

# ***International Services Outsourcing: Service Characteristics Strategic Implications***

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## **Abstract**

The process and dynamics of international services outsourcing is basically a microeconomic process that depends on strategic decisions adopted at the firm level. Therefore, it is theorized that effective services management for global marketing, outsourcing or offshoring requires a deep understanding and comprehension of its unique characteristics and subsequent strategic challenges. This paper provides a conceptual overview of services characteristics and its relation to the dynamics and process of international outsourcing. The purpose of this research was the development of a conceptual managerial framework of service unique characteristics (intangibility, heterogeneity, perishability and inseparability) and its strategic implications for the management of offshore outsourced services. Propositions and recommendations with valuable managerial insights are offered for further research.

**Key words:** Internationalization of service firms, Service Outsourcing, Service Offshoring, Service characteristics, International services marketing

## **Introduction**

Services outsourcing refers to the delegation of service activities to a third party, either onshore, or near shore, or offshore (Chanda 2008). Global or international outsourcing of services refers specifically to offshoring of services or the delegation of service activities to another country (Chanda, 2008; Winkler, 2010).

A decade ago, most services were considered non-tradable, but the emergence and development of new information communication technologies (ICT's) has made many services tradable (Winkler 2010). The liberalization of international services trade has further accelerated this process. Offshoring of services appears to be much faster and less costly compared to offshoring of manufactured goods, as neither large factory buildings nor assembly lines are needed (Winkler 2010). The services more likely to be outsourced are business services, computer and information services, professional services, training and education, financial services, health related services, and audiovisual and cultural services (UNCTAD 2004).

The motives behind an offshoring decision can be mainly market-oriented, cost-oriented or procurement –oriented (Winkler 2010). However, the main factor that drives global outsourcing of services is the availability of skilled and low-cost labor (Chanda, 2008). The distinguishing feature of the international outsourcing of services is that it goes far beyond the service sector and affects business processes regardless of sector (Stare and Rubalcaba 2009).

A recent research study on services outsourcing (Tate and Ellram 2006) showed that more organizations outsource services than those that outsource direct or indirect materials. Global outsourcing of services has grown in importance in recent years (Winkler, 2010). Services outsourcing has been growing at an annual compounded rate of 32% between 1998 and 2003. Business process outsourcing services (BPO) is the fastest growing segment. Global demand for information technology services and BPO reached over a billion dollars by 2007. Estimates of

indicated that this industry created over a million service jobs worldwide by 2007. Among the source economies, the US is the main market and more than 50% of the top 500 US companies outsource one or more business processes to external service providers. Europe, Asia, Africa, Japan and Canada among other countries account for the remainder of the market (Chanda 2008).

Services outsourcing is expected to expand in the future and even to become more pervasive. Nevertheless, popularity does not guarantee good results. The outcome of services outsourcing is mixed (Baitheimy 2003). According to a report in June 2005, the number of buyers prematurely terminating an outsourcing relationship has doubled to 51 percent while the number of buyers satisfied with their providers has "plummeted from 79 percent to 62 percent" (Li and Choi, 2009 citing Weakland 2005, p. 2). Therefore, as stated by Li and Choi (2009, p. 27) it is reasonable to ask: "Why have there been so many failed attempts in services outsourcing? The existing literature in services outsourcing has focused on two key questions -- "should we outsource" and "what to outsource."... But "a careful examination reveals a serious omission. The question of how to manage the process of services outsourcing is missing". Based on this line of reasoning this paper theorizes that effective services management for local marketing, global marketing, outsourcing or offshoring requires a deep understanding and comprehension of its unique characteristics since they introduce strategic managerial challenges that need to be considered.

Marketing management activities in the service sector have historically been distinguished from those in the manufacturing sector on at least five generic differences: intangibility, inseparability, heterogeneity, perishability, and lack of ownership (Clemes, Mollenkopf and Biurn 2000).

1. Intangibility is the dominant characteristic of services because it is often not possible to feel, see, taste or smell a service, as services are an experience or a performance and not a physical object. Although most services include some type of tangible element, the service performance itself is basically an intangible and is often mentally difficult to grasp.
2. Inseparability means that services are produced and consumed at the same time. Therefore, it is often difficult to separate the provider of the service from the service itself. In addition, it means that customers interact with the service provider during the process of delivery.
3. Heterogeneity refers to the difficulty in achieving a standardized output in people-based performances.
4. The fourth defining characteristic of services is perishability. Services are performances and if they are not sold today, they cannot be saved or stored for a sale tomorrow.
5. Lack of ownership in services refers to the situation that customers only have access to, or use of, a facility where a service is performed. Payment for the service is for access only, and no tangible ownership results from the exchange.

