

## Modes of Governance in Business Process Outsourcing: Executive versus Market's Perspective

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### Abstract

*Outsourcing success - its all in Governance" reported Lauren Bielski in the ABA Banking Journal 2006 [6] and consequently, governance represents the key concept when discussing outsourcing in practice. However, when analyzing the business process outsourcing practice of Swiss Retail Banks, governance aspects seem so far only to play a minor role in the evaluation of outsourcing decisions.*

*This article deals with outsourcing in Swiss retail banking and raises the question whether the mode of governance does matter from the capital markets' point of view, and what modes of governance might be valued most. Our findings provide evidence that governance concepts applied in practice might divert when viewed from the executive's versus the market's perspective or in other words, outsourcing governance in the banking industry is much more a matter of coping with uncertainty than a process of truly aligning contracts in an optimal way.*

### 1. Introduction

Outsourcing success - its all in Governance" reported Lauren Bielski in the ABA Banking Journal 2006 [6] and indeed the examination of outsourcing has been a domain of IS research, as well as of strategy research for several years now. Thereby it focused on the following three fields: i) why should a company outsource?, ii) what should it outsource? How should it outsource? [15]. Our research aims at contributing to the third question as to the issue of how to outsource, which is closely related to governance of outsourcing. The article is strongly linked to the 40-Hawaii Conference Proceeding on Outsourcing Relationships. Whilst the focus there was on the 'how to do' of outsourcing, such as the structuring of the relationship

and subsequently the management of arrangements [15], we shall focus on a specific form of outsourcing (business process outsourcing), and group the management of observed business outsourcing initiatives along four modes of governance. The focus will thereby not be on operational issues such as the right contract clauses, but rather on the appropriate ownership and governance structure in a BPO (business process outsourcing) agreement. We measure the expected rigor of this governance mode by market reaction on the announcement, and contrast the findings to executive's observed practice. Backed by expert interviews, we discuss the question as to whether and why difference in governance mode is perceived differently by the market, and how this might link into the future practice of outsourcing in business process management.

The key contribution of this paper is to present a governance mode framework that allows discussing recent outsourcing agreements in the Swiss retail banking industry, respectively the lack thereof, when compared to expert-predictions, and to link the findings to implications for business process outsourcing in practice.

The remainder of the paper is organized as follows: Section two will sketch the conceptual scope and present the key definitions before introducing the existing theoretical background. In section three and four, we present the base cases and the method applied, whilst section five discusses the results and conclusion.

### 2. Background

The paper bases its argument on previous findings on outsourcing and governance, and places them into the context of business process management (BPM-) practice. Speaking with Zairi [36] BPM is concerned with all aspects of business operations where there is high leverage and potential for added value. Processes

therefore have to be modeled and managed, whilst performance has to be measured. Following an outsourcing decision, these processes have to be newly defined and proper performance metrics must be installed. This is to ensure an undisrupted workflow and a stable operational risk environment. This role is attributed to the BPO-governance. The general importance of governance structure within any outsourcing relationship has already been emphasized by various researchers [10, 11, 12]. These researchers identify agency problems as underlying cause for potential disruptions and stress that an efficient relationship management with a well-organized governance structure is an important success factor to attain expected benefits. For example, Clark, Zmud, and McGray [10] explicitly state that the “truly critical success factors associated with successful outsourcing are those associated with (vendor) governance”. Gellings [15] consequently showed that the important tool therefore is to be seen in contracts as management tools meant to align interests and minimizing agency costs; thus forming the primary vehicle through which IS outsourcing relationships is governed in BP-practice. However, existing literature on outsourcing relationship remains largely focused on this operational or contractual level of performance and risk control. It describes, analyzes and evaluates contractual clauses to monitor performance through e.g. Balanced Scorecards or specifically defined Key Performance Indicators (KPI's), and sets rules for an undisrupted workflow through clauses such as Service Level Agreements (SLAs), penalty reward systems, pricing, benchmarking, audits and more. Lacity and Hirschheim [25] or Kern and Willcocks [21] provide a good and broad overview. Thus, BP-governance traditionally combines operational performance measurement and quality monitoring as a means to reduce contract-induced risks [33].

