Executive Summary

Business Process Outsourcing (BPO) has matured into a powerful organizational lever for achieving a variety of strategic business objectives. But despite BPO's strategic promise, many organizations are unprepared for the governance of this new way of working. Thus, many outsourcing programs fall short.

We suggest that insufficient attention to BPO governance is the main reason BPO relationships fail to deliver value. We present a governance model that increases the odds of BPO success. It is based on the premise that three key requirements of the outsourced process—its interdependence with other processes, its complexity, and its strategic importance to the enterprise—should determine three key BPO governance capabilities—the outsourcing contract, relationship management, and technical capabilities. When this alignment is explicit, the relationship will succeed.

We have tested the model using survey data on 137 BPO relationships. We illustrate the model's premise using the successful experiences of Merrill Lynch and Qatar Airways at governing very different business processes, one transformational and the other transactional.

Why Business Process Outsourcing Succeeds or Fails

Business Process Outsourcing (BPO) means transferring the primary responsibility for executing and managing a business process to an external organization. Often, this involves outsourcing the infrastructure supporting the business process, including its IT infrastructure. BPO is no longer viewed as being appropriate only for the transaction-intensive, peripheral functions of enterprises. It is increasingly being used for strategic purposes. In fact, the traditional vertically integrated business model is fast evolving into new forms of sophisticated outsourcing, such as “capability sourcing” and “strategic outsourcing.”

Capability sourcing espouses that every activity in the value chain can and should be evaluated as a candidate for “externalization.” This new view of how to organize business functions sees each firm as a specialized provider of information-intensive and knowledge-intensive core functions. Being specialized gives each a competitive advantage in its industry. The result has been a new class of “function-based companies,” such as UPS, Solectron, and Hewitt Associates, each of which has transformed its core functions into entirely new industries.

For example, UPS, traditionally a parcel delivery company, has leveraged BPO to develop scale and skill in logistics processes and technology. It has emerged as a single-source solution for organizational logistics needs, including supply chain design and planning, sourcing, manufacturing, order fulfillment, and supplier management.

Strategic outsourcing involves outsourcing strategic business processes, that is, processes that affect an organization’s critical success factors and, in turn, its competitiveness. Strategic outsourcing has the potential to disrupt industry leadership. A Wall Street Journal article describes how American firms, such as Kodak and Apple, have leveraged BPO to “seize the momentum” from Japanese leaders in the consumer electronics industry.

1 Jeanne Ross was the accepting Senior Editor for this article.
2 We gratefully acknowledge the insightful comments and suggestions provided by Cynthia Beath. We have also benefited from the detailed inputs provided by Jeanne Ross and two anonymous reviewers. A research summary, referencing this article, was featured in the Intelligence Section of the Winter 2006 issue of Sloan Management Review.
4 Ibid.
electronics industry to rapidly grow their revenue and market share. The bulk of Kodak’s cameras are now built by contract manufacturers in China, while Apple’s iPod is predominantly assembled in Taiwan. By outsourcing, both have attained cost and flexibility advantages over Sony’s in-house manufacturing and proprietary technology.

Outsourcing can yield significant strategic payoffs and seize momentum from industry leaders. But it must be done right to yield such results. A recent survey by Deloitte Consulting found that 70% of the respondents had negative experiences with outsourcing. BPO introduced complexity and cost, and required broader and deeper management skills than originally envisioned.

So, despite the strategic promise of BPO, many organizations are unprepared to manage this new form of organization. Some have responded to the complexity by bringing their outsourced operations back in-house. But this move does not correct the adverse effects the outsourcing failure had on customers and overall firm competitiveness.

Outsourcing failure appears to stem not from an inappropriate vision of potential value but from the lack of a comprehensive strategy to capture that value. Often, BPO managers first identify a service provider, then negotiate a contract, confirm delivery capabilities, and then focus on how to govern the relationship. Such outsourcing arrangements do not deliver value.

Our research suggests that early attention to governance is central to BPO success. With the “right” governance model, the BPO relationship manages risks well, exploits new sources of value, and is flexible enough to adapt to changes in the business.

The design of a firm’s BPO governance model also affects that firm’s technology strategy because most outsourced business processes are information intensive. They require significant technology support to both manage and execute the outsourced processes. In fact, technology investments are required in BPO to coordinate and communicate between the client and provider, assure business continuity and disaster recovery, and handle security management. When the BPO governance model is clear, these activities efficiently support the relationship.

However, most enterprises do not take a holistic approach to designing a BPO governance model that best fits their outsourcing context and objectives. The model needs to align with the requirements of the outsourced process. When the outsourced process is non-core, the risks of BPO are limited and probably well understood. But, when the process is core, understanding the operational risks can be difficult. Alignment is the key to uncovering and then managing these risks, and obtaining the expected value from BPO.

