processes from Client to Vendor Site

It is interesting to note how some of the vendors are trying to convince the clients to take up the risk of BPO, and it also shows how very confident the vendors are in their ability to execute third-party business processes from a far-off location. For example, the Wipro Web site (http://www.wipro.com/bpo/methodology.htm) tries very hard to market the importance it lays on the smooth transfer of business processes from the client site to the vendor site:

For BPO projects, we follow the Wipro Service Delivery Model, which is a robustly defined framework to manage the complete BPO process migration and transition management and has been developed based on the experience gained from migrating more than 400 remote business processes to India over the past ten years. This proven service transfer platform is designed to ensure process integrity and minimize inherent migration risks. The model includes a tried and tested Transition Toolkit to support transition management by ensuring that there is a documented methodology with formats, tools, guidelines and past learnings in place to aid the transition team in de-risking the transition of a customer's processes and reducing the pain of migration as much as possible. A coordinated project management system captures critical client documentation and incorporates an extensive knowledge base that assists the transition management team in understanding, duplicating, and migrating mission-critical business processes.

The Infosys Web site (http://www.infosys.com/bpo/methodology.asp) gives a good overview of the steps and planning that goes into BPO from the vendor perspective. They provide the following step-by-step approach for BPO execution:

**Step1:** "***Assessment*** *– Build the case and ready the client organization for BPO.*"
**Step 2:** "***Transition*** *– Migrate the processes after mapping processes, creating technology infrastructure and training resources.*"
**Step 3:** "***Parallel run*** *– Phase out the process at the client (site) and put in place measures for ongoing tracking and monitoring.*"
**Step 4:** "***Steady State*** *– Manage the process in the steady state – ensure continuity, and continuous quality and process improvement.*"

If a client chooses a vendor that has already been involved in a lot of BPO deals, then the vendor would already be aware of the better ways to migrate the business processes from the client site to the vendor site. However, most business processes are interlinked to other business processes, and (before outsourcing) all these business processes harmonize with each other like parts of a well-oiled machine. BPO is equivalent to dismantling some parts of this well-oiled machine, and then reassembling the removed parts back together in a different fashion. The risk here is that the client cannot afford to trust the vendor completely, and should remain alert on the approaches the vendor takes in transferring the business processes. The outsourced business process may be highly integrated with other business processes at the client site, and efforts must be made by the client to ensure that the *interfacing* between the in-house business processes and the outsourced business processes is satisfactory.

There is something more for the client to ponder about. The vendor takes proactive initiatives to make sure that the client is comfortable with BPO and that the transfer or migration of business processes occurs smoothly. But if someday the client decides to get these business processes back in-house, then would the vendor be as cooperative

in ensuring the effective and smooth transfer of the business processes back to the client site?

### Strategy for Getting the Business Process Back In-House

What does an organization do when its wants to bring back in-house the business processes that it had previously outsourced? The term "*backsourcing*" was coined for this strategy (Hirschheim & Lacity, 1998). But why would an organization want to bring back business processes that it had previously decided to outsource? There can be a variety of reasons (Hirschheim & Lacity, 1998). On a positive side, it might be something that was actually planned during the initial outsourcing decision itself. For example, it is possible that the organization was going through a major transformation (Sparrow, 2003, p. 10), or needed a major realignment of processes, labor, or work allocation, and had therefore decided that some of its business processes could be temporarily outsourced during that period. On the other hand, the *backsourcing* may be an unplanned compulsion, such as the result of dissatisfaction from BPO experiences (for example, poor customer feedback, high overhead costs, breach of contracts or trust, or simply too many conflicts with the vendor), or as a result of certain business processes turning out to be more strategic and closely associated with the client's core competence than previously thought (irrespective of the performance of the vendor).

The process of bringing back previously outsourced business processes has its own risks and is a challenge for any organization (Hirschheim & Lacity, 1998). During the time the processes were outsourced, the client organization might have lost key resources (such as employees with relevant expertise, infrastructure, and tacit knowledge). Setting up the business processes again and integrating them back into the organization would require significant investments of time, money, and effort.