Especially in the context of the banking industry, (operational) risk governance is a key driver, as it affects direct regulatory capital. This is either positive as risk is mitigated, or negative as an increased equity layer is required [2, 3]. Thus, successful outsourcing governance has the potential to influence not only operational performance, but also to leverage on the equity value.

Several empirical studies have been conducted that illustrate this direct risk-performance relationship: Hunton et al. [19] analyzed a sample of 77 information systems IS outsourcing announcements (non-bank) between 1990 and 1997. They found evidence that capital markets react positively on the announcements, and abnormal returns were greater for smaller firms than for larger firms (defined by the market value). Glassman [18] examined 27 companies which

undertook large information technology outsourcing initiatives between 1993 and 1999. He found an average gain in shareholder value of 5.7% over the general market trend, two months prior, to two months after the announcements. Based on the study by Glassman, Albright [1, 18] extended the timeframe to cover a data set of 45 deals from 1993 until 2002. The effects were proven similarly positive. Another event study by Farag, Krishnan [14] examined purely information technology outsourcing deal announcements between January 1994 and August 2001. They concluded that capital markets react positively to IT outsourcings announcements of IT industry firms and service industry firms. They found positive market reactions to strategic sourcing projects, but not for cost-cutting projects. Similarly, Wonseok and Gallivan [35] analyzed a sample of 97 information technology outsourcing deal announcements between 1998 and 2001. In contrast prior research, they found only weak evidence with respect to investors' positive reaction to IT outsourcing announcements, but more specifically, they detected that abnormal returns are negatively associated with asset specificity, and with contract size. Whilst these results speak quite strongly in favor of outsourcing, a study by Gilley and Rasheed [17] that focused on the effect of outsourcing of peripheral and near-core tasks on a firm's financial and non-financial performance displayed a different truth: They found no significant direct effect of outsourcing, but conclude that outsourcing interaction with corporate strategy suggests a positive performance.

In this strategic sense, outsourcing agreements are meant as an instrument to coordinate less specific tasks for a firm's success with less capital and control costs, whilst at the same time ensuring undisrupted workflow with reduced transaction costs. The optimal degree of outsourcing governance is thus to be seen as an equilibrium between cost of capital intense equity stakes in the outsourcing agent, and efficiency oriented saving potential [24, 28]. Direct transaction costs are also relevant with respect to the direct transaction process [27].

To conclude these findings, it seems clear that there must be something in outsourcing that drives performance; if not outsourcing itself than some variable related to it. When focused now in the specific case of retail banks, these results do have another implication: Apparently strategic relevance or specificity of assets and transaction size are important factors shaping future performance after striking outsourcing deals. Bearing in mind that outsourcing naturally inherits a great deal of risk, the capital markets are assumed to pay special attention to a combination of these issues.

This led us to the focus of this research project: Do executives anticipate risks in the outsourcing deal (at least in line with other market participants)? Do those risks outweigh the potential chances (e.g. higher earning potentials) arising from outsourcing initiatives? Are these judgments reflected by market prices and do they deviate?

We focused our discussion on the financial services industry, whereby we have taken a special look at banking and providers of services for banks. The industry seems especially valuable to the endeavor as there is a common assumption within the banking industry that the sector is at the eve of a substantial disintegration process of its value chain. Similar processes could earlier on be identified in the textile or in the automotive industry [4].

### 3. Theory

As indicated in the background literature, outsourcing problems are understood mostly through transaction cost theory [28], the resource-based view [30] or agency theory [30]. Whilst most previous set ups focused on one of the approaches, empirical evidence suggests that a combination of the factors might be of the highest explanation power [17, 27].

