Comparing Business Process and IT Outsourcing Risks
- An Exploratory Study in Germany and Australasia -

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Abstract
Outsourcing is a well-accepted and commonly used business practice. Practitioners and scholars acknowledge that there are not only benefits but also risks involved in the external production of company services. But are the risks the same for different types of outsourcing?

This paper explores how senior management evaluates the risks of business process outsourcing (BPO), compared to those of IT outsourcing (ITO). Thirteen expert interviews were conducted, with informants from client firms and outsourcing vendors. The interviews took place in two different cultural backgrounds, namely Western Europe and Australasia.

The research highlighted 15 key risks and revealed that while there were some differences in emphasis, there were few differences in perceptions across the two regions. Interviewees specifically reported that the smaller the vendor market, and the less “mature” this market was, the higher were perceived risks. They also observed that the more complex and non-standardized the business process, the greater the risk, with fewer BPO vendors with a track record in the delivery of complex, less-standardized processes.

1 Introduction

The growth of both IT outsourcing (ITO) and business process outsourcing (BPO) has continued for several years [15]. The market research firm Gartner Group estimates that BPO will further continue to grow at approximately 5% annually, worldwide, until at least 2013, with growth areas including finance, HR, supply chain management, customer management and legal/real estate/tax [15]. Gartner also suggests that BPO will make up between 13 and 16.5% of all outsourced IT services by 2013 [16]. The result of this growth has important implications for the roles performed within client firms by the IT function. In the future we would expect the contributions of IT managers to be even greater, as they are called upon to provide sourcing advice to the business, and understanding of the complexities of outsourcing arrangements.

The benefits and risks of outsourcing received substantial attention in the academic literature during the last 20 years [21]. Several aspects of the risks of outsourcing were discussed [20], however, the majority of research was published on the benefits of outsourcing [17]. This may be due to the fact that the primary research object – managers responsible for outsourcing – are much more focused on the benefits than the risks of outsourcing [18].

Given that outsourcing has become an accepted tool for management to increase corporate productivity, it seems likely that the distribution of roles within the outsourcing decision process will shift. IT management will assume even more responsibility for guiding business managers through the outsourcing process and will evolve to become the trusted advisor who knows not only about the benefits but also about the risks of outsourcing [4]. Without access to expertise on the deeper risks and hidden costs associated with outsourcing, there is a danger that firms will enter into outsourcing arrangements poorly informed and likely to fail to obtain expected outcomes. Worse, they may end up in a situation where costs unexpectedly increase as a result of outsourcing [31; 36].

Many IT managers feel comfortable in judging ITO engagements but feel uncertain about the specific issues of BPO. However, in the last few years outsourcing practice has increasingly involved the outsourcing of whole business processes rather than simply IT services.

This raises the question: “Are the risks of outsourcing different when a business process, rather than just IT services, is outsourced?”

Based on case study research, Willock et al [42] have suggested they do. However, the issue of risks in business process outsourcing is still poorly understood [18], and it is not yet clear which particular risks increase, or conversely decrease, when discrete IT-
supported business processes, rather than IT services, are outsourced.

This paper aims to add to the understanding of similarities and differences in risk profiles of different types of outsourcing. Exploratory research was carried out via expert interviews to assess whether the risks of BPO are different from those associated with ITO (derived from literature analysis). To add another perspective, research was carried out in two different geographies, Australia/New Zealand and Western Europe (Germany).

The paper starts with the definition of different types of outsourcing and an explanation of the outsourcing process. This is followed by a review of the applicable literature and an overview of the risks of ITO. The research approach is then presented and the findings discussed.

2 Different Types of Outsourcing

Business process outsourcing has been defined as outsourcing one or more specific business processes together with the IT that supports them [22]. A business process is defined as a set of logically related tasks performed to achieve a defined business outcome [12]. BPO contrasts with IT outsourcing, which essentially involves contracting for delivery of IT services and/or equipment by an external party. This definition would embrace a variety of activities like helpdesk services, network management etc. Although project-based IT services (such as systems development) would be included under IT outsourcing, projects have a range of peculiar risk factors (like failure to meet deadlines, fuzzy scope, multiple objectives, etc. [13; 26], so systems development and similar project-based IT outsourcing are not included in our investigation.

