BUSINESS PROCESS OUTSOURCING STRATEGY AND COMPETITIVE ADVANTAGE IN COMMERCIAL BANKS IN KENYA

By:

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DECLARATION

This project is my original work and has not been submitted for a degree to any other University.

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MUGI JOSEPH KARANJA **DATE**

This project has been submitted for examination with my approval as University supervisor.

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DEDICATION

This project is dedicated to my wife Lucy Kabura, my mother Mary Nyambura for the prayers and encouragement, also my children Caroline, Cindy and Christine for being an inspiration to me.

May the Lord, God Almighty bless you abundantly.

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ABSTRACT

The purpose of this study was to investigate the effect of business process outsourcing strategy and competitive advantage in commercial banks in Kenya. Specifically, the study sought to fulfill the following objectives: To establish the services outsourced by commercial banks in Kenya; To determine competitive advantages gained by commercial banks in Kenya through engaging in business process outsourcing and; To establish the challenges faced by commercial banks in Kenya in business process outsourcing. This study was justified by the fact that outsourcing has become a vital element of the business strategies of many organizations. Increasingly, organizations have been looking beyond the traditional boundaries of the firm to reduce costs and improve performance.

This research problem was studied through the use of a descriptive survey design. The survey was cross sectional in nature since it covered all 43 commercial banks in Kenya. The research employed a census method due to the small size of the population which did not validate sampling. All the 43 commercial banks were included as study subjects. The study used both primary and secondary data. Primary data was collected using semi-structured questionnaires to CEOs. The data and information obtained through the questionnaires was first checked for completeness and consistency and then analyzed based on descriptive statistics. These were then presented using tables, pie charts and bar graphs for easier interpretation.

Findings indicate that commercial banking sector has adopted business process outsourcing albeit on a low level. There have been various competitive advantages arising from this practice which include efficiency, better service and focus on core processes. Major challenges from business process outsourcing include information privacy, poor employee morale, and lack of reliability of some service providers.

Other major challenges include poor knowledge retention by suppliers which leads to slow learning, hidden costs which become evident after the contract has commenced, information security and privacy issues and high transaction costs which even surpass the costs of providing the costs in-house.

Recommendation made include the following. BPO industry requires some policy and regulations to streamline it since it is in its infancy. However, BPO vendors will have to use business rules to expose the key decision-points within their processes whether or not they provide transparency in a more general case. Companies simply have their own way of doing business and even in a standard process there will be variation in decision-making that needs to be imposed by the client on the outsourcer. The industry can also adopt the use of business rules management systems which would allow the outsourcer to expose these decisions to each of their clients while still running a standard, and black-box, process. BPO Best Practices should include choosing a vendor that's leveraging technology effectively and asking for visibility into the vendor's processes and platforms.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Due to increasing global competition and declining profit margins, most corporations are pursuing different operations strategies to keep market share and improve profits. A competitive enterprise must satisfy their customers by improving service speed, flexibility and response capability within the changing environment. The Great Race in the business environment has been heating up for years. This "reality" drama has players seeing increased challenges ahead from rising interest rates, ever changing product offerings, consumer demands and intense competition from mega originators and servicers (Shekell, 2010). The stakes are higher than ever. Performance and execution will ultimately determine who gets eliminated. You must commit to discipline in the utilization of your energy and limited resources. To win in this race, many organizations are strategically adapting their game plan to incorporate outsourcing services. In the banking industry, the competition has reached cutthroat levels with innovative, personalized banking and marketing taking on new standards in the rush to get a piece of the market pie.

1.1.1 Business Process Outsourcing strategy

To facilitate organizations' competitiveness in the market, enterprises can re-adjust their production management system through processes re-design and suitable outsourcing strategies (Copacino, 2003). The increasing outsourcing has resulted in numerous outsourcing arrangements, ranging from out-tasking and managed services to business process outsourcing. Service good outsourcing decision can reduce costs and result in competitive advantage for enterprises, the right outsourcing decision is critical for a manager to advance business operations.

Through appropriate process design and right outsourcing strategies, enterprises can control critical factors of production management. Then they can maintain flexibility and adaptation within each process. But there is no "one size fits all" outsourcing strategy (Bardhan, Whitaker and Mithas, 2006). Thus, this research uses an empirical study to investigate the condition and compare the business process outsourcing strategies employed by commercial banks and how these strategies influence the banks' competitiveness.

Business process outsourcing strategy is the use of third parties to assume the management responsibilities of key business process. It involves contracting with outside parties to provide management for an entire business process not just selected activities. Among the broad business processes that companies are beginning to outsource include human resource management, finance and accounting, and customer care including operating call centers and managing other customer interactions (Sinnet, 2006). Two primary factors have been observed to drive this development. First is the desire of many companies to focus on core business processes and leave non-core activities to specialist firms that can provide world class performance in delivering these activities. This is in line with management excellence theory that indicates that organizations should 'stick to the knitting'.

Second is the significant value proposition offered by BPO firms. This includes specialized expertise, economies of scale, leverage from investment in high value processing technologies and the ability to reengineer business processes to incorporate best practices and meet world class standards (Han and Mithas, 2009). Another advantage of using BPO firms includes lower costs from operating selected activities at lower cost locations. Commercial banks are engaging in BPO to take these strategic benefits and hence this study sought to assess the case in Kenya.

Sinnet (2006) indicate that organizations may choose to outsource certain activities for various motives. Some of the motives cited are: cost reduction, access to new technology, focus on core activities, improvement of quality of services and greater flexibility. In addition, the study identified the following challenges associated with outsourcing of processes: loss of control over service, operational risks, loss of internal skills, loss of flexibility, cultural and social problems, technical constraints, decline in quality and competitive advantages.