Services marketing academics have recurrently argued that a number of implications arise from the distinguishing characteristics of services, principally, that the characteristics cause a number

of marketing problems for service marketers that are not encountered by marketers of tangible goods (Bateson, 1977; Zeithaml, Parasuraman and Berry, 1985). If these problems are not carefully managed they usually have a negative impact on perceived service quality, which reduces customer retention and organizational profits. The managerial issues that need to be addressed strategically in an integrated manner in services are related to operations, efficiency, productivity, personnel management, capital investment, staffing, distribution, promotion, supply and demand management, pricing, service quality and facility design (Zeithaml et al., 1985). Therefore, a conceptual managerial framework of service unique characteristics (intangibility, heterogeneity, perishability and inseparability) and its strategic implications on the implementation phase will be helpful in providing insights on how to manage the process and dynamics of international services outsourcing for ensuring business continuity and the best reallocation of resources, managing risk, and lowering costs without compromising quality.

## **Literature Review**

### **Offshore/Outsourcing**

Offshoring is one of the most debated topics in international business (Mudambi and Venzin, 2010). It is defined in the popular press as the 'relocation of business processes to foreign countries to take advantage of a supply of skilled but relatively cheap labor. In recent academic literature, offshoring has been defined as 'the transnational relocation or dispersion of . . . activities' (Mudambi and Venzin, 2010 citing Doh, Bunyaratavey and Hahn, 2009).

One stream of academic literature shares the popular perspective that the primary objective of offshoring is cost minimization through the relocation of business processes to low-wage locations (Mudambi and Venzin, 2010 citing Bock, 2008; Farrell, 2005; Grote and Täube, 2007). Another stream of literature views offshoring as a more general location strategy that incorporates cost minimization and knowledge seeking (Mudambi and Venzin, 2010 citing Demirbag and Glaister, 2010; Kedia and Lahiri, 2007; Lewin, Massini and Peeters, 2009; Maskell, Pederson, Peterson and Dick-Nielsen, 2007).

Even though there has been some debate regarding the downward implications of offshore outsourcing, such as the loss of jobs (Tate & Ellram, 2009 citing Drezner, 2004), this practice has been also associated with overall economic benefit in terms of productivity, quality and customer satisfaction (Tate & Ellram, 2009 citing Farrell, 2003). Furthermore, the highly competitive markets resulting from globalization are pushing firms to subcontract activities overseas in order to stay in business. Offshore outsourcing started as a regional practice in the 1960's, but economic liberalization and improvements in the telecommunications sector have made it possible to transfer business functions to other firms located around the world (Agrawal, Goswami & Chatterjee, 2010; Bahrami, 2009).

### **International Outsourcing of Services**

The amount of money that businesses spend on services continues to grow with the increase in outsourcing and offshoring (Ellram, Tate and Billington, 2007). Organizations are increasingly

focusing on the services spend because of the large dollar value and growing importance to the organization. When purchasing materials and components, the supply management department has historically been tasked with negotiating to get the right materials, at the right time, in the right quantity, from the right source, at the right price (Baily, Farmer, Jessop and Jones, 1994). However, the characteristics of services: heterogeneity, intangibility, perishability, and inseparability (for example see Lovelock, 1983) make the purchasing of services more difficult than the purchasing of goods (CAPS Research, 2006). The lack of tangibility makes the specification of the service less precise and more difficult to measure, as there is no physical product to flow through the receiving and inspection process. Simultaneously, the trend towards decreasing the supply base and developing closer, more reliant relationships with the remaining suppliers (Burt, Dobler and Starling, 2003), makes supplier relationships even more strategic. Offshore outsourced service suppliers present an additional level of risk and complexity due to geographic and cultural differences.

The decision to outsource (or buy) must consider the relative cost and risk associated with internal versus external operations (Ellram et al., 2008). The theory of TCE has a number of important premises as it relates to the offshore outsourcing decision, including asset specificity and uncertainty (Williamson, 1985). Offshore outsourcing of services increases uncertainty because the transactions occur in an opportunistic environment where players are limited by their own bounded rationality (Williamson, 1988). There is higher risk in the offshore services

outsourcing environment due to opportunism, investments in transaction specific assets, and the opportunity to hide behaviors.

