

2005

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Recommended Citation

Medlin, B. Dawn, "IT Enabled Business Process Onshore Outsourcing: An Empirical Analysis" (2005). *AMCIS 2005 Proceedings*. 414.
<http://aisel.aisnet.org/amcis2005/414>

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It-Enabled Business Process Onshore Outsourcing: An Empirical Analysis

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ABSTRACT

IT-enabled business process onshore outsourcing (BPO_o) in relationship to the community banking industry has grown steadily for the past several years. Business processing onshore outsourcing in comparison to offshore outsourcing uses firms within a country's own geographic boundaries to address back-end processes such as accounting, payroll, and customer support. Many banks are evaluating the different onshore outsourcing opportunities to determine if this approach is truly a viable one. The authors propose that most community banks are using onshore outsourcing and find that there are factors such as cost and enhanced capabilities that are the drivers of this adoption.

A survey was designed to gather data from members of the North Carolina Bankers Association to identify the services that they are outsourcing and to determine if through the use of these services they have achieved enhanced capabilities, increased profitability, and reduced operating costs. The results of this study will assist banking executives in identifying business functions that are currently being outsourced by their peers, those that will be outsourced in the future, and those that will to never be outsourced.

Keywords

Business Process Onshore Outsourcing

INTRODUCTION

Competitive pressures, customer demands, and cost efficiency considerations have all manifested themselves in increased employment of information technology (IT) enabled services within community banks. The banking industry has in the past several years begun to rely more heavily on onshore outsourced firms and consultants to address their daily tasks. With the complexity of business issues surrounding topics such as deregulation and operational effectiveness, banks are hard pressed to hire and retain staff with networking and Internet expertise.

The topic of outsourcing and in particular offshore outsourcing has become so heated in controversy that it seems to have overshadowed what may be an even larger trend in outsourcing, which is the outsourcing of business process services within the United States. In fact, the market for on-demand application services is projected to grow from \$425 million in 2002 to \$2.6 billion in 2007, which represents a compound annual growth rate of 44 percent, according to a May 2003 IDC report.

Regulatory Control

In the early 1990s regulatory examinations were primarily focused on IT issues and the core applications (e.g. deposits, loans, general ledger, etc.) as they related to in-house computer systems. After the preparation and completion of the century date change, more attention was directed towards risk management in the regulatory approach to IT examinations. This was particularly true within the arena of community banking, whether it was related to core processing that occurred in-house or activities requested to be outsourced to a third-party vendor.

On February 29, 2000, the Board of Governors of the Federal Reserve System issued the Supervision and Regulation Letter SR 00-04 that provided regulatory guidance related to the issue of the outsourcing of information and transaction processing activities to either third-party providers or affiliated institutions. The Federal Reserve stated that it expected institutions to ensure that controls over outsourced information would be handled the same as if the activity was handled in-house.

Benefits

Outsourcing to companies with specialized expertise and a fully configured infrastructure can be a smart alternative. Onshore outsourcing in the United States or within one's own country can deliver cost savings that are as good as, or better

than, typical offshore engagements (McAdam, R. & McCormack, D., 2001). For instance, software services are often 50 percent or less the cost of installed and internally managed software when outsourced domestically, while most analysts predict between 15 percent and 30 percent cost savings from overseas outsourcing (Krebsbach, K., 2004). Moreover, overseas outsourcing projects can often take years to capture cost benefits, given startup costs, knowledge transfer and process issues. Software services, on the other hand, can often be live in weeks or months, and cost benefits begin to accrue immediately if onshore services are used.

As a general rule, onshore companies that are selected can provide fixed costs on long-term contracts and can deliver quickly on service level agreements (SLAs). If a firm does not deliver, it can be replaced quickly. Most service providers routinely include powerful developer hooks, internal teams and third-party integrators that can work with the products, as they would any installed product (Larson, 1998).

Although offshore development firms have proven themselves on technical grounds, most lack the business, organizational and change-management skills to deliver the anticipated business benefits. However, organizations can realize those benefits through effective onshore management of business processes.

The risk of project failure is minimized when using a domestic outsourcing alternative in part because services firms are generally paid on a monthly basis and if the system is no longer needed, the bank is not tied to a lengthy contract. Additionally, companies that are contracted as third-party vendors are highly specialized and provide or manage one or a few applications at a time. Generally, third-party providers are security-conscious, since most stake their reputations on a high level of security. While there is no guarantee that choosing a firm within one's own country will mitigate negative risk, there is certainly a greater sense of control and supervision when the outsourced firm is within the same border.

The savings generated from vendor's support offerings can be redirected in several ways to benefit an organization, other than in simply reducing costs. The money can be redirected to other company functions that need strengthening or enhancements can be made to existing applications. There are other advantages including the freeing up of management attention from operational issues to strategic issues, such as business development and the improvement of client relations. In the current economic context of less spending and reduced budgets, the tangible savings accrued from onshore outsourcing gain even greater importance.