1.1.2 Competitive Advantage

A competitive advantage exists when a firm has a product or service that is perceived by its target market customers as better than that of its competitors. Porter (1996) says that competitive advantage is at the heart of a firm's performance in competitive markets and goes on to say that competitive advantage means having low costs, differentiation advantage, or a successful focus strategy. In addition, Porter argues that competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Peteraf (1993) defines competitive advantage as sustained above normal returns. She defines imperfectly mobile resources as those that are specialized to the firm and notes that such resources can be a source of competitive advantage because any Ricardian or monopoly rents generated by the asset will not be offset entirely by accounting for the asset's opportunity cost.

Barney (2002) indicates that a firm experiences competitive advantages when its actions in an industry or market create economic value and when few competing firms are engaging in similar actions. Barney goes on to tie competitive advantage to performance, arguing that a firm obtains above-normal performance when it generates greater-than-expected value from the resources it employs. Ghemawat and Rivkin (1999) say that a firm that earns superior financial returns within its industry (or its strategic group) over the long run is said to enjoy a competitive advantage over its rivals. Besanko, Dranove, and Shanley (2000) say that when a firm earns a higher rate of economic profit than the average rate of economic profit of other firms competing within the same market, the firm has a competitive advantage in that market. Saloner, Shepard and Podolny (2001) indicate that most forms of competitive advantage mean either that a firm can produce some service or product that its customers value than those produced by competitors or that it can produce its service or product at a lower cost than its competitors. They also say that in order to prosper, the firm must also be able to capture the value it creates. In order to create and capture value the firm must have a sustainable competitive advantage.

John Kay (1993) defines distinctive capabilities as ones derived from characteristics that others lack and which are also sustainable and appropriable. A distinctive capability becomes a competitive advantage when it is applied in an industry or brought to a market. Kay measures the value of competitive advantage as value added, with the costs of physical assets measured as the cost of capital applied to replacement costs. Dierickx and Cool (1989) have echoed Barney (1986) in arguing that competitive advantage is not obtainable from freely tradeable assets. From the foregoing discussions from different authors, it is evident that competitive advantage implies a firm having better returns that competing firms or offering a better product and/or service to the market. This was the measure applied in this study.

1.1.3 Commercial Banks in Kenya

Kenya’s commercial banking sector comprises of 3 public, 30 local, 11 foreign and 2 Islamic banks as at 30th June 2011. The Banking sector in Kenya is governed by multiple rules such as the Companies Act, the Banking Act, the Central Bank of Kenya Act and various prudential guidelines and policies issued by the Central Bank of Kenya (CBK) (CBK, 2009). The financial sector in Kenya was finally liberalized in 1995 where exchange controls and other control regimes were lifted.

The commercial banking sector has seen tremendous growth in recent years. Much of the growth in the banking sector has been witnessed in branch network expansion, growth in capitalization and asset base and the expansion of some of the banks regionally. The banks have also been in the frontline of automating their functions to give their customers good service. Kenyan banks have engaged in product innovation where internet banking and mobile banking have taken root in various local banks. As the Kenyan financial market is expanding, banks have realized that they are facing more and more competition from others thus forcing them to increase their marketing spend, lower charges such as lending rates and increase their presence. The sector was not affected by the first round effects of recent financial global crisis as it had no exposure to the toxic assets at the heart of the crisis (CBK report, 2010). However, threats to the sector continued to be posed by the lag effects of the crisis as it spread from the centre, (CBK, Kenya Bankers Association and Reuters, 2010).

The profitability of commercial banks depends heavily on the net of income generating activities and the related activities’ expense. Due to the problem of profitability and stiff competition in the industry, commercial banks have changed their behavior of income sources, by increasingly diversifying into non-intermediation income generating activities as opposed to the traditional inter-mediation income generating activities. The objective of this paper will be to establish how the banks in Kenya have engaged in BPO to increase competitiveness and create competitive advantage.

1.2 Research Problem

BPO is quickly becoming a frontline solution for organizations desperate to reduce costs and automate business processes. Outsourcing has become a vital element of the business strategies of many organizations. Increasingly, organizations have been looking beyond the traditional boundaries of the firm to reduce costs and improve performance. The business process outsourcing (BPO) phenomenon has grown as organizations have been transferring responsibility for entire functions such as human resource management, finance and information services to service providers. According to Nelson Hall, the BPO tracking company, the global business process outsourcing market is estimated to exceed US$300 billion by 2011 (Nelson Hall, 2007). Information technology and human resources are particular growth areas for outsourcing. Outsourcing has grown as organizations seek ways of becoming more flexible and responsive to customer requirements. The outcome of increased outsourcing has been the restructuring of organizations from hierarchies performing the majority of business processes to more network-oriented structures working with specialist service providers (Sako 2006). Gottfredson, Puryear and Phillips (2005) has suggested that competitive advantage from a capability perspective is no longer concerned with a company's ownership of capabilities but more exactly about its ability to control critical capabilities, whether owned or outsourced.

Organizations now have a level of confidence in negotiating business process outsourcing contracts that are enabling far more to achieve strategic objectives. Increasing demand for BPO mirrors the growth of BPO services specifically in developing countries such as India and Eastern Europe. More value added processes such as R&D are outsourced to more advanced countries with better skills and educations. Altogether, the growth of offshore BPO is attributed to a combination of various factors, including advances in network technology and high-speed data networks. Business process outsourcing considers external factors such as customer and market environment and internal factors such as business and marketing strategy, customer relationship, IT system and business culture. Developing the ability to control and leverage critical capabilities, irrespective of whether they reside within the organization or otherwise is more vital than the ownership of capabilities (Gottfredson et al., 2005). In the present era companies are using strategic and transformational business process outsourcing to seek improved business focus, mitigate risks, build sustainable competitive advantage, extend technical capabilities and free resources for core business purposes according to a study by Bartell (1998).

In the face of shifting markets and economic changes, commercial banks now more than ever are seeking ways to improve margins by leveraging technology, reducing quality risks, cutting cycle times and reducing costs. Whether seeking to improve performance in specific areas or overall, all points of leverage need to be considered as factors in a successful formula. BPO is just one of a number of options for commercial banks (Kauffman and Tsai, 2009). Others include programs of internal performance management, quality improvement, automation and business process alignment to core competencies, and value propositions. The relatively recent growth in offerings of BPO services by offshore and local companies has generated much attention and consideration due to the tremendous cost savings they promise in terms of labor. As offshore players have gained a foothold in many industries and started to gain acceptance in the commercial banking sectors, commercial banks are taking a harder look at BPO with its promise of greater savings and potential to improve cycle times and quality.