3 Outsourcing Fundamentals

The process of outsourcing can be separated into seven main steps (based on [23]):

Within the Decision to Outsource step the opportunities deriving from outsourcing are analyzed. Using tools like business case calculation, core competency examination, critical success factor analysis etc. the firm assesses the potential benefits and downsides of outsourcing, finally answering the question of whether to, and what to outsource. Based on this decision the outsourcing project moves through Vendor Selection and Contract Negotiation into the actual Implementation (or handover) to the steady state Operations and Relationship. Periodically the outsourcing arrangements is subject to an Evaluation upon which the contract will be Renewed (either with the same vendor or with a competitor) or the outsourcing ceases and the operations are brought back into the firm (Separation).

For the purpose of this paper, two main phases are important, the Pre-Deal Phase (comprising the steps up to the point when the outsourcing contract is signed) and the Service Delivery Phase (implementation/handover and operations).

In essence, the decision to outsource either IT services or business processes will depend on the analysis conducted during the pre-deal phase. It is here that the purchaser establishes the extent to which the likely benefits (including savings in comparison to the costs of internal delivery) will outweigh the likely costs and predictable risks. This is captured in the following equation (adapted from [35]):

\[
(\text{financial + non-financial benefits}) \geq (\text{transaction costs + coordination costs + risk exposure costs})
\]

In other words, outsourcing is a sensible decision when the expected benefits clearly outweigh the likely additional transaction costs, coordination costs, and risk exposure costs. Outsourcing is not sensible when expected benefits are themselves highly uncertain, or when the margin between benefits and the other side of the equation is small. Given that all estimates are quite error prone, a reasonable margin of benefits needs to be likely, as the move to outsource itself can be expensive and divert organizational attention.

In this equation, the “risk exposure costs” are based on the likelihood (probability) of negative consequences occurring, multiplied by their likely negative impacts (or costs). In our discussion of risks, we differentiate between risks (the probabilities associated with a negative outcome, such as financial loss or firm reputation), and risk factors – those firm behaviors or characteristics that increase the likelihood of these outcomes [35].

The fact that outsourcing can produce negative outcomes has been discussed in the literature from the earliest research (for examples, see [13; 29]. In fact, the academic and trade literatures have identified many downsides that firms might encounter when outsourcing complex processes (including ITO and BPO), although few have discussed the relative frequency with which firms encounter these downsides. Many firms seem to take the view that because they believe their ventures to be relatively well-managed, negative outcomes are unlikely. This might be an issue of managers over-emphasizing the benefits and neglecting the risks. The evidence that expected cost savings from outsourcing are frequently not obtained, and the high levels of reported dissatisfaction with the strategy [31; 36] suggests that
firms fail to understand, or to factor into their decisions, the risks that are inherent to outsourcing. An important reason for many firms failing to reap expected benefits from outsourcing may thus be that few firms seem to plan for risk exposure costs [35].

The segregation of the outsourcing process into different phases is important, because once purchasers enter into the service delivery phase, they no longer have direct control over outsourced employees, processes or information systems. By this stage, too, firms have often reached a point of no return, as the costs and timeframe to terminate the arrangement have become prohibitive [36]. At this point the firm has finalized its a priori risk assessment. The service delivery phase is when firms begin to find out whether their chosen scenario unfolds as predicted — the stage of risk confirmation. The total (objective and subjective) experiences of the purchaser firm (whether expectations are met, or not) result in a level of outsourcing satisfaction, and in turn will affect the ongoing relationship between vendor and purchase firms.

It is largely during the pre-deal phase when risks are estimated. But it is only during the service delivery phase that the arrangement can be assessed, and decisions made about how to respond. By then, most purchaser firms will already have expended much of their outsourcing budget, and may have lost a range of capabilities as a result of staff migration.