THE TWO DIMENSIONS OF BPO ALIGNMENT

Any process can be a candidate for BPO. However, to improve the odds of success, the approach to governance should reflect the requirements of the process being outsourced. The concept of alignment hinges on these two dimensions of the BPO arrangement:

Alignment Dimension 1: The Requirements of the Outsourced Process

The first step in designing aligned BPO governance is to evaluate specific requirements of an outsourced process. Our research points to three particularly relevant requirements:

• Interdependence of the process with other processes—that is, whether the process is self-contained or whether it requires working with other processes;
• Complexity of the process—that is, how difficult is it to analyze or understand process workings and verify or measure process output;
• Strategic importance of the process—that is, whether the process affects the enterprise’s competitiveness.

Every business process works within an organizational and industry context. Therefore, a process may have common functionality across firms, but the requirements of that process likely differ considerably across enterprises. For example, take the product design and development process. Most firms use this process to create new products. But the levels of interdependence, complexity, and strategic importance of this process vary across enterprises.

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Alignment Dimension 2: The Capabilities of the Governance Model

Much of the prior research on governance design for outsourcing focuses on the contractual structure used to formalize the outsourcing relationship. However, as BPO becomes a strategic way of working, and spans regional borders, the contractual structure may not sufficiently align incentives across the firms nor effectively coordinate their activities.

Theories on inter-firm coordination suggest that both the mutual exchange of rights (contractual coordination) and the mutual exchange of information (procedural coordination) affect the performance of a relationship. We agree that capabilities of the governance model must provide synergy between these two dimensions. From our research, we found the three most important BPO governance capabilities to be:

- The outsourcing contract
- Relationship management
- Technical capabilities

Therefore, the BPO governance includes the institutions, processes, and technologies that empower decision making and action to deliver sustainable value.

Alignment of the Two Dimensions

Many enterprises fail to align their BPO governance model with the requirements of the outsourced process. They either make sourcing decisions on a piecemeal basis and under-invest in governance, or they fail to exploit scale efficiencies and over-invest in governance.

Our analysis of 137 BPO relationships—all domestic, none offshored—uncovered 67 aligned relationships and 70 misaligned relationships. The BPO arrangements that aligned governance with process requirements were significantly more satisfied and operationally efficient. Their average satisfaction level was 27% higher than in the misaligned relationships. Similarly, their average operational efficiency level was 39% higher than in the misaligned relationships.

Our analysis uncovered two forms of aligned and misaligned relationships; see Figure 1.

Two Aligned Relationship Types

The aligned relationships appear in two cells of this matrix: in the upper right cell, where both process requirements and governance capabilities are high, and in the lower left cell, where both are low.

Transformational BPO—the high requirements-high governance capabilities cell—represents the new strategic approach to outsourcing, where the intent is...

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8 Principles of cluster analysis were used to empirically validate this initial evidence of the positive impact of alignment on service satisfaction and operational efficiency.
business and process transformation. The outsourced process shares interdependencies with other business processes, it is complex, and it is strategically important to the enterprise. In short, it has high process requirements.

The most appropriate governance model is a partnering arrangement between client and provider because this model includes joint ownership of the outsourced process, high levels of information exchange, and emphasizes coordination tasks.

Contracts for transformational BPO outsourcing are generally called relational contracts because they emphasize the relationship (the partnering arrangement).9

**Transactional BPO**—the low requirements-low governance capabilities cell—aims for process efficiency, process improvement, and lower costs of ownership. The outsourced process has low process requirements because it has low interdependence with other processes, low complexity, and low strategic importance.

The most appropriate governance model has the provider taking over ownership of the process and includes a well-defined plan for externalizing the process, and clear service level agreements, output metrics, and investments by the provider in technology and process improvements.

Contracts for transactional BPO outsourcing are generally called performance contracts because they emphasize performance to pre-defined requirements.

**Two Misaligned Relationship Types**

Misalignment in our sample resulted from either over-investment or under-investment in governance capabilities, relative to the requirements of the outsourced process.

**Resource overkill**—the low requirements-high governance cell—results in low satisfaction levels. Expectations cannot be realized because the resources have been misappropriated. In short, this misalignment leads to inefficient use of resources.

**Inadequate resources**—the high requirements-low governance cell—has an even more negative effect on satisfaction and efficiency because expectations are fully unmet. BPO was supposed to transform the processes and increase the enterprise’s competitiveness. The expectation was competitive differentiation. However, because the client under-invests in governance, no transformation takes place. Instead, the client shoulders high costs to recover and transition from the failed relationship, putting a significant dent in its bottom line and its satisfaction.

Our model of aligned BPO governance provides the outline for designing an efficient and comprehensive governance strategy that realizes the potential of BPO to create strategic value.

**A MODEL OF ALIGNED BPO GOVERNANCE**

A model of aligned BPO governance takes into account the three key process requirements—process interdependence, process complexity, and the strategic importance of the process—and the three key governance capabilities—the outsourcing contract, relationship management, and technical capabilities. These six components of aligned BPO governance are shown in Figure 2 and discussed in turn.