Any outsourcing decision carries risk. As one senior vice president at a top-25 lender says, BPO is just a tool—not a solution (McIvor, 2005). Leaders in commercial banking need to consider the issues of core competency, organizational stability, cost benefits, returns on investment and brand reputation. When the BPO decision involves the relocation of work outside the country, commercial banks are finding the decision further complicated by a host of additional risks in implementation and perception in the marketplace. These risks must be weighed against the competitive advantages they can produce. In Kenya much has been studied in the area of experiences of service quality and outsourcing. Mwaura (2002), Murugu (2003) and Njoroge (2003) have studied diverse industries including, Banking/Mortgage, hospitality, transport, port services and the Matatu industry. Kirui (2001) and Motari (2002) researched on outsourcing but none of them linked outsourcing to competitiveness. Ndungu (2009) researched how BPO strategy is applied in manufacturing companies and established that manufacturing companies in Kenya are engaging in BPO as call for better service and quality increases.

Industries are looking forward to BPO as a means to revitalize their organizations, reduce costs and build competitive advantage. But no known research has been carried in Kenya to determine whether business process outsourcing contributes to firms' competitiveness in the commercial banks. As Business Process Outsourcing is not so developed in Kenya, there is need for research in this area to give businesses more empirical data on BPO and its place in strengthening a firm's competitiveness. This study therefore sought to fill this gap by answering the following questions. What business processes do commercial banks in Kenya outsource? What is the strategic advantage derived from outsourcing business processes by commercial banks that enables them to enhance their competitiveness? And what are the challenges that are faced by commercial banks in Kenya in business process outsourcing?

1.3 Research Objectives

The study sought to fulfill the following objectives;

i) To establish the services outsourced by commercial banks in Kenya

ii) To determine competitive advantages gained by commercial banks in Kenya through engaging in business process outsourcing.

iii) To establish the challenges faced by commercial banks in Kenya in business process outsourcing

1.4 Value of the Study

This study will prove to be important to commercial banks in Kenya, other organizations in the country and even policy makers in area of ICT which is the main mover of BPO. The study will also add more knowledge on the concept of BPO thus making it of value to scholars, students and researchers. It is widespread notion that BPO is performed on the contractual basis and thus market mechanisms are the BPO governance mechanisms. Companies in demand of BPO must make the right decisions about which BPO services to outsource and which services to retain in-house, precisely take into account the potential benefits and risks involved in BPO and calculate the long-term economic consequences they get from BPO. A decision to BPO may be driven by the need to reduce costs, improve flexibility to changing market conditions, focus on core competencies, access to skills and resources (ASR), improve service quality (SQ), or to achieve a combination of these benefits. However, these benefits can only be achieved if the outsourcing company selects its provider effectively and there is partnership in the process. Thus, BPO is strategically vital to companies that wish to remain competitive. Practitioners have realized this importance by spending money, time, and resources on these supporting management practices. However, many other firms have failed because of risks including loss of organizational learning, information security and privacy (ISP) problems in BPO arrangements, declining rate of innovation, low-performance rates, high-transaction costs, and other hidden costs (HC) that may significantly exceed initial capital estimates.

The study findings will therefore be important in helping established and upcoming Firms in finding out important considerations in a BPO Decision. This will guide them in making informed decisions in BPO. The findings will also help BPO vendors in having a glimpse of what outsourcers look for when selecting a BPO vendor. This will make the vendors improve on those areas to increase their competitiveness in the BPO field and also to improve their effectiveness in service provision.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

Outsourcing has become a vital element of the business strategies of many organizations. Increasingly, organizations have been looking beyond the traditional boundaries of the firm to reduce costs and improve performance. The business process outsourcing (BPO) phenomenon has grown as organizations have been transferring responsibility for entire functions such as human resource management, finance and information services to service providers. According to Nelson Hall (2007), the global business process outsourcing market is estimated to exceed US$300 billion by close of 2011. Most large companies outsource some business activities, often support functions such as payroll processing and IT operations, but even marketing services and manufacturing. Within the past few years, the pace of business-process outsourcing (BPO) has picked up dramatically, as companies have started to outsource broader business processes-particularly ones supported intensively by technology, such as human resources, finance and accounting, procurement, supply chain management, and customer care. Outsourcing business processes can significantly boost a company's strategic competitiveness - but only if companies do the homework needed to make the deal work.

2.2 Business Process Outsourcing Strategy

BPO has moved from focusing primarily on transactional support processes such as payroll, benefits administration, document management to encompass more critical processes such as procurement, mortgage processing in banking and waste management in local government. Also, organizations have been increasingly outsourcing processes to a range of service providers offshore notably in India, the Philippines and Brazil. Although outsourcing is increasing in prominence – both locally and offshore – many organizations are still encountering considerable difficulties in evaluating the suitability of processes for outsourcing. The outsourcing decision involves consideration of a number of complex issues including the importance level of processes to the organization; organizational capability in processes relative to competitors and/or suppliers and service provider selection (McIvor, 2005). However, organizations often fail to fully assess the implications of these issues when considering outsourcing. In particular, a major reason found for outsourcing failure has been that organizations are outsourcing processes that should not be outsourced (Barthelemy, 2003). In addition, senior management may be taken in by the allure of headline cost savings associated with BPO, which may lead to rushing into outsourcing business processes without fully understanding the implications for the strategic development of the organization. It has been found that many outsourcing projects fail to meet expectations. Aron and Singh (2005) highlighted that inadequate attention to the business processes being outsourced is a major contributing factor. They argued that companies spend insufficient time evaluating processes for outsourcing and what assessment is done is performed too narrowly.