In order to take into account these theories in practice, governance is in the BPM-context often discussed by applying a five axe concept proposed by the IT Governance Institute (ITGI) originally [34]: This framework discusses governance along the dimensions of strategic alignment and value management (resource based view), performance and risk measurement (agency theory) and resource management (transaction cost theory). Given this framework, optimal governance should be expected to balance these five axes soundly. Accordingly, BPM practice focuses on structuring, managing and measuring outsourcing partnerships along these axes on the managerial level. Given equal strategic importance, executives would be expected to form governance decisions based on the parameters of transaction cost and risk. Risk thereby is controlled by the definition of scaleable, standardized SLAs as indicated in table 1. The number of partners involved in an outsourcing scheme is thus not relevant from a risk governing point of view; transaction costs are reduced, however at the expense of increased coordination cost which is in line with BPM practice. Holding equity ownership in the outsourcing partner should however not affect risk variables, but rather the transaction cost side. Ownership thus should be disentangled from governance.

When holding strategic relevance and SLA agreements on the operational level constant, a risk-control

function such as ownership and the scope of the sourcing network can be described along the dimensions driving the implied costs: Transaction and information costs, dependent on the scales in a BPO agreement, or the number of participating firms, as well as coordination costs or more specifically overinvestment thereof. We sketch the first dimension along Joint-Venture structures (dyadic) to network structures, whilst the second dimension is modeled by equity ownership versus market coordination of the contractual agreements.

The theoretical core of this paper's argument rests on agency theory assumption, which is asymmetric information in the ex-ante and ex-post stage of an outsourcing agreement. This theoretical framework has managed to shape the discussion on many problems having a cooperative structure [13 p. 57] successfully in the past. Particularly when discussing a field amidst risk and organization, such as outsourcing structures where the rich array of applications of the theory, allow drawing on as many facets of the corresponding literature. All decision patterns generally suffer from the classical three aspects: Moral hazard, Adverse Selection and Imperfect commitment as the client is faced with the problem to choose an agent (outsourcer), motivate and coordinate its decisions and behaviors with those of its own organization. Explicitly moral hazard is faced [13].

Adverse Selection occurs where principals cannot observe ex-ante the characteristics of its agents. It might therefore happen that outsourcing offers extremely competitive terms that lure a principle into a long term relationship despite the fact that the agent cannot sustain the promised services after a couple of years. Having out sourced in such a relationship could turn out for the principle to be costly. Operational risk of disruption in processes and transaction capabilities cease to run and eventually even put him out of the market. As governance methods such as ITIL or COBIT only manage in a BP-practice sense the ex nunc or ex post relationships, executive decisions are faced beyond managerial governance methods and at a higher degree of uncertainty. In this environment, risks are greater the more specific the outsourced service is. Having said that we acknowledge that the competitive environment in the business process outsourcing industry, as well as the ability to re-build out contracted services are two key intermediating factors for outsourcing relationships.

In this context, agency theory is of practical relevance in this decision-state in two ways: First, business process outsourcing (BPO) providers are positioning themselves in the market in a way to consciously

signal certain governance features to potential customers. Secondly, especially banks, willing to outsource certain services employ agency theoretical considerations to choose the right partner.

Therefore, executive's BPO decisions gain a meta-level dimension beyond operational SLA structuring. On this meta-level available information and expected cost factors are seen as the main decision factors and form the modes of governance framework. Viewing cooperation as information sharing implies the possibility of both the moral hazard and adverse selection. Cooperation needs to overcome asymmetric private information and to a requisite minimum of shared, common, public information [33]. By choosing the combination of equity ownership to the number of outsourcing partners, they move within modes of governance. Interestingly, these two layers ex-ante and ex-post, respectively their attributes show interestingly entangled features.

As a result of the analysis of the underlying cases, we found a strong correlation between equity-ownership and individual SLAs (where the two owners are the only participants in the agreement) and more standardized (multi-partner targeted) market solutions. In this paper we restrict focus on the meta-layer of governance, which is described by the ownership and membership structure rather than by SLA design (although correlations are evident).

