



Risks and benefits of business process outsourcing: A study of transaction services in the German banking industry

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ABSTRACT

We developed a model of the adoption of business process outsourcing (BPO) based on risk–benefit analysis. The model was tested in the German banking industry in four areas of transaction processing. Our results showed that, in general, perceived BPO benefits have a substantially stronger impact on intention to increase the level of BPO than perceived risks. However, the experience that banks have with the BPO process, [whether already decided on BPO (Pro), still in the pre-decision phase (Neutral), or opted against BPO (Contra)], moderated the impact of factors affecting the perceived risks and benefits of BPO. Banks that opted for BPO were mostly driven by a desire to focus on their core business while considering financial risks. Banks in the neutral position had the most balanced view of risks and benefits, mainly financial and performance ones, and also focusing on the core business and increased business process performance. Those banks that decided against BPO mostly focused on benefits while the perceived risks were mostly formed by strategic and performance risks rather than financial ones. The results point out the path dependencies of the BPO decision.

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1. Introduction

Business process outsourcing (BPO) involves the delegation of an entire business process to a third party provider, including its supporting services. Business processes in which IT plays an important role have become prime candidates for BPO. One industry whose way of carrying out business processes has dramatically changed is the banking industry. Associated business processes like trade settlement or execution control are now conducted using IT systems. In virtually every BPO engagement, the service provider assumes responsibility for both the business process and the underlying IT services. Thus, the BPO client transmits a set of information input to the service provider who executes the process and passes processed data back to the client. However, in the German marketplace, studies of service providers [8] and market research firms [23,43] indicate that the BPO adoption rate is still unexpectedly low. This raises the question: *What are the main factors that hinder as well as drive the intention to increase the level of BPO from the perspective of key decision makers in organizations?*

Most prior studies have emphasized the high growth potential of BPO. A study of 31 European banks reported in 2003 that the

majority intended to increase their level of outsourcing, particularly of BPO [31]. Based on an in-depth case study about Lloyds London, Willcocks et al. [44] concluded that the market for back office transactions was large enough for new vendors to enter and that it would grow substantially. They further found a rising market for BPO when reanalyzing over 350 case studies on outsourcing. In spite of these promising BPO scenarios, however, there is still scant empirical research on the actual determinants of the BPO decision [40], except for one study that focused on whether business processes should be outsourced domestically or offshore [41].

This motivated us to analyze the determinants that enable or obstruct the BPO decision, developing a model that integrates multiple BPO decision criteria. We focused on two important antecedents of the decision: the risks and benefits that senior management associates with BPO.

2. Theoretical foundation and the development of hypotheses

2.1. Conceptualizing the dependent variable

While some firms have already adopted and implemented BPO, others are still evaluating it, while some have not yet seriously considered it. Rather than seeking to explain variation in the current degree of BPO across banks, we focused on the variation in their intention to increase the current level of BPO.

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2.2. Risk–benefit concept

In line with Ajzen’s TRA [1], we argued that management’s intention to change the BPO level depended on its attitude towards BPO, which was influenced by salient beliefs about it. However, we did not wish to test the entire causal chain from salient beliefs to attitude and intentions as an antecedent for BPO behavior. Instead we focused on the more immediate salient beliefs about BPO that may form a decision maker’s attitude towards BPO.

This view is consistent with the risk–benefit concept of decision theory [36,37]. Accordingly, we argue that positive beliefs about BPO increase the manager’s perceived benefits, while negative beliefs result in perceived risks [26]. Risks have been found to influence adoption behavior in various ways. For example, in IS research perceived risk has been shown to influence the adoption of e-services and of new IT systems [21,24]. Taken together, the influential role of perceived risks in adoption processes in general and in outsourcing decisions in particular is widely supported at the individual as well as the organization level.

Perceived BPO benefits aid in reaching an organization’s objectives, achieved by reaching a higher level of efficiency or effectiveness in performing business processes, e.g. by reducing IS costs or closing gaps in different types of IS resources [22,42].

The decision maker assesses the potential risks and benefits that arise from BPO and combines them into overall perceived risks and overall perceived benefits. The result is an overall evaluative appraisal of BPO which influences the intention to change the

current level of BPO. Accordingly, the following hypotheses were made:

H1. A high level of perceived risks of BPO negatively influences the intention to increase the level of BPO in the bank.