## STRATEGIES FOR CONTRACTING AND ALLIANCE BUILDING

### Strategy of Linking Realization of Bene.ts from BPO to Payments

How can a client ensure that it would, in fact, receive the benefits from BPO being promised by the vendor's marketing team? What if the client does not receive the benefits being promised? One way to get over the dilemma is to contractually link the realization of the promised benefits from BPO to the payments. The contract would attempt to clearly define the specific expectations of the client organization from BPO, and the client would pay the vendor in proportion to the realized benefits. This has been termed as *business benefit contracting* (Millar, 1994, as cited in Lacity & Hirschheim, 1995, pp. 4-5), and it enables the sharing of risks by linking a client's costs to the realization of the expected benefits from BPO. Hence, well-defined client expectations can be embedded in the contract, and detailed evaluations of whether and how much the vendor actually contributed towards the client's performance would have to be carried out (Willcocks & Lacity, 1998, p. 26, pp. 30-31).

However, the major risk lies in not being able to come to mutually agreeable interpretations of the specific benefits or benchmarks that are linked to the payments. For example, the client may put across a pessimistic view of the benefits actually gained from BPO in order to reduce the amount of payments due to the vendor, while the vendor may put across an overly rosy scenario of the benefits gained by the client in order to get the highest possible payments from the client. With the vendor's revenue/profits from its clients

being linked to benchmarks, problematic disagreements on the benchmarks may emerge, and hence, due to the difficulties associated with the related measurements and negotiations "business benefit contracting" is difficult to adopt (Lacity & Hirschheim, 1995).

## Strategy of Getting the Best BPO Deals with Innovative Contracts

In order to be competitive clients need to get the best out of their outsourcing relationships in terms of costs and value addition. For many of business processes that can be possibly outsourced, there are a plethora of vendors willing to bid for the contracts. It is important for clients to recognize that its bargaining power is probably the highest at the point of drafting and signing the contracts. Hence, the client should always be on the lookout for the best deals to satisfy its needs, and adopting the attitude of a hard bargainer or tough shopper in the contract formulation stage might be the right thing to do. Willcocks and Lacity (1998, pp. 32-33), for example, have discussed "creative contracting," which has ingenious practices, such as short term contracts, flexible pricing, competitive bidding for extra or value-added services, and so forth. By using short-term contracts (even if the intention is to have long-term relationships) the vendor can keep the vendor on its toes, and also renegotiate better terms every time a contract is renewed based on past experiences and future expectations. The risk here is that the vendor may be hesitant in making long-term investments (into manpower or infrastructure) for the outsourced business processes since it would be unsure about the renewal of the short-term contracts.

The client may also ask the prospective vendors the question: "what more can you give us apart from meeting our basic requirements?" In other words what would be the vendor's value addition? What can the vendor do to beat the client's expectations? Hence, the client can induce a competitive spirit among the prospective vendors to gain maximum value from BPO. Moreover, the client may also insist on pricing mechanisms that are flexible and that bring in the possibilities of rewarding the vendor for exceptional performances and penalize the vendor for below expectation performances.

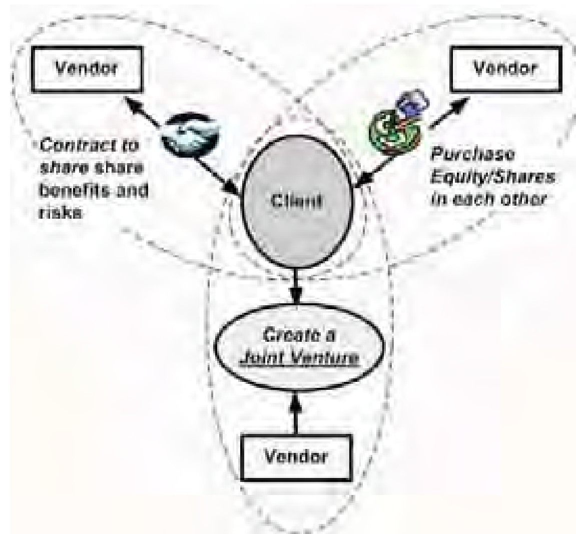
## Strategies for Sharing Ownership

Business benefit contracting, which was discussed earlier, is a method of sharing benefits and risks. However, its major deficiency lies in the difficulties involved in defining and measuring the specific benefits or benchmarks in the contract. Sharing of ownership might be a much more effective BPO strategy, and would eventually lead to risk sharing (see Figure 3).

