

# **ESSENTIALS**

## **of Business Process Outsourcing**

**Thomas N. Duening**  
**Rick L. Click**



**John Wiley & Sons, Inc.**



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## **of Business Process Outsourcing**

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# Preface

**B**usiness process outsourcing (BPO) has emerged as one of the leading business and economic issues of our time. A natural extension of the free-trade movement that has been a dominant force in global economics over the past two decades, BPO has been met with mixed reactions. Workers whose lives have been disrupted because their jobs have been outsourced to lower-wage workers overseas have understandably decried “offshoring” as a threat to their way of life. Others, especially those in the foreign locations where new jobs are rapidly being created, are elated finally to have an opportunity to gainfully deploy their hard-earned skill sets.

In this book, we attempt to examine BPO from the perspective of its application and implementation in businesses of all sizes. We do not address the political or economic controversies swirling around outsourcing. Instead, we assume that the movement of service work to lowest-cost providers, no matter where they may reside, will continue in some form in the coming years. It seems unlikely that new barriers will be erected that will seriously limit global free trade. With that in mind, we have developed a rigorous methodology that businesses can use to analyze the outsourcing opportunity, to make informed decisions about choosing a vendor, and to manage change and execute an outsourcing project.

## Preface

The team-based approach to BPO project analysis and management that we recommend is based on the fact that BPO is a sociotechnical phenomenon. That is, a well-executed outsourcing project must involve both social and technical resources of the organization. BPO is transformational to the organization and requires attention to the social and human impacts that accompany business transformation. At the same time, one of the primary enablers of BPO is the set of technologies that has emerged to connect the world in a global communications network. As a sociotechnical phenomenon, effective BPO management requires a diverse skill set that is not likely to be present in a single individual. Thus, we recommend a team-based approach since the necessary skills are more likely to be available in a group of people united to achieve common objectives.

We also develop the concept of the BPO Life Cycle to denote clear milestones in development of the BPO project, and to provide more specific management and leadership guidelines to be applied at different stages of the Life Cycle. The BPO Life Cycle applies to any type of outsourcing project, and to any size company.

It has become clear that BPO provides far more than mere cost savings to firms that use it. BPO has become a strategic business choice that can be leveraged for competitive advantage as well. When a business outsources a process to a vendor whose core competence is centered on that process, the buyer is likely to experience service enhancements that can be turned into competitive advantages over rivals. Furthermore, when the buyer-vendor relationship evolves into a business partnership, both sides will be motivated to look for mutually beneficial ways to leverage the combined asset pool.

As this book is going to press, outsourcing has become an important new force in the global economy. It is our hope that the prescriptions, guidelines, concepts, and tools provided in this book will be useful to executives in organizations of all sizes as they struggle to determine their

## Preface

best opportunities for outsourcing. With the rapid evolution of outsourcing techniques and methodologies, we are certain that this book only makes a dent in the growing understanding of BPO. At the same time, there are timeless change and relationship management lessons in this book that apply to outsourcing and to global, interorganizational business relationships. We hope that readers will enjoy this book and that it provides executives with insights and concepts to make informed decisions and choices.

TOM DUENING

RICK CLICK

*March 2005*



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**W**e want to thank the many individuals who contributed to this book. Among those who were instrumental in its genesis are the editors and writers we called upon for feedback and help on our prose. Most significant among this group is Mr. Doug Williams of Tomasini W2K in Houston, Texas. Doug's assistance in editing and condensing this material was both instrumental and timely. In addition, our Wiley editors Mr. Sheck Cho and Ms. Jennifer Hanley were very helpful and patient. Finally, we want to thank our families. My (TND) family put up with a lot of stress during the writing of this book as we moved from Texas to Arizona. My daughters Jennifer and Tiffany and my wife, Charlene, are my inspiration and foundation. My (RLC) move from Texas to California also occurred during the writing of this book and I thank my wife, Amy, for her patience during the process.

# The BPO Revolution

## Overview

The Internet bubble bursts, and the world keeps turning. Terrorists attack the World Trade Center, and the world keeps turning. The global economy reels in the throes of a major recession, and the world keeps turning. Despite their unpredictable—and sometimes despicable—natures, humans are nothing if not innovators and perpetual optimists. In the face of doubt, ambiguity, and even terror, we continue to strive to build a better world. We are fortunate to be so resilient.

