Chapter 1: Introduction

The outsourcing market, especially Business Process Outsourcing (BPO), is growing every year. International consulting companies like Accenture, Gartner IBM, and PricewaterhouseCoopers offer opportunities and report annual growth figures of more than 60 percent in the last few years in BPO (Accenture, 2004a; PWC, 2005). Recent studies show that 85 percent of all North American and European companies have outsourced at least one function (Logan et al., 2004). Furthermore, the contracting period for most outsourcing contracts is more than one year (Accenture, 2004a).

For decades, companies have successfully used outsourcing to generate significant savings. Two market forces are driving this practice: a growing low-cost white-collar labour pool, and the automation and codification of best practices (Namasivayam, 2004). However, discussions with any employee will reveal some resentment of outsourcing. Some enterprises and their external service providers (ESP) have had numerous less than successful experiences with outsourcing. However, there are encouraging signs that enterprises are learning from their mistakes and from the mistakes of others (Scardino, 2002).

Maintaining successful client-supplier relationships is key to benefiting from outsourcing (e.g. Klepper and Jones, 1998; Zhu et al., 2001). An outsourcing relationship is "an ongoing linkage between an outsourcing vendor [provider] and customer that has a long-term orientation and a mutual recognition and understanding that the benefits attained by each firm are at least in part dependent on the other firm" (Goles and Chin, 2002, p. 227). Better relationships lead to greater benefits from outsourcing (Lacity and Willcocks, 2001). Swiss Banks (clients) enter into BPO relations seeking the advantages of lower cost, greater flexibility and the access to specialised knowledge (Williamson, 2002; Dittrich and Braun, 2004).

Given these observations, the outsourcing relationship domain must be carefully reviewed. After all, many organisations are entering into long-term commitments with their providers. The outsourcing contract plays an important role for the duration of the outsourcing relationship. Lacity and Hirschheim (1995) stated that the contract is the only guarantee that the expectations of the both parties are realized. In many outsourcing situations, the opportunity to add details to the SLA (Service Level Agreement) is very limited (Beulen and Ribbers, 2003; Margulius, 2005). However, the premise must be a willingness to cooperate and to arrive at joint solutions (Barnard, 1938; Beulen and Ribbers, 2003).

To date, there has been scant research into Business Process Outsourcing relationships. My research will provide insight into two important areas of interest in Business Process Outsourcing (BPO): the management of the outsourcing relationship, and the challenge of managing and monitoring Service Level Agreements. My analysis is both descriptive and explanatory.

Chapter 2 reviews and discusses several terms in the outsourcing literature, Chapter 3 outlines the methodology used in this study, and presents the Data Collection process. Chapter 4 presents a selection of individual perceptions and the findings are compared with existing theories and research. Chapter 5 answers the research questions, reflects on possible implications for practice and concludes with a discussion of the limitations of the study and recommendations for further research.

Chapter 2: Literature Review

This chapter will review the literature on outsourcing and has the following four sections. The first section is an overview that defines outsourcing terms. The second section presents the foundation of outsourcing from time sharing to the breaking up of the Value Chain (Porter, 1980) and a discussion of the parts in the outsourcing life cycle. In the final section, I present the setting of the problem and pose the research question that study will address.