**Requirements of the Outsourced Process**

In 2004, JP Morgan Chase & Co. announced that it would cancel a $5 billion outsourcing contract with IBM Corp. that was to have lasted until 2010. It would bring the work back in-house. At about the same time, investment bank UBS AG announced that it would end its 11-year outsourcing contract, worth $1.8 billion, with Perot Systems Corp. It too would bring the work back in-house.

Industry experts saw these two cancellations as a reflection of two BPO trends. The first was a shift away from large-scale contracts to more tightly focused outsourcing arrangements for specific applications, functions or business processes. The second trend was the increasing need to continually reevaluate the outsourcing relationship to accommodate shifts in the business environment and the enterprise’s strategy.

Prior research on outsourcing governance10 has focused primarily on the relationship, and the need

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9 A relational contract emphasizes the relationship between client and provider, as opposed to a performance contract, which specifies required performance levels that the provider must meet. Performance contracts are suitable for transactional relationships but not transformational relationships. Transformational BPO requires a relational contract.

10 This stream of research is primarily influenced by transaction cost economics, which focuses on the hazards of cooperation that arise from behavioral uncertainty. It suggests that hierarchical controls are effective in handling such appropriation concerns. The greater the appropriation concern, the more hierarchical the contractual structure.
As BPO becomes more strategic and globally distributed, resolving process uncertainty becomes an important determinant of success. Is the outsourced process well understood? How will process tasks be allocated between the firms? How will the tasks be executed? How will the firms need to mutually adjust their behavior during process execution? These questions can be answered by analyzing the issues raised by the three primary requirements of the process being outsourced: process interdependence, process complexity, and strategic importance of the process.

**Process Interdependence**

Process interdependence can significantly complicate BPO because interdependencies among organizational processes limit a firm’s ability to unbundle just one of the processes from the others. It is not easy to independently examine the one process, analyze it, modify it, and enhance it, and continue to maintain its well-defined interfaces to the other processes.

Interdependencies often stem from a process’s functionality. For example, processes like payroll and benefits management relate to a single business function, so they are self-contained and can be reconfigured to respond to business needs with little impact on other processes. But processes like new product development may be integrated with other processes to increase their value to customers.

Interdependence determines the amount of enterprise-wide involvement needed to manage and support the BPO relationship. For example, in the case of interdependent processes like new product development, a cross-functional team from operations, marketing, and finance may be needed to ensure that the process functions efficiently and that important information about it is disseminated at the appropriate times.

Creating the shared vision for a BPO initiative requires uncovering potential conflicts and trade-offs among interdependent processes. Performing this analysis requires significant coordination among departments. And to transfer the value of a process from its outsourced environment back to the client requires buy-in from all the stakeholders. BPO’s benefits can be leveraged by the most business units when the BPO strategy aligns with their interests. Maintaining this alignment requires involvement. An example is GMAC. When it outsourced its Web portal call center and customer relationship functions to Edcor, GMAC established a user involvement committee with partners from each of its business units.

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The extent to which a process affects other processes also determines the amount of coordination and communication needed between client and provider. For example, a pharmaceutical company in our sample outsourced its clinical research function. The output from this outsourced process provided necessary input to various projects in the firm. But the firm’s business environment not only shifted priorities among these projects but also imposed new conditions, objectives, and deliverables. To keep abreast of these changes, the pharmaceutical company and its provider needed tight coordination and communication with each other. Their efficient communications helped the project teams understand the impact of the outsourced process on their work, which, in turn, allowed them to leverage the process changes to gain more benefits.

Interdependent processes can pose greater risks, such as the risk of losing strategic information to the provider through its interactions with the enterprise. To mitigate such risks, clients need to invest in incentives, mutual goals, and mechanisms that provide greater visibility.

Interdependencies between components of an outsourced process also increase outsourcing challenges. For example, a wireless service provider that outsourced customer support had to develop a sophisticated communications framework between its billing department and its provider’s call center so that billing queries could be answered seamlessly. Such coordination challenges become even more pronounced when a firm adopts a multi-sourcing approach, that is, it outsources a process to more than one provider. In a multi-sourced environment, the client must ensure that all the providers operate in concert. Clients need high levels of discipline and coordination competence to effectively manage multiple providers and ensure that the integrated business processes execute properly.

Process Complexity

Process complexity refers to the difficulty in analyzing and understanding inner workings of the process and measuring and verifying the process’s output. A brokerage firm in our study outsourced its customer technology education. It wanted to measure process performance and output. On the other hand, a mobile service provider in Asia, which frequently introduces innovative services as part of its competitive strategy, needs to change its outsourced billing environment to match these new services. But the billing provider viewed these changes as exceptions. The provider based its prices on a standard transaction environment. Both examples illustrate process complexity.

Before outsourcing a complex business process, a client must identify and untangle the unwanted complexity from the process workflow. By eliminating redundant applications, functions, systems, and communication channels, the client can reduce the costs of complexity in BPO. Dynamic mapping tools, such as visual process maps, can give visibility into the workings of complex processes. They can be used to guide efforts to reduce that complexity.

