Organizational Readiness for Business Process Outsourcing: A Model of Determinants and Impact on Outsourcing Success

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Abstract

In innovation adoption literature, the important role of the organizational context as a determinant of information systems (IS) success has long been pointed out. Various factors such as top management support, process formalization, and availability of resources have been shown to contribute to the successful implementation of new information systems. By drawing on relevant insights from IT innovations literature, our conceptual piece of research aims at identifying organizational context factors which are critical for the success of business process outsourcing (BPO) as part of a firm's overall Business Process Management activities. More specifically, process readiness, IT readiness and business management readiness are proposed to be important dimensions of organizational readiness for BPO. Furthermore, IT business alignment, as a routine-based process of knowledge sharing and creation, is proposed to be a driver of organizational readiness for BPO.

1. Introduction

Business Process Management (BPM) is increasingly attracting interests of both practitioners and researchers, as it promises to improve business agility and operational governance by discovering, analyzing, modeling, simulating, optimizing, executing and governing business processes using well-defined methods, policies, metrics, practices, and software tools. Despite its relative recentness, business process outsourcing (BPO) is emerging to be one of the most promising instruments of BPM that optimizes performance in both core and non-core business processes. It aims to develop mutually beneficial interorganizational alliances among firms based on the level of competence in various business processes. The emergence of standardized and open IT platforms in recent years has made such alliances not only operationally feasible but also economically attractive.

Nevertheless, until now BPO has received little attention in academic literature [45]. Moreover, descriptive studies found a significant number of BPO deals showing serious problems; a survey [60] conducted in 2004 among Germany's 500 largest banks on process performance issues, the role of IT, and outsourcing tendencies in the credit business found that among the managers of banks which had already outsourced (parts of) their credit process, practically no one was fully contented with the outcomes of the outsourcing deal. Only 29% of the managers in charge with the specific process stated to be "rather content" with the outcomes of BPO. A subsequent study found that the risk of *not achieving expected cost savings* from an outsourcing deal (because the underlying business case does not contain all prospective costs) ranged among the top three managerial concerns regarding business process outsourcing (BPO) [62].

Much of the academic literature on outsourcing focuses on the outcomes of outsourcing [15]. The general tenor is that customers can successfully exploit

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the outsourcing market, but that it requires a tremendous amount of in-house management [31]. But while some researchers have focused on the impact of contract design and relationship quality between outsourcer and service provider, only a few papers have addressed the organizational context – i.e., factors grounded within the outsourcer's organization – as a determinant of successful outsourcing.

By contrast, the literature strand on the adoption and implementation of IT innovations by organizations has pointed out the important role of the organizational context as a determinant of successful innovation adoption and implementation for a long time [43]. It has been stressed that firms need to become organizationally ready in order to successfully adopt and implement an (IT) innovation [53].

When outsourcing IT-intense processes – such as credit processing or other transactional or back-office processes in the financial services industry, the outsourcer's IT unit needs to provide strong support to the business domain – for example, by helping managers to identify potential hyphenation points where the business process can be split between the outsourcer and the sourcing provider, by determining prospective costs of systems integration, and by interfacing the IT applications supporting the business process. From a knowledge-theoretical point of view, this means that different knowledge pools within the organization – namely, the IT and business units – need to be incorporated into the process of BPO adoption. IT and business units need to work together in an aligned way.

The objective of this ongoing study is twofold. First, by drawing on insights from innovation adoption literature we want to explore relevant dimensions of organizational readiness for BPO and to evaluate their impact on BPO success. Second, we want to assess the role of IT business alignment as a determinant of organizational BPO readiness. The purpose is to enhance our understanding of nuances of BPM by assessing the impact of the strength of relationship among business processes, practices and coordination of the business and IT sides of a firm on the firm's readiness at three levels to carry out this emerging BPM practice.

In this context, we will specifically address both, the business knowledge of IT managers (which has been typically considered in most of the past alignment research) as well as the IT knowledge of business managers (which has been widely ignored so far).