Service firms usually carry out activities that can be classified into two types: the core service and the supplementary services (Kotabe & Murray, 2004 citing Anderson & Narus, 1995; Carman & Langeard, 1980; Lovelock, 1992). The core service includes those activities that the company must provide and perform well to stay in business, while the supplementary services are those needed to carry out the core service or to improve its quality (Kotabe & Murray, 2004). Therefore, the latter are more likely to be internationalized.

The subcontracting of services internationally is a growing phenomenon, but little research exists in this area (Tate, Ellram, Bals & Hartmann, 2009). However, some scholars are starting to pay attention to the offshore outsourcing of professional services (Sinha et al., 2011 citing Di Gregorio, Akoorie, Ding and Wu, 2009; Ellram, Tate and Billington, 2009), making this an interesting opportunity for research.

Services have one enduring characteristic -- the customer interacts with the service provider during the process of delivery (Gaither and Frazier 1999; Sampson 2001; Sampson and Froehle 2006). For instance, Sampson and Froehle (2006) reviewed the services literature and highlighted this interaction and the role of customer inputs in this interaction. Chase and Aquilano (1977, p.

17) state, "the main feature that sets a service system apart from a manufacturing system is the extent to which the customer must be in direct contact." In this regard, services may be classified as:

1. "Pure services" where "major production is carried out in the presence of the customers" (Chase 1981, p. 701). Pure services emphasize the importance of the real-time interaction that occurs between the service providers and the customers.
2. "Mixed services" which commonly involve a mix of face-to-face contact and loosely coupled back office work" (Chase 1981, p. 701).

Not all services or service functions can be outsourced, due to constraints such as the need for face-to-face contact, regulatory requirements, other legal factors (e.g., professional qualifications), or data security. Until ICT (International Communications Technology) dramatically changed the tradability of services, outsourcing in general and international outsourcing in particular was much more limited. Outsourcing is convenient mostly for information-centered services that can be digitized through ICT, stored, and transmitted worldwide (Stare and Rubalcaba, 2009). At present, the services more likely to be outsourced are business services (e.g., call centers, electronic publishing), computer and information services (e.g., data processing, web content management), professional services (e.g., accounting, architectural services), training and education, financial services, health-related services (e.g.,

diagnosis, medical record management, consultations), and audiovisual and cultural services (e.g., news agency services, animation) (Stare and Rubalcaba, 2009 citing UNCTAD 2004).

Another approach to determine services that can be outsourced accounts for service functions and identifies the following broad groups of business functions in which established outsourcing patterns already exist: software development; data processing and data entry; sales; customer services; creative and content-generating functions, including research, development, and design; financial functions; management; human resources; and training functions (Stare and Rubalcaba, 2009).

The activities/processes that can be internationally outsourced are Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO), and Knowledge Process Outsourcing (KPO) (Nassimbeni, Sartus and Dus, 2010). ITO regards the externalization of processes associated to the technological infrastructure of the client firm (Bhalla et al., 2008; Ghodeswar and Vaidyanathan, 2008) (i.e. software development, web development, help desk). BPO refers to the partial or total outsourcing of support activities (Sen and Shiel, 2006) (i.e. Finance and Accounting, HR). KPO services involves highly complex, knowledge intensive and judgment-based processes (e.g. medical diagnostics, policy administration) (Currie et al., 2008; Sen and Shiel, 2006). Some authors denote that companies usually start with the outsourcing/offshoring of IT functions and continue, if the previous operations are successful, with the outsourcing/offshoring of more complex processes, such as Finance and Accounting (Dossani and

Kenney, 2007; Frost, 2000; Lewin and Peeters, 2006). Estimates on the ITO, BPO and KPO market size indicate that outsourcing and offshoring nowadays represent an increasing phenomenon (Budhwar et al., 2006; Currie et al., 2008; Lacity et al., 2008).

Services outsourcing is more prevalent than ever (Grossman and Helpman 2002; Roth and Menor 2003; Amiti and Wei 2005). A recent CAPS Research study on services outsourcing (Tate and Ellram 2006) showed that more organizations outsource services than those that outsource direct or indirect materials. Services outsourcing is expected to expand in the future -- in the future. However, popularity does not guarantee good results. The outcome of services outsourcing is mixed at best (Baitheimy 2003; Aubert and Croteau 2006). According to Weakland (2005) the number of buyers prematurely terminating an outsourcing relationship has doubled to 51 percent while the number of buyers satisfied with their providers has "plummeted from 79 percent to 62 percent." An example provided to attest this is Dell Inc., which outsourced its technical support for business customers to a supplier in Bangalore, India, in 2001, and not long after, in 2003, moved it back to the United States (InfoTech 2003; Aubert and Croteau 2005). Other companies such as AT&T, Capital One, and J. P. Morgan Chase have also taken their outsourced services functions back in house (Overby 2003, 2005; McLaughlin and Peppard 2006; Pfeffer 2006). In this regard it has been predicted that 60 percent of organizations that have outsourced services functions would see significant numbers of frustrated customers switching to competitors (Chon 2005). A CNN.com columnist (Jeffrey, Pfeffer 2006) stated, "a penny saved, a customer spumed."

