Offshoring and Offshoring Satisfaction Study

Offshoring and the Impact on Customer Satisfaction

While firms are increasingly offshoring front office functions such as customer service and back office functions such as IT, there is limited work on the implications of offshoring for consumers. This research addresses these implications by considering the relationship between offshoring and customer satisfaction. Customer satisfaction, expressed through the American Customer Satisfaction Index™ (ACSI), is an important indicator of firm performance. Higher ACSI scores have been linked to higher firm profitability, shareholder value and risk-adjusted stock returns.

We analyzed longitudinal data of 154 North American firms and business units from 2003 – 2007, and find that offshoring front office functions is associated with a decrease in customer satisfaction, and offshoring back office functions is associated with an increase in customer satisfaction. Additional analysis shows that front office offshoring is associated with a decrease in each of the primary determinants of customer satisfaction – perceived quality, perceived value and customer expectations. Back office offshoring is associated with an increase in perceived quality and customer expectations. Our findings suggest that in addition to considering whether or not to offshore, firms must carefully evaluate which functions are suitable for offshoring. The finding that neither front nor back office offshoring are associated with an increase in perceived value suggests that firms may be reducing their costs by offshoring, but are not passing the value to consumers.

Introduction

Firms are increasingly offshoring front office functions such as customer service call centers and back office functions such as IT to manage their operations and achieve their strategic objectives. While cost is the primary motivation for firms to pursue offshoring, recent research suggests that firms may achieve both cost and quality benefits through offshoring. However, there has been limited research on implications for consumers, despite the fact that customers interact directly with offshore call centers and customer satisfaction is an important indicator of firm performance.

We suggest that offshoring may have negative implications for North American consumers; citing examples of some firms that initially offshored customer service functions and then subsequently brought part of the work back to North America. Consumers may be aware of these reports, along with other coverage that highlights negative implications of offshoring for U.S. job and salary growth. Despite the potential for consumers to formulate negative perceptions of firms that offshore, North American firms are increasing their level of offshoring presumably because they want to maximize firm performance measures such as customer satisfaction.
This paper addresses these implications by considering the relationship between offshoring and customer satisfaction. We build on the information systems and marketing literature to identify the relevant considerations for how offshoring may impact customer satisfaction and its underlying determinants, and test empirical relationships using data on North American firms and business units from 2003 – 2007. We find that offshoring front office customer service functions is associated with a decrease in customer satisfaction, and offshoring back office functions is associated with an increase in customer satisfaction. Additional analysis shows that front office offshoring is associated with a decrease in each of the primary determinants of customer satisfaction – perceived quality, perceived value and customer expectations. Back office offshoring is associated with an increase in two of the three primary determinants of customer satisfaction – perceived value and customer expectations.

Offshoring vs. Onshore Business Satisfaction

A Range of Issues Holds Back Development

Despite the investments that firms have made, we believe that the broad adoption of a full peer-to-peer global delivery model is still three to five years away. With the exception of language intensive BPO tasks, only 5% to 8% of the IT-centric projects executed today are done across multiple back-end locations.

A number of factors combine to slow the Global Deliver Model adoption:

- **Rising attrition, wage inflation, and skill shortages in India.** The combination of the Managed Network Center IT services companies setting up shop, the explosion in captive centers, and the increasing complexity of work has dramatically recast the labor market in India. Attrition rates have almost doubled, especially in the more experienced technical ranks and middle manager level. And wage inflation in the mid-tier technical band is reported to be running as high as 20%. Wage inflation, once only an issue for staff with three to 10 years experience, is now being felt even at the entry level. Not only does this make it harder for suppliers to deliver consistently, it leaves clients questioning the long-term economic benefit of their main GDM operations center.

- **Limited options in terms of alternative geographies.** To combat the pressure in India, suppliers have turned their sights to other destinations like China, Vietnam, and Argentina with mixed results. A variety of issues — from lack of scale in the case of Malaysia or Chile to high telecom costs for South Africa or Vietnam to IP concerns haunting China — undermine the ability of these countries to serve as a GDM pressure release valve for India.

- **Increased geographical complexity that stresses developing GDM processes.** The growth in locations also stresses the methodologies and practices of suppliers. The addition of a third location raises the difficulty exponentially. The MNCs already struggle with front-end-versus back-end finger-pointing issues, and the Indian companies are ramping up to deal with non-English-speaking employees.
Quality Advantage and Value for the Money are Diminishing

Comparison of offshore providers with large onshore services firms concerning quality of deliverables –

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Comparison of offshore providers with large onshore services firms in regard to value for money –

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Comparison of offshore providers with large onshore services firms in regard to on time delivery –

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Summary

Companies are beginning to realize that there are plenty of cases in which outsourcing or offshoring are not the best business strategies—even when it comes to manufacturing, a realm that's generally considered well suited to these practices.

We recommend to clients; “Never outsource what you don’t fully understand yourself”, and “Never outsource mission critical functions”. These two factors are key points on why outsourcing and offshoring may not be the best approach.

There are three sets of issues, each of which leads to individually compelling arguments against out-sourcing anything critical:

- At the top of the list are the control and flexibility issues.
  Doing it yourself may seem to cost more, but when you want something done, you can usually get it done with a minimum of hassle and incremental cost.

- Second on the list, particularly in the United States, are the responsibility, liability and trust issues.
  If your outsourcer has ever had to admit a data loss (something that's true of all the major players) you've had the warning needed to know that their procedures are inadequate.

- And third on the list are the competitive advantage issues.
  There is no competitive advantage in using the same software, the same methods, and interchangeably the same people as your competitors.

Look at all three sets of issues and two commonalities should stand out:

- Outsourcing fundamentally depends on a failure to differentiate: if either your needs or your IT group’s ability to meet those needs, are indistinguishable from those of your competitors and there are advantages to scale, then outsourcing can provide overall financial benefits because the outsourcer basically acts as a kind of industry co-op; and,

- Insourcing, or doing it yourself, is always a bet on your IT vision and delivery being better than the industry average. In other words, out-sourcing has a downwards averaging effect across the outsourcer’s customer base.

Think about this a bit and it should be obvious that outsourcing can never be a competitive strategy, only a cost-cutting one. Thus for IT outsourcing to make sense, two things must be true; your industry must be stagnant with your operation indistinguishable from everyone else’s and all the IT staff involved, your own and that of the outsourcer, must be drawn from the same pool, use the same tools, and value their loyalty and commitment to whatever technical ideology dominates that labor pool significantly above their loyalty and commitment to you.
Commentary

- With the dollar's decline and the growing affluence abroad, it's getting cheaper and cheaper to do the work domestically -- which might spell the end of Indian outsourcing.

- "Assuming a 15% year-to-year salary hike rate, and a 2007 cost advantage of 1:3 in favor of India, if U.S. wages remain constant, India’s cost advantage disappears by 2015.

- While there will always be international labor arbitrage, the U.S. may be in the early stages of seeing some of the business it’s lost to overseas providers the past couple of years come back to it.

Can you imagine Silicon Valley cheaper than Bangalore?