A *strategic alliance or partnership* between a client and a vendor that ensures sharing of risks and rewards may be implemented in the following three forms: (1) contracts that specify clauses on sharing of risks and rewards, (2) creating a joint venture company that would perform the outsourced business processes, and (3) both the client and vendor hold shares or equity in each other (Currie & Willcocks, 1998, p. 124; Sparrow, 2003, p. 12; Willcocks & Lacity, 1998, p. 26, pp. 27-28). As discussed earlier, "business benefit contracting" is an effective risk sharing mechanism based on a contractual agreement linking realization of expected benefits to payments, and "creative contracting" can have pricing mechanisms that reward exceptional performances and penalize poor performances. However, given the difficulties in measuring specific benefits in a mutually agreeable manner, the *sharing of ownership* strategies through *joint ventures* or *share/equity holding* may be better alternatives.

When a client and vendor invest to form a *joint venture*, it truly honors their commitment and dedication towards the success of the BPO endeavor. If the joint venture fails to meet expecta-

*Figure 3. Strategies for sharing ownership*




tions, it is a loss for both the client and the vendor. And similarly, when the joint venture performs well, it is a win-win situation for both the client and vendor. The resources (such as manpower, infrastructure, knowledge, etc.) for the *joint venture* organization can be provided by both the parties. This enables the client to gain access to the vendor's capabilities and skills, to reorganize and induce efficiency into business processes, and to gain new sources of revenue by offering the joint venture's services to the external market (Sparrow, 2003, p. 12). The client does not lose total control of the outsourced business processes since it would have invested in the joint venture, and at the same time it will be assured that the vendor would use its best expertise to bring in operational efficiencies (Currie & Willcocks, 1998). The vendor, on the other hand, would feel more secure and will be willing to invest more time and effort into the venture, since a joint venture is essentially a long-term relationship. However, joint ventures can also fail due to various factors (Reuer, Zollo & Singh, 2002), and the client might have outsourced large amounts of business process work to the failed joint venture. Hence, the risk here is that the outsourced business processes and their contribution to the client's competitiveness would be at the mercy of the success or failure of the joint venture.

If the amount of business processes that need to be outsourced (or some other factor) does not justify the viability of a joint venture, can the ownership still be shared? An *equity holding* deal is the answer. In a share/equity holding deal, the client can purchase substantial equity in the vendor, thereby giving the client greater power and control in its relationship with the vendor.

The vendor may also take an equity position in the client, and that would ensure that both the client and vendor keep each other's interests in mind, thereby leading to a situation where risks and rewards are effectively shared through

ownership (Willcocks & Lacity, 1998, p. 26, pp. 27-28).

## STRATEGIES ON THE ROLE OF THE VENDOR AND NATURE OF THE RELATIONSHIP

### Strategy for BPO That Demands Client-Vendor Cooperation

What does an organization do when all the functions related to a particular business process cannot be outsourced? For example, though an organization may outsource its call-center or help-desk activities, it may still need to retain the technical staff that actually fixes the problems reported. There would need to be effective cooperation between the outsourced call centers/help desk and the in-house technical staff to address customer complaints. Hence, to a certain extent, the execution of such business processes would be done jointly by the client and the vendor, and it is known as *cooperative sourcing* (Millar, 1994, as cited in Lacity & Hirschheim, 1995, pp. 4-5). The risk lies in not being able to lay down effective protocols that would ensure high cooperation and easy conflict resolution. For example, in addition to the frequent meetings needed for building cooperation, it is also important to actually document the communications/decisions/schedules/plans made, and enable easy and quick access to such documentation whenever the need arises. Of course, tacit or intangible factors such as trust or personal relationships are very important in ensuring cooperation (Chakrabarty, 2006a). However, such formalization or protocols in the relationship encourages accountability and fixes responsibility, which can lead to better cooperation in executing the business processes.