The research questions motivating this project thus are:

1. What are relevant dimensions of organizational readiness for BPO and what is their impact on BPO success?

2. What is the impact of IT business alignment on the achievement of organizational readiness for BPO?

2. Theoretical foundation

2.1 Business Process Outsourcing

BPO has only recently attracted the attention of researchers although it has been acknowledged in the past to be one of the largest areas of growth in the outsourcing market [21]. BPO is generally seen as the delegation of entire, or parts of, organizational business processes to a third party provider – including the hardware and software that supports those processes [45, 61]. BPO thus represents a combination of traditional information technology outsourcing (ITO), which has been a major trend since the early 1990s [15], and the outsourcing of non-IS business functions [27]. At the same time, BPO is orthogonal to the concept of ITO since it does not separate the tight interconnection between business unit and IT unit. Nevertheless, we argue that this interconnection has a potential impact on successful BPO because outsourcing IT-intense parts of the firm requires the subsequent implementation of inter-organizational systems to ensure straight-through processing. Thus, a strong involvement of the IT organization throughout the process of outsourcing is required.

BPO represents a *major administrative innovation* for today's organizations, very similar to how IT outsourcing represented a fundamental change for the way organizations could meet their IT needs in the early 1990s [36]. This perspective allows us to base our research efforts on prior findings from the literature on organizational adoption of innovations, which thus provides a suitable theoretical basis for analyzing the adoption of BPO by organizations.

2.2 Organizational Readiness

As we already mentioned, the role of the organizational context as an important determinant of successful innovation adoption and implementation has been pointed out for a long time. Various factors such as firm size, process formalization, and resources have been shown to contribute to the successful implementation of information systems [18, 43].

The notion of organizational readiness has been described in innovation literature as the level of preparedness of a firm for adopting and implementing an (IT) innovation [24]. This literature postulates that organizational innovation readiness – in terms of a sophisticated IT, integrated processes, availability of slack resources and the like – help to lower the level of risk associated with the innovation and thus contributes

to more successful innovation outcomes [54]. Furthermore, it speculates that a managerial lack of information about the own organizational innovation readiness comes along with increased uncertainty about the risks posed by the innovation and thus with a decreased ability to mitigate those risks [53].

However, while the importance of organizational readiness for successful innovation adoption and implementation has been highlighted repeatedly, there is no consensus about which dimensions constitute organizational readiness. In Iacovou et al.'s model of EDI adoption by small and mid-sized enterprises, organizational readiness refers to the *level of financial resources* and *availability and sophistication of the technological resources* of the firm [24]. The availability of resources is considered to be important because "small firms tend to lack the resources that are necessary for EDI and other IT investments" [24, p. 469]. Chang et al. [12] extend the scope of organizational readiness by including *process integration* as a further measure for the preparedness of a firm to adopt IT innovations. Furthermore, the *process readiness* dimension has been defined as the "level of fit" between the existing business processes within the adopting firm and the prospective innovation [53]. This "level of fit" reflects the extent to which processes and the innovation need to be altered in order to be compatible to each other [53]. Researchers also noted the importance of *inner-organizational business process integration* for the successful adoption of IOS, positing that firms with a high degree of integration within their business processes are better prepared to undertake cooperation projects by means of IOS [12, 24].

In this paper, we develop a concept of organizational readiness for BPO by drawing on the insights from innovation literature about the organizational factors which contribute to the successful adoption of innovations. Hereby, we concentrate on the organizational context from an *outsourcer's perspective*.

2.3 IT Business Alignment

As mentioned in the introduction, IT and business units need to work together in an aligned way throughout the whole process of BPO implementation. This is why we regard IT business alignment as an important factor for achieving high organizational readiness for BPO.

There is an ongoing discussion about whether alignment should be regarded as a state (an outcome) or as a process which affects the outcome dimensions [46]. Several authors link alignment to the resource-based view and describe it as a dynamic capability to develop and implement congruent IT and business plans [e.g., 48, 58]. The most prominent argument for the view of alignment as a process stems from Kearns and Lederer who state that alignment is a "process in which managers participate in the exchange of knowledge" [28, p. 5]. The alignment process itself is based on the concept of routines which describe the formal and informal purposeful interaction of entities within an organization [1]. Routines are essentially patterns of activity based on human actors [57]. "Smoothly functioning routines between IT and business units are seen as valuable, leading to a more effective development and use of IT" [58, p. 4].