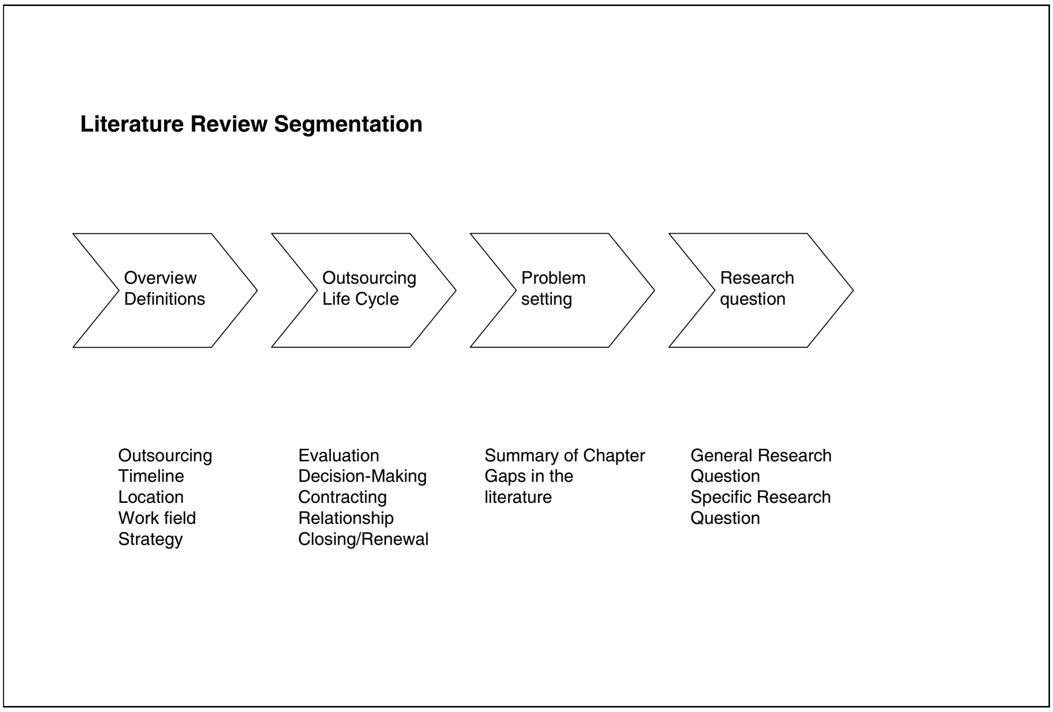

Figure 1: Literature Review Segmentation

Overview and Definitions in Outsourcing

To ensure a basis of common understanding, I start with a series of definitions and explanations of the most important terms in outsourcing. This is followed by a discussion of the origin of the BPO phenomenon and the definition of terms with respect to location, working field and strategy.

Definition of Outsourcing

Outsourcing, the acronym for '*Out*side Re*sourc*e Us*ing*' is one of the more conspicuous forms of contemporary organisational change. The term 'outsourcing' reflects the decision of an organisation to contract-out or sell its assets, and/or activities to a third party supplier, who in exchange provides and manages assets and services for monetary returns over an agreed period (e.g. Loh and Venkatraman, 1992b; Lacity and Hirschheim, 1993; Kern and Willcocks, 2001). However, various definitions of outsourcing are used in the academic literature and business press. I grouped the definitions into three clusters: dictionary, researcher and regulator.

Definitions in Dictionaries

The *American Heritage Dictionary* defines 'outsourcing' as

> The procuring of services or products, such as the parts used in manufacturing a motor vehicle, from an outside supplier or manufacturer in order to cut costs

and the verb 'to outsource' as

> To send out (work, for example) to an outside provider or manufacturer in order to cut costs

Here 'cost' alone is singled out as the reason for companies to outsource and limits outsourcing to the manufacturing segment. However, there are other strategic approaches apart from cost differentiation, such as seeking a market niche of differentiating products or services. During the 1980s, Michael Porter (1980; 1985) introduced the concepts of 'interoperability across the value chain' and 'horizontal organisation' as major strategic issues for firms. But market niches do not apply when a product is universal, like crude oil, and differentiation cannot exist when products are undifferentiated, like lean hogs, telecommunications, or unleaded gasoline. It follows that outsourcing defined by cost alone only applies when the product or process outsourced is a commodity.

'What are commodities?' is the next natural question. Porter's 'Maturity' and 'Decline' phases of the industry life cycle illustrate the Commodity position well.

According to Porter, in the Maturity phase the product has reached market saturation, has mass market appeal, repeat buying is common, there is superior quality, less product differentiation, standardization and less rapid product changes. The Decline phase is similar, typically including sophisticated buyers, little product differentiation, and interchangeable product quality. This leads us to assume that outsourcing is just for commodities.

The *Cambridge Dictionary* adds 'cost' as a stimulating factor:

> If a company outsources, it pays to have part of its work done by another company

and the dictionary offers two examples:

> (1) Unions are fighting a plan by universities to outsource all non-academic services.
>
> (2) Some companies outsource to cheaper locations to cut costs.

Of interest in Example (1) is the point 'to outsource all non-academic services'. Here, services here are a possible subject for outsourcing. Example (2) points to 'outsourcing to cheaper locations to cut costs', a practice known as 'offshoring'.

Researcher's Definitions

Loh and Venkatraman (1992a, p. 9) single out the information technology (IT) part of a company and define outsourcing as

> … involving a significant use of resources- either technological and/or human resources – external to the organisational hierarchy in the management of the Information Technology (IT) infrastructure.