### Strategies for the Number of Clients and Vendors in BPO Relationships

A client may not be able to find a vendor with the capability to perform a wide array of business processes all by itself. In such a scenario, the client may decide to opt for specialized vendors, and the different business processes would be outsourced to the respective specialist vendors (Chakrabarty, 2006c). This is known *multivendor outsourcing* (Gallivan & Oh, 1999, pp. 1-6) or *multisupplier outsourcing* (Currie & Willcocks, 1998) or simply *multisourcing* (Willcocks & Lacity, 1998). Such a one-to-many outsourcing arrangement (one-client-to-many-vendors) would allow a client to engage multiple vendors for various business processes. Let us first discuss the case where *interdependent* business processes need to be outsourced to multiple vendors. For example, though the HR functions and payroll processes may be interdependent, the client may outsource HR-specific processes to one vendor and payroll processes to another vendor. Similarly, there might be other interdependent business processes that are outsourced. Since the processes are interdependent, the division of work and related contracts would be *jointly* negotiated, understood, and agreed upon by the client and *all* the involved vendors (Gallivan & Oh, 1999, pp. 1-6). This form of multivendor outsourcing, where the outsourced business processes are interdependent, would require *all* the vendors and client to cooperate and work together (Chakrabarty, 2006c). The risks would arise out of the difficulties in cooperation, and the need for timely and accurate exchange of information amongst the various vendors and the client. The client would have to take the lead in ensuring and verifying that there is proper coordination between the vendors and that the interdependent business processes are being executed harmoniously. On the other hand, the task probably becomes easier when the business

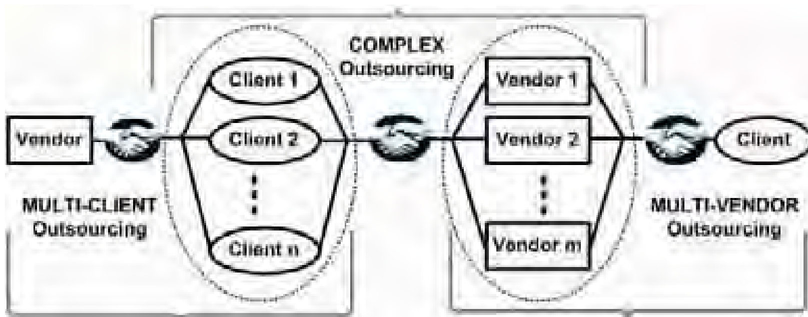
processes outsourced to multiple vendors are independent (that is, they are not interdependent). Such an example would be the outsourcing of financial services (banks and insurance) to one vendor, and travel/transportation management to another vendor. Here the client would not have to worry about coordination between the respective vendors.

Importantly, clients can sometimes take advantage of multiple vendors, competing in the marketplace, that provide services for the same business process. For example, there are multiple vendors that offer call center services. In such a scenario, the client can distribute chunks of the same business process to multiple vendors to safeguard against being overly dependent on a single vendor, and thereby negate the possibility of any vendor gaining complete power and control over the client's business process. The client can encourage competition among the vendors to provide the same business process at the best possible value and quality by using "short-term contracts" that are not necessarily liable for renewal with the same vendor. Hence, if a client engages two or more vendors for the same business process, it yields cost advantages due to intervendor competition, and also prevents the risk of a client firm being held hostage by a monopolistic vendor (Klotz & Chatterjee, 1995, p. 1317). Additionally, if the perceived risks associated with any business process are high, then the client can share the risks with the multiple vendors through various ownership sharing mechanisms (such as business benefit contracting, joint ventures, strategic alliances, and equity holding deals, which were discussed earlier).

Just like a single client can engage multiple vendors in a one-to-many relationship, multiple clients can also engage a single vendor in a many-to-one relationship (see Figure 4). In such a *multiclient* outsourcing relationship, multiple clients can pool their requirements and resources to form an alliance, and contract with a single vendor for joint delivery of certain generic business processes. For example, multiple clients can get together and jointly negotiate and bargain for the best possible deal from prospective vendors for all their payroll services. Hence, this leads to buyer economies of scale, increased client bargaining power, and risk sharing. Examples of such relationships have been found in information systems outsourcing, co-marketing, and R&D consortia (Gallivan & Oh, 1999, pp. 1-6).