Prior research has identified two primary consequences of alignment: increased IS effectiveness [11] and increased firm performance [46]. In contrast, misalignment of business and IT has been said to lead to undesirable organizational effects like poor utilization of scarce organizational resources, sub-optimal performance of business units and the organization, a cyclical relationship between higher IS spending and expectations for success, costly IS investments with low yield returns, missed identification of high potential IS applications, and lack of capitalization of first-rate technology-related ideas [10, 33].

In this paper, we argue that the process of IT business alignment, based on smoothly functioning communication routines, is an important prerequisite for the achievement of high organizational readiness for BPO.

3. Research Model and Propositions

Based on a literature review, we consider three factors as essential dimensions of organizational readiness for BPO. Our main propositions are that these factors are drivers for BPO success and that they are in turn driven by the smooth alignment process between IT and business organizations of the outsourcing firm. These relationships are summarized in Figure 1.

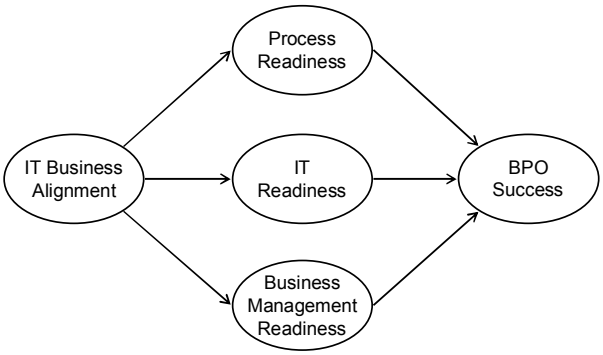

Figure 1: Proposed research model

Obviously, business process-oriented research models highly depend on the characteristics of the particular business process to be analyzed. Although we develop a generic model, we are aware of this and will consider several process characteristics, discussed by the literature, such as variety [13, 29, 49, 55], customer interaction and influence [7, 16, 52], degree of automation, complexity [51], flexibility [23], and information intensity [30], as control variables for the overall model. This allows us to evaluate the following constructs in light of specific process requirements in different industries and business segments. Additionally, we would like to point out the four propositions – P1, P2, P3 and P4 – that directly relate to BPM as they are aimed at a firm's readiness to undertake a specific process management initiative and the likelihood of success in that initiative. Whereas, the other two propositions – P5 and P6 – provide insights on the overall readiness of the firm's business and IT sides for undertaking any interorganizational process management initiative.

3.1 BPO Success

Many researchers have conducted studies on outsourcing success without producing a common definition of what exactly constitutes outsourcing success [15]. Lacity et al. [32] have found that the *achievement of anticipated cost savings* was the criterion used by most companies when assessing outsourcing success. Therefore, based on Lacity et al., we use the achievement of targeted cost savings as the measure for BPO success.

3.2 Process Readiness

When deciding to alter a business process by outsourcing (parts of) it, the implications or consequences of this action need to be well comprehended by the managers in charge. Many authors have stressed the importance of a firm's business processes being prepared for the adoption and implementation of an innovation [12, 24, 42]. Raymond [43] posits that "formalization requires that organizational processes be well understood, if explicit procedures, instructions, and communications are to govern them". Ein-Dor and Segev [18, p. 7] proposed that organizations with a high degree of process formalization were more likely to successfully adopt and implement an innovation. In the domain of BPO, altering the process by splitting it up between two organizations *represents* the innovation. This underlines the importance that the outsourcer thoroughly understands the implications, or side effects, of BPO implementation. Managers need to understand to what extent, and in which ways, altering a process by outsourcing (parts of) it, affects the other processes which are to be kept in-house. Being able to foresee all relevant side effects of BPO necessitates a thorough understanding of the process subject to outsourcing and of its interfaces to the surrounding processes. We therefore conceptualize process readiness for BPO as the *degree of formalization* of the processes subject to BPO, reflected by the existence of documentation, rules, procedures, and clear management practices [18].

It has been shown that process formalization is related to more efficiency, involving the application of rules and standard procedures to reduce ambiguity [14]. Thus, we expect that high levels of process formalization will lead to more efficiency and less ambiguity during the process of BPO implementation, helping to avoid unexpected costs and thus to achieve anticipated cost savings. Therefore, we propose that

P1 Higher levels of process readiness lead to higher levels of BPO success.

