Journal of World Business 48 (2013) 407–419

Contents lists available at SciVerse ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

Governing business process offshoring: Properties, processes, and preferred modes

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ARTICLE INFO

Keywords:
Business process offshoring (BPO)
Governance mode
Transaction cost economics
Organizational control
Emerging markets

ABSTRACT

This article examines an important yet understudied issue—the governance mode for business process offshoring (BPO). By applying transaction cost economics and organizational control perspective in the global BPO context, we suggest that BPO's governance mode (foreign captive, joint venture, and independent vendor) is determined by task features, such as knowledge specialization, information security, and process codifiability, and by needed process integration, horizontally between departments and units within the provider and vertically between the provider and its global client and its local subcontractor. Findings from our analysis of 308 global BPO units in India and China confirm our hypotheses.

1. Introduction

One of the most significant emerging topics in international business today is global business process offshoring (BPO), that is, transferring operational ownership of one or more business processes to foreign units or entities that conduct or manage the services according to predefined metrics. According to a study by McKinsey and NASSCOM (2009), global BPO will become the largest offshoring opportunity, with a total market approaching US$ 670 billion by 2020. BPO has garnered significant attention as an economic driver fueling growth and employment in emerging economies (Farrell, 2005; Ramamurti, 2004) and as a strategic catalyst upholding competitive positions for developed country multinational enterprises (MNEs) (Aron & Singh, 2005; Doh, Bunyaratavej, & Hahn, 2009; Gupta, 2005). Because BPO reduces costs, streamlines worldwide services, and increases net profits, MNEs rely increasingly on offshore services for information technology (IT)-enabled business processes. These processes range from managing global back offices and customer supports to providing advanced value-added services in banking, financing, taxation, accounting, law, logistics, healthcare, consulting, data analytics, and other business solutions.

When planning and organizing BPO practices, a key issue that a global BPO client must address is what and how to choose an appropriate governance mode (Mani, Barua, & Whinston, 2006; Mudambi & Tallman, 2010). Unlike traditional MNEs that truly "enter" a foreign country to undertake foreign direct investment (FDI) via various "entry" modes, BPO clients choose an "operational" mode in an offshore territory that will enable them to pursue IT-enabled global spatial advantages (Doh, 2005; Kedia & Mukherjee, 2009). Such governance modes primarily include independent vendor (offshore third-party outsourcing), foreign captive (setting up a fully controlled center, also known as offshore insourcing), and joint venture (allying with a local partner via equity-based joint venture or cooperative alliance). Choosing a suitable mode is critical because an appropriately governed BPO project can translate into high customer satisfaction and, ultimately, firm competitiveness (Lewin & Peeters, 2006; Vivek, Banwet, & Shankar, 2008).

Determine an "appropriate" BPO governance mode remains largely unknown. In this study, we present a succinct framework arguing that BPO's governance mode choice is determined by transactional properties unique to BPO (i.e., knowledge specialization, process codifiability, and information security), and by the needs for process integration horizontally between departments or units within the provider and vertically between the provider and its global client and its local subcontractor if the latter is used. What motivated us to study this issue is that we noticed a pattern in our field studies of BPO in India and China that BPO mode choice

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http://dx.doi.org/10.1016/j.jwb.2012.07.024