Managers should not outsource the responsibility for analyzing process complexity or reducing it. They must at least work collaboratively with their provider to reduce such complexity.

Complex business processes actually result in less complete BPO contracts because the parties cannot precisely define tasks, allocate the tasks, or specify their measurement in advance. In fact, there are few comparative metrics for complex processes, so measurement of performance and output against benchmarks is difficult. Therefore, service level agreements (SLAs) cannot easily capture outputs and desired behavior. As a result, the parties end up renegotiating service standards and requirements frequently. Therefore, complex outsourced processes require flexible and adaptive relationships marked by high levels of coordination between client and provider.

Strategic Importance

The strategic importance of a process is assessed by its impact on the enterprise’s critical success factors. Traditionally, firms have viewed outsourcing as an option that allows them to focus on their core competencies. These firms have insisted that their strategically important business processes, such as research and development, must remain in-house. However, that stance is no longer true. As marketplace volatility increases, and speed and flexibility of a firm’s response become integral to competitiveness, enterprises are increasingly outsourcing strategic business processes. More than 40% of our cases stated that they were pursuing strategic objectives in partnering with their service provider(s).

Writing the outsourcing contract for a strategically important business process is difficult and costly because of the adaptive nature of the process. The parties cannot pre-define their future actions. Hence, their contract is incomplete. Furthermore, the provider incurs higher learning costs and fewer
### Figure 3: Questions to Ask About the Three Key Process Requirements

#### Process Interdependence
1. To what extent does the candidate process maintain standard interfaces with other organizational processes?
2. To what extent do changes to the candidate process affect other organizational processes?
3. How difficult is it to assess performance of the candidate process independently of the performance of other organizational processes?
4. To what extent can the candidate process be decomposed or disaggregated into sub-processes that can be executed independently?

#### Outsourcing Challenges of Interdependent Processes
- Changes in the outsourced task environment may affect multiple functions and processes—requiring sponsorship of and coordination among several departments. The broader the impact, the more coordination and communication are needed with the provider.
- As the breadth of provider involvement in organizational processes increases, the risk of losing strategic information increases.
- Interdependent components create problems of shared ownership, requiring a skilled integrator to assume ownership and management of the interrelated components.

#### Process Complexity
1. To what extent does a clearly defined body of knowledge guide the effective functioning of the process?
2. During the course of their work, how often do process managers and workers come across difficult problems that they don’t know how to solve immediately?
3. On average, how quickly do managers know whether or not the process has executed successfully?
4. To what extent are the activities and methods in the process common across different inputs and parameters (e.g., across categories of claims or clients)?
5. In doing their daily jobs, how often do members of an organizational unit have to adopt different methods or procedures to do their work?

#### Outsourcing Challenges of Complex Processes
- Costly, incomplete contracts—contracts do not capture outputs and desired behavior
- Lack of industry standards and performance benchmarks
- Increased coordination and communication costs

#### Strategic Importance
1. To what extent does the process contribute significantly to creating a distinctive brand proposition?
2. How significant is the contribution of the outsourced process to the perceived customer benefits of the end product(s) of the firm?
3. To what extent does the process play a key role in any of the following?
   - Linking the organization to customers or suppliers
   - Integrating internal business processes
   - Enabling the development of new products and services based on information
   - Providing information for executive management to develop strategies

#### Outsourcing Challenges of Strategically Important Processes
- Information “poaching” and strategic information loss
- Costly, incomplete contracts, relatively higher learning costs, and lower scale economies for the provider
- Larger relationship-specific investments by both client and provider

Scale economies. Consequently, the client must make significant investments in incentives and processes to encourage collaboration and capture the process know-how. The client must also permit greater contractual flexibility and more exit options to mitigate the greater risk of losing proprietary process knowledge.

Finally, strategically important outsourced processes must be continually reviewed—their scope reevaluated,
their terms renegotiated, their performance monitored, and their feedback cycles validated. Such management of change requires high levels of coordination within and between client and provider(s).

These three process requirements demonstrate that the more interdependent, complex, and strategically important an outsourced process, the more the client and provider need to invest in means to handle the high needs for coordination, process adaptation, performance evaluation, and internal organizational change. The costs are higher than for low requirement processes, but the payoffs can be high. By analyzing a process early and recognizing the challenges of outsourcing it, an enterprise can more likely design the “right” BPO governance, that is, governance that maximizes the outsourcing value by managing the risks and aligning with the process requirements.

Figure 3 lists questions to ask in analyzing these three key process requirements before outsourcing a candidate process.

**Capabilities of the Governance Model**

Three capabilities of a BPO governance model are key to its effectiveness: its outsourcing contract, its relationship management, and its technical requirements. By resolving the issues in each, clients can design a BPO governance model where the three mutually reinforce each other.