3.3 IT Readiness

Based on Byrd and Turner [8], Duncan [17], and Bassellier and Benbasat [3], we conceptualize IT readiness as the level of flexibility of the outsourcing organization's IT infrastructure and the business knowledge of IT managers.

Prior research divides IT infrastructure into two components [8, 17]: technical IT infrastructure and human IT infrastructure. The technical infrastructure is referred to as "set of shared, tangible IT resources forming a foundation for business applications" [8, p. 169]. The human IT infrastructure refers to the *technology management* knowledge and skills and *technical* knowledge and skills of the IT personnel [35]. Duncan [17] states that "infrastructure is flexible as the IT organization is able to respond rapidly and effectively to emergent needs or opportunities".

Byrd and Turner [9, p. 43] state that a flexible IT infrastructure can "support the design, development, and implementation of a heterogeneity of business applications. […] For example, if an organization supports a wide variety of hardware and software, that organization can more easily cope with changes [...]". In the context of BPO, we expect a high degree of IT readiness to require *fewer investments in IT systems and IT expertise*, thus lowering the costs of BPO implementation and helping to achieve the targeted cost savings.

Table 1: Dimensions of organizational readiness for BPO

Dimensions	Description	Sources
Process Readiness - Process formalization	• Degree of process formalization indicated by the existence of rules, procedures, and clear management practices for the processes affected by BPO	[18], [43]
IT Readiness - IT infrastructure flexibility - Business knowledge of IT managers	• Technical IT infrastructure as the "set of shared, tangible IT resources forming a foundation for business applications". • Human IT infrastructure as the technology management knowledge and skills and technical knowledge and skills of the IT personnel. • Knowledge and skills of IT professionals that enable them to "understand the business domain, speak the language of business, and interact with their business partners"	[3], [8], [9], [17]
Business Management Readiness - IT knowledge of business managers - Experienced project leader - Top management support	• Experience and knowledge of business managers that enables them to exert IT leadership in their area of business. • Active support by top managers for the BPO implementation project	[2], [26], [53]

Bassellier and Benbasat [3] found that IT professionals have a greater intention to develop and strengthen relationships with the business organization when they reach higher levels of business competence. They define business competence of IT managers as "the set of business and interpersonal knowledge and skills possessed by IT professionals that enable them to understand the business domain, speak the language of business, and interact with their business partners" [3, p. 676]. Relationships between business and IT are seen as essential for achieving high performance from IT [41, 57]. It was also discussed that a lack of business knowledge of IT managers leads to an inaccurate understanding of the actual requirements [39]. We conclude that, for BPO implementation, higher business competence of IT managers leads to a better understanding of the requirements posed by BPO to the IT domain and therefore to a more efficient and effective execution of IT-related tasks during BPO implementation (like interfacing IT applications and creating user interfaces).

Therefore, we propose:

P2 Higher levels of IT readiness lead to higher levels of BPO success.

3.4 Business Management Readiness

While IT readiness describes the IT context within the outsourcing firm, business management readiness refers to the fostering factors for BPO grounded within the outsourcer's business domain. One important aspect of business management readiness discussed in prior literature is the *experience of business managers* with outsourcing projects [53]. The underlying premise here is that organizations are able to learn from their experiences and that learning is a means of coping with change [50]. Furthermore, *top management support* has been widely acknowledged as one of the most important stimuli for successful innovation adoption [26]. It seems logical to conclude that for BPO, too, the availability of an experienced project leader and active support from top management are important factors for the implementation of BPO within time and budget, thus helping to achieve targeted cost savings from BPO.

As mentioned earlier, the outsourcing of IT-intense business processes typically has strong IT implications, namely the need to interface IT applications supporting the business process with other internal and external systems. The business problem, then, is how to best manage the interorganizational context from an IT perspective. Lack of attention to integrating information systems has been identified as one of the main reasons for failure of interorganizational projects [37]. As stated earlier, IT innovation literature mentions that knowledge of managers about their own organizational readiness fosters their ability to understand and mitigate the risks posed by the adoption of an innovation [53, 64]. Bassellier et al. [2] pointed out the importance of business managers' IT competence for their ability to exert IT leadership in their area of business: "Business managers are now expected to deploy IT effectively and strategically, to assume ownership of IT projects within their domain of

business responsibility, to develop a partnership with IT professionals, and to take the leadership in IT implementation" [2, p. 160]. We argue that in the domain of BPO IT competence enables business managers to understand the IT-related challenges posed by BPO and to cope with those challenges by taking the "right" business decisions. Therefore, IT competence of business managers helps to avoid unexpected costs and to achieve anticipated savings. We thus propose:

P3 Higher levels of business management readiness lead to higher levels of BPO success.