Even as our hopes for an easy peace and new economy prosperity in the twenty-first century were dashed within months of its arrival, we continue our pursuit. Part of that quest is based on the technological breakthroughs that seemed to appear with breathtaking speed in the 1990s. Standing on the shoulders of the innovators of the time, a new generation of visionaries has leaped ahead. Of all the vast array of novelties introduced in the past few years, none is more important than the creation of the global communications and information infrastructure that has now burrowed into nearly every city, village, hamlet, and encampment around the world. Fiber-optic cable spans oceans and continents. Low-earth-orbit satellites provide streaming images, data, and voice to the most remote locations. No place on earth, or in near-earth, is now beyond the reach of the information and data nervous system that was constructed

over the past few decades. This *is* revolutionary, and this nearly universal telecommunications infrastructure is a major part of what gives life to the business innovation called *business process outsourcing*.

## **BPO Defined**

Business process outsourcing (BPO) is defined simply as the movement of business processes from inside the organization to an external service provider. With the global telecommunications infrastructure now well established and consistently reliable, BPO initiatives often include shifting work to international providers. Five BPO international hot spots have emerged, although firms from many other countries specialize in various business processes and exporting services:

1. *India*. Engineering and technical
2. *China*. Manufacturing and technical
3. *Mexico*. Manufacturing
4. *United States*. Analysis and creative
5. *Philippines*. Administrative

Each of these countries has complex economies that span the range of business activities, but from a BPO perspective, they have comparative advantages in the specific functions cited.

## **A Strategy To Eliminate Noncore Functions**

Because of the job shift that accompanies the quest to employ the highest-value talent, BPO has been both hailed and vilified. Business executives and owners praise it as a way to eliminate business processes that are not part of their organization's core competence. Back-office functions, such as payroll and benefits administration, customer service, call center, and technical support, are just a few of the processes that organizations of all sizes have been able to outsource to others who specialize in those

areas. Removing these functions from their internal operations enables organizations to reduce payroll and other overhead. In an era when executives have been admonished by business commentators and analysts to focus on core competencies, BPO offers an opportunity to achieve that goal in a dramatic new way.

Like appliance manufacturers that moved production from the Midwest to Mexican *maquiladoras* or apparel firms that moved production to the Far East, businesses of all types and sizes are now shifting back-office jobs to international locations such as China, India, and the Philippines, where labor is inexpensive and highly skilled. In the past several years, companies have turned to these regions for increasingly sophisticated tasks such as financial analysis, software design, tax preparation, and even the creation of content-rich products (e.g., newsletters, PowerPoint presentations, and sales kits).

### **BPO Not Confined To Routine Jobs**

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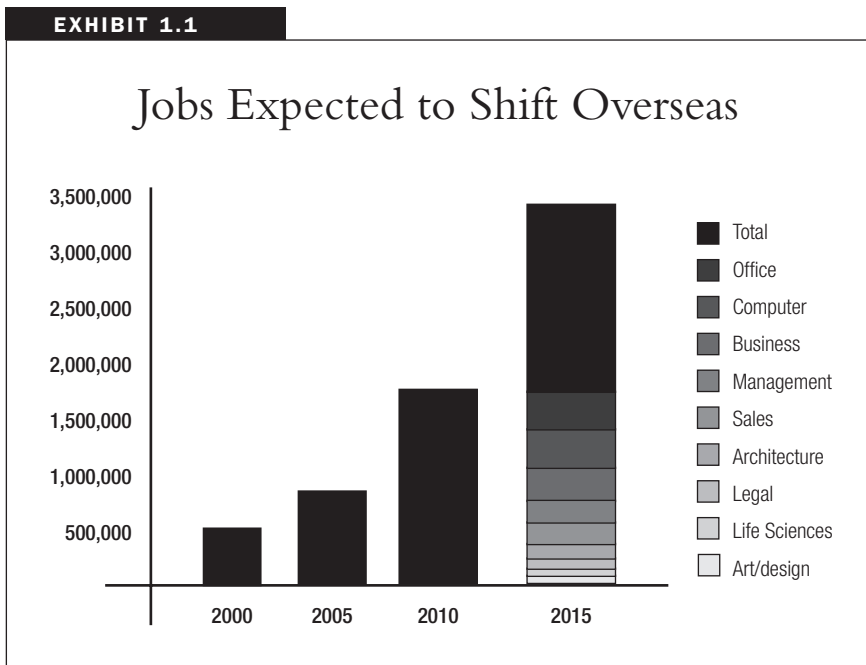
With the increasing education levels around the world, BPO is no longer confined to routine manufacturing jobs or boiler-room telemarketing centers. Today's outsourcing involves complex work that requires extensive preparation and training. For example, Indian radiologists now analyze computed tomography (CT) scans and chest X-rays for American patients out of an office park in Bangalore. In the United States, radiologists are among the highest-paid medical specialists, often earning more than \$300,000 per year to evaluate magnetic resonance imaging (MRI), CT scans, and X-rays. In Bangalore, radiologists work for less than half that. Not far from the radiology lab in Bangalore, Ernst & Young has 200 accountants processing U.S. tax returns. Starting pay for an American accountant ranges from \$40,000 to \$50,000; in Bangalore accountants are paid less than half that.<sup>1</sup>