Business process outsourcing as a key strategy has been used by companies in various industries for many decades. Competitive pressures have forced companies to look objectively and critically at business processes. Companies have been outsourcing manufacturing operations, business services and even entire business lines successfully for a long time now (Graf and Mudambi, 2005). Recently, contract manufacturing sector has benefited with considerable outsourcing, initiated by the electronics and pharmaceutical industries. Business processes such as information technology (IT), payroll, logistics and human resources (HR) management are among the common ones regularly outsourced in most of the industries. Outsourcing of core functions like engineering, research and development (R&D), manufacturing and marketing are being considered by corporations. Developing the ability to control and leverage critical capabilities, irrespective of whether they reside within the organization or otherwise is more vital than the ownership of capabilities (Gottfredson et al., 2005). Competitive pressures and the need for enhanced financial performance are driving an increase in the nature, scope and scale of outsourcing across industries worldwide.

The option to transfer all or part of a company's business function to an external entity plays an increasingly important role in the strategic arsenal of organizations (Kakabadse and Kakabadse, 2003). Traditionally organizations considered outsourcing to rapidly improve performance and reduce operating costs. In the present era companies are using strategic and transformational outsourcing to seek improved business focus, mitigate risks, build sustainable competitive advantage, extend technical capabilities and free resources for core business purposes (Bartell, 1998). Competitive advantage can be gained when the most appropriate business processes are performed more effectively and efficiently by external suppliers (Lankford and Parsa, 1999). Organizations consider outsourcing nearly all the services they need – printing, legal services, accounting and book-keeping, telecommunications, vehicle maintenance, security, payroll, recruitment and many others, thus restricting their own employees to the core functions that define the organization’s business.

Firms essentially have three kinds of processes: core processes which give strategic advantage, critical non-core processes which are important but not competitive differentiators, and non-core non-critical processes which are needed to make the environment work. Outsourcing non-core processes frees the firm's time and resources for core competencies (Kakabadse and Kakabadse, 2003). As IT services are becoming commoditized the industry is looking forward to BPO as a means to revitalize their organizations, reduce costs and build competitive advantage. The service provider owns, administers and manages the business process, based upon defined and measurable performance metrics with an objective to improve overall business performance and competitiveness. Globalization, competitive markets and mergers and acquisitions are the primary stimuli for BPO. The prime objective of BPO is to deliver the greatest value to all the stakeholders and to achieve and sustain the highest degree of competitiveness for an organization's business units. This study had the aim of investigating the BPO strategies employed by Kenyan commercial banks to create competitive advantage.

2.3 Services Usually Outsourced

The number of commercial banking BPO providers has increased over the past years, and, at the same time, some industry providers have begun to consolidate in order to offer more comprehensive services and to capture larger market shares in the different parts of the world (Lacity and Rottman, 2008). The banking BPO industry has significantly enhanced its knowledge base to deliver processes of more breadth and depth. The employees of both captive and third party offshore banking operations have cultivated more specialized knowledge and are now equipped to handle complex banking processes (Hoetker, 2005). Much of this knowledge has been acquired through rigorous employee training and career-development initiatives. These programs focus on teaching employees skill sets specific to a vertical industry such as underwriting or loan-pool pricing, rather than training them across a horizontal process such as customer service or basic data entry.

In commercial banking, equity research, financial data analysis and projections are some of the higher end options, which also have high potential for growth. Outsourcing as a key business strategy has been used by companies in various industries for many decades. Competitive pressures have forced companies to look objectively and critically at business processes (Brown and Wilson, 2005). Companies have been outsourcing manufacturing operations, business services and even entire business lines successfully for a long time now. Recently, contract manufacturing sector has benefited with considerable outsourcing, initiated by the electronics and pharmaceutical industries. Business processes such as information technology (IT), payroll, logistics and human resources (HR) management are among the common ones regularly outsourced in most of the industries.

Transferring business processes to an outside provider to achieve cost reductions and improved service quality is a rapidly growing trend (Cullen, Seddon and Willcocks, 2005). Finance, accounting, IT administration, call center and offshore application development processes are increasingly being moved overseas or transferred to outside providers to improve the bottom line and increase service levels. In manufacturing industry, the processes that are usually outsourced are logistics, sourcing of raw materials and parts and distribution of finished products. For early stage manufacturing organizations, business process outsourcing is often mandatory to get the business off the ground. Some of the fundamentals include payroll processing, benefits administration, product/service agreements (Legal services) and accounting functions (financial services) (McIvor, 2005). For most organizations, it simply doesn’t make sense to bring these functions internally when external experts can handle the tasks more efficiently.

In the growing global economy, HR services are becoming increasingly complex and resource-intensive. Outsourcing specialists facilitate the client organization in developing HR strategies and policies, sourcing and selecting employees, leading and managing employees, creating rewards and incentive programmes, administering benefit and retirement programmes, and managing payroll (Feeny, Lacity and Willcocks, 2005). The end-to-end HR outsourcing model includes more strategic processes such as employee acquisition functions, these are, recruitment, pre-employment testing, temporary staffing in addition to optimization functions such as absence management, compensation or incentive planning and e-learning. This enables the HR department of the client organization on leveraging employee performance and supporting strategic initiatives.

Established banking institutions are also outsourcing research and knowledge based activities. Knowledge Process Outsourcing (KPO) is the outsourcing of business, market, and/or industry research. KPO requires a significant amount of domain knowledge and analytical skills. KPO suppliers design surveys, collect new data, mine existing data, statistically analyze data, and write reports. Although the KPO market is currently small, industry analysts expect a huge growth in this sector over the next five years. For example, the Evalueserve (2007) evaluated the current offerings of the top 11 Indian suppliers and found that KPO is currently only 4 per cent of their revenues. However, this advisory firm predicts a rapid growth in KPO as suppliers cannibalize some of the onshore work and actively create demand for these services. Evalueserve (2007) estimated that the KPO market in 2007 was $3.05 billion and will grow annually by 39 per cent. They expect the KPO market to be $16 billion by 2010 or 2011 and will employ approximately 350,000 professionals globally.