Lastly, relationships can get even more complex with many-to-many relationships, aptly termed as "complex sourcing" (Gallivan & Oh,

*Figure 4. Number of clients and vendors in outsourcing*



1999, pp. 1-6). This involves multiple clients and vendors in the same outsourcing contract, and can be conceptually interpreted as a combination of the multivendor and multiclient relationships described earlier (see Figure 4).

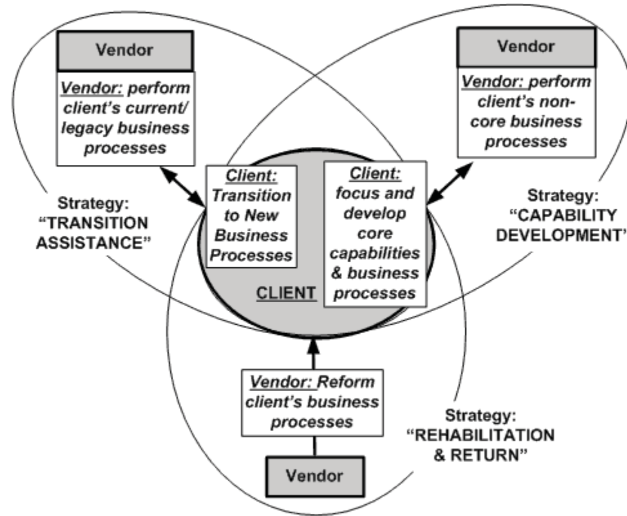
It is important to note that, most often, a one-to-one or *dyadic* relationship actually exists between a client and a vendor, even though the overall scenario may first point to a multiclient, multivendor, or complex sourcing environment (Gallivan & Oh, 1999, pp. 1-6). For example, a vendor may execute the business processes outsourced by multiple clients, but its clients are independent of each other, with separate contracts between each client and the vendor. Similarly, a client can outsource its business processes to multiple vendors, but its vendors are independent of each other, with separate contracts between each vendor and the client.

## Strategy of Utilizing Vendors While Infusing Maturity and Ushering Transformations in Client's Business Processes

Can a client use the expertise of a vendor for infusing maturity or growth into its own business processes? Wibbelsman and Maiero (1994, as cited in Dibbern et al., 2004, p. 11) provided an interesting framework in which the client could use three strategies to retain its business processes in-house over the long term, and use the vendor's expertise to improve them. The three strategies were named as (a) rehabilitation and return, (b) transition assistance, and (c) capability development, and each strategy can be adapted to BPO (see Figure 5). There are subtle differences between the three strategies. "Rehabilitation and return" involves bringing inefficient processes back to life, "transition assistance" involves a changeover to newer processes, and "capability development" involves the strengthening of a client's business processes and core competencies.

In the first strategy of "rehabilitation and return," the vendor (or an external consultant) who has the required expertise in the relevant business processes would assist the client in reforming its business processes at the client site. Here the presumptions are that (1) the client's business processes are in bad shape and need restoration, (2) the client does not want to outsource its business processes, and (3) the client wants to "learn" directly from the experts. This is not strictly "outsourcing" since no business process is really transferred over to the vendor. However, the vendor uses its own expertise to help the client gain operational effectiveness in its business processes by actively suggesting and implementing various changes. Forexample, if the client feels that it is not performing a certain business process (such as data management) efficiently, and at the same time does not want to outsource it (probably because of its strategic nature, security issues, core competence related nature, etc.), then the client can engage a specialist vendor (for data management) that would send over its personnel to the client site on a temporary basis. The vendor personnel would go to the client site, assess the relevant business processes of the client, suggest changes, possibly oversee or actually implement the suggested changes, gauge if the changes are actually leading to desired improvements, and then return. The risk is that the client may not be able to actually replicate the efficiency and effectiveness of vendors in running the business processes. The relevant business process is, in all probability, the core competence of the vendor in which it has developed expertise and tacit knowledge that cannot easily be replicated elsewhere. Additionally, vendors rely on economies of scale and economies of scope to derive cost and quality advantages in the relevant business processes. Many of these factors that help a vendor run certain business processes efficiently cannot be easily replicated on the client site. Of course, the vendor can possibly bring about a greater efficiency in the client's business processes

Figure 5. Utilizing vendors while infusing maturity and ushering transformations




by making suitable recommendations and even implementing them, but it may not match the vendor's own efficiency levels.