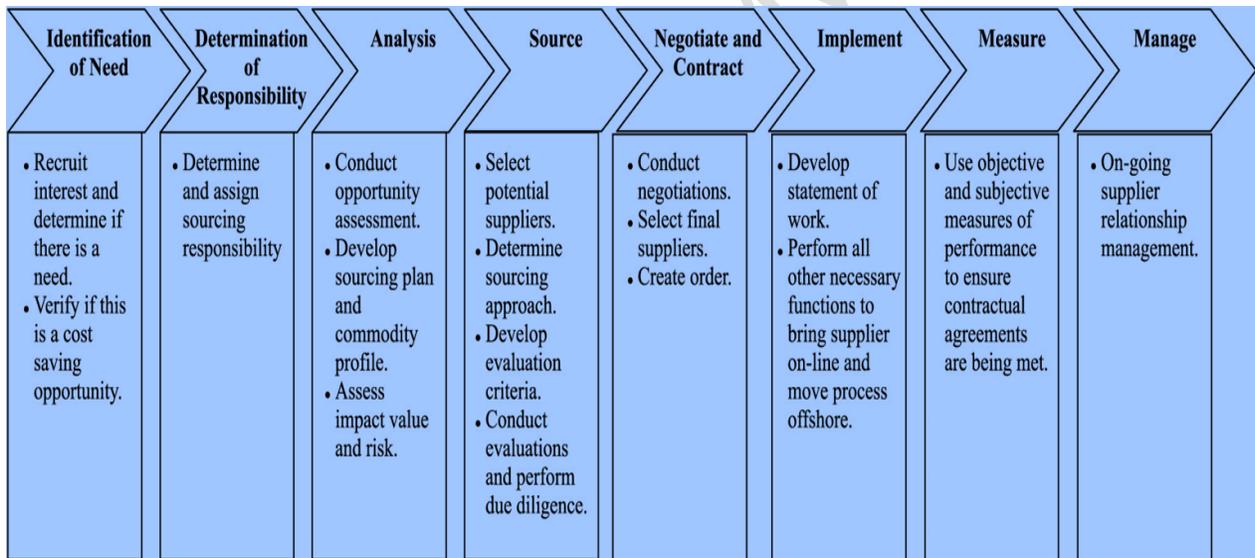
The questions that needs to be addressed by strategists is: Why have there been so many failed attempts in services outsourcing? In spite of this, the existing literature in services outsourcing has focused on two key questions -- "should we outsource" and "what to outsource." The former has generally been addressed by economists interested in the impact of services outsourcing on the national economy (Fixier and Siegel 1999; Amiti and Wei 2004, 2005; Gorg and Hanley 2004). The latter was studied by scholars looking for the key drivers of outsourcing decisions building on transaction cost economics (ICE) (Williamson 1975; lensen and Meckling 1976; Milgrom and Roberts 1992; Lacity and Willcocks 1995; Ang and Straub 1998; Williamson 2008), core competence theory (CCT) (Venkatesan 1992; Quinn and Hilmer 1995; Jennings 2002) or the resource-based view (RBV) (Wernerfelt 1984; Harrigan 1986; Barney 1991, 2001; Jennings 2002). Granting that these scholars have addressed their questions well, a careful examination exposes a serious oversight. The question of how to manage the process of services outsourcing is missing when it is basically a microeconomic process which depends on strategic decisions adopted at the firm level. For which, it is imperative a careful consideration of the service characteristics and its managerial implications from the customers perspective.

### **Conceptual Framework of Services Characteristics and its Managerial Implications for the Implementation of International Outsourced Services**

The proposed model main focus is to provide an answer on how to manage and implement the process of international services outsourcing. The strategic sourcing process consists of a number of formal steps: identification of need, analysis, sourcing, negotiation and contracting,

implementation, measurement and management (Figure 1) (Tate and Ellram, 2009 citing Monczka, Trent and Handfield, 2004, Handfield, Ragatz, Peterson and Monzcka, 1999). As organizations identify a need for the product or service, they typically analyze the purchase and classify it using a portfolio approach. Such an approach is used by both marketing and purchasing departments in strategic decision making to support resource allocation decisions (Olsen and Ellram, 1997).