**The Outsourcing Contract**

Effective contract design is the first step in good governance. The contract represents a mutual attempt to control uncertainty in desired behaviors and outputs. It defines the important parameters of the BPO relationship, such as SLAs, intellectual property rights, performance metrics and indicators, rewards, privacy and regulatory issues, and exit conditions. When the contract is not appropriately created or managed, the BPO tasks are poorly executed. The result is higher-than-anticipated costs and lower-than-expected results.

The overall objective in contract design is a contract that matches the uncertainty of the outsourced process environment. The three key elements that address uncertainty are: process ownership, contractual flexibility, and risks.

*Process ownership.* By understanding the three requirements of the outsourced process, the parties can better negotiate appropriate process ownership. The independence of the outsourced process, for instance, determines process ownership, which, in turn, dictates contractual responsibility for process performance.

For example, an independent process may have future uncertainties and contingencies. But these will have little impact on other processes, and vice versa. Therefore, the process can be owned by a best-of-breed specialty provider with minimal interaction with the client. In fact, if the client tries to retain control of this process, the process could actually become less efficient and overrun expected costs.

Interdependence among components in an independent outsourced process can also affect process ownership. For example, an interactive television service provider in our research outsourced its telephone-based technical support to a telecommunications firm. However, it overlooked the tight links needed between its technical support group and its other customer care departments (such as billing). The results were high coordination costs and operational inefficiencies, which adversely affected customer value. The firm resinded its contract and designed a new BPO relationship that took these interdependencies into account. The firm architected an integrated communications infrastructure that allowed its provider to take ownership of its customers. The provider thus became responsible for all dimensions of customer care, including billing, connectivity, usage, and technical support. This reconfigured relationship increased both operational efficiency and customer satisfaction.

*Contractual flexibility.* To a large extent, contractual flexibility is determined by the strategic importance of the outsourced process. Strategically important business processes have a pronounced effect on a client’s critical success factors. These processes must evolve rapidly to continually align the firm with its business environment. Therefore, the BPO contract must be flexible enough to accommodate business change over time.

Furthermore, when the strategic importance or complexity of an outsourced process increases, the provider morphs into becoming a collaborative partner, who must be involved in the strategic vision for the relationship to work well. A traditional performance contract, which emphasizes specific terms of work, must be replaced by a relational contract, where the relationship and its incentives are based on the future value of the relationship. These synergistic BPO relationships have high switching costs. That is why renegotiating and restructuring the contract are seen as far better than terminating it. Even so, renegotiations
are costly. The client must carefully analyze the provider’s proposals and ensure that both understand the service requirements and standards from the outset.

**Risks.** Finally, a client must pay special attention to the risk of information poaching or loss when outsourcing strategically important processes because such losses can significantly hurt its competitiveness. In global outsourcing transactions, all the participating firms must understand each country’s laws and regulations on data privacy and general contracting.

The BPO contract must be complemented by strong relationship management and technical capabilities.

**Relationship Management**

The BPO contract broadly describes the institutions put in place to govern the relationship. Relationship management describes how these institutions are to be used every day to create and sustain value in the relationship. The relationship management aspect of BPO governance is arguably the most important. Ironically, it is often the most ignored. Many firms vest their resources in contract development and execution, giving little thought to the relationship management processes and capabilities they will need.

A Conference Board study found that 97% of respondents would outsource their operations again but would pay less attention to service levels and more attention to relationship management. Therefore, early attention to relationship management is integral to effective BPO governance because these relationships need a sound, collaborative working relationship to constantly adapt and remain aligned.

The strategic importance of an outsourced process provides guidelines for managing the BPO relationship. Strategically important processes have fewer areas where providers can achieve economies of scale and standardization because the processes have unique workflows and routines. So both client and provider need more time to define the scope of the relationship and establish baselines.

Furthermore, if the strategic importance of the process increases, the client must shift from protecting itself against the risk of the provider acting opportunistically to giving the provider incentives. In these cases, the firms must use a partnering model because it emphasizes the mutual trust, shared risks and rewards, commitment, and joint action needed to make such a close relationship work. Problem solving and decision making must be collaborative. Metrics and incentives must be based on shared goals and mutual benefits.

In essence, the more transformational the outsourcing, the more collaborative the BPO contract must be, and the more comprehensive the relationship management must be.

A comprehensive approach to relationship management emphasizes coordination over control. Strategically important, complex business processes require higher levels of coordination. In fact, strategic discussions about continuous improvements, periodic exchanges on ideas and future plans, and regular communications take precedence over such non-strategic tasks as price negotiation, performance monitoring, and resolution of operational issues. Such a shift in emphasis indicates that the parties are trying to move from controlling uncertainty through the contract to managing uncertainty through the relationship.

BMW’s cooperative outsourcing arrangement with Magna Steyr illustrates relationship coordination. BMW retained responsibility for the design and concept of its X3 SUV. Magna was responsible for development and production. In a recent interview, BMW’s head of purchasing, Wilhelm Becker, remarked that Magna Steyr works like a BMW facility. Magna’s employees spent several weeks at BMW to learn the company’s processes; and the relationship has high levels of collaboration. Technology and quality links exist between the two firms so that Magna can get all the information it needs to mirror BMW’s production process. In addition, the two firms meet frequently to discuss their mutual needs and progress. Their partnering approach, which emphasizes coordination, aligns with the high levels of trust and commitment their relationship needs.