## Outsourcing of Service Jobs to Escalate

In the next 15 years, Forrester Research predicts that 3.3 million service jobs will move to countries such as India, Russia, China, and the Philippines (Exhibit 1.1). That is the equivalent of 7.5 percent of all jobs in the United States right now.<sup>2</sup>

Estimates from leading research firms more than support this trend. The Gartner Group, a Stamford, Connecticut-based research firm, predicts that:

- One in ten jobs at specialty information technology (IT) firms in the United States will move abroad by 2005, along with one in 20 IT jobs in general businesses—a loss of about 560,000 positions.
- BPO will reach \$178 billion in revenues worldwide by 2005, representing a compound annual growth rate of 9.2 percent for the five-year forecast period.<sup>3</sup>





Additionally, market research firm IDC predicts that finance and accounting outsourcing will grow to nearly \$65 billion by 2006, up from \$36 billion in 2001. Two thirds of U.S. banks already outsource one or more functions.<sup>4</sup>

BPO has caught on as well with the venture capital community. In 2002, venture capital firms in North America poured nearly \$3 billion into BPO firms and nearly \$1 billion more by June 2003. Some BPO providers enjoy operating profit margins as high as 40 to 50 percent. Even though margins are expected to level out to between 20 and 25 percent as the market matures, these returns are greater than those being experienced in nearly any other industry.<sup>5</sup>

### **Concerns Over Job Losses**

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Despite this, BPO is not without its critics. There is no doubt that the history of outsourcing in manufacturing has been black-marked by the many Americans who lost their jobs and cannot find new ones in the traditional manufacturing sector. Today, everything from electronics to home furnishings is being produced by low-cost labor in places such as Shanghai and Monterrey. The prediction that free-trade agreements such as the North American Free Trade Agreement (NAFTA) would create a “giant sucking sound” as jobs moved to low-wage labor environments has rung true for many U.S. workers. Factories across the country, including many staples of America’s industrial past, have gone silent—apparently for good.

Although such wrenching change is painful and unsettling, the resilience of the American worker to find new ways to create value in a global economy shows few limits. As the nineteenth century’s Agrarian Age came to an end and workers moved from farms to factories, they adapted and built some of the greatest cities in the world. At the end of the twentieth century, the Industrial Age gave way to the Information Age, and many workers moved out of factory jobs into information-rich



**IN THE REAL WORLD**

## Does BPO Increase the U.S. Unemployment Rate?

The Labor Department, in its numerous surveys of employers and employees, has never tried to calculate the number of jobs that are shifted overseas as a result of BPO. But the offshoring of work has become so noticeable that experts in the private sector are trying to quantify it. Initial estimates are that at least 15 percent of the 2.81 million jobs lost in America since the recession began have reappeared overseas. Productivity improvements at home account for the great bulk of the job loss. But the estimates suggest that work sent offshore has raised the U.S. unemployment rate by four tenths of a percentage point or more.