Heshmati (2003, p. 98) argues that there is no general definition or measurement of outsourcing, which he describes as

> …different kinds of corporate action related to all subcontracting relationships between firms and the hiring of workers in non-traditional jobs.

Beaumont and Khan (2004, p. 689) define outsourcing and insourcing as follows:

> *Outsourcing* is defined as having work that was formerly done inside the organization performed by an external organization. The vendor (hereafter the outsourcer and outsource are, respectively, referred to as vendor and client) may be an independent entity or a wholly owned subsidiary. *Insourcing* means applying outsourcing's discipline to internal suppliers, often having them compete with external suppliers.

Beaumont and Khan's (2004) definition implies that outsourcing is just for existing companies. However, using outside resources could be a strategy from the beginning of a company. Further, in terms of *Insourcing*, the paper does not provide an explanation of the 'outsourcing discipline'.

Regulator Definition

The Basel Committee on Banking Supervision (BCBS, 2005, p. 4) defines outsourcing as

> … a regulated entity's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the regulated entity, now or in the future.

By comparing these definitions, I have adopted the definition of the Basel Committee on Banking Supervision since this paper relates to the Swiss banking industry. This paper understands outsourcing as 'a regulated entity's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis'. In my definition, I have left out the 'normally undertaken' phrase, because it is too broad.

Timeline in Outsourcing

What are the origins of outsourcing? In the late eighteenth century, Adam Smith (1776) noted the accumulation of operational procedures or work sequences in the time of early industrialisation. His division of working procedures is one of the basic principles of outsourcing. The division of the work process led to a centralisation and specialization of the workforce. While Adam Smith was concerned with the wealth of the nation, Frederick Winslow Taylor (1911) investigated the industrial aspects of the separation of planning from execution within the firm, what he calls 'scientific management'. His four principles are: 1) one must decouple the labour process from the skills of the workers; 2) management should prescribe exactly how the tasks should be performed; 3) management should prescribe exactly how quickly the task should be performed; and 4) money should be used as a motivational factor. This 'command-and-control' approach drew a line between managers and employees in the sense of 'workers work, and managers think'. Taylor wanted to subdivide the work that was usually performed by a single gang boss among eight job positions: route clerks, instruction card clerks, cost and time clerks, gang bosses, speed bosses, inspectors, repair bosses and a shop disciplinarian (Taylor, 1911, p. 104). Therefore, Taylorism implies low-trust relations between employer and employees and tends to carry the division of labour to new extremes, where work cycles are measured in seconds. Direct control is needed to ensure that labour power bought is converted into labour performed and Taylorism became a formalized, bureaucratic system. Taylor himself recognised that to execute his model is expensive because it entails creating jobs with little or no value supervisors and other indirect workers.

Another characteristic attributed to Taylorism is high automation, a consequence of which is a lack of flexibility. According to Zuboff (1988) a high level of automation tends to deprive workers of the ability to cope with unexpected situations, which leads to the necessity of advancing automation even further. However, it is easier to integrate new and cheaper workers quickly into a high automated production process, and it allows for downsizing without losing knowledge from the organisation.

Ritzer (1993) noted that the application of pure Taylorism has been very firmly established in some areas, such as the McDonalds-type firm, characterized by predictability and controllability. Furthermore, advanced automation can entail the incorporation of human skills and decision making into machinery, and thus the removal of brainwork from the 'shop floor', a key element of Taylorism. This statement is significant because early in the twentieth century Henry Ford already capitalised on Taylor's theories and created a workforce trained and organised around the standardisation of worker tasks on the production line. The established production line is a successful example of dividing and grouping operational procedures. Ford produced much cheaper but higher-quality automobiles with this new process working model. However, the past has shown that the Taylor's approaches had to be adjusted to organisations and their specific requirement. A number of element of the so called 'Taylorian' enterprise remain present in today's companies. The formalisation of prescribed work is an example of this (Peaucelle, 2000).

Zuboff (1988) stated that early organisation theories are based on Taylorism as business automation. Business Process Outsourcing (BPO) is the most recent step in a long cycle of business automation that traces its origins to the time-sharing and data processing model of the 1960s which is asserted (e.g. Lacity and Hirschheim, 1993; Michell and Fitzgerald, 1997; Currie et al., 2003; Cullen and Seddon, 2004; Nag, 2004; BCBS, 2005). The chart below shows the historical trajectory from time sharing (outsourcing a task) through entire IT Operations outsourcing (hardware and software) to today's Process Outsourcing (entire process):