4 OUTSOURCING RISK

Although the literature on the risks associated with business process outsourcing is limited, there is a large body of theoretical and case-based literature on the risks of information technology outsourcing. In both BPO and ITO, control moves from day to day hierarchical control of employees’ activities to a contract-based arrangement. Outsourcing requires the purchaser to specify services to be supplied and required quality levels that are to be provided for the agreed price. However, the complex nature of the services typically involved in both ITO and BPO, as well as the rate of change in the business environment, mean that many aspects of the arrangement cannot be contracted for at the beginning. Furthermore, to contract for every possible eventuality becomes prohibitively costly, and performance impossible to evaluate. Hence ITO and BPO contracts in general are premiere cases of incomplete contract theory, which states that it is virtually impossible to have a perfect contract covering all aspects [26]. The substantial uncertainty surrounding prediction of future service requirements, service levels, quality standards, and indeed the captured benefits, is a major source of risk associated with both BPO and ITO [4; 8].

The academic literature provides a wealth of information on ITO risks. The most salient as reported in the literature are summarized in Table 1. We note that many of the “risks” described in the literature are not risks per se, but instead examples of poor management practices or firm attributes (like inexperience). These risk factors may increase poor outcomes/financial damages, but are not risks in themselves. Therefore Table 1 lists more risk factors than we actually discuss during the interviews (see Table 3).

<table>
<thead>
<tr>
<th>Negative Outcome</th>
<th>Sources of Risk (Risk Factors)</th>
</tr>
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<tbody>
<tr>
<td>Failure to obtain expected cost savings</td>
<td>Inadequate business case [5; 29] [38] Deliberate or inadvertent underquoting (the ‘winners’ curse’) [11; 25] Inability to predict all requirements over life of the contract [26; 30; 39]</td>
</tr>
<tr>
<td>Unexpected increases in purchaser costs</td>
<td>Unexpected (thus poorly understood) management and transition costs [13; 30] Unexpected switching costs [6; 40; 41] Costly contract amendments due to unexpected business changes [5; 6; 13; 36] Unforeseen technology discontinuity [5; 30] Unforeseen need for additional sources of advice, e.g. consultants [35]</td>
</tr>
<tr>
<td>Service debasement or failure</td>
<td>Misrepresentation of capability on part of vendor [11; 24; 26; 39] Vendor redeploy resources elsewhere or reduces effort [29] Disagreement over meaning of contract terms [5] Failure of purchaser to perform role expected by vendor in service delivery [29] Problems in assessing the quality of services provided, i.e. a form of “measurement problem” [3; 6]</td>
</tr>
<tr>
<td>Failures/errors due to communication mismatch</td>
<td>Unforeseen differences in functional and procedural agreements [1; 11]</td>
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</tbody>
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Table 1: Risks of IT outsourcing identified in literature

<table>
<thead>
<tr>
<th>Negative Outcome</th>
<th>Sources of Risk (Risk Factors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consequences of security breaches and/or vendor failing to adequately protect proprietary or customer information</td>
<td>Consequences of failed disaster recovery [43] Consequences of loss or theft of private records [37; 43] Consequences of failed or delayed delivery of services [43] Consequences of other security breaches [43] Consequences of theft of intellectual property [26; 27]</td>
</tr>
<tr>
<td>Being forced to continue with an unsatisfactory arrangement (vendor lock-in)</td>
<td>Small number of alternative vendors [6; 33] Prohibitive costs or prohibitive redeployment of organizational attention associated with changing supplier [4; 36; 38]</td>
</tr>
<tr>
<td>Disputes and litigation</td>
<td>Unforeseen legal consequences [43] Costs and difficulties of legal disputes [32; 43] Liabilities to third parties (e.g. software licensors) [43]</td>
</tr>
<tr>
<td>Reduced IT capabilities</td>
<td>Loss of internal capabilities [13; 14; 30]</td>
</tr>
<tr>
<td>Vendor fails or is taken over by another party</td>
<td>Forced change of service provider due to bankruptcy or acquisition [2; 26; 36]</td>
</tr>
<tr>
<td>Long term negative strategic/competitive impacts</td>
<td>Loss of strategic business flexibility and organizational competence [34] Loss of capacity to innovate [28; 38] Loss of cross-functional skills (staff who are knowledgeable about many functions in the firm and their interfaces) [7; 34; 38]</td>
</tr>
<tr>
<td>System failures due to poor interface design</td>
<td>Poor or inadequately tested interfaces [1]</td>
</tr>
</tbody>
</table>

Table 1 continued from previous page -

5 Research Approach

The research question tackled in this paper is: "Are the risks in ITO and BPO different?", as suggested by Willcocks et al. [42]. Given the shortage of research on the specific risks of BPO [19], we chose an explorative, qualitative, research approach. This involved: (1) deriving the risks of ITO from the current literature, and (2) testing these in interviews with managers involved in BPO outsourcing.