Among economists and researchers, one high-end job-loss estimate comes from Mark Zandi, chief economist at Economy.com, who calculates that 995,000 jobs have been lost overseas since the recession began in March 2001. That is 35 percent of the total decline in employment since then. Most of the loss is in manufacturing, but about 15 percent is among college-trained professionals.

*Source:* Adapted from Louis Uchitelle, "A Missing Statistic: U.S. Jobs that Went Overseas," *The New York Times* (October 5, 2003).

occupations and built some of the greatest technologies in the world. There is every reason to believe that BPO will help create a more tightly integrated business world that will lead to a more tightly integrated cultural and economic world. BPO has the potential to create new prosperity for workers everywhere through participation in a BPO-based business superculture that spans the globe.

## **BPO: A Sociotechnical Innovation**

Many executives and managers shy away from BPO because they wrongly believe it to be a technical innovation—one better left for the chief information officer (CIO) or other technology administrators. In part, this belief results from the IT origins of BPO. Many early adopters of outsourcing were those who needed software development expertise or who sought technical expertise to staff help desks and call centers. During the 1990s, the labor pool for such talent in the United States was tight, prompting many leading companies to search abroad for the personnel they needed. These organizations turned to international labor markets, where they were able to identify and hire highly skilled technical workers who were far cheaper than their U.S.-based counterparts. Today, the talent shortage in the United States has abated, but the cost savings to be gained by using outsourced talent remains.

### **BPO Transcends IT Origins**

BPO has evolved far from these IT-specific roots and now encompasses nearly every business process. To be sure, the implementation of a BPO initiative will always involve a technology component, but for that matter so does implementation of a benefits administration office at the local beer distributor. The point is, nearly every modern business innovation comprises both a technical and a social component. Decision making, strategy setting, service delivery, and virtually every other business activity are now sociotechnical in nature, involving humans interfacing with technical systems. BPO is like that.

Fundamentally, then, BPO is a sociotechnical business innovation that provides a rich new source of competitive advantage. By sociotechnical we mean that BPO requires skillful management of people and technology (hardware and software). The manager who initiates a BPO strategy must find effective ways to introduce people to technology and

vice versa. If left solely in the hands of technical specialists, a BPO initiative is likely to fail for lack of paying attention to the soft issues of human relationships, change management, and organizational culture. If left solely in the hands of nontechnical managers, it is likely to fail for unrealistic expectations about the potential and limitations of the enabling technologies.

### **Human Factors and Technology Issues**

BPO is one of those interdisciplinary workplace innovations that demands a diverse set of skills to be successful. Initiating and implementing a BPO project requires a focus on several human factors, both within the organization initiating the project and within the outsourcing vendor. These factors cannot be ignored and must be handled correctly in order for the project to succeed. Human factors include:

- Developing various teams to manage the BPO initiative throughout its life cycle
- Reassuring staff of their role in the company
- Training people on the new way of doing business
- Dealing with job loss and/or reassignment
- Keeping morale high throughout the change process
- Encouraging people to participate in decision making
- Understanding cultural differences between the organization and BPO partner

The initiation and implementation of a BPO project also requires attention to technology issues such as:

- Compatibility of systems between the BPO buyer and vendor
- Data and system security
- Backup and recovery procedures in the case of system failure

- Data interface challenges and strategies
- Software and database compatibility challenges
- Data and knowledge management

These various issues will be discussed at some length in Chapter 6.

## **D**Driving Factors

Scholars who study how complex systems change over time are familiar with two types of change:

1. *Evolutionary*, which are changes a system is likely to produce based on its current design and goals
2. *Emergent*, which are system features or capabilities that would not have been predicted in advance based on the understood design and goals of the system.

BPO is revolutionary because it is such an emergent phenomenon and because there is no evidence that anyone set out to design the potential for organizations to use BPO. It grew from a set of driving factors, illustrated in Exhibit 1.2, that have unintentionally converged at this particular time to enable the shifting of work to its lowest-cost/highest-quality provider regardless of the provider's physical location. BPO is a business innovation that leverages these driving factors and applies them to practical business problems.