The market for outsourced contracting in the Swiss banking industry can be described as either dyadic or network based and the traded services as either near-commodity or specific. In practice we observe the following: Banks outsource specific services to partially equity controlled BPO's and near-commodity to more network or market based independent BPO's.

In this framework, BPO initiatives display or change operational risk features of the underlying processes ex-ante in the form of management decisions, respectively market announcements. As risk is relevant for banks both as a means for uninterrupted service [16] production as well as a major cost factor under the prejudices of general capital requirements, it is of high relevance both for executives as well as for the market to signal those risks ex-ante in a transparent way. Thus, outsourcing announcements help evaluating asymmetries in risk features more rigorously. Furthermore, operational risks can be lowered the more standardized the bank services are, and the easier the bank can switch suppliers, in case of service disruption. This allows the bank to mitigate partially the risk to the BPO service provider. In the context of outsourcing and asymmetric information, we assume that operational risk should be lower were banks source out on a standard way to BPO's that are replaceable – thus not equity controlled and within a

market of alternatives and strong corporate governance schemes. We thus assume that an announcement for outsourcing has a stronger impact where the ex-ante expectation of good governance is high and where BPO provider offer services “at market” (with transparent pricing and standardized products). This is because a track record in a competitive environment signals good governance more credibly than a less transparent joint venture.

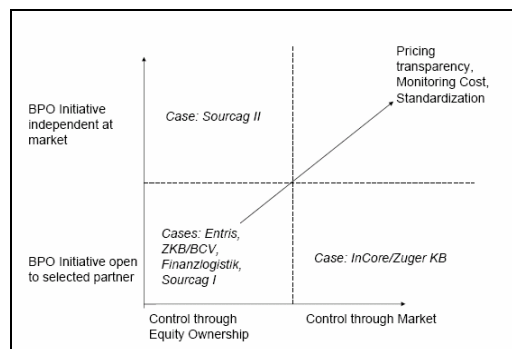
One has to bear in mind that players in the financial service industry tend to be more risk averse than in other industries, be it through culture or through respective regulations. The thereby raised coordination and control costs, contrast with uncertainty in potential future gains from sourcing or from forming sourcing networks. In this environment, stringent corporate governance measurements can eventually stimulate the formation of new sourcing linkages as transparent, but where trust is enhanced and coordination costs are reduced. Thus risk adjustment of expected savings is an inherent part of the decision function for entering into BPO initiatives. If factors such as anticipated risk, contract size and other variables are to affect performance, one should assume that the respective data is also ex-ante considered by the responsible executives when forming an BPO initiative, as well as by markets, when evaluating the announced initiatives and adjusting stock prices accordingly to the (new) inherent firm value perception.

Beside, risk features and asymmetric information strategy literature teaches us that only non-core processes have been sourced out. We take this to be true for this model as well [31].

We thus assume the decision function for entering into BPO initiatives to be defined by cost-benefits only at the highest level of aggregation. On a second layer, cost is to be seen as a variable, dependent of standardization of the process and monitoring, the inherent additional operational risk and the availability of efficient evaluators just as well as alternatives to switch to, in case of business disruption. Furthermore, this decision is only true under the conditionality of non-uniqueness of the involved resources for the firm. One therefore can conclude that two dimensions are of interest for the evaluation of governance modes: Being “at market” with standardized and exchangeable products, or being part of a less transparent “club”, most extremely a joint venture style outsourcer.

Sources of operational costs associated with membership in certain modes of governance are frequently summarized under the term coordination cost, whilst sunk costs for the uprising or re-positioning as such is ignored for the economic decision process [23]. We show that this optimization process results in stable governance schemes that

contribute to the operational performance of the networks and thus may serve as a valuable instrument for risk management in sourcing decisions. Especially the scope of a sourcing partner broadens standardized procedures and corporate "network" governance mechanisms [22], seem to be crucial to success. We therefore treat network scope versus dyadic interaction as the second dimension in the mode of governance scheme.