In the second strategy of "transition assistance," the client attempts to transition to a newer set of business processes, and uses the assistance of a vendor in various ways during this transition. Here, the client's existing business processes are in good enough shape, but a decision might have been made to changeover to a newer set of business processes. For example, business processes with newer technologies are continually adopted in response to the changing market dynamics. Such a situation demands that while the newer processes are being adopted by the client personnel, the current processes cannot be completely discarded, and need to be kept running during the transition period. Hence, while the client personnel adopt, learn, and transition to the new business processes, the vendor personnel would take the responsibility of keeping the current processes running. Once the client successfully transitions to the newer businesses processes, both the current business processes and the vendor's services would be discontinued. There are two major risks here: (1) the vendor fails to successfully carry out the client's current business processes and hence hurts the client's prospects in the market, and (2) the client fails to transition to the newer system successfully or decides to fall back on the current system. Similar to the "transition assistance" concept, Sparrow (2003, p. 10) speaks about *transformational outsourcing,* where certain activities are outsourced to the vendor while the client transforms by comprehensive reorganization and optimization of its business processes, and Millar (1994, as cited in Lacity & Hirschheim, 1995, pp. 4-5) speaks about *transitional outsourcing,* where clients usher in a major transition or changeover involving three

phases: (a) the outsourcing of legacy processes, (b) the transition to the new processes, and (c) the management of the new processes.

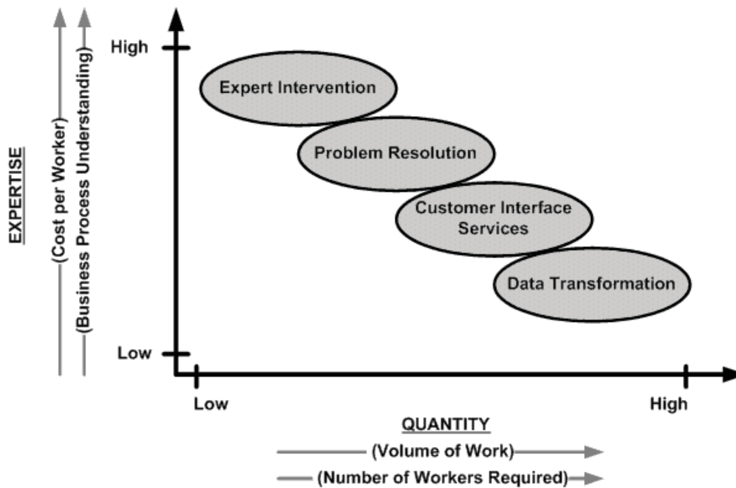
In the third strategy, of "capability development," the focus of the vendor is to build on its core capabilities (and related business processes) that maximize its competitiveness in the marketplace. This implies that the client keeps its focus on its "core" capabilities, and at the same time attempts to add newer capabilities to strengthen this "core" with the aim of making itself more competitive in the marketplace. Additionally, the business processes that are not strictly related to their core capabilities are then candidates for temporary or permanent outsourcing. In other words, the client can focus and build on its strengths (core capabilities) by: (1) handing over some noncore activities to a vendor, and/or (2) making use of a vendor's help to further develop its own core capabilities. After the client has confidently consolidated and built on its core capabilities, the client will have the option of discontinuing or renegotiating the extent of its engagement with the vendor. The risk lies in getting blinded by the urge to focus on the core capabilities and forgetting the importance of monitoring the vendor's activities during that period.

