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The Role of Social Capital in Determining BPO Outcome

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Abstract

Organizations are pursuing the outsourcing of business processes (BPO) to offshore locations. This research applies social capital theory to study the benefits of social capital resources on knowledge sharing process capabilities in an offshore BPO relationship. The research framework is based on the resource based view of a firm where knowledge processes are the capabilities, social capital is the resource and the BPO costs are the outcome. The study posits that the benefits of creating social capital translate to improved knowledge process capabilities, which result in a better BPO outcome as measured using vulnerability, coordination and production costs from coordination theory. Moreover, the social capital resource is also postulated to have a moderating effect in the relationship between knowledge process capabilities and the BPO outcome.

INTRODUCTION

The concept of transferring the operational ownership and execution of one or more business processes to a foreign location such as India or China, is referred to as offshore Business Process Outsourcing (BPO). Offshore outsourcing allows domestic firms to tap into large pools of educated workers at significantly lower labor costs. Additionally, client firms benefit by getting access to large markets for products and services in the foreign countries. However, actual outsourcing case studies indicate that many organizational goals remain unfulfilled. Lacity and Willcocks (1998) reported that only 54% of the outsourcing agreements that they surveyed realized cost savings. While the risks and challenges are significant in an offshore outsourcing relationship, management practices can play a major role to improve the effectiveness of these arrangements (Willcocks, Lacity, and Kern, 1999). A study of knowledge management practices in IT outsourcing by Willcocks, Hindle, Feeny and Lacity (2004) indicated the importance of social capital in outsourcing relationships. Indeed outsourcing success is significantly linked to factors that fall beyond the written contract between the client and vendor (Koh, Ang and Straub, 2004). These include transfer of tacit knowledge and the development of relationship/social capital in the form of human obligations within the outsourcing teams. Complex business obligations can never be completely
written up. Koh, Ang and Straub (2004) stress the need to have psychological contracts that can drive the behavior of vendor personnel. The focus should be placed on the individual rather than at the client-vendor organizational level. This individual focus is consistent with the working of knowledge processes in professional organizations such as technical support and healthcare (Ghosh and Scott, 2005a). This research poses the following question: Can social capital in the BPO relationship improve the knowledge sharing processes and improve the BPO outcome?

THEORETICAL BACKGROUND

Social capital theory (SCT) is centrally concerned with the significance of relationships, or social capital on the effectiveness of the knowledge management in the organization (Nahapiet and Ghoshal, 1998). This theory argues that effective knowledge combination, exchange and transfer occur when sufficient social capital is present in the inter-organizational relationship. Nahapiet and Ghoshal (1998) define social capital as “the sum of the actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit”. Social capital thus comprises both the network and the assets that may be mobilized through that network. In a large empirical study of public organizations in Singapore, components of social capital such as organizational norms and structure were found to moderate the usage of electronic knowledge repositories in sharing knowledge (Kankanhalli, Tan and Wei, 2005). Social capital has also been found to be an important component in the successful adoption and use of knowledge management systems (Wasko and Faraj, 2005). Given the above results, it is clear that social capital (i.e., the relationship between the client and vendor personnel) is a key concept in BPO arrangements that need to be explored further.

RESEARCH MODEL AND HYPOTHESES

This research proposal is based on the resource based framework of the firm and views the social capital as the firm’s resource, which impacts the firm’s knowledge process capabilities and together impacts the firm’s outcome (Wade and Hulland, 2004). The research model is presented in Figure 1. Ko, Kirsch and King (2005) found the impact of several relationship components on the effective sharing of knowledge in inter firm relationships. They identified common social capital factors such as shared understanding that impacts knowledge transfer. Knowledge sharing is more likely when social relationships
are strong (Szulanski, 2000). Social capital also allows strategic networks to be built that facilitate knowledge sharing (Gulati, Nohria and Zaheer, 2000). These arguments support hypothesis 1, below.

**H1 - The higher the social capital resource, the higher will be the knowledge process capabilities in the BPO organization.**

Coordination theory offers a vehicle to study the impact of BPO on organizations through business processes (Malone, 1987, Ghosh and Scott, 2006). There are three kinds of costs associated with coordination theory: (a) Production costs include the “transaction” costs of running the outsourced processes, (b) Coordination costs are the “management” costs to manage the process and (c) Vulnerability costs are the “strategic” costs associated with a delayed response to a changed market situation. Knowledge processes reduce the efforts involved with coordination of BPO activities (Ghosh and Scott, 2005b). Productions costs related to the operation of the process that is outsourced are also lowered with the increase in knowledge transfer since improved performance is to be expected from the vendor as they become more knowledgeable. Creating opportunities for knowledge sharing also results in more informal exchanges of information among personnel effectively reducing coordination costs (Ghoshal, et al., 1994). Typical outsourcing arrangements are usually set up to have a loose relationship between the firms, which can hamper the information flow and cause the typical BPO client to be vulnerable to market changes (Lacity and Willcocks, 1998). However, with an increase in knowledge sharing, the vulnerability costs will also be lowered. Therefore the impact of increasing the knowledge sharing in the BPO relationship is to reduce all three costs, which lowers the total BPO outcome costs, leading to hypothesis 2.

**H2 - The higher the knowledge process capabilities, the lower will be the BPO outcome costs.**

The Resource-based view of the firm links the performance of the organization to resources and skills that are firm specific and difficult to imitate or substitute (Barney, 1991). Grant (1991) also distinguishes between resources and capabilities – where resources are the tangible or intangible assets that can be used
to build capabilities, which are abilities of the firm to perform some work. Case studies using the resource based view have established that the resources of the firm must be paired with the firm’s capabilities to impact the firm’s outcomes (Mata, et al, 1995). Hence the “Knowledge Process Capabilities” construct (a Capability) has a feedback relationship together with the social capital resource (a Resource) and their interaction can affect the BPO Outcome (an Outcome), leading to hypothesis 3:

**H3 - Greater social capital resource in conjunction with higher knowledge process capability are associated with lower BPO outcome costs.**

**METHODOLOGY**

The methodology will involve a survey to collect data from the client organization at the knowledge worker level. The survey will measure the existence of the components of social capital – pro sharing norms, identification and generalized trust; the knowledge sharing processes that take place between the two organizations and the BPO outcome costs. The quantitative data that is collected from the surveys will be analyzed to test the hypotheses using structural equation modeling (SEM) with PLS graph.

**Study and Control Variables**

Items for the constructs have been adopted from prior research studies to measure the three second order constructs – Knowledge Process Capabilities (Gold, et. al, 2001), Social Capital (Kankanhalli, Tan and Wei, 2005) and BPO Outcome Costs (Ghosh and Scott, 2006). Items will be scored on a 5 point Liekert scale.

The strategy and organizational profile of the client as well as the characteristics of the candidate processes determine the success of the BPO (Ghosh and Scott, 2006). Centralized processes can fare better when outsourced (Malone, 1987). Likewise, firms with more mechanistic cultures can be better outsourcing candidates. Therefore, control variables included in the study will measure the organizational profile, strategic profile and process profile of the client and vendor and the candidate process.

**CONTRIBUTIONS**

The novel contributions of this study include: (1) Modeling and measuring the social capital construct for an offshore BPO, (2) Developing and validating a measure of BPO outcome based on coordination theory, and (3) Studying the role of the social capital on the knowledge process capabilities and the BPO outcome.
REFERENCES