The increase in KPO is directly related to offshore suppliers moving up the value chain (Gottfredson, Puryear and Phillips, 2005). Financial services providers have long leveraged outsourcing and offshoring; low-value services such as janitorial work have been outsourced for quite some time. However, business services have traditionally been more location-bound due to inherent characteristics like intangibility and need for co-production. A variety of recent developments, such as innovations in information technology (IT) and newer managerial practices have enabled unbundling of design and consumption of these services. Firms can now unbundle their value chain, distribute unbundled discrete processes to optimal service teams/locations and then assemble "serviced" processes. This unbundling can be either "vertical" – of processes that are input to firm's product/service in the market, or "horizontal" – of corporate processes such as finance and accounting (Sako, 2006). This study sought to find out those processes that Kenyan commercial banks outsource.

2.4 Advantages of Business Process Outsourcing

Theoretically, the benefits that BPO brings to an organization are numerous (McCormack and Johnson, 2001). It affects the soft side of organizations as well as the bottom line figures. Some of the benefits reported in the literature are: cost savings through a more efficient execution of work, reduced cycle times, improved customer focus, better integration across the organization, increased flexibility of the firm along with improved customer satisfaction and elimination of redundant and duplicated activities (Galbraith, 2002). Implementing BPO as a way of organizing and operating in an organization will improve internal coordination and break down the functional silos that exist in most companies. Achieving cost reductions is the aim of every company aiming at remaining competitive in today's business environment. Through BPO, companies can eliminate unnecessary operating costs while reducing and bringing other administrative costs under better control through re-engineering, process improvements and implementing advanced technologies (McCormack and Johnson, 2001).

The documented advantages of BPO are; enabling the client firm to focus on core competencies, giving the client flexibility, having access to wider skills and resources, service quality and product and process innovations. Processes and competencies that do not have significant strategic value to a firm are prime candidates for BPO (Mouhalis, 2006). It is already recognized that firms which focus on core activities and competencies, are in a better position to compete effectively in the market. BPO can improve Flexibility and responsiveness in meeting market needs and business requirements (Weerakkody et al., 2003). In implementing BPO strategies, this study seeks to find out the benefits that commercial banks derive from BPO. This study sought to establish the competitive advantage derived by these banks that can lead to enhancement of their performance.

While the literature presents more than a plentiful supply of benefits of BPO, their empirical confirmation is scarce. McCormack and Johnson (2001) conducted an empirical study to explore the relationship between BPO and enhanced business performance. The research results showed that BPO is critical in reducing conflict and encouraging greater connectedness within an organization, while improving business performance. Their results indicate a surprisingly strong relationship between BPO and overall performance.

Outsourcing can empower organizations to use global assets effectively and efficiently by using the industry best practices in enhancing their value chain and enter and create new markets (Farrell, 2004). By the very nature of their specialization, outsourcing providers bring extensive world-class resources to meet the needs of their customers (Jacobides and Hitt, 2005). Partnering with an organization with world-class capabilities can offer access to new technology, tools and techniques that the organization may not currently possess; more structured methodologies, procedures and documentation; and a competitive advantage through expanded skills (Quinn and Hilmer, 1995). Host organizations thus are empowered to deliver higher value-added services to their customers.

Outsourcing IT allows companies to use a large number of computing resources on demand, no matter where they are located (Sako and Tierney, 2005). Due to economies of scale, vendors are capable of modernizing their IT regularly at lower unit costs thus giving host organization the most current and efficient IT solutions (Porter, 1991). Outsourcing enables host organizations to build flexible long-term platforms capable of adaptation or evolution. To keep pace with the emerging market dynamics outsourcing allows host organizations to buy technology from a vendor that would have been financially intensive and difficult to build internally (Lankford and Parsa, 1999). Outsourcing repetitive and IT intensive activities allows staff to focus on core business functions such as product development, service delivery, partnership building, thus reducing growth risk since external costs are easier to reduce than staff thus increasing flexibility, that is, ability to adapt to changing market conditions quickly (Sako, 2006).

Marketing services forms an important function of several organizations (Willcocks and Feeny, 2006). A whole host of services can be outsourced under this. Client organizations acquire capabilities in executing marketing programmes, printing and publishing, advertisement, sales and sales management, strategic planning, business communication, publications and web development. This ensures enhanced levels of success for the client organization in addition to higher value addition to the customer and shorter time to market (Graf and Mudambi, 2005). Customer interaction services require unique set of capabilities that facilitate the building of customer contact centers, enable Customer Relationship management and telesales, warranty administration, order processing, and customer feedback. These are important capabilities a host organization in the services sector must acquire for sustainable competitive advantage.

2.5 Challenges of Business Process Outsourcing

Companies in demand BPO must make the right decisions about which BPO services to outsource and which services to retain in-house, precisely taking into account the potential risks involved in BPO and calculate the long-term economic consequences they get from BPO. Many other firms have failed because of risks which include loss of organizational learning (Gartner Group, 2004), information security and privacy problems in BPO arrangements (Farrell, 2004), declining rate of innovation (Mouhalis, 2006), motivation loss of remaining employees (Aron and Singh, 2005), low-performance rates, high-transaction costs, and other hidden costs (Willcocks and Feeny, 2006) that may significantly exceed initial capital estimates. This study had the purpose of investigating the challenges encountered by commercial banks in Kenya when implementing their BPO strategies.

The issue of strategic alignment between clients and suppliers has been a largely unresolved issue (Pfannenstein and Tsai, 2004). Incentives are clearly mis-aligned because every dollar out of a client's pocket typically goes into the supplier's pocket (Udo, 2000). Clients are incented to demand more services from the supplier without wanting to pay more (Weerakkody et al., 2003). Suppliers are on the other hand incented to squeeze as much profit from existing contracts or to sell additional services to increase revenues (Hussey and Jenster, 2003).