## Strategies Based on Required Expertise and q uantity of Workers

When business processes are outsourced to a vendor and/or offshored to another country, important human-resource-related concerns arise. The salaries of personnel vary from organization to organization, and country to country. At the same time, the availability of skilled personnel would vary from location to location. Hence, various factors need to be taken into consideration before business processes are outsourced or offshored (Iyengar, 2005; Karamouzis and Young, 2004). A location with high density of academic institutions would increase the availability and talent pool of skilled professionals in that location, and provide the firms with greater options of hiring fresh talent. Additionally, a location that is a hub for particular businesses or industries would have a greater availability of experienced personnel in those particular businesses. The cost of personnel would vary depending on the supply-demand characteristics, cost of living, and various other economic characteristics of the particular location. India and China, for example, are currently attractive destinations for firms searching for high-quality skills, at low costs, and with high availability (Chakrabarty, 2006d). Aron and Singh (n.d.) provided an interesting classification on the expertise and the number of the workers required for business process outsourcing. They suggest that the various business process tasks can be classified in decreasing order of "worker expertise required" and increasing order of the "number of workers required" as: (a) expert intervention, (b) problem resolution, (c) customer interface services, and (d) data transformation (see Figure 6). Tasks that require high expertise, such as expert intervention or problem resolution, require greater business process understanding from the involved personnel (attained through academic pursuits, training, or work experience), and hence involve greater costs per worker. Alternatively, tasks like data transformation and customer interface services involve greater volumes of work that need to be handled by a larger number of workers.

Hence, it is important to consider the following three factors before outsourcing or offshoring business processes: (a) the tasks involved in the business process, (b) the expertise required for the tasks, and (c) the number of workers required. After these three factors have been considered, a decision on the viability of outsourcing to vendors and/or offshoring to another country must be made, based on (1) the availability of workers with the required expertise, (2) the cost of workers with the required expertise, and (3) various other outsourcing and offshoring related considerations discussed in this chapter.

*Figure 6. Business process tasks, expertise, and quantity (Source: Aron & Singh, n.d.)*




## THE IT STRATEGY

IT (information technology) applications or software are often very tightly integrated into business processes, and personnel access and use these IT applications to execute or manage the business processes effectively. For example, the personnel managing the payroll or accounting-related business processes would certainly make use of IT applications, such as spreadsheets and other software, that allow entry, manipulation, and storage of data and also generation of reports of various kinds. The IT applications are commonly off-the-shelf products or are custom developed by software service providers, and need to be purchased. Of course, the software can also be custom developed in-house, which is equivalent to purchasing software from one's own IT department. However, after the purchase, both the off-the-shelf and the custom-developed software need to be hosted on servers and maintained, and for this purpose, the company is forced to hire additional IT staff. This chapter will not go into the aspect of purchasing software products or custom development, since a huge number of books and academic literature is already available on off-the-shelf products and custom development of software, inclusive of insourcing/outsourcing of custom software development (Chakrabarty, 2006a; Nelson et al., 1996; Poppo & Zenger, 1998). However, this chapter will touch the issue of "renting" software, which is a relatively newer and possibly path-breaking concept in the usage of IT in business process management.

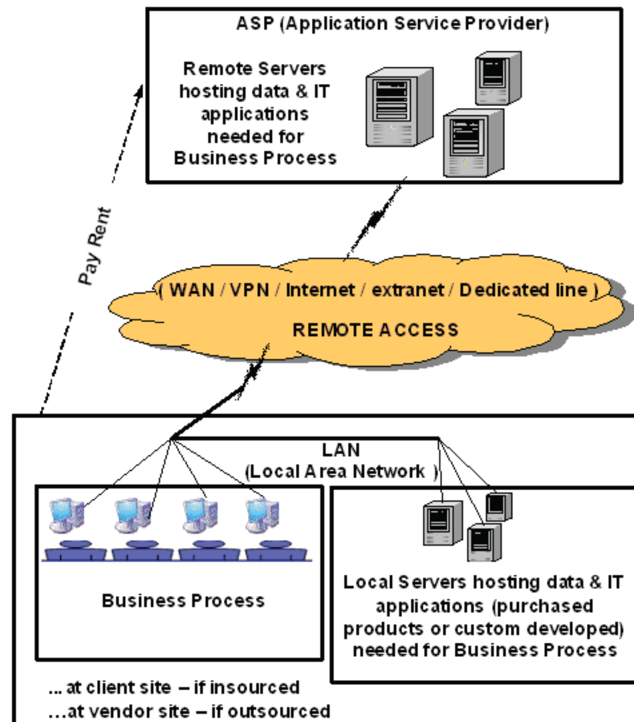
### Strategy of Renting Remotely Hosted IT Applications for Business Processes