**Technical Capabilities**

The overall complexity of a BPO relationship determines the technical capabilities needed to both execute the outsourced process and handle coordination among the parties. These technical capabilities must align with the BPO governance model and the governance mechanisms. Complex BPO relationships – which have relational contracts and cooperative process mechanisms – require high levels of information exchange, which, in turn, require a more sophisticated technical infrastructure.

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For example, consider how the U.S. National Aeronautical and Space Agency (NASA) outsourced “IT seat management.” Seat management is an approach for coordinating all the workstations in an enterprise network by overseeing the installation, operation, and maintenance of the hardware, software, and other services at each workstation. Affiliated Computer Services (ACS) was awarded NASA’s Code R Outsourcing Desktop Initiative (ODIN) contract in July 2000. The contract had 6 seat types, each with an average of 12 services, five service levels, and 600 change requests a month. The scope and complexity of this contract required sophisticated technical capabilities to manage the BPO relationship.

ACS used Provance Technologies’ Web-enabled software to manage the seat configurations, comply with its contractual obligations, reconcile billing, and allow NASA to specify the services and technologies delivered. Using the Web interface, ACS staffers and NASA users and managers can view activity over the entire seat management system. All components are tracked accurately and each service request is routed to the appropriate ACS staff person. These powerful technical capabilities provide transparency and enhanced customer service in this BPO contract.

Figure 4 summarizes guidelines for determining needed BPO governance capabilities.

**TWO EXAMPLES OF ALIGNED BPO GOVERNANCE**

To illustrate the power of alignment, here is a look at two successful outsourcing experiences:

- **Merrill Lynch** outsourced the restructuring of its wealth management workstation platform. This example illustrates transformational BPO, that is, high levels of both process requirements and governance capabilities.
- **Qatar Airways** outsourced its revenue accounting and recovery processes. This example illustrates transactional BPO, that is, low levels of both process requirements and governance capabilities.

Figure 5 summarizes these two BPO governance models and their attributes.

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**Transformational BPO at Merrill Lynch**

One of Merrill Lynch’s largest outsourcing initiatives is the complex restructuring of its wealth management workstation (WMW) platform. The goal is an efficient and fully integrated desktop for its financial advisers. The platform will incorporate market data, financial planning tools, and customer relationship management (CRM).

The objective of the new platform is to improve the efficiency of the previous platform – Trusted Global Advisor (TGA). TGA was developed in-house. It has high maintenance costs, poor scalability, integration problems, and no CRM. Merrill’s executives have high hopes for the WMW effort. They expect to resolve all these issues and generate competitive advantage by also reducing the cost of equipping the financial advisers with better and faster information, addressing changing client information needs better, and raising the overall cost-of-entry of being a financial advisory firm.

The process requirements are high:

- **Process interdependence.** The new platform is to have cross-links among client management systems, the financial advisors, the company’s call centers, and the online service management. With such integration, Merrill’s clients and financial advisors can access the same information.
- **Process complexity.** The new platform is also complex, with tight links among 130 applications, including the critical proprietary databases that contain client information, portfolio services, news, HR, accounting, and financial data.
- **Strategic importance.** The new platform will let Merrill’s financial advisors focus on high-net-worth clients because it will divert clients with net worth under $1 million to Merrill’s call centers or the company Web site. This prioritization of work is a strategically important goal of the new platform.

In alignment with these high outsourcing process requirements, Merrill is adopting a high governance capabilities model.

- **Outsourcing contract.** Merrill tested competing vendor capabilities before selecting Thomson Financial as its lead “partner.” Thomson Financial coordinates a variety of sub-contractors, including Dell, HP, AT&T, and


**Figure 5: Characteristics of Two Governance Models**

<table>
<thead>
<tr>
<th>Governance Model</th>
<th>Process Requirements</th>
<th>Governance Capabilities</th>
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<tbody>
<tr>
<td>Transformational BPO</td>
<td>High Interdependence</td>
<td>Contract—Relational contract emphasizes joint ownership of the outsourced business process.</td>
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<td></td>
<td></td>
<td>Relationship Management—Partnering model marked by relational emphasis on coordination and high levels of information exchange, joint action, and commitment between the client and provider.</td>
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<tr>
<td></td>
<td>High Complexity</td>
<td>Technological Capabilities—High technological capabilities</td>
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<td></td>
<td>High Strategic Importance</td>
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</tr>
<tr>
<td>Transactional BPO</td>
<td>Low Interdependence</td>
<td>Contract—Arm’s-length performance contract emphasizes transfer of ownership of the outsourced process to the provider.</td>
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<tr>
<td></td>
<td>Low Complexity</td>
<td>Relationship Management—Relationship marked by emphasis on control and low levels of information exchange, joint action, and commitment between the client and provider.</td>
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<td></td>
<td>Low Strategic Importance</td>
<td>Technological Capabilities—Low technological capabilities</td>
</tr>
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Given the strategic importance of this initiative, the contract with Thomson allows flexibility to adapt to changing business, process, and user needs. In addition to specifying SLAs and performance bonuses, the contract links Thomson’s compensation to customer satisfaction measures. In short, the contract is a relational contract rather than a performance contract.