We chose the risks of ITO as a reference point (to compare the risks of BPO with), as all interviewees said that they were familiar with both outsourcing types and ITO is the dominant outsourcing practice.

Interviewees worked in both purchaser and service provider firms. To gather additional insights we conducted the study in two different markets: Australasia and Western Europe (Germany). Thirteen interviewees from ten firms involved in BPO were interviewed. Informants were selected opportunistically for timely availability for interviews; therefore the findings are not statistically representative. Nevertheless, purchaser interviewees represent senior management of two large universal banks in Germany, a medium sized Australian bank, and a medium sized Australian firm working in the environmental monitoring business. Vendor interviewees came from two of the largest service providers in the German market, a large international service provider in Australia, and a smaller New Zealand service provider. Additionally, a consulting firm, specialized in advising vendors and purchasers on BPO transactions was included.

<table>
<thead>
<tr>
<th>Role of Interview Partner</th>
<th>Employer of Interview Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Two senior risk managers</td>
<td>Large German bank operating as BPO client</td>
</tr>
<tr>
<td>Senior operational risk manager</td>
<td>Large German bank operating as BPO client</td>
</tr>
<tr>
<td>Senior BPO business manager</td>
<td>Large IT services firm operating as BPO provider</td>
</tr>
<tr>
<td>Member of the board (COO)</td>
<td>Large German BPO provider</td>
</tr>
<tr>
<td>Head of retained organization</td>
<td>Large German bank operating as BPO client</td>
</tr>
<tr>
<td>Member of the board</td>
<td>Medium German consulting firm (specialized in BPO consulting)</td>
</tr>
<tr>
<td>Senior manager responsible for sourcing</td>
<td>Medium sized Australian bank operating as BPO client</td>
</tr>
<tr>
<td>Senior sourcing manager; Senior line manager</td>
<td>Medium sized Australian firm working in the environmental monitoring business</td>
</tr>
</tbody>
</table>
Table 2 continued from previous page -

<table>
<thead>
<tr>
<th>Role of Interview Partner</th>
<th>Employer of Interview Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Former Outsourcing Services Manager;</td>
<td>Large international IT and BPO service provider in Australia</td>
</tr>
<tr>
<td>Outsourcing Services Manager</td>
<td>Medium New Zealand BPO service provider</td>
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</tbody>
</table>

Table 2: Characterization of Interview Partners

Interviews took between 90 minutes and 2 hours and were largely conducted with two researchers present. During the interviews, the interview partners were confronted with the risks of ITO (derived from the literature) and asked for their opinions about the risks of BPO. Those in Europe were asked whether these were the same (0), higher (1 to 3) or lower (-1 to -3) compared to IT outsourcing. Interviewees were encouraged to elaborate on their experiences which led to the classification of the respective risks. At the end, interviewees were asked if they are aware of any type of risk we had not yet covered. If such a risk was detected (e.g. misuse of trust) the list was expanded accordingly. As all informants were experienced managers the concept of risk was well understood.

The researchers did not experience cases where risks were downplayed for marketing reasons. Also no systematic bias between vendor and purchaser firms was detected.

6 Research Findings

During our interviews four themes were repeatedly cited by the interviewees. Therefore, we structured the risk factors into four themes, as shown in Table 3: Key themes and corresponding risk factors. These are expanded on below the table.

<table>
<thead>
<tr>
<th>Market Maturity</th>
<th>Process complexity</th>
<th>Extent of collaboration</th>
<th>Competitiveness and specificity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Security breaches</td>
<td>Communication mismatch</td>
<td>Failing interfaces</td>
<td>Vendor exploitation of customer expertise</td>
</tr>
<tr>
<td>Incapable vendor resources</td>
<td>Lock-in situation</td>
<td>Measurement problems</td>
<td>Misuse of trust</td>
</tr>
<tr>
<td>Default of vendor</td>
<td></td>
<td></td>
<td>Loss of strategic business flexibility</td>
</tr>
<tr>
<td>Inexperienced customer or vendor</td>
<td></td>
<td></td>
<td>Loss of competences</td>
</tr>
<tr>
<td>Not achieving planned benefits</td>
<td></td>
<td></td>
<td>Loss of cross-functional skills</td>
</tr>
<tr>
<td>Service debasement</td>
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</table>

Table 3: Key themes and corresponding risk factors

6.1 Market Maturity

Market maturity relates to the number of vendors competing in the marketplace that have experience in delivering a particular service. Over time it is expected that a vendor market matures as more vendors enter the market; vendors gain experience in delivering the service and as services becomes more standardized.