3.5 IT Business Alignment

In this article, we explicitly draw upon the *process view* of alignment, as described earlier. We regard alignment as a continuous process of communication and knowledge sharing, based on routines as the underlying dynamic element. According to Hansen [22], knowledge sharing among people from different subunits is a dual problem of searching for (looking for and identifying) and transferring (moving and incorporating) knowledge across organizational (sub)units.

In this view, alignment describes effective communication and knowledge exchange patterns which affect the outcome dimensions of shared knowledge and mutual understanding [44, 56] and lead to the fit of business and IT strategies and plans [6]. Nelson and Winter [40] refer to such exchange patterns as "routines" which are to the organization what skills are to the individual, incorporating tacit knowledge and unconscious coordination [58].

Prior research has stated that high degrees of process formalization and strong alignment routines may also lead to more inertia and thus to *less* organizational flexibility [47, 57]. The argument here is that a high level of alignment and strong process formalization may reduce the recognition of a possible need for change, thus reducing flexibility [57]. For this debate it is important to keep in mind that the concept of organizational flexibility has two temporal aspects, which comprise "an ex ante mode – preparing in advance for some future transformation, and an ex post mode – after-the-fact adjustments undertaken once a triggering episode has occurred" [20, p. 75]. While alignment may reduce a firm's ability to *recognize* the need for change (ex ante), we argue that ex post – i.e., once the need for change has been recognized – good alignment will act as a driver for efficient adaptation of the firm, because routine frequent interaction and knowledge sharing increase the ability of individuals from different units to know where to find and get knowledge from diverse parties [59]. This assumption is supported by Beimborn et al. [4] who found a strong positive link between operational alignment and IT flexibility of a firm, because of increasing business knowledge availability to the IT domain through knowledge exchange routines.

Prior research has also discussed the link between IT business alignment and organizational maturity, which is the degree to which organizational processes have been systemized by rules, procedures, and organizational practices [43]. It has been stated that communication and regular knowledge exchange lead to a better understanding of business processes and of the underlying IT and thus to higher organizational maturity [57].

Based on these findings, we thus conclude that routine-based, frequent interaction between business and IT domain also leads to a higher IT understanding of business managers, which in turn helps them to recognize and mitigate IT-related risks of BPO. We thus postulate that strong IT business alignment processes lead to high organizational readiness for BPO. More specifically:

P4 By enhancing organizational maturity, strong IT business alignment leads to higher process readiness for BPO.

P5 By enhancing IT flexibility and business knowledge of IT managers, strong IT business alignment leads to higher IT readiness.

P6 By enhancing business managers' understanding of IT, alignment leads to higher business management readiness.

4. Proposed Research Approach and Unit of Analysis

This section gives a brief overview on the research approach and the unit of analysis.

This research project consists of three phases. Phase 1 (of which the current paper is a first result) is a piece of descriptive research. The aim of this phase was to identify and narrow down the problem to be studied (which arises from the poor outcomes of BPO in the German banking sector). We identified and formulated relevant research questions for this problem domain, stated our intended contribution to practice and theory, developed a theory-based research model and, based on this model, formulated the expected results of the study.

Phases 2 and 3 will consist of a qualitative and a quantitative research step, respectively. Since the constructs of the research model and most of the hypotheses are already well grounded in theory, the appropriate research paradigm is positivism. Nevertheless, within the positivist context we want to get deeper insights into what the relevant facets of the

chosen constructs in the relevant context of BPO adoption are and therefore propose a sequential data collection process of both case studies and a subsequent quantitative approach based on the case study results. Applying such dual approaches in IS research is asked for by Mingers [38], who found that only a small minority of all empirical research works applied more than one research method. Since case study research has been accepted as a valid and valuable research approach within the positivist paradigm [5, 25, 34], the combination of both approaches for data collection and analysis allows to deeper focus on specific aspects of reality and thereby getting a richer understanding of the object of analysis. For the aim of this research we intend to conduct a multiple case study since variability of the main construct – alignment – is needed. To reduce the impact of further organizational factors which might affect the analysis, we will conduct the case studies in a rather homogenous industry (in terms of product variety).

