Business Process Outsourcing Risk Mitigation

Nanayakkara B.S\textsuperscript{1}, Hirano.M\textsuperscript{2}, Waseda Business School

Abstract

Business process outsourcing is usually seen as a risky business for both the outsourcing party and for the receiving company. The inherent risks of outsourcing can be visualized under many different classes such as strategy risks, implementation risks, selection risks and management risks, among others. Sometimes, outsourcing literature focuses mainly on the operational risks arising in the form of people, process and also technology. Whatever the classification, most of these risks discourage potential outsourcing companies from giving away total control of their sensitive business processes to third parties. Similarly, the receiving companies sometimes may try to play safe in a back footed stance without taking certain risks, in order to avoid possible lawsuits and failures. In other words, BPO risks are a barrier to the development of the multi-billion dollar BPO industry and a proper understanding of such risks and effective mitigation mechanisms to counter them must be sought.

Keywords: BPO, Risk Mitigation, Information Systems

1. Introduction

The risks associated with business process outsourcing could be seen as a major limitation on the healthy growth of the outsourcing industry. Some of these risks are mainly related to the outsourcing strategy. According to industry experts, outsourcing of undesirable functions versus the ones that provide true competitive advantage is one of the preliminary pitfalls encountered in this business. Further, the lack of a clear definition of goals and objectives before outsourcing a particular function is also a usual strategic risk. Among other strategic risks are the absence of effective internal baselines to benchmark service providers with regard to cost and service delivery, not considering the impact of outsourcing on other functions and areas of risk such as environmental and regulatory factors and also inadequate international operations experience [1]. Then, there are implementation specific risks such as inflexible outsourcing relationships that don’t work well in changing business conditions, poorly planned transformation processes, inadequate planning related to information systems and also, insufficient technology development prior to implementation. Additionally, outsourcing companies overlook the all important training of the provider on the company product line or service expectations before or during the implementation phase [1]. Moreover, some companies make mistakes when selecting a service provider mainly due to mishandling of selection related risks [2]. Not using adequate resources to effectively manage the vendor selection process, poorly documented service or product specifications, insufficient knowledge of provider capacity limitations, not exploring the whole provider space before making a selection decision and inaccurate costing of assets transferred to the receiving company are some of the major risks encountered during the selection phase [1]. Another set of risks are related to the outsourcing management practices. Some companies do not measure the full impact of an outsourcing agreement on a company’s overall financial condition or its impact on their future financial projections. The apparent reasons for this shortcoming is the lack of firsthand experience in outsourcing and also the concept and theories in modern outsourcing being somewhat vague and confusing to many decision makers. Further management risks are brought about by the lack of contingency plans for major disruptions at the provider’s end, disregard to provide incentives for the provider for continuous service improvements and the lack of a comprehensive mechanism for internal and external communication [3]. The next section discusses the common risks and mitigation methods of off-shoring the internal processes.
2. Common Risks in Off-shoring the Business Processes and Their Mitigation

In addition to the general risks encountered, off-shoring of processes creates a new array of other risks. These risks can be understood as project risks, business value risks and intellectual property and legal risks. Frequently encountered project risks include, but are not limited to outsourcing party’s non-readiness for the off-shoring shift, unrealistic cost saving targets and erroneous integration of onshore processes with offshore processes [4]. It has been noted that in most cases, the offshore business receiving company’s geographic location, time zone difference and cultural similarities play in favor of the outsourcing project [5]. However, in certain cases it might not be the case and may pose very peculiar risks. These project related risks can be mitigated by reviewing the organizational readiness for off-shoring, formulating onshore organizational structures and appointing a strong project champion to coordinate work between the outsourcing company and the receiving company. Some companies have already successfully experimented with organizational changes in the form of executive groups, outsourcing governance groups, in-house business process groups and also outsourced business process groups. The BPO feasibility framework is known to be an effective tool that helps manage project risks [6].

The lack of a clear definition of the business value that the outsourcing party aims to achieve is known as the business value risk. For many, the targeted value is cost saving, innovation, operational efficiency or all of the above. Simply, the absence of a clear definition leads to difficulties and failures in measuring the success of the outsourcing initiative. Effective Service Level Agreement (SLA) negotiation throughout the project duration and proper project management practices can be used for identifying and mitigating these risks [4].

The intellectual property and other laws governing the business process outsourcing industry vary from one country to another. One needs to make sure that the security mechanisms adopted at the receiving end can actually protect sensitive business information and proprietary business processes from employees, corporate espionage and exposure due to negligence. Further, the outsourcing party needs to be well aware of legal standards and business practices stipulated to protect sensitive information in the concerned countries. Most of the time, the security certifications and industry security consortium ratifications aid in taking informed decisions as to how much a receiving company is secure with regard to intellectual property; security guidelines developed by the Banking Industry Technology Secretariat (BITS) for financial industry outsourcing projects, Health Insurance Portability and Accountability Act (HIPAA) of the US government for the healthcare sector and the ISO 27001 certification awarded to organizations adopting strict information security policies are some of the well-known methods used in the industry [4]. The subsequent section focuses on the operational risks and possible mitigation mechanisms.