H2. A high level of perceived benefits of BPO positively influences the intention to increase the level of BPO in the bank.

The resulting risk–benefit BPO adoption model is shown in Fig. 1.

2.3. Perceived risks of BPO

We adopted the framework developed by Cunningham [14]. He divided into six dimensions (risk facets): performance, financial, risk/time, psychological, social, and safety. When applying this framework to the BPO context, we reduced it to four facets: performance, financial, strategic, and psychosocial.

Performance risk admits that the BPO engagement may not deliver the expected level of service. Potential losses due to this can be significant in the banking industry. They may severely damage the bank’s reputation and even initiate corrective action by a regulatory body. Therefore, managers must carefully analyze the ability of the service provider. Potential sources of failure are the inability to provide the resources [39], a lack of vendor capabilities, declining service levels over time or the service provider’s lack of experience.

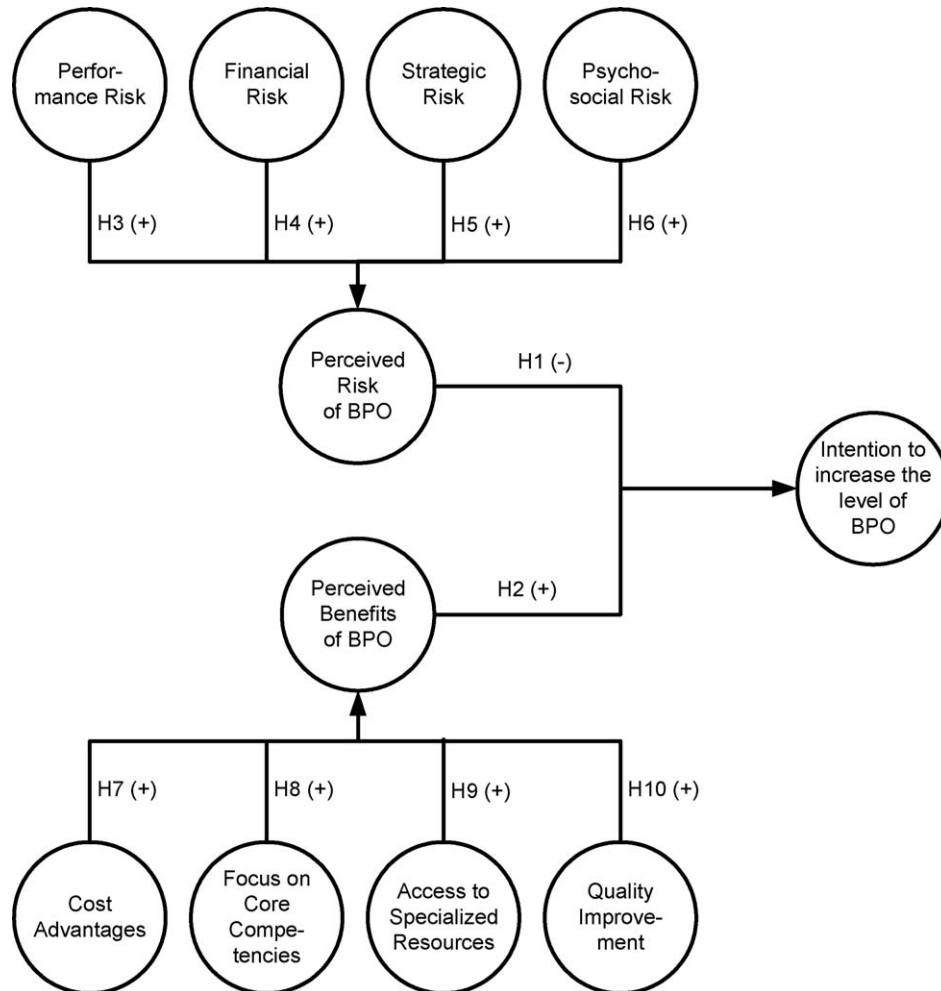


Fig. 1. Perceived risk–benefit BPO adoption model.

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