An evolving trend of outsourcing parts of the back office of the mortgage business to so-called credit factories may currently be observed in the German banking industry. To be able to offer mortgage products in an effective manner, the front office needs to get very prompt feedback from the evaluation (pre-defined scoring provided by the sourcing provider) after the credit application data has been entered. After granting the loan, the electronic credit file is set up and archived by the credit factory. In cases of customer contact (e.g. if the customer situation changes or the loan has to be prolonged), the electronic credit file is handed over to the bank. These patterns just represent some examples of bank-credit factory interaction, but they reveal that tight integration of the bank's systems with the applications of the service provider has to be established.

The banking industry in Germany is highly regulated and consists of three different sectors. Two of them, the public savings bank sector and the credit cooperative sector, internally consist of autonomous, but structurally quite similar institutions (similar owner structure, quite similar product portfolio, often they even use the same software provided by a joint data processing center). Banks of these sectors provide, together with the increasing dynamics of the BPO market, a promising homogenous data base for conducting multiple case studies on the same phenomenon in different but structurally similar firms. This enables us to discard many disturbing factors [19, 63].

The case studies are intended to give valuable insights for the design of the subsequent quantitative data collection step (phase 3). Since BPO of mortgage processing is a starting trend in Germany, there comes up the opportunity of examining BPO success and the underlying alignment dimensions to validate case study findings on a cross-sectional basis. Moreover, the survey can be extended to other – more mature – BPO segments in the financial services industry, such as payments processing, securities processing, or custody and account management, in order to take into account different process characteristics which might affect the results and therefore have to be considered as control variables as proposed at the beginning of section 3. Those differ in degree of technical integration and type of IOS (and therefore may have differing demands towards IT business alignment), but also are embedded in the quite homogenous and regulated banking industry to allow comparisons and to make a step towards the generalizability of the results.

5. Conclusion

Many firms are considering outsourcing some of their business processes under their overall business process management (BPM) programs. An attractive argument for such practice is that BPO enables firms to achieve a very high degree of process efficiencies and effectiveness through the economies of scale and scope offered by external business process providers. However, being a recent phenomenon, success factors in BPO are not well understood. It is unclear why some firms do not achieve the same degree of success as others do in their BPO initiatives causing overall failure or even negative effects in their BPM programs. In this paper, we developed a research model that captures the effect of organizational readiness on BPO success as well as the enabling effect of alignment for organizational readiness. The three dimensions of organizational readiness, i.e. process readiness, IT readiness and business management readiness, are limited to *readiness for BPO* as a specific type of interorganizational relationship involving a process management initiative. While restricting the meaning of this notion, this limitation may at the same time be considered a strength of our research because it will allow us to clearly pinpoint the dimensions of this notion within this narrow focus.

This model and the subsequent empirical validation will enhance our understanding of the organizational factors that affect successful outsourcing of business processes by integrating findings from the adoption of innovations stream of research with findings from the outsourcing and the IT business alignment literature. To our knowledge, this paper is one of the first to specifically address not only business knowledge of IT managers as a means for achieving alignment, but also IT knowledge of business managers, thus acknowledging that alignment may be built from both sides, not just from IT side.

The use of proxy variables (namely, the achievement of targeted cost savings) for measuring outsourcing success may be viewed as another limitation of this research. Nevertheless, the use of proxy variables is a widely-spread practice when direct measures for the construct of interest are missing. As a further limitation, we need to state that we are aware of the existence of a principal-agent problem in the context of BPO. Good IT business alignment may under certain circumstances negatively impact outsourcing success – namely, if IT and business managers fear personal negative consequences of some sort from BPO (for example, loss of power or even losing their jobs). If both agree that successful BPO implementation will lead to personal disadvantages for themselves, they may work together seeking to bring the deal to failure. In the empirical part of the project, we will need to explicitly check for this effect by asking if IT and business managers have been given personal incentives to perform well in implementing BPO.

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