**Illustration 1: Modes of governance for BPO Meta structures**

When turning towards the more “hands-on” view of outsourcing processes one sees that BPO initiatives are set up on a meta structure – meaning an ownership and control layer rather than on the project management and operational control layer that is managed by the choice of optimal contract decisions and surveillance – normally designed as contractual agreements. This separation is not necessarily true for banks or other large out-contractors. In cases of large contract

been observed to take equity stakes in the provider firms (as it happened in most of the herein observed cases) in order to close asymmetric information induced gaps, and ensure that their risk management standards are met, as well as the service firms strategic objectives which later on can be altered along the banks positioning, thereby enhancing real options available.

Such behavior leads to either dyadic (one-to-one relationships) or network relationships. A mixed form is seen in constellations that are featured by a broad network, coordinated by an integrator company virtually offering turnkey business process outsourcing solutions to a wide set of customers. These three forms obviously can be characterized by different risk-return and different cost-return patterns. The potential gain from outsourcing is higher the more scale-sensitive parts of a value chain are sourced towards a reliable partner at low coordination and ongoing transaction costs, which is capable of extracting a maximum of value from the insourced processes. This again strengthens our concept of the governance mode dimensions “network or market” and “dyadic”, but adds to others, namely whether to hold equity stakes or not after a completed BPO initiative.

To sum up, the theory is generally well developed when it comes to comparing governance modes shifts with respect to distinctiveness or specificity of a sourced resource, based on standards of strategy research [25, 31, and 32] on the ex-ante meta layer as well as through operational governance methods [31, 33]. However, in the observed industry, business process sourcing announcements refer to identical and not strategic labeled services.

BPO Initiative Cases	Finanzlogistik	ZKB/BCV	ENTRIS	SOURCAG I	SOURCAG II	InCore
Sensitive Bank	BK CA St. Gallen AG N	BC VALD N	BBOS / BCBE N	BASLER KB PS	BASLER KB PS	ZUGER KB I
Business Process	Backoffice	Backoffice	Backoffice	Backoffice	Backoffice	Backoffice
Process Changes	Newly defined	Newly defined	Newly defined	Newly defined	Newly defined	Newly defined
Contractual agreements	SLA, Penalty-Reward, Insurance, Audit Rights	SLA, Penalty-Reward, Insurance, Audit Rights	SLA, Penalty-Reward, Insurance, Audit Rights	SLA, Penalty-Reward, Insurance, Audit Rights	SLA, Penalty-Reward, Insurance, Audit Rights	SLA, Penalty-Reward, Insurance, Audit Rights
Activity level	Regular meetings (project management and executive level)	Regular meetings (project management and executive level)	Regular meetings (project management and executive level)	Regular meetings (project management and executive level)	Regular meetings (project management and executive level)	Regular meetings (project management and executive level)
	Controlling & Monitoring of outsourcing deal	Controlling & Monitoring of outsourcing deal	Controlling & Monitoring of outsourcing deal	Controlling & Monitoring of outsourcing deal	Controlling & Monitoring of outsourcing deal	Controlling & Monitoring of outsourcing deal
Announced expected savings	20% relative to prior internal cost	20% relative to prior internal cost	20% relative to prior internal cost	20% relative to prior internal cost	20% relative to prior internal cost	20% relative to prior internal cost

**Table 1: Cases for BPO Initiatives in Swiss Retail banking between 1998 and 2007**

volumes or perceived barriers such as operational risk, one often observes that the subunits that were entrusted with the business process before the sourcing decision are, at least for some time, employed by the BPO provider to ensure smooth and undisrupted operations during the transition phase. Along the transfer of their employees and their processes, especially banks have

On the other side, cost and risk factors are the decisive variables. Especially in areas with low added value per single transaction and high cost per transaction, the implied control costs are critical. Outsourcing here is walking on a thin line as the internal cost of coordination and control for an agreement soon might outweigh beneficial effects from scales and

standardization. Thus, the nearer a BPO initiative is to market the lower the marginal internal cost for control and the higher the standardization is, which corresponds to lower weighted operational cost. The same is true for network relationships, which is why we identify the intersection “network at market” as the preferred mode of governance on the Meta frame for BPO initiatives.