During the past 15 years, a number of pundits have referred to outsourcing relationships as marriages (Linder, 2004). With that analogy, clients and suppliers perceive each other as seductive partners during the wooing phase, enthusiastic partners during the honeymoon phase, then bored partners during the "seven year itch. Willcocks and Lacity (2006) called this later phase the "mid-contract sag", and they found that it usually occurs in year three, not seven. The mid-contract sag occurs after the supplier has dispensed all their transformational levers (consolidation, standardization, reduced headcount, better technology, and better processes). The suppliers' transformation leaders typically move on to new challenges on new accounts. The remaining staff on both client and supplier sides are either too exhausted or lack ideas for launching new rounds of transformation (Galbraith, 2002).

In the outsourcing market, knowledge transfer has been one of the biggest impediments to success. With offshore outsourcing, clients do not typically transfer knowledgeable employees to the supplier like they typically do in large-scale domestic outsourcing (Udo, 2000). Clients complain that offshore employees have little understanding of their business domains. It is quite expensive to train offshore supplier employees, and the threat of supplier turnover and loss of Information Privacy (IP) is high.

Before outsourcing can be successful, the client organizations must resolve some of their own enduring challenges (Aron and Singh, 2005). In many large organizations, the back offices are not truly aligned with the business. While senior executives may use the rhetoric of the “vital role” back offices provide, they still treat back offices as cost burdens (Quelin and Duhamel, 2003). Besides the clout of the back office manager, other structural issues must also be addressed before back offices can be aligned with the business (Lacity and Rottman, 2008). Misalignement of back office and the main operation is another big challenge that outflows to outsourced processes.

Whereas the challenge of information privacy focused on knowledge transfer, this challenge focuses on the client's knowledge retention. After the first few years of a large outsourcing contract, the client's knowledge retention can dramatically erode through attrition. While all organizations deal with turnover, clients that extensively outsource have a smaller pool of talent to retain and develop. We have increasing heard clients asking where the next generation of their project managers will come from. While the core capabilities model by Feeny and Willcocks (1998) addresses what types of talent to nurture, there are unresolved HR management issues associated with its implementation. These include questions on how client organizations can pay suppliers enough to compete with service providers; how client organizations can consistently provide suppliers and their employees with the level of challenge they look for in the job; and how client organizations can provide supplier employees with a career path despite the very small numbers. Both client and supplier organizations have failed to successfully deal with all these issues to lower the level of dissatisfaction and turnover in supplier organizations. This study sought to determine how commercial banks in Kenya are challenged in dealing with BPO.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology that was used to carry out the study. The chapter considers in detail the methods that were used to collect any primary data or secondary data required in the study. In this chapter, the researcher also discusses the research design, population size and sample that were used. The researcher also discusses how this data was analyzed giving details of any models or programmes that were used in analysis with reasons as to why these particular models or programmes were applied.

3.2 Research Design

This research problem was studied through the use of a descriptive survey design. The survey was cross sectional in nature since it covered all commercial banks in Kenya. It was important to enable comparison regarding business processes that are outsourced and competitiveness achieved from outsourcing in the industry. The comparison was done among banks in different categories, ages and sizes. This design was also appropriate because it enabled the collection of a broad category of data from commercial banks in Kenya and hence was not biased in any way. This data assisted in describing the pattern of BPO strategies in these organizations and also related BPO to competitiveness. Descriptive research portrayed an accurate profile of events or situations surrounding outsourcing of business processes in the targeted commercial banks. According to Angus and Katona (1980), it is this capacity for wide application and broad coverage which gives the survey technique its great usefulness.

3.3 Target Population

The target population of this study was all the 43 commercial banks in Kenya as at 31st July 2011 (CBK, 2011). The research employed a census method due to the small size of the population which did not validate sampling. All the 43 commercial banks were included as study subjects.

3.4 Data Collection

The study used both primary and secondary data. Primary data was collected using semi-structured questionnaires (Appendix II) to CEOs of the selected companies, while secondary data was in form of literature review and other secondary information contained in books, journals and other relevant secondary sources. The questionnaire was the chief data collection instrument. The questionnaires were distributed to the CEO of each company since he/she is the one who must be involved in all strategic issues affecting the company. This resulted to a total of 43 questionnaires being distributed to all the targeted commercial banks. The questionnaire was designed to address the research questions. The questionnaire was divided into four sections; A, B, C and D. Section A addressed the general information about BPO and the organization. Section B addressed the specific objective about determining what business processes the banks outsourced. Section C addressed the strategic and competitive benefits derived from BPO strategy while section D dealt with questions about strategic challenges associated with BPO. The questionnaire consisted of both open and close-ended questions. They also consisted of Likert type questions that were intended at weighing perceptions of respondents on the variables under study.

After designing the questionnaire, the researcher tested for effectiveness on 3 senior employees from the banks. Respondents were required to critique the questionnaire on content, design and validity. This pretest was done to detect and correct any weaknesses in the questionnaire. After the pretest, the researcher made any amendments that were deemed necessary.

The researcher distributed the final questionnaire to the CEOs through contact persons in the banks. An introductory letter accompanied the questionnaires so as to give authenticity to the research and explain the purpose of the survey. The researcher requested the questionnaires to be filled and collected as arranged and communicated.

3.5 Data Analysis

The data and information obtained through the questionnaires was first checked for completeness and consistency. The questionnaires found correctly filled and fit for analysis were coded and all the data entered into statistical package for social sciences and analyzed based on descriptive statistics. The descriptive statistics that were used included mean scores, percentages and ratios. Percentages were used to analyze the business processes that are outsourced as per the first objective. Mean scores were used to determine the magnitude of competitiveness achieved from business process outsourcing as well as the magnitude of the challenges that commercial banks face as a result of BPO. These were then presented using tables, pie charts and bar graphs for easier interpretation.

CHAPTER FOUR: DATA ANALYSIS, PRESENTATION AND DISCUSSIONS

4.1 Introduction

This chapter considers the results and findings from the questionnaire survey. The findings of the study are presented according to the research questions. There were forty three questionnaires distributed to forty three commercial banks in the target population. The respondents to the questionnaires were senior executives of the banks who were selected on the virtue of their involvement in developing and implementing outsourcing strategies.