**Figure 1**  
**Purchasing Process for Offshore Outsourced Services**



Source: Tate and Ellram 2009

The research proponent theorizes that effective services management for global marketing, outsourcing or offshoring requires a deep understanding and comprehension of its unique characteristics since they introduce strategic challenges that need to be considered. The conceptual framework (see Figure 2) synthetizes the literature on services operations and

international services outsourcing in a model linking each characteristics to a type of service quality dimension, managerial issues and tactical activities.

An important part of the implementation phase on the outsourcing process is the transfer of knowledge required to effectively and efficiently satisfy customer inquiries (Tate and Ellram 2009). Since customer satisfaction requires the understanding and appropriate management of service characteristics, the proposed model considers the managerial implications posit by service characteristics of the outsourced services and the tactical activities that may be used to guarantee customer satisfaction.

### Conceptual Framework components

- **Service distinctive characteristic** - Services are more difficult to evaluate due to services distinctive characteristics:
  - Intangibility- Most services are intangible and because they are performances rather than objects, precise manufacturing specifications concerning uniform quality can rarely be set. Services cannot be counted, measured, inventoried, tested, and verified in advance of sale to assure quality.
  - Heterogeneity – Services with a high labor content, are heterogeneous for which their performance often varies from producer to producer, from customer to customer, and from day to day. Consistency of behavior from service personnel is difficult to
  -

- assure because what the firm intends to deliver may be entirely different from what the consumer receives.
- Simultaneity of production and consumption - Production and consumption of many services are inseparable and as a consequence, quality in services is not engineered at the manufacturing plant, then delivered intact to the consumer. In labor intensive services quality occurs during service delivery, usually in an interaction between the client and the contact person from the service firm. In consequence, the service firm may also have less managerial control over quality in services where consumer participation is intense because the client affects the process. In these situations, the consumer's input becomes critical to the quality of service performance.
  - Perishability – Services are performances, therefore if they are not sold today, they cannot be stored or saved for tomorrow.
- **Type of service quality or dimension of service performance** - Service characteristics quality evaluations are not made solely on the outcome of a service; they also involve evaluations of the process of service deliver. In this regard, Gronroos (1982) suggested that two types of service quality exist: technical quality, which involves what the customer is actually receiving from the service, and functional quality, which involves the manner in which the service is delivered (Parasuraman, Zeithaml and Berry 1985 citing Gronroos 1982). Additionally, Lehiinen and Lehtinen's (1982) proposed that service quality is produced in the interaction between a customer and elements in the service organization

and acknowledged three quality dimensions: physical quality, which includes the physical aspects of the service (e.g., equipment or building); corporate quality, which involves the company's image or profile; and interactive quality, which derives from the interaction between contact personnel and customers as well as between some customers and other customers. They further differentiate between the quality associated with the process of service delivery and the quality associated with the outcome of the service (Parasuraman, Zeithaml and Berry 1985 citing Lehiinen and Lehtinen's 1982).

- **Managerial implications and Tactical activities** - The managerial implications and tactical activities presented are the new propositions that need to be further examined to assure customer satisfaction of outsourced services.

**FIGURE 2**  
**Conceptual Framework of Services Characteristics and its Managerial Implications**  
**for the Implementation of International Outsourced Services**