Concerns

Outsourcing is not without its opponents. One of the largest issues involves systems integration. Software vendors and systems consultants have long argued that better integration of front, middle and back offices is the key to better risk management. For banks that have invested heavily in integrated systems, it may be difficult or painful to give up some of the systems integration they have so worked hard to achieve.

Certainly, pricing needs to be one of the most important factors that are considered when a bank considers outsourcing. However, it is also one of the most difficult things to get right. With many community banks the entry into business process outsourcing is still in an immature stage, and drawing up the precise cost structure and identifying good deals is often a guessing game.

Earl (1996) also found that the actual savings are frequently less than those claimed and are highly dependent on the contract itself and on the approach taken to managing the contract. King (1994) also warned of the long-term strategic dangers that can arise from a relatively short-term decision to outsource, suggesting that the management of the outsourcing vendors may be more problematic than is initially expected. Finally, it should be noted that renegotiation can be a costly experience.

Two additional factors compound the success of outsourcing. First, business process incorporates a desire to improve practices or deliver operational transformation. It can be difficult to discern where the danger points lie in the relationships governing these critical but intangible qualities. Second the very nature of BPO requires companies to negotiate functions that they may have little or no knowledge about, which is one of the reasons they choose to outsource in the first place. This factor though can have a serious risk. Unscrupulous vendors may use this lack of knowledge to produce inaccurate information or inferior products.

THEORETICAL BACKGROUND

In the field of outsourcing, researchers have introduced several different theoretical models to explain the decision-making process of both on and offshore outsourcing. Among the well-known theories are the resource-based theory and the resource-dependency theory. From a strategic management view which involves both the resource-based theory and the resource-dependency theory, they define similar risks to Lonsdale's Risk Management Model (Lonsdale, 1999). This model puts importance on determining the value, rareness, substitutability of outsourcing while the risk management model is used

for determining the two main risks of the practice: the loss of the resources that underpin competitiveness and the danger of dependency on suppliers.

Another relevant theory is that of social exchange, which is applicable to outsourcing, and can be related to Beulen's Five Governance Factors Method (Beulen, E., & Ribbers, P). The social view model focuses on power-structure relationship and dynamic relationship processes to reduce risks in outsourcing while Beulen's Five Governance Factors emphasizes the importance of developing a tightly coupled relationship. Therefore, the theoretical models related to Outsourcing seem to give an overview of combining different risk assessments to determine the benefits and risks of outsourcing.

RESEARCH METHODOLOGY

A research methodology was designed to identify the benefits and capabilities related to IT-enabled business process onshore outsourcing within the North Carolina banking community. The methodology consisted of the following: research instrument, data collection, and statistical methods.

Research Instrument

The research instrument measured the different types of onshore outsourcing selected for use by the members of the North Carolina Bankers Association who were either the Presidents or CIOs of their organization. Other data collected included demographic information (location of bank and its assets). The instrument was pilot tested using banking officials comparable to those used in our study to eliminate any ambiguity as well as to ensure a complete understanding of the questions and the survey instrument. These individuals were not included as sampling units in the actual survey, and the survey instrument was modified according to the feedback received during the pilot test.

A five-point Likert-type scale was used to measure respondents' propensity to use onshore outsourcing methods (1= Currently Outsourcing Onshore and 5 = Never Outsource Onshore). The survey instrument did require that the bankers reveal their identity for tracking purposes, but individual responses remained confidential.

Data Collection and Statistical Methods

The research instrument was administered to bankers who were members of the North Carolina Bankers Association which consists of one hundred and thirty one members. The delivery of this survey was administered online. Electronic surveys provide a faster reaction time than mail surveys, with many studies reporting that most e-mail responses arrive within two to three days following the initial e-mail contact (Bachmann & Elfrink, 1996; Kittleson, 1995; Mehta & Sivadas, 1995; Sproull, 1986; Schaefer & Dillman, 1998). Participants were given appropriate instructions to complete the survey. Thirty-two completed surveys were received and will be analyzed using statistical methodologies such as ANOVA. The internal validity of the survey was conducted using Cronbach Alpha and was found to be .886.

Further Research Plan

This paper represents the first step in an ongoing research project that will identify which activities bank executives have chosen to outsource. After completing our quantitative empirical research the researchers will be able to offer greater insight into the decisions that community banks are making in relationship to onshore outsourcing.

CONCLUSION

The banking industry has witnessed dramatic change in terms of its method of handling business processes. Through the adoption of new technologies firms are able to concentrate on core competencies while outsourcing various processes such as check imaging, statement rendering, and credit card processing. This paper will reveal choices banking executives are making with regard to business process onshore outsourcing. The results of this study will provide information to the banking community with regard to competitive practices that are being carried out by their peer organizations. Additionally, such information may result in enhanced strategic planning in relation to business process onshore outsourcing (BPOnO).

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