4.2 Response Return Rate

Of the 43 questionnaires sent to the sampled subjects, 35 were filled by respondents and later collected by researcher. This translated to 81% response rate. This high response rate reduced the risk of non-response bias. It was achieved through the great cooperation between the researcher and the respondents. All the returned questionnaires were found fit for analysis.

4.3 General Information

The study sought to establish the age of the banks, their employee workforce and whether they practiced strategic positioning. On age, the years of incorporation of the banks ranged from 1896 to 2009. All the banks surveyed were considered big institutions since the smallest reported and employee workforce 378 while the largest reported a workforce of 5492. The study sought to establish whether the respondent banks practiced business process outsourcing. All respondents indicated that the banks practiced business process outsourcing.

4.4 Nature of Processes Outsourced

This research had the aim of finding out the processes that are outsourced by commercial banks in Kenya. The researcher also sought to establish the nature of processes that were usually outsourced by manufacturing firms in Kenya. Respondents were required to indicate among the listed processes which their organizations usually outsourced. Findings are presented in Table 4.1.

Table 4.1: Nature of Processes Outsourced

Process	Frequency	Percentage
Call centres	7	20
Research and Development services	10	29
Software development	25	71
Data transcription services	15	43
Data entry services	15	43
Human Resource	22	63
Payroll or Benefit Administration	16	46
Logistics and distribution	12	34
Contact centres	6	17

Findings presented in table 4.2 indicate that the mostly outsourced business process included software development (71%), human resource processes (63%), payroll or benefit administration (46%) and data entry and transcription services (43%).

4.4.1 Outsourced Services with most benefits

The study had the aim of finding out the outsourced services that gave the banks the most advantages. An open question was asked to the respondents and they were required to indicate the outsource services that gave the banks the most benefits. Information technology outsourcing is the main type of outsourcing in commercial banks in Kenya that gives the greatest advantage. The respondents mentioned that this is principally because it adds more value than any other form of outsourcing here. According to the respondents, uniqueness and value adding competences are the business drivers of the future. What has been realized in commercial banks in Kenya is that outsourcing decisions reflect at least one of three main rationales: Institutional framework, Business mentality, Security. Further, respondents were required to state the major benefits they derived from business process outsourcing. The mentioned advantages included Lower upfront cost and increased control of fixed cost. Respondents indicated that outsourcing often comes with lower cost provided the provider provides the same services as the banks IT department. This is because IT services are insufficiently standardized and if the banks do them internally, they would usually overspend.

4.5 Competitive Advantage gained from Business Process Outsourcing

The researcher sought to establish whether there was any competitive advantage that was gained by the banks from Business Process Outsourcing. Data to fulfil this objective was collected using a likert rating scale. Closed ended questions were also used to collect data to fulfil this objective. Rating was done on a five point scale. “No Extent’ was given a score of 1, while ‘Very great extent’ was given a score of 5. Data from likert scale rating was analyzed through mean scores while data from the Yes/No Questions was analyzed through percentages. Mean scores which were above 3.00 were interpreted to mean little extent while those above 3.00were interpreted to mean great extent. Respondents were required to rate the extent they perceived their commercial bank to have received the stated competitive advantages from business process outsourcing. Results are presented in Table 4.2.

Table 4.2: Strategic Benefits From BPO

Strategic Benefits	Mean Score	SD
Focusing on Core processes	4.43	1.08
Flexibility	4.36	1.38
Having access to wider skills	3.93	1.43
Better service and product quality	2.50	1.23
Better Consumer relationship management	3.36	1.78
Better service Quality than was provide internally	3.86	2.17
Grand Mean	3.62	

Results analyzed and presented in Table 4.2 indicate that the greatest competitive advantage arose from outsourcing some business processes in the commercial banking are the ability to focus on core business (4.43) and flexibility (4.36). Respondents also indicated that the banks had access to a wider range of skills through business process outsourcing (3.93). Other advantages from business process outsourcing indicated included better consumer relationship management (3.36) and better service quality than was provided internally (3.86).

The study sought to establish whether the banks derived any competitive advantage from BPO. Most outsourcing initiatives were reported to provide more upside production capabilities with fewer aches and pain. Commercial banks reported that they may decide to change from one information services platform to another. Such flexibility is needed to maintain their competitive positions. The IT departments of commercial banks were reported to be unable to improve their services temporarily (e.g. by keeping counter services longer when new applications are introduced). In such cases, BPO gave the best solution.

Another advantage of business process outsourcing mentioned by the respondents was realizing a strategic focus on central competences. By outsourcing non-core aspects of the banks, the banks could simply concentrate on their business. This was because the strategy includes focusing on central competences and IT services are not part of the banks central competences. Further, findings indicate that achieving a technology shift was another competitive advantage derived from business process outsourcing by commercial banks. Respondents indicated that IT departments lack sufficient knowledge to implement new technologies. IT departments lack capacity to implement new technologies while keeping current systems working. BPO therefore enables the banks to have a technology shift at minimal costs.

Further, the study established that business process outsourcing enabled the banks to shorten time to-market for new IT services. IT departments have to react quickly to the dynamic markets. This is very difficult and makes it better for an external supplier, who as a rule has many more clients, and is cost effective. The IT departments of commercial banks were reported in the study to be unable to deliver on time the IT services that the business wants.

4.5.1 Considerations When Making an Outsourcing Decision

The researcher also sought to establish the factors the commercial banks considered when making an outsourcing decision. This was to establish how the commercial banks made the decision on whether to do an activity internally or to outsource. Findings were analyzed through mean scores and presented in the Table 4.3.