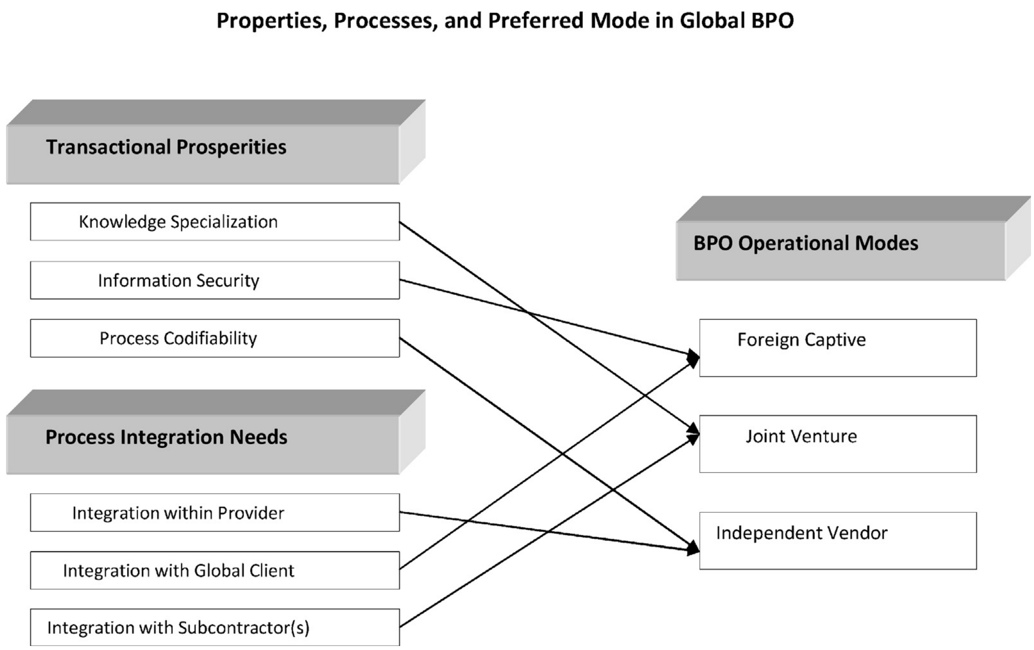

Fig. 1. Properties, processes, and preferred mode in global BPO.

often hinges on the task/project characteristics. Task/project-level factors are generally considered weak determinants of traditional FDI mode choice while country-, industry-, and firm-level factors overwhelm in determining this choice for traditional FDI (Luo, 1999). In this study, we intend to solve this puzzle by proposing and testing the effect of task/project-level characteristics on BPO governance mode.

We hope this study will advance understanding of how firms protect their proprietary knowledge, ensure information security, control service quality, and reduce process-related coordination costs by selecting the optimal BPO governance mode. This study may also stimulate more extensive research on the structural and spatial design of global business processes and organizational control over offshore activities in services. We use transaction cost economics and organizational control logic to elucidate our arguments and use global BPO units in India and China to test our propositions (Fig. 1).

2. Theoretic perspective and hypotheses

2.1. Global BPO and governance modes

Consistent with previous studies (e.g., Doh et al., 2009; Lewin, Massini, & Peeters, 2009; Metters, 2008; Youngdahl, Ramaswamy, & Verma, 2008), this study defines "business processes" as not only back office processes (e.g., human resources, finance, accounting and taxation) and front office processes (e.g., customer-related services) but also as high-end knowledge processes (e.g., research in global markets, credit rating, customer analytics, logistics, legal services, education, software development, and data analytics). Increasingly, firms choose to offshore business processes or functions when these can be performed better, faster, and less expensively by overseas entities (Gupta, 2005; Kehal & Singh, 2006). Moreover, BPO clients could obtain strategic renewal and create new value through access to complementary knowledge of external professional service providers. Emerging economies, especially those in Asia, Eastern Europe, and Latin America, play a key role in providing BPO services (Lewin et al., 2009). Firms in these economies are ideal providers of BPO services due to their advantage in abundant educated talents, cost leadership in services, and conductive BPO environment (including favorable government policies) (Willcocks & Lacity, 2006).

BPO involves significant challenges, including difficulties in ensuring service quality, codifying BPO content, and coordinating multiple processes and tasks (Luo, Zheng, & Jayaraman, 2010; Mudambi, 2008). A suitable governance mode can help mitigate such challenges and provide strong implications in cost savings, risk control, quality assurance, process monitoring, and overall profitability (Madhok, 1997; Stratman, 2008). The decision may be a difficult one—among pursuing a *captive* mode (i.e., building a wholly owned new unit or subsidiary either from scratch or by means of complete acquisition), committing to a *joint venture* with a local partner, or using an *independent vendor* for a pure client–service relationship.

A foreign captive unit or a wholly owned mode facilitates a BPO client to control over offshore operations particularly those high-end processes that must be integrated with its global operations (Willcocks & Lacity, 2006). BPO clients, such as General Electric, American Express, British Airways, and Prudential, have led the path for captive services by building wholly owned units in India. BPO clients choose to build a captive unit when skilled labor is not available locally and/or when a full control is central to knowledge or information protection. Additional advantages of the captive mode include a lower business discontinuity, a higher quality assurance, and a more systematic process migration and improvement (Vivek et al., 2008). Unisys built its captive unit, Unisys Global Services Center (UGS), in Shanghai because information security is so important that the company did not believe other mode choices were safe enough. On the other hand, rising managerial and administrative costs, as well as organizational commitments, can pose challenges for BPO clients pursuing the captive mode of operation.

The joint venture mode is a hybrid arrangement, allowing the global client to own some degree of control over the transaction without fully internalizing it. Employing a joint venture mode enables the global client to simultaneously leverage the benefits of scale for volume driven processes and to address cost and risk concerns to some extent (Hennart, 1993; Mudambi & Tallman, 2010). Furthermore, operating in a joint venture mode can provide the global client company with an opportunity to gain new