

GLOBAL OUTSOURCING OF SERVICE OPERATIONS: CHALLENGES AND IMPLICATIONS FOR INNOVATION

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ABSTRACT

Firms have to keep innovating in all aspects of their operations in order to transform outdated business processes. The impact of service offshoring on innovative capabilities needs to be considered. This paper outlines the objective of an empirical research project which seeks to contribute to the understanding of the relationships between outsourcing operations overseas, stimulating innovation in service organizations, and the building of long-standing competitive advantage in service companies.

INTRODUCTION

Outsourcing service operations to overseas destinations has been perceived for the last fifteen years as an opportunity to reduce operating costs, while also compensating for high employee turnover and labor shortfalls at certain skill levels. Labor stands as only one aspect of the total cost of offshoring. Overall savings might prove to be significantly lower than what salary differentials suggest. The effects of globalization in sectors such as financial service and insurance, telecommunication services, and information technology services have dramatically increased the intensity of outsourcing in recent years.

GLOBAL OUTSOURCING OF SERVICE OPERATIONS

Service organizations are using relatively new approaches to manage their operations. These include the following: a) de-localization of back-office activities, as well as externalization of support functions; b) outsourcing of knowledge-based services and activities, such as strategic project management; c) international distribution of services via the internet, even more often with the mobilization of “intelligent agent” technologies; d) exploitation of the customer-service support potential of suppliers and sub-suppliers, in terms of the intangible, yet highly valuable, content of the services they are in position to offer. In the extended paper, the authors focus on the issues regarding the relationships between outsourcing operations and preserving, if not stimulating, the innovative capability of the service firm.

The Challenge of Innovation in Global Services Outsourcing

Opinions regarding the risks and rewards in outsourcing are still diverging while there being no definite directions in reality. It has been found that the majority of the service jobs relocated no longer require highly qualified skills. They include mainly paper-based back-office tasks that can be digitised and telecommunicated anywhere around the world, as well as more routine telephone inquiries that are increasingly being bundled together into call centers [1].

American industry leads in this global service outsourcing with an estimated 70 percent of all offshoring business, immediately followed by the United Kingdom. Despite multiple attempts in this activity by

French, German and Japanese firms, “offshoring” service operations have tended to be confined to the English-speaking countries mainly. This situation is gradually changing over time. A few Japanese companies have shifted operations to North-east China where Japanese is spoken. Bain & Co forecasts that the market for offshoring activities in Russia and India will grow by 45 percent and 57 percent by 2006 respectively [2].

While cost savings continue to be the dominant motivation for the transition to global sourcing models, other important factors are emerging, such as improved quality and increased flexibility. Increasingly, people skills and availability are not the primary factors that influence offshoring decisions. A country’s financial structure and business climate are important considerations. The attractiveness of a country can be influenced by compensation costs, infrastructure costs, taxes and regulatory considerations. Firms may also seek a friendly business environment that encourages investment.

Leveraging Overseas Service Units as a Source of Innovation

Managers are currently discovering the virtue of applying lean production and operations automation to service activities [3]. Some of them already work at establishing sets of strategic objectives for their service production sites. While currently working toward massive relocation of large parts of service production systems, firms now have the responsibility to clearly define the role of the new sites they are opening or outsourcing overseas.

In the manufacturing environment, Ferdows [4] identified six individual profiles as strategic roles in foreign factories. These included: a) the “Offshore factory” established to produce specific items at a low cost; b) the “Source factory” still focusing on low cost production but with a broader strategic role; c) the “Server factory” supplying specific national markets; d) the “Contributor factory” also serving specific market, but with responsibilities extending to product and process design; e) the “Outpost factory”, placed in an area where advanced customers, competitor, or research laboratories are located, and primarily collecting information; and finally, f) the “Lead factory” creating new processes, products, and technologies for the entire company.

Analyses show that comparable strategic roles might be assigned to service production sites relocated out of the firm’s original country. It is possible to define sets of requirements associated with the anticipated location for each possible type of service site, and this stands as a possible topic for further development in the current research program. Refer to Table 1 for the definition of the strategic role of international service units, and Table 2 for examples of production units in existing service networks.

Several factors could upset offshoring operations. The high demand for these services offshore could result in the erosion of price advantage and therefore increasing costs. Another is the lack of awareness of offshoring brands among software offshorers. Remote management and the execution of a global development model still remains a difficulty for many software companies. Other concerns have been difficult office space acquisition, intellectual property theft, communication and some dissatisfaction with the offshore vendor’s performance (e.g., the lack of initiative, risk taking and training).

Despite these factors there is a general optimism about the future with increased adoption and sophistication in offshoring, some of the trends that companies see an added benefit include the following: leveraging and expanding offshore capabilities; emergence of regional centres of expertise; increasing importance of domain expertise; and the rise of multi-lateral business and global sourcing. Workforce flexibility, faster time-to-market and gaining additional skills have also become common reasons for leveraging overseas service units. There is also the maturing of the vendor selection process.

Talented resources, scalability, flexible costs, ready infrastructure, and development experience are still counted as the benefits and relevant domain expertise than they were in the early years. At the same time, the importance of vendors having the lowest costs and parent company presence have declined significantly with maturing offshoring setups becoming a source of innovation.

Table 1. Strategic Role of Production Units in International Service Networks

Type of service production unit	Characteristics and expected benefits	Requirements regarding its location
Offshore service facility	Producing specific service operations at low cost, Investment and managerial resources kept at the minimum level, International coordination is simple and beyond the control of the site	Qualified workforce at low cost, Decent infrastructure, Possible language skills
Source service facility	Still low cost production, but with broader authority over service design, supply and sub-contractors, Ability to produce a service as the best site in the firm's global network	Low cost service producing environment, Infrastructure relatively developed, Well qualified workforce available with ability to develop skills over time
Server service unit	Serving specific regional market, Way to overcome distance barrier, Authority and competence over service and process design still limited	Significant regional market opportunity
Contributor service unit	Also serving specific market, but with broader responsibility over design, development and choice of sub-contractors, The unit may complete with home site to be the testing ground for new service/process	Active and demanding regional market
Lead service center	Creating new services, processes and developing technologies for the entire company, Collects data and transform knowledge into innovative service solutions	Stimulating market and research environment

Table 2. Examples of Production Units in Existing Global Service Network

Type of service production unit	Example of companies	Example of offshored functions
Offshore service facility	HSBC Wanadoo Lufthansa British Airways AOL	Call centers in India, China, etc. Call center in Tunisia Accounting center for Europe in Poland Mumbai, reservation and processing E-mail management in Philippines
Source service facility	Delta Airlines GE Capital (first step in 1997) McKinsey American Express DHL	From Call center, to RH management, to accounting in India 270 different service operations in India Analysts in India Relocated software development in India Cy's European IT overseeing in Prague
Server service unit	Citigroup (first step in 1998) PACT	Call center for Indian domestic market Development center in Manila for Asia
Contributor service unit	Citigroup (second step in 2002) Cap Gemini EY	Call center in Mumbai for overseas Business processes in Guangzhou, China

References will be provided on request.