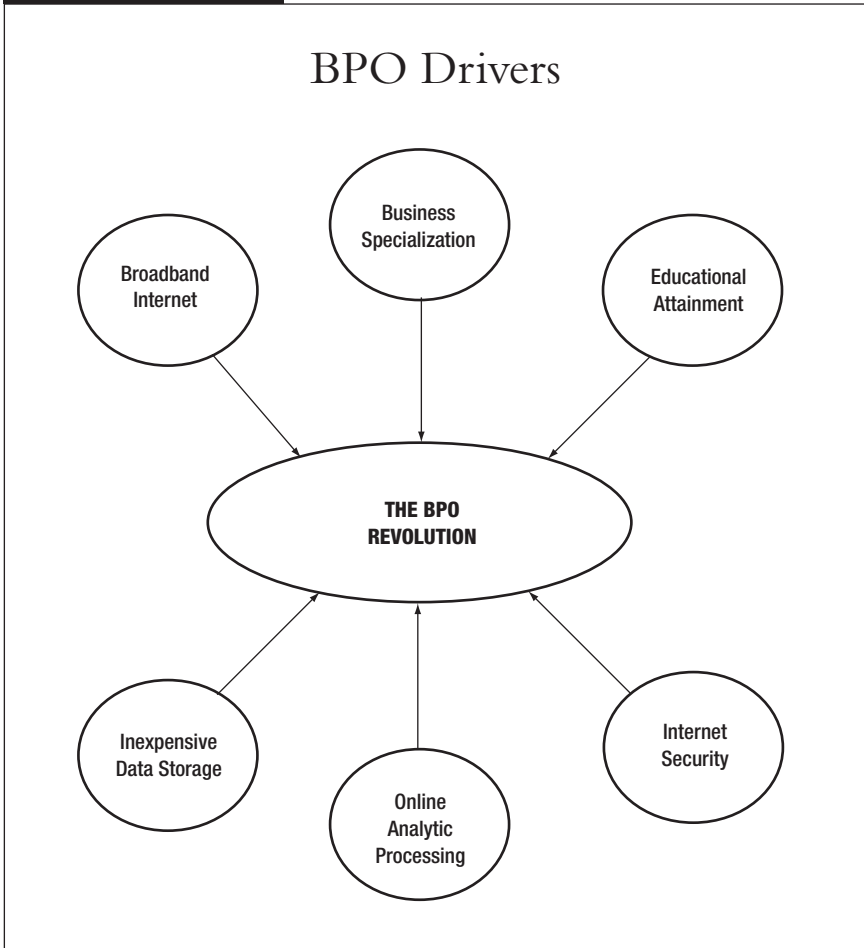
A discussion of each of these drivers follows.

### **Educational Attainment**

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The United States remains the global leader in higher education, but the rest of the world is catching up quickly. As more and more Ph.D.-qualified faculty return to their home countries with degrees from Harvard, MIT, Stanford, and other prestigious schools, they are helping to

**EXHIBIT 1.2**

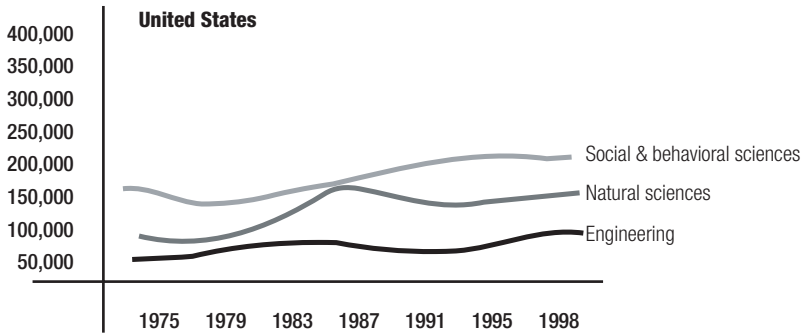


transform higher education worldwide. At the K–12 level, it has long been noted that the United States lags other countries, especially in technical areas such as math and science as measured by standardized test scores. The gap between the United States and many foreign nations has increased over time in technical education, which now also translates into fewer U.S. students seeking degrees in technical fields. In Asia, for example, far more students are pursuing science and engineering disciplines at the collegiate level than are their counterparts in the United States (Exhibit 1.3). Clearly,