- **Relationship management.** Given the proprietary nature of the components in the platform, and the tight links across Merrill, the restructuring process is owned by both firms. This
partnering approach represents a fundamental shift from the hands-off, “delegate-and-abdicate” approach of transactional outsourcing, where the process is delegated and ownership is abdicated. The relationship between Merrill and Thomson is tight and relational. Thomson employees and other contractors work onsite with Merrill employees under the guidance of a management team with members from both firms.

The project involves frequent communications between the firms, even at the top management levels. Senior executives at both firms sponsor the work and participate in it. Senior management fosters the partnering model and shares responsibility for its success and realization of the benefits.

- **Technical capabilities.** Integration of Merrill’s proprietary back office with Thomson’s front office is critical to the success of the project. The integration framework uses Microsoft’s .NET and is one of the largest Web services implementations. The Web services framework enables Merrill to isolate changes to the system and leverage a range of front-end applications, in addition to Thomson’s. These forward-thinking technologies are integral to delivering value in this outsourcing project.

It might be too early to judge whether Merrill’s approach to strategic outsourcing has paid off. However, commenting on the status of the project, which entered the user acceptance phase in early 2004, Merrill’s CTO, John Killeen, remarked in an interview with Wall Street & Technology, “We are making the right progress...The fact that we have something that we can put in front of the financial advisors and we’re in our user acceptance testing—it all bodes well.”

**Transactional BPO at Qatar Airways**

In 2001, Qatar Airways decided to outsource its revenue accounting and recovery processes to India-based Kale Consultants, so that it could focus on its core business function: flying. The airline wanted industry-standard service levels and best practices from BPO, rather than make hefty investments in specialized skills and infrastructure itself. BPO would lead to significant cost savings and enhanced competitiveness in its price-sensitive market, management reasoned.

The revenue accounting and recovery process had low process requirements:

- **Process interdependence.** The output of the revenue accounting and recovery process affected other Qatar functions; however, the process could easily be disaggregated from the airline’s value network. Thus, it could function independently. This independence allowed Qatar Airways to outsource the process to a best-of-breed specialty provider and relinquish most operational involvement.
- **Process complexity.** The process was straightforward and well understood. The process, therefore, had low complexity.
- **Strategic importance.** The revenue accounting and recovery process was a “strategically peripheral corporate function” to the airline. The process did not contribute to Qatar’s competitiveness, but its quality and timeliness were important because the resulting revenue reports were key to Qatar accurately billing other airlines and recovering revenue from agencies and other airlines. So the process did need sound process expertise and appropriate technical investments to function effectively.

The relatively low requirements of the outsourced process allowed Qatar to have low BPO governance capabilities, that is, use a transactional BPO governance model.

- **Outsourcing contract.** Qatar Airways signed a performance contract with Kale Consultants, which included a well-defined transition plan and clearly defined SLAs and output metrics based on performance. In addition, Qatar transferred ownership of the outsourced process to Kale.
- **Relationship management.** Relationship management focused on service control via the SLAs. The business processes were well documented and the means to train teams to resolve operational issues were well defined. So Qatar’s oversight of the process could be arms’ length.
- **Technical capabilities.** Qatar Airways was not required to make any investments in technology infrastructure nor processes. Furthermore, the system interfaces were clean. Kale’s interface with Qatar was restricted to transactional data only, such as manual tickets, uplifted coupons, and inward billing data.

Qatar Airways’ transactional BPO governance model matched the low requirements of the outsourced
过程。结果表明，Kale审计了代理销售，这使得收入恢复更高。这提高了卡塔尔航空的底线并提高了其整体效率。此外，通过控制成本，卡塔尔航空已经将其在过程中的角色从管理该过程转变为管理结果。这种BPO安排的成功在2005年卡塔尔航空与Kale续约四年时显而易见。

哈林斯顿的潜力

有效的BPO治理需要对所外包过程的要求进行全面和早期的分析，以及适应这些要求的治理模型。当治理模型与过程要求匹配时，结果更有可能是更高的效率和服务满意度。

研究的发现导致了三条推荐措施：

**看主要要求过程。**

过程的两个匹配的治理模型代表了我们在研究中发现的BPO模式。过程要求和治理能力会群集，很大一部分如上所述。也就是说，复杂的战略重要性业务流程通常具有高水平的相互依赖。类似地，关系合同通常需要一个协作性治理模式来管理关系并拥有高技术水平。

但是，当过程要求不同，治理能力应该由主导的影响在群集。例如，考虑一个业务流程，低复杂性但高相互依赖和高战略重要性。在这种情况下，高相互依赖和战略重要性抵消了低复杂性的影响。最合适的治理模型是合作伙伴模式，拥有各自所外包过程的共同所有权，高关系管理，和高技术能力。