Security breaches IT-systems were widely identified as a risk in outsourcing arrangements by both Australian and German informants. Informants suggested this was as likely, or perhaps more likely for outsourced business processes. Risks may increase if data cannot remain encrypted (as is the case in BPO, where vendor staff must work with live data). The risk may also increase if the execution of the process requires the service provider to access an IT-system which has not been designed to allow for restricted access to just a limited area of its data. In this case it may turn out to be very difficult to comply with current security standards and regulations. One informant suggested that this risk may increase if a new vendor were chosen who did not yet have access to IT-systems, thus increasing the total number of parties with access rights.

As the BPO market is the least mature outsourcing market, informants described the risk of vendors’ lack of capability as the same or higher in BPO compared to ITO. The magnitude of this risk strongly depends on the maturity and specific structure of the business process involved. The risks for processes of low to
medium complexity are lower for both ITO and BPO. The risk of incapable vendor resources were seen as equivalent to ITO in Germany, but in Australia, informants highlighted the “thin” vendor market, and the fact that some chosen vendors had no prior experience in delivering the business process. As one informant stated: "the more complex a process, the less probable it is to find a vendor with a strong track record in its delivery". All informants quoted this risk as being a major aspect of business process outsourcing.

The risk of vendor default or sale during the operations/relationship phase was seen as about the same for BPO in Germany but higher in Australia – perhaps influenced by the fraud and effective failure of the international outsourcing vendor Satyam [2]. Satyam had several large clients in Australia, most of whom discontinued their contract. One German interviewee suggested that a small outsourcing vendor, new to the market, is more likely to default or fail than larger, more experienced vendors, though the Satyam experience suggests this is not always the case.

Our informants suggested unrealistic expectations on purchaser or client side, due to inexperience, represented a risk. Interviewees suggested this was definitely a higher risk with BPO, due to the lower maturity of the marketplace. As with the risk of vendor’s lack of capability, the level of experience tends to depend on the maturity of the market for the individual process in question.

Failure to achieve originally-planned benefits during the operations/relationship phase is often used as an indicator for outsourcing performance and success [7]. Informants suggested this is likely to be higher for BPO; and the less experienced both parties are, the higher the risk will be compared to ITO.

In relation to service debasement, a creeping service quality reduction over time [4], informants suggested that this was likely to be similar for BPO and ITO. Generally, they saw no difference between ITO and BPO with respect to decreasing service quality. "Service providers all start high and decrease over time. When it comes to contract renewal, you will see hectic activity again so they can claim they worked their a**es off on this contract and hardly earned any money" [original quote from a German financial institution, head of supplier management].

6.2 Process Complexity

Differences in functional and procedural agreements resulting in communication mismatches were seen to be critical, but German informants suggested that the likelihood is lower in BPO compared to ITO. They argued that because the external delivery of business processes requires well documented processes the danger of misinterpretation is regarded as being lower. This is particularly so if the contract is also based on interfaces and bilateral deliverables, not solely on process descriptions. One German interviewee added that with BPO compared to ITO, it is the fact that, on both purchaser and vendor-side, business process professionals are talking to each other that reduces the potential for misunderstandings. The vendor takes on the responsibility of ensuring that its own IT department implements the business process correctly. With ITO, in contrast, business professionals within the client firm sometimes have to interact directly with the vendor’s IT professionals. This can be problematic due to differing worldviews and terminology.