3. Operational Risk Mitigation

Managing operational risk is a continuous activity which primarily deals with slippages of quality, cost and speed of process execution. In fact, most top level managers are extensively concerned with these metrics and perceive them as performance indicators for outsourced functions. Simply, operational risk is nothing but getting undesired results in the form of too many mistakes, errors and defects. In IT Outsourcing (ITO) for example, if the developed software falls short of agreed functionalities or if there are budget overruns or delays in delivering the system, then the outsourced function has fallen victim to operational risks.
There are many causes for operational risk; first the complexity of the outsourced function. In order to evaluate operational risk, outsourcing companies should classify processes by how precise their metrics for quality are, as well as the extent to which work can be codified. The following figure lists some processes classified in this manner. Then there is the business context unfamiliarity of the receiving party, which may act as a negative force for outsourcing company’s interests. A good example for this type of a scenario is an offshore company that does not understand the concept of “float” and that manages the back-office corporate treasury function of a bank. In a situation where the bank instructs the offshore provider to reconcile various invoices and make payments to a corporate customer, the provider should engage in speedy reconciliation in order to improve the float for customers. Although this is the case, assume that the provider does not understand the business context of the bank and delays the reconciliation process. The ultimate result of such a delay is customer dissatisfaction, since the customers were unable to achieve better working-capital management through improved float [7].

Going further, factors that introduce operational risk can be classified as people, technology and process related metrics. People risks encompass absenteeism, training and turnover issues. Employee turnover is a key metric that decides the success or failure of an outsourced process. Business receiving companies with high turnover rates should focus on a constant stream of new recruits and fast track training programs. On the other hand, call centers rely on agents arriving on time to the helpdesks and therefore, absenteeism is also an important key metric. Other metrics like average waiting time for a customer depends on absenteeism. A prerequisite to mitigate technology related risks is a seamless computing and communications infrastructure. Further, metrics such as system uptime, network uptime and application uptime must be measured and benchmarked at regular intervals, in order to minimize interruptions to the daily operations. Qualitative risks arising from processes can be understood and avoided if periodic customer satisfaction surveys are conducted. In fact, the quality is ultimately perceived by customers and their feedback is essential to mitigate future risks. Then there are quantitative risks too. Quantitative risks are twofold; effectiveness risks and efficiency risks. Efficiency metrics are the time-related aspects of a process such as average handle time and average hold time for telephone based customer support. Further examples would be the number of bank loan cases handled per hour or the number of medical insurance claims processed per hour. Effectiveness metrics usually involve outbound or inbound selling. The percentage of outbound calls that resulted in a successful sale is an example of a good effectiveness metric [8]. Having discussed the general operational risks, the following section aims to focus upon the major technology elements, especially effective information systems that can reduce BPO risks.

4. Key Technology Elements to Reduce BPO Risks

In order to reduce implementation risks, especially during initial transition from in-house to outsourced business processes, comprehensive and pre-configured software solutions could be used. The business receiving companies should focus on using software that supports best industry practices and should avoid costly custom development. Further risk reduction could be achieved by running homogeneous systems at
the provider’s (receiving company) end and outsourcing company’s end, which minimizes data migration issues. Then there’s the problem of assessing how well a given pre-configured software package fits the BPO venture. For this matter, the experience and capabilities of the software vendor must be considered. Questions like, does the vendor have a wide customer base of large, complex organizations, have they solved unique and technically difficult requirements and can they localize applications in a country specific manner should be answered in this respect [9]. In fact, when technology comes pre-configured in a box, it can shorten process deployment time and can deliver competitive advantage over competitors. Nevertheless, one cannot expect the requirements of all outsourcing companies to be the same. Therefore, the providers should consider whether a particular software solution can be tailored to each of their customer’s requirements without expensive customized code. Moreover, outsourced processes do not run in isolation and outsourced solutions run by a provider should ultimately integrate with other applications at the outsourcing company’s end. Therefore, the selected enterprise-wide solution must have a large number of built-in, standardized and upgrade-compatible interfaces to reduce integration risks [9]. Apart from the above mentioned features, the selected solution should provide plug-and-play reporting tools, comprehensive training, a proven implementation methodology and efficient after sales service.

Furthermore, business requirements of outsourcing companies can change on a frequent basis [10]. The providers of such services should ensure that they can accommodate potential functional and geographical extensions on the existing systems, without new and complicated implementations. Progressively adding new scenarios and sub-processes to an existing platform during the evolution phase of a BPO venture should be easy and swift to ensure risk-free business evolution. It is also important to consider the end of an outsourcing contract in terms of the information systems to mitigate reintegration risks. Usually a portable architecture and technology means the outsourced process can be more easily reintegrated with the outsourcing company’s in-house systems or that of a new provider.

5. Conclusion

In this paper, several key risks encountered in the BPO industry were brought into focus along with mitigation techniques to counter the same. It should be noted that the possible spectrum of risks vary according to the exact process that is outsourced and also to whom it is outsourced. The experienced players in the BPO industry can in fact anticipate certain risks well in advance when compared to novice industry operators. However, the authors found a common set of risks faced by almost all BPO players, both outsourcing companies and business receiving companies, as presented in this work. Last but not least, the impact of effective technologies, especially information systems built according to best industry practices were seen as a strong deterrent to many types of risks throughout the BPO cycle.

References

[1] Logistics Today, 40 outsourcing risks you need to know now, 2004