**不要采取一成不变的BPO治理。**

一家管理BPO关系组合的公司不能采取一刀切的BPO治理方法。每个过程都有其独特的业务背景和对企业的竞争优势的显著影响。因此，每个BPO关系必须根据所外包过程的要求、治理能力和总体对BPO关系的满意程度而定制。

**定期重新评估您的治理模型。**

BPO关系的治理不是一个一次性的解决方案。作为其外包战略的一部分，企业需要定期重新评估过程的要求、治理能力和总体对BPO关系的满意程度。重新评估有助于进化BPO关系，更好地预测和准备未来外包需求的变化，并确保拥有最佳的治理能力。然后，BPO的真正潜力可以被实现。

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APPENDIX: RESEARCH METHODOLOGY

We developed a structured questionnaire based on our review of academic and practitioner literature and initial interviews with 20 BPO experts. The subject experts were directors of strategic outsourcing practices in Fortune 100 firms (in financial services, healthcare, retail, and high-tech), outsourcing advisory consultants, leading Indian offshore vendors, and academicians. These interviews focused on critical outsourced organizational processes – equity research, R&D and innovation, procurement, product design, and customer service operations.

Our sample, which comprised small, medium, and large organizations, was representative of a range of outsourcing objectives from transactional to transformational. We received a total of 145 valid responses, of which 137 were complete in all respects. The respondents were offered the option to complete any of: a print survey, telephone survey, or an online questionnaire. Almost all the responses came from the online questionnaire. All the respondents were assured that their responses would remain confidential and that the results would be reported only in aggregate, thereby addressing privacy concerns and minimizing potential bias in self-reported data.

The characteristics of the respondents are shown in the following three figures, Figures 6-8.

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**Figure 6: Distribution of Respondents by Enterprise Revenue (All figures in %)**

<table>
<thead>
<tr>
<th>Revenue</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $500,000</td>
<td>9</td>
</tr>
<tr>
<td>$500,000 - $1m</td>
<td>5</td>
</tr>
<tr>
<td>$1m - $5m</td>
<td>16</td>
</tr>
<tr>
<td>$25m - $100m</td>
<td>14</td>
</tr>
<tr>
<td>$100m - $500m</td>
<td>6</td>
</tr>
<tr>
<td>$500m - $1b</td>
<td>10</td>
</tr>
<tr>
<td>$1b - $10b</td>
<td>5</td>
</tr>
<tr>
<td>$10b - $50b</td>
<td>15</td>
</tr>
<tr>
<td>Over $50b</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
</tr>
</tbody>
</table>

19 A study released by IDC (“Vertical Views of BPO Demand: A Study of Five U.S. Industries”) indicates that business process providers will likely see maximum investment from financial services companies over the next 12 months. The retail/wholesale industry is also likely to witness significant investments in BPO services, specifically for customer service operations. Most of our exploratory interviews were with executives in both of these high-outsourcing-growth industries.

**Figure 7: Distribution of Respondents by Functional Responsibility (All figures in %)**

<table>
<thead>
<tr>
<th>Functional Responsibility</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman/CEO/President</td>
<td>24</td>
</tr>
<tr>
<td>Owner/Principal/Partner</td>
<td>7</td>
</tr>
<tr>
<td>Director-level Management</td>
<td>27</td>
</tr>
<tr>
<td>VP-level Management</td>
<td>25</td>
</tr>
<tr>
<td>Sr. Contracts Manager</td>
<td>2</td>
</tr>
<tr>
<td>Purchasing/Procurement Officer</td>
<td>2</td>
</tr>
<tr>
<td>HR Executive</td>
<td>2</td>
</tr>
<tr>
<td>Other*</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
</tr>
</tbody>
</table>

* Other functional responsibilities include Sourcing Advisor, Business Process Manager, CIO, CFO, Technology Manager, and EVP-level Management

**Figure 8: Distribution of Respondents by Enterprise Industry (All figures in %)**

<table>
<thead>
<tr>
<th>Industry</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electrical, Electronics, and High-Tech</td>
<td>28</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>13</td>
</tr>
<tr>
<td>Financial Services*</td>
<td>11</td>
</tr>
<tr>
<td>Healthcare</td>
<td>11</td>
</tr>
<tr>
<td>Pharmaceutical &amp; Chemicals</td>
<td>9</td>
</tr>
<tr>
<td>Professional Services</td>
<td>9</td>
</tr>
<tr>
<td>Consumer Business, Retail or Wholesale</td>
<td>5</td>
</tr>
<tr>
<td>Software &amp; Telecom</td>
<td>5</td>
</tr>
<tr>
<td>Other**</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
</tr>
</tbody>
</table>

* Includes Insurance, Banking, & Capital Markets

** Other industries include Research & Education, Non-Profit, Pulp & Paper Products, Chemicals, and Construction