

Outsourcing of front-end business processes: Quality, information, and customer contact

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Abstract

We examine the recent supply chain phenomenon of outsourcing front-end business processes in this paper. Few, if any, of the existing theories provide satisfactory explanation for the rapid growth in this area. We use a model proposed by Sridhar and Balachandran [Sridhar, S.S., Balachandran, B.V. 1997. Incomplete information, task assignment, and managerial control systems. *Manage. Sci.* 43(6), 764–778] to determine the factors that might contribute to this phenomenon. Our analysis reveals that the ability of the vendor to forecast the task environment without bias and to gain sophistication in interpreting contract terms might make the firm indifferent between outsourcing and retaining front-end processes in-house. We validate our findings against the work of Apte and Mason [Apte, U.M., Mason, R.O., 1995. Global disaggregation of information-intensive services. *Manage. Sci.* 41(7), 1250–1262], who develop a theoretical framework to identify criteria for companies to select services to be outsourced. They base their decisions predominantly on the nature of “customer contact.” The combined theories are shown to provide a rich framework for identifying customer-facing tasks that can be outsourced.

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1. Introduction

The recent trend of outsourcing front-end processes, such as customer care and marketing services, is a paradigm shift in how firms structure their business processes. This trend is part of a larger phenomenon of outsourcing business processes that began more than a decade ago with the outsourcing of IT. It now includes the outsourcing of customer care processes, finance and accounting functions, as well as travel-related and real estate management services. The outsourcing of one or

more of these specific functions or business processes to a third-party vendor has come to be called business process outsourcing (BPO) (Gartner Dataquest, 2003). The latest Nasscom-Mckinsey report-2005 (Nasscom-Mckinsey Report, 2005) states that the addressable market for global offshoring exceeds USD 300 billion of which USD 110 billion will be offshored by 2010. India has been one of the main beneficiaries of BPO spending. The BPO industry in India is growing at a compounded annual growth rate greater than 25%, is expected to generate export revenues of USD 60 billion by 2010, accounts for 1% growth per year of India's GDP and for 44% of export growth by 2010 (Nasscom, 2003). A snapshot of the outsourcing industry is provided in Tables 1 and 2. Table 1 reports the worldwide BPO spending for different business processes. Sales and Marketing, which are front-end

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Table 1
Worldwide BPO spending by segment, 2001 (Nasscom, 2003)

	2001 (US\$ million)	Share (%)	2006 (US\$ million) prediction	Share (%) prediction
Human resources	7,373	1	25,555	2.1
Logistics	140,700	19.8	308,651	25.7
Purchasing	5,288	0.7	12,185	1.0
Engineering/R&D	69,798	9.8	123,882	10.3
Marketing	76,666	10.8	108,340	9.0
Sales	107,412	15.1	165,736	13.8
Facilities Opns. Mgmt.	120,635	16.9	172,329	14.4
Administration	36,644	5.1	53,396	4.5
Legal	111,273	15.6	163,962	13.7
Finance/Accounting	36,356	5.1	64,872	5.4
Total	712,145	100	1,198,908	100

processes, constitute about 26% of the worldwide BPO spending in 2001 and are expected to account for about 23% in 2006. Table 2 lists the number of Indian companies that provide different BPO services. Front-end processes constitute 46.3% of the services offered by Indian firms. Moreover, as of March 2003, customer care alone contributed to 30% of the BPO revenues (Nasscom, 2003).

In this paper, we outline alternative views of outsourcing with a view to determine the factors that favor the outsourcing of front-end processes. The survey of literature reveals that few, if any, of the existing theories provide satisfactory explanation for the rapid growth in this area. In our analysis, we focus on the essential difference between outsourcing operations and keeping them in-house. For example, firms that only wish to access low cost resources could achieve this objective by shifting operations to a suitable location. Instead, many firms have chosen to outsource their front-end operations instead of relocating them.

Table 2
Distribution of BPO firms in India (Nasscom, 2003)

Service Lines	No. of companies
Customer care	103
Web sales/marketing	100
Billing services	81
Database marketing	80
Accounting	76
Transaction documentation management	75
Transcription	75
Telesales/telemarketing	70
Benefits administration	32
Tax processing	30
HR-hiring/administration	26
Biotech research	15
Total	763

Prior research by Sridhar and Balachandran (1997) established that information asymmetry affects the decision to outsource in a significant manner. We refer to their model as SB in the paper. In their model the firm is initially assumed to have production facilities sufficient to perform only one of the two tasks that are performed sequentially. The key informational issue in the SB model is the quality of information about the task environment available to the internal and external agents. SB find that when the external agent has incomplete information about the task environment, firms prefer to outsource back-end processes and retain the front-end processes in house. This prediction is contrary to the trend of outsourcing front-end tasks. Nevertheless, information asymmetry is a well-accepted and key variable for deciding whether to outsource. We contribute to this literature by showing that even when the external agent has incomplete information about the task environment, there are several conditions on the information structure which could cause the principal to be either indifferent to which agent performs the front-end task or even prefer that the external agent performs this task.

In order to complete our analysis, we turn to the service system design literature which also provides guidelines on which front-end tasks to outsource. We use the work of Apte and Mason (1995) for this purpose and refer to their model as AM. We combine our findings with the theory proposed by AM to develop a comprehensive framework for describing front-end tasks that can be outsourced.

Section 2 of the paper contains a review of the related literature in two parts. In the first part we review the economics and strategy literature, and in the second part review literature related to service system design. In Section 3, we present the SB model and state the main results from our paper. In Section 4, we combine our

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