What does an organization do when it does want to take the responsibility of hosting, managing, and maintaining software applications related to its business processes? In other words, what if the organization concerned does not want to

have anything to do with the management and technology overhead that goes into "owning" certain software applications that help it run its business processes (which are purchased as a product or custom developed)? IT is, after all, not the core competence of many businesses, and many businesses might find having an in-house IT department as an *overhead* or *cost-center*. An answer to this dilemma is the concept of what is traditionally known as application service providing (ASP), and has been more recently termed in various flavors such as "on Demand" service, "software-as-a-service" (SAAS), "real-time delivery," "application utilities" (Pring & Ambrose, 2004), or "net-sourcing" (Kern, Lacity, & Willcocks, 2002). It has gained greater significance and prominence in recent times due to broadband and other technologies that have made Internet access faster.

This strategy would involve contracting with an application service provider (ASP) whereby the client organization would have access to IT applications hosted by the ASP over a wide area network (WAN), a virtual private network (VPN), or over the Internet (Susarla, Barua, & Whinston, 2003, p. 103). In other words, the client organization would be adopting a strategy of selectively "renting" IS applications rather than "owning" IT software for its business processes (Bennett & Timbrell, 2000, p. 196). Technologically, the difference lies in where the application is hosted (Dewire, 2000, p. 14). Normally, IT applications for any business process would be hosted on the employee's/user's personal computer, or in the

*Figure 7. ASPs and on-demand software services*



organization's own local area network (LAN) or data center (see Figure 7). However, when the application is "rented," it would be hosted in a server or data center managed by the ASP (see Figure 7). IDC (International Data Corp., as cited in Dewire, 2000, p. 14) explains that an organization would rent the IT applications from the ASP "on a subscription basis and can bundle a full range of hosted application services" which can range from "low-end, productivity programs (e.g., word processing) to high-end ERP modules"

A major advantage of this strategy is that the ASP would purchase, customize, and manage IS applications at remote locations and host them for clients over the Internet (or maybe over a WAN, VPN, or extranet), and hence the related overheads and responsibilities would lie entirely with the ASP. Moreover, in the fast-changing software marketplace, the onus of getting the latest software upgrades, keeping the software defect free, securing the software application and data (against hackers and other threats), and ensuring 24×7 operations would be the ASP's responsibility. The client organization just has to make sure that the network connectivity between the organization and ASP is secure and active, and that proper budgeting is done for the software services that are being rented.

The major risks would be "loss of control" and "reliability" issues. The ASP would be in complete control of the software application, and the client would be dependent on the ASP for reliable access to the software application. ASPs often host software on a centrally managed facility, and provide access to the software application to multiple-client organizations (Dewire, 2000, p. 14). Now, multiple-client organizations might have divergent needs or customization requirements with regard to the software being rented. If it is a simple word processing application, then there would be low chances of divergent needs, but if it is an ERP or some complex application, then the clients might have divergent interests in terms of the software features, upgrades, or customization. In case of conflicting interests among clients, the ASPs may be inclined to give greater importance to larger clients, or arrive at some sort of compromise that does not ensure 100% satisfaction to all clients but is just "good enough." Furthermore, the client organization is completely dependent on the ASP for 24×7 reliable accesses to the software application. Clients should make sure that the contract has clauses that safeguard the client organization from risks resulting from the ASPs unsatisfactory behavior. When IS applications are tightly integrated into business processes, any failure to reliably access an IS application can affect the entire gamut of associated business processes (see Figure 7).

## CONCLUSION

Though BPO has many advantages, it is also fraught with many risks. Effective strategies need to be adopted for successful BPO, along with suitable assessment of risks and maximum utilization of the opportunities. This chapter attempted to provide a comprehensive overview of several BPO strategies, along with an analysis of the associated opportunities and risks, which would be of help both to the practitioners and the academicians.

## NOTE

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