These risks and their costs of monitoring are primarily the critical factors allowing for business process outsourcing in banks. An optimal mode of governance on the Meta level (say in the absence of unique resources, a market-based outsourcing relationship) should therefore be the preferred governance solution from a management as well as a market’ perspective.

**Proposition:** Market and Network based governance modes (which minimize risks and maximize scale) are judged superior than dyadic relationships or equity based means of control.

#### 4. Research Method

This section explains our research approach that was based on expert interviews with CEO’s and responsible project managers for BPO’s in the Swiss retail banking industry and market data from the Swiss Stock exchange (SWX).

We structured the analyzed cases along four modes of governance, previously identified through market observation and evaluated by expert interviews. We selected those cases based on the analysis of BPO announcing press releases for retail banks quoted at the Swiss stock exchange. We then selected the herein used sample of comparable BPO initiatives in terms of same sourced processes. We back tested those findings by questioning the experts at the initial phase of the interviews.

Based on the broad literature available, we saw a positive relationship between outsourcing and performance as given at the onset. As we had a sample of cases that shared the basic characteristics in governance at the contractual level, and at the announced expected savings from the BPO initiative, we implicitly controlled for the relevant factors. We however did not control the size of the transaction, although Wonseok and Gallivan found evidence for this to be relevant [35]. The reason for not controlling for transaction size was that in the given sample, the companies sourcing in the dyadic modes had always comparable size (in terms of assets, transaction volume and profit margin at time of the initiative’s start). The only deviations from this homogeneity were seen in the cases “InCore” and “Sourcag II”. Both represent unique positions in the governance mode scheme and

are not directly compared to each other. It is to mention here that according to the interviews the homogeneity in expected savings stems exactly from the fact that the partners in transaction combined comparable volumes each time they announced a BPO initiative.

Having set up this framework as initiated in the theory part, we now start to test the market performance as a re-test to find positive outsourcing-announcement effects. Given such effects, we take it that the market has adopted the information and acts as a valid instrument for measuring the signaling effect of the different governance mode’s perception [31].

We then move on to measure how the signaling of one or the other mode of governance to be applied did affect the respective stock’s above-market performance. We measure above market performance by combining the stock-value appreciation at different points in time with a comparables benchmark. This benchmark is based on all the retail banks quoted at the Swiss stock exchange, except for the two largest UBS and Credit Suisse. These two were not included, since the Swiss retail business accounts for only a small part of the respective stock assets and valuation. Thus including them would clearly distort the results. We did not weigh the stock by their transaction volume, because the small sample of retail stock available compared to the observed cases would lead to distortions by the very effects to be measured.

We knew that from every case analyzed, only one partner was quoted, and thus used this partner to indicate as a proxy sensitive to the BPO initiative’s impact. Furthermore, all BPO initiatives were strategically relevant for the involved banks and gained considerable attention in the media.

As the preconditions apart of governance mode were identical, our model set up suggests that out performance should be higher, the stronger the market supervision of a deal is, and the less equity ownership the out contracting partners had to commit. As we strongly based the theoretical body on agency theory, it is to bear in mind that in this context that agency theory virtually is split into two camps [20] leading to differences in interpretation: On the one side Barney and Ouchi [5] argued that agency theory emphasizes how capital markets can affect the firm, whereas other authors made no reference to capital markets at all [13]. This paper adapted the prior view and used capital markets as an independent scale of measurement for outsourcing announcements.