The purchaser’s dependence on the vendor resulting from the transfer of specific assets, or the difficulty of “back-sourcing” a specific function, can lead into a lock-in situation. Our interviewees saw this risk as the same or higher for BPO when compared to ITO. However, the level of standardization and complexity of the process plays a major role as a driver of this risk. The more customer-specific a process, the greater the difficulties associated with a switch to another service provider. The maturity of the market is a significant factor. The dependence on a vendor may change over time if the market gets more mature and a significant number of service providers are available to offer "plug-and-play" business processing. However, one Australian informant suggested this only tends to happen for fairly generic services (a reason his firm was wary of outsourcing its non-generic business processes). One German interviewee, and several Australians, added that this risk is severe whenever specialist employees leave the company following the outsourcing deal. In that case, in-house process competence is lost.

6.3 Extent of Collaboration

The issues associated with the interfaces between outsourcer and service provider have been raised by previous researchers [1] and regulators [9; 10] alike. Assuming that the execution of a business process requires more human interaction between outsourcer and service provider than does ITO, the chance of failing interfaces was perceived as higher by the German informants. This was largely due to the potential for communication mistakes. German informants regarded this risk as severe and likely to be higher in BPO. Choice and design of interfaces between both partners was seen as crucial for an engagement’s success by most informants.
Measurement problems relate to the difficulties in assessing the services provided by the outsourcer [7]. German informants saw this risk as being the same to higher for BPO. They reasoned that depending on the scope of process, the measurement of the fulfillment of services is more difficult for BPO than ITO. If the measurement points and objects are clearly defined and can be measured, the risk should be about the same as in ITO. Some interview partners regarded the level of human interaction within the process as a good proxy to anticipate potential measurement problems. Australian informants, on the other hand, saw ITO outsourcing as inherently difficult to measure, because service level agreements (SLAs) were often couched in technical terms, which had little relationship with the business impacts of service debasement. This seemed to be a function of limited experience in crafting SLAs.

6.4 Competitiveness and Specificity

Interviewees suggested that the risk that vendors might exploit the purchaser’s expertise [26] was similar for both BPO and ITO. They suggested that provided the businesses processes are not the purchaser’s core competencies, the service provider has little incentive to exploit the purchaser’s expertise. “We wouldn’t outsource a competitive advantage and for these commodity services it is in our best interest to educate the vendor if necessary.” [Quote from a German financial service institution]. In BPO engagements the transfer of professional knowledge is often desired, as employees of the outsourcer are transferred to the vendor. This knowledge transfer is intended by both parties and was not seen to be an exploitation of the purchaser’s know-how.

Trust is a fundamental component in outsourcing relationships and the misuse of trust was seen by informants as a crucial risk for the overall outsourcing engagement. This risk had not been raised within the initial list of risks derived from the literature. It is associated with the access given to vendors to live data, often sensitive customer data. For business processes to be outsourced, employees of the vendor need to have access to actual unencrypted client data. Especially in the banking industry this data is quite sensitive. This issue was first raised by one German informant who represented a purchaser, however most German and Australian purchaser informants saw this risk as critical, as did many vendor informants. It was perceived as likely to be higher for BPO compared to ITO. One German informant (a service provider) reported the fear of his clients that employees of the service provider could pass on information about the securities portfolios handled in daily work (the outsourced process was securities settlement) to colleagues working for the purchaser’s competitors. In Australia, another service provider pointed out that once private data left the Australasian environment (which has onerous privacy and data-release legislation) there was little to protect it legally, thus trust in the vendor’s own processes was critical. Other Australian informants reported concern with protection of private customer records, citing examples of breaches such as that of CardSystems in the US (where thousands of Australian records were compromised). One German service provider noted that: “As long as there is no technically feasible way to hide client names in banking processes, this risk is persistent and for some banks a major inhibitor to outsourcing back office processes”. Australian informants suggested this risk was magnified if data was sent offshore.

Purchasers face the risk of losing business flexibility and innovation capacity, as an external provider might not be as flexible and easily controlled as an internal business unit [28]. As external providers of business process functionality rely on a one-to-many business model [26], to remain profitable they inevitably need to provide clients with standardized processes to achieve economies of scale. This limits the purchaser’s flexibility to change a business process quickly in order to react to changing market requirements or business opportunities. In both the German and Australian interviews, the risks were seen to be higher in BPO, compared to IT outsourcing. The German informants noted that the drivers for flexibility and innovation in the financial services sectors are more likely business processes than hardware and software. One interviewee remarked that “as processes which offer competitive advantages should be kept internally, the outsourced processes are regarded as not carrying significant potential for first mover advantages”. Some Australian informants, however, noted that it is not always possible to foresee which processes will lead to competitive advantage in the longer-term.