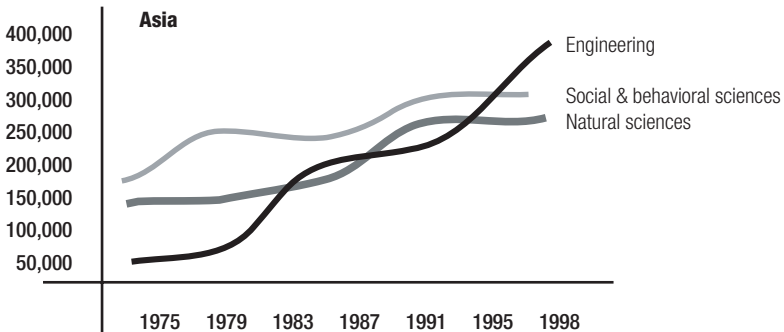
**EXHIBIT 1.3**

## Comparison of Asian and U.S. Technical Education

**Bachelor's S&E Degrees in the United States and Selected Asian Countries and Economies by Field (1975–1988)**



Natural sciences include physics, chemistry, astronomy, biology, earth, atmospheric, ocean, agricultural, as well as mathematics and computer science.



Asian countries and economies include: China, India, Japan, South Korea, and Taiwan. Data for China is included after 1983.

Source: Science and Engineering Indicators—2002.

they recognize that the business world increasingly appreciates and utilizes their new abilities.

Of the nearly 590,000 foreign students enrolled in U.S. higher education in 2002, more than 20 percent came from India or China. Ironically, the United States is not only relocating its coveted technical jobs to these foreign locations, but also preparing many of the workers who fill those jobs. The following list provides some sobering statistics on technical education worldwide that indicates why so many U.S. firms are looking abroad for the talent they need to be competitive:

- In 2001, 46 percent of Chinese students graduated with engineering degrees; in the United States, that number was 5 percent.
- Europe graduates three times as many engineering students as the United States; Asia graduates five times as many.
- In 2003, less than 2 percent of U.S. high school graduates went on to pursue an engineering degree.
- In 2001, almost 60 percent of those earning Ph.D.s in electrical engineering in the United States were foreign born.
- Among the more than 1.1 million seniors in the class of 2002 who took the ACT college entrance exam, fewer than 6 percent planned to study engineering, down from 9 percent in 1992.
- Less than 15 percent of U.S. students have the math and science prerequisites to participate in the new global high-tech economy.
- In the United States, more students are getting degrees in parks and recreation management than in electrical engineering.<sup>6</sup>

It now makes sense for U.S. firms to rely on foreign providers of highly skilled labor. The logic is simple: The quality of talent is high and the cost is low. Educational attainment around the world will drive BPO innovators to seek new ways to tap that talent. There is no way to put



that genie back into the bottle. It would be foolhardy to the point of malfeasance for managers not to seek and use the best available talent that fits the organization's budget—wherever that talent may reside.

## **Broadband Internet**

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In fall 2003, *The Wall Street Journal* published its annual report on telecommunications. In the front-page article, the *Journal* writer stated, "After years of hype and false starts we can finally declare it: The Age of Broadband is here."<sup>7</sup> The article reports that by the end of 2003, 21 percent of all U.S. households will have broadband Internet, and that number increases to about 50 percent by 2008. It is also expected that more than 7 million businesses will have broadband connectivity in the United States by the end of 2003.

*Broadband* refers to the growing pipeline capacity of the Internet, allowing larger chunks of information to flow with fewer congestion issues. The term is generally applied to Internet connectivity speeds that are in the range of 2 megabits/second (2 million bits/second). Leading semiconductor maker Intel has predicted that by 2010 there will be 1.5 billion computers with broadband connections.<sup>8</sup> High-speed Internet access is becoming commonplace in regions where dial-up was once the only option. With broadband, workers in different countries can share data—an important factor in BPO—while consumers can surf the Web for the latest bargains.<sup>9</sup>

Growth in broadband connectivity is largest in regions where deployment is still scattered: Latin America (up 63 percent to 619,000); South and Southeast Asia (up 124 percent to 1.12 million); and the Middle East and Africa (up 123 percent to 107,000). The Asia-Pacific region is the runaway regional leader, with nearly 11 million digital subscriber line (DSL) users, followed by North America with 6.5 million and western Europe with 6.3 million. Eastern Europe has the lowest level of broadband connectivity, with barely 70,000 DSL users. In relatively