We tested both for “no above normal returns” of outsourcing companies compared to market, and for structural breaks in valuation before and after the deal announcement. The relationship should hold if

measured for outsourcing effects as a whole and mainly also for the differences in the four modes of governance. We will test so for varying time windows: First for the announcement date compared to one day prior (one announcement was on January 1 2007; the respective dates for the calculation are December 29 2006 and January 03 2007 as these were the last and the next trading days). We re-ran the tests for the timeframe 3 days prior and after announcement, and 30 days prior and after announcement. At latest in the 3 day time frame the information should be worked in the price and over the pre and post 30 day frame, the valuation of the observed stock should display significant differences in valuation if the assumptions were to be correct.

## 5. Cases

The cases relevant for this project were the business project outsourcing initiatives of BCV (Banque Cantonale Vaudoise) and ZKB (Zürcher Kantonalbank), RBA group and BEKB (Berner Kantonalbank), the two cantonal banks of Basle (Sourcag I), the extension of Sourcag I by means of acquiring additional customers at the market (Sourcag II) and the set up of InCore, a service bank established by the privately owned Maerki Baumann group with its customer Zuger Kantonalbank.

The cases were largely identical by strategic objective and largely driven by scales in operations for unanimously not-strategic labeled back office functions. All cases involved the outsourcing of business services to a new provider that was, however, set up prior by the involved partners as a custom-tailored, separate legal entity. The processes were not – as in non business process outsourcing usual – adopted from one of the partners, but rather redesigned from scratch. We therefore speak of business process outsourcing also in the dyadic-modes that otherwise might also be labeled joint ventures. The key difference is that the properties for BPO are met according to bmp.org definitions.

## 6. Results and Discussion

We displayed the results by first addressing the insights from the expert interviews on the theory and the framework of governance modes, whilst than looking at the “facts” in the market through the capital market’s lenses. We concluded by discussing the different views on BPO governance and the lessons for practice that could be drawn.

Discussions during the executive interviews revealed that the experts generally agreed with both the idea of

the split of governance into a Meta model of ownership and control layer, and an operational contractual layer as well as on the theoretical background and the structuring of the meta-governance along the four modes of governance. Interestingly enough, when speaking about positioning within these four modes of governance and future strategic initiatives for the outsourcing providers, there was some consent that the firms should and would move towards “market”, although they strongly relied on their mostly dyadic outsets. This situation was explained mainly by two arguments: First, the (involved) experts brought forward the need to exert direct control in order to ensure the commitment with banking regulation and to cope with arising issues of operational risk management. Second, the executives indicated that so far, no market existed and as long as no one moved in this fourth preferred field of the governance matrix, the others would be trapped in their inferior positions.

If the first argument can be treated as somewhat contradicting to previously accepted theory and may be at least partially disguising the willingness or ability to reposition oneself, the second argument reminds of a game theoretical trap. However, if we refer to the case of InCore that has moved towards market, but failed to attract additional customers so far by this positioning we might remind ourselves of the result of Wonseok and Gallivan [30] who stress the role of size in transactions. As in the dyadic transactions more or less equally sized partners met, InCore would most probably draw either smaller partners (in less favorable negotiation positions) or larger partners (with apparent pride on their systems) into an outsourcing agreement. Thus, in an environment (currently) shaped by strong margins, the pressure to re-position oneself with respect to business process outsourcing may not have been strong enough. However, with view to the modes of governance, one can conclude that the framework seems to hold, as well as the implied decision function for the executives.

Quite in line with agency theory the story goes that risk can ex-ante be reduced best when closing the asymmetric boundaries with quasi-vertical equity control [5]. However, when turning towards cost-risk relationships, realizing scales by attracting new partners, or even towards possible gains from diversification effects in the risk portfolio, the picture looks different. When asking executives on their decision prior to enter into BPO initiatives, the dominant answer is not “by means of strategic rigor”, but rather by mere “cost-benefits analysis”. However, if this were true, it might be hard to argue for the current market structure that can be observed in Switzerland or in other (European) countries. The

dominance of strongly integrated entities is overwhelming [4].