The loss of organizational competence was a risk frequently cited by informants. The German informants, and the Australian informant working for a bank, felt that the risk to loss of competences is likely to be higher in BPO than in IT outsourcing. They seemed to suggest that if that the outsourced process is not one that carries competitive advantage, the loss of competences in this field is of minor importance. On the other hand, informants in the other Australian site saw loss of organizational competence as a very important issue for ITO outsourcing (as IT was critical to almost all their business functions). They also saw this as critical to some business processes. It appears that the key differentiation is not BPO vs. ITO, but
instead the criticality of the organizational competence to the businesses' ongoing activities.

Finally, all purchaser informants noted that the risk of **loss of cross functional skills** was critical, though they did not see the risk as differing between ITO and BPO. They were all concerned at losing employees knowledgeable about more than one business process in the firm, and thus able to recognize the inter-relationships between different processes, or between processes and IT.

7 Limitations

This paper provides an exploratory research into the risks of BPO and ITO. As such it can only provide guidance but is not a reliable research for theoretical grounding. The number of interview partners was limited and it cannot be ruled out that there is a bias towards either ITO or BPO. In essence this research provides an initial insight which needs to be explored in further detail.

8 Discussion and Conclusions

Our findings suggest that the risk factors for BPO and ITO are essentially similar, though some are accentuated for ITO or for BPO. Figure 1 depicts our findings graphically, showing the 15 most salient risk factors of ITO and the informants' opinion whether the resulting risks were the same (0), higher (1 to 3) or lower (-1 to -3) in BPO.

![Diagram showing the risks of BPO compared to those of ITO](image)

**Figure 1: The risks of BPO compared to those of ITO**

Comparing traditional IT outsourcing and BPO, one risk factor was seen by informants to be lower with BPO; seven were seen as relatively comparable (range -1 to 1; marked grey); and eight risk factors were seen by informants to have a tendency to be higher when business processes were outsourced. The risk factors were grouped into four key themes: maturity of the BPO market; complexity of the business process; extent of human interaction; and impacts on purchaser competitiveness. The less simple and standardized the business process, the higher the risks were seen to be, by informants. Similarly, the smaller the vendor market, and the less “mature” this market was, the higher were perceived risks.

Our research has highlighted the criticality of trust in the vendor, particularly for business processes that involve sensitive data or intellectual property. For Australasian informants, the risks to data seemed to be magnified once data moved out of the Australasian region, where strict privacy laws, and substantial consequences to firm Directors if data is breached, provided a level of comfort. It was, in fact, a NZ vendor informant who noted that data held in high corruption countries (the informant referred to India and some South-East Asian countries, citing Transparency International's website) was essentially unprotected legally, as legal sanctions have little impact there. He felt that few client firms seemed to think this through, or to insist contractually that sensitive data was not sent offshore to subsidiaries of a local vendor.

As our discussion of the outsourcing literature shows, the potential risks in ITO have been considered by several authors, whilst there is comparatively little research yet on specific risks in BPO. Analyzing the phases of an outsourcing engagement reveals that the operations/relationship phases bear the highest risk since direct control is handed over from outsourcer to vendor. However, by the time this phase is reached, it is often too late for a purchaser firm to alter the outsourcing arrangement, at least in the short term. This highlights the importance of careful analysis and planning for risks in the earlier outsourcing phases.

This paper is an initial step towards answering the question whether the risks of ITO and BPO are the same, or not. It identified that, in the eyes of practitioners, ultimately BPO and ITO share similar risks but the respective peculiarities of the risks seem to differ. As with all exploratory research, the applicability to the wider population of outsourcing clients of the findings is limited. Statistical generalizability was not the purpose of the research, which was instead to raise propositions which can later be tested using confirmatory research. Our informants were largely from a particular industry, and based in
only two countries, a limitation of the research. There is clearly more scope for additional research on the extent of the negative outcomes discussed in this paper, and what their likely probabilities are. Such research will allow IT managers to give even better advice to their business peers when it comes to making informed outsourcing decisions, and wherever possible, mitigate identified risks.

9 References