Service characteristics	Service quality dimension	Managerial implications	Tactical activities
Intangibility	Functional	<ul style="list-style-type: none"> <li>Services need to be clearly explained and defined on the elements and symbols that appeal to the culture of customers being served.</li> <li>Services method of communication should be significant and congruent to the company and brand image.</li> </ul>	<ul style="list-style-type: none"> <li>Brand training</li> <li>Product training</li> <li>Corporate image training</li> </ul>
	Corporate		
	Interactive		
Heterogeneity/ Variability	Functional	<ul style="list-style-type: none"> <li>Service quality is a top priority for which standard procedures need to be enforced in which cultural values and expectations of customers served are incorporated.</li> <li>Procedures for customization of service delivery should be provided to appeal customers served.</li> </ul>	<ul style="list-style-type: none"> <li>Establish service standards and procedures for service delivery and for customization.</li> <li>Monitor and supervised human resources procedural fulfillment.</li> <li>Establish rigor and discipline in process.</li> <li>Periodically evaluate customer satisfaction in relation to service delivery.</li> </ul>
	Interactive		
Simultaneity of production and consumption	Functional	<ul style="list-style-type: none"> <li>Customers' interaction with service provider affects perception of quality for which the employee needs extensive training on cultural differences and nuances with the customer serviced.</li> <li>The employee needs to be highly motivated since their participation is determinant of customer satisfaction.</li> <li>Employee recruitment and selection process is crucial since they are the service and are the ones responsible for customer satisfaction.</li> <li>Customers served need to have clear expectations in the service that will be deliver to them.</li> </ul>	<ul style="list-style-type: none"> <li>Careful personnel selection.</li> <li>Conduct cultural gap analysis.</li> <li>Provide cultural training.</li> <li>Provide accent neutralization training.</li> <li>Diligently supervised and monitor service provided.</li> <li>Motivate and reward employee performance.</li> <li>Educate customers on the service that will be deliver.</li> </ul>
	Interactive		
Perishability	Functional	<ul style="list-style-type: none"> <li>Demand and supply of services need to be synchronized to differences on time, season and holidays.</li> </ul>	<ul style="list-style-type: none"> <li>Align service provision to customer demand.</li> <li>Manage customer demand to solicit service on non-peak hours</li> </ul>

### Conceptual Framework propositions

The following are the propositions drawn from the conceptual framework developed for the management of international outsourced services:

**P1** - The service distinctive characteristics (intangibility, heterogeneity, simultaneity of production and consumption, and perishability) affect consumers' satisfaction and perception of quality of offshore outsourced services.

**P2** – The service quality dimensions affected by offshore outsourced services distinctive characteristics are the corporate quality, the functional quality, and the interactive quality. The quality dimensions affected vary by type of service characteristic:

- The level of Intangibility affects corporate, functional and interactive qualities.
- The level of heterogeneity affects functional and interactive qualities
- The degree of simultaneity of production and consumption affects functional and interactive qualities
- The degree of perishability affects functional qualities

**P3** – Offshore outsourced services should manage their level of intangibility to

guarantee customer satisfaction by:

- Clearly explaining and defining the elements and symbols that appeal to the customers culture
- Defining a communication method that is congruent to the company and brand image

**P4** – Offshore outsource services should manage their level of heterogeneity to

guarantee customer satisfaction by:

- Establishing standard procedures that considered consumers' expectations
- Providing procedures for service customization

**P5** – Offshore outsource services should manage their level of simultaneity of production and consumption to guarantee customer satisfaction by:

- Carefully recruiting and selecting personnel
- Motivating and rewarding personnel
- Training personnel on the culture of customers served
- Educating consumers on what to expect of service

**P6** – Offshore outsource services should manage their level of perishability to guarantee customer satisfaction by synchronizing demand and supply to differences on time, season and holidays of countries served.

### **Concluding Remarks**

The purpose of this article was to present a managerial framework of service unique characteristics (intangibility, heterogeneity, perishability and inseparability) and its strategic implications on the purchasing process for offshore outsourced services. The proposed framework provides insights on how to manage the process and dynamics of international services outsourcing.

Even though there has been a rapid growth and scaling up of outsourcing of services it has been affected with stories of failed attempts (Li and Choi, 2009). This paper suggest that a possible cause or explanation of these failures is the lack of understanding of the service characteristics and how to manage them at different steps of the services outsourcing process. As stated by De Groot (2001), even though international services outsourcing has macroeconomic consequences it is basically a microeconomic process that depends on strategic decisions adopted at the firm level. From that perspective, the understanding and appropriate management of service unique characteristics is highly valuable at the implementation step for offshore outsourced services. The inherent

characteristics of services (intangibility, perishability, variability, and inseparability) not found in goods, and its experiential and holistic nature creates unique challenges to managers (Bateson, 1977; Zeithaml, Parasuraman and Berry 1985). Services outsourcing practices are very complex. The framework is only a first step toward considering these challenging issues.

The model provides a conceptual framework in an area where little prior research has been done. It is based on an interpretation of theoretical information consistent with procedures recommended for marketing theory development. The conceptual model and the propositions emerging from it imply a rich agenda for further research. Research is now needed to evaluate the propositions presented and if there are differences across service industries regarding and their impact on quality and customers satisfaction. In addition to offering valuable managerial insights, answers to questions like these may suggest refinements to the proposed model. Research focusing on the relative impact of these factors on consumers' service expectations, within as well as across service categories, will have useful managerial implications.

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