When referring to strategic literature for structuring the discussion, the point was raised that outsourcing relationship and governance thereof generally focuses on core or non-core, respectively unique or commodity resources of a firm, which seems to be in clear contrast. We make the point that this contrast stems from the difference in the ability to mitigate risks through outsourcing agreements (on the equity respectively market dimension) and to minimize coordination and monitoring costs (on the dyadic, respectively network dimension).

The signaling effect displayed when chosen one of the governance modes implied by these dimension has an impact on market evaluation of the goodness of the chosen strategy. We labeled capital markets the independent institution to assess the goodness of fit, of a certain form of outsourcing governance comparable to the discipline of capital market corporate governance on the intra-firm level of analysis.

By applying the markets perspective, we found first of all evidence that the outsourcing announcement had a positive effect on the stock prices of the involved banks that were forecasted. This is quite in line with the previous findings in literature, as we had implicitly controlled for size and strategy [1, 7, and 8]. Further more, we found that the positive reaction was stronger and more persistent in the cases of market solutions. When this issue was addressed in CEO-level interviews, we received two alternative explanations: First of all, all officers agreed unanimously that in the current industry environment it is seen as standard procedure to take a stake in the outsourcer. This was reasoned for by indicating improved control means (only for the outsourcer taking a stake in the insourcer) and by a general thrive for independence of the involved banks in a stable and currently high-margin environment (all officers). Contrary to the first point, transactions at arms' lengths were commented on, as not stronger in terms of control rights compared to equity stakes. Further more, they saw the fact that banks continued to hold equity stakes in the insourcing providers as a reason for new potential customers not to join an existing partner, but rather to form a joint venture of their own. Thus, they saw besides operational risks, also future expected savings (in the form of forgone scale-effects) were at risk. In our opinion, a further argument has to be met with respect to press coverage after an outsourcing agreement. Certainly the joint venture of ZKB and BCV has found a broader audience than the Entris-deal, a matter of broadness of the involved partner's owner base. A similar argument could be true for the case of Zuger

KB and InCore. However, stock market reaction at announcement date indicates that the signaling effect in fact is received by market participants, so why not by executives?

We find that executives clearly define a market – network mode of governance as the preferred position for their firm. This objective seems to be consistent with market expectation. However, managers are normally observed to move towards this position in practice. A possible reason could be seen in the fact that the move towards the market involves uncertainty that only can be overcome at high (information) cost, as long as the market does not exist. This however is contradicted by the positive market reaction to the InCore announcement. Outsourcing success does not seem to be directly linked to (contractual) ex-post governance methods. Results both from market reaction as well as from executive objectives hint towards a preferable position with lower cost and equal risk, without tight governance methods where the necessary surveillance schemes are coordinated by the market. The market with such a concept also provides an additional feature of increased flexibility in terms of switching options for certain services.

The lesson to be learnt for practice is therefore to build additional degrees of freedom by reducing switching costs in the market. As ex-ante uncertainty factors are equal to asymmetric information features in the agency theory, a means to reduce risks could be the broadening of public information by applying market functions as an efficient independent monitoring agency when signaled properly. Finally, market solutions foster standards that again reduce switching costs, and costs from disruption in the BP workflow. Consequently, all the interviewed companies agreed in stating that their primary objective is to move towards a market for processes. Accordingly, even Banks and BPO providers that today form dyadic joint ventures see their choices only as a first step towards such a market. We find that the capital markets to tight governance structures and equity stakes prefer this increased tradability of services. These results contradict well established concepts. Although governance probably still matters in BP outsourcing agreements, it might not necessarily be linked so firmly to success as BPM literature previously assumed. Especially the availability of public information is in this context a variable that has to be taken into account, especially as market solutions with low switching costs and high public information content appear to offset highly specific governing costs - making "tradable" processes a superior choice to bilaterally sourced processes.



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