Table 4.3: Considerations When Making an Outsourcing Decision

Factor	Mean Score	SD
Quality	4.93	1.11
Experience	4.21	1.56
Honesty	4.14	1.58
Reliability	4.50	1.60
Fairness	2.36	2.24
Trust	4.64	0.77
Turn around time	4.50	1.65
Grand Mean	4.18	

Findings presented in Table 4.3 indicate that the biggest considerations made by the surveyed commercial banks before making a decision on whether to outsource or do an activity in-house included quality of the service (4.93) and level of trust of the vendor (4.64). Other major considerations included experience of the company providing the service (4.21), honesty of the service provider due to data privacy (4.14) and reliability of the vendor to deliver as per agreement (4.50). other consideration in making the outsourcing decision as indicated from the commercial banks survey was turn around time (4.50).

4.5.2 Relation of BPO and Bank Competitiveness

The study sought to establish whether the amount of business processes outsourced by the commercial banks surveyed was related to their competitiveness. Results are indicated in Figure 4.2. Findings indicated that 71% of the commercial banks reported that the amount of business the commercial bank had outsourced was related to that bank’s competitiveness. However, 29% of the respondents believed that amount of business processes that the bank had outsourced did not affect its competitiveness.

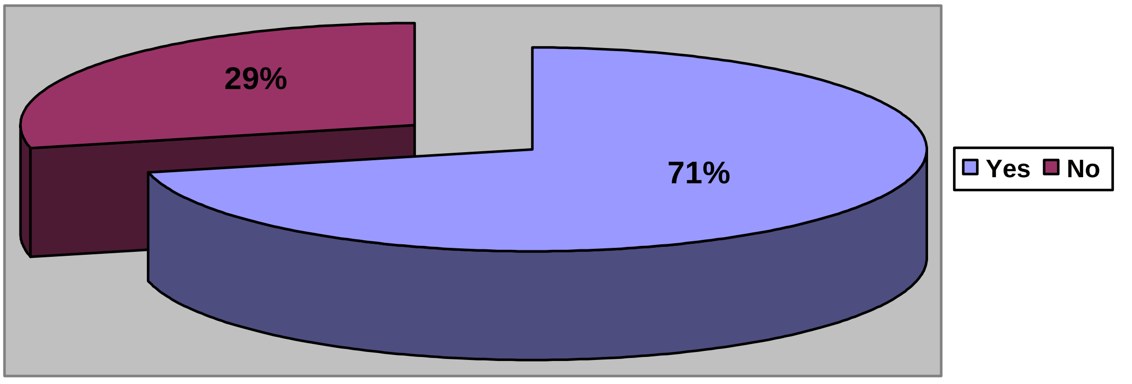

Figure 4.2: Relation of Process outsourcing to Competitiveness

Ways mentioned that the commercial banks had gained competitive advantage from BPO included the indication that processes outsourced had improved their business in enabling host organizations to build flexible long-term platforms capable of adaptation or evolution. The commercial banks were also reported to focus on building skills in narrow areas where they currently excelled which was made possible by process outsourcing. This, the respondents said, helps the commercial banks to keep pace with the emerging market dynamics, allows host organizations to buy technology from a vendor that would have been financially intensive and difficult to build internally. Respondents also observed that business process outsourcing had enabled them remain competitive by giving them access to extensive world-class resources that are provided by specialized vendors. Partnering with a vendor with world-class capabilities was reported by the respondents to offer access to new technology, tools and techniques that the commercial banks may not currently possess. Outsourcing business processes also was reported to provide the commercial banks more structured methodologies, procedures and documentation; and a competitive advantage through expanded skills that are availed by the vendor.

4.6 Challenges Arising from Business Process Outsourcing

The study sought to establish to what extent the commercial banks were exposed to the listed challenges as a result of outsourcing business processes. Responses were rated on a scale of 1-5 (no extent – very great extent). The responses were analyzed using mean scores and findings are presented in Table 4.4. Findings presented in Table 4.5 indicate that the biggest challenges emanating from business process outsourcing are poor knowledge retention by suppliers which leads to slow learning, hidden costs which become evident after the contract has commenced, information security and privacy issues and high transaction costs which even surpass the costs of providing the costs in-house.

Table 4.5: Strategic Risks Arising from BPO

Strategic Risks	Mean Score	SD
Loss of Organization learning	4.21	1.37
Information security and privacy issues	4.79	1.16
Declining rate of innovation	3.50	1.24
Motivation loss of remaining employees	4.43	1.34
High transaction costs	4.71	1.25
Hidden costs	4.86	1.06
Misalignment of BPO strategy and Business Strategy	2.50	1.45
Misalignment of supplier and client needs	4.43	1.36
Poor knowledge retention by Suppliers	4.79	1.16
Grand Mean	4.25	

Other challenges indicated to arise from business process outsourcing are loss of organization learning after the process being outsourced, motivation loss on the part of employees when lay-offs occur as a result of the process outsourcing and misalignment of supplier and client needs. Challenges which arise on a low extent included declining rate of innovation in the company after removing some processes from the business and misalignment of Business process outsourcing strategy and business strategy.

Further the study established that business process outsourcing iincreased dependence on providers. Respondents indicated that contracting information services means dependence on provider which might be very risky. The findings indicated that banks performing their own information service can independently decide to invest in technology innovations specific to their situation. Price changes during a particular period, may significantly affect banks total cost of ownership.

Another challenge emanating from BPO was loss of knowledge and know-how. IT Outsourcing was reported to risk of transferring bank IT staff to the company providing services. This was indicated by the fact that staff sent by service providers usually has a narrower technical expertise and much less knowledge of the bank.

Confidentiality risk was another major challenge from business process outsourcing indicated by the respondents. The study established that essential bank information which most often is confidential might be disclosed to providers. This was observed by the respondents to risk the bank information to privacy threats. Respondents observed that outsourcing while it improves the service providers competitive position, it may decrease the banks competitive power.

The respondents also indicated that there were challenges in selecting the right service provider. This required thorough selection criteria to ensure that the selected service provider was fit on all fronts. This challenge was compounded by the fact that future information needs are unforeseeable for service recipients and future mergers and acquisitions are unforeseeable. Further, future changes in the service provider strategy are unforeseeable for service recipients. This makes the service providers to be very unpredictable and hence difficulty in selection.

Lastly, commercial banks were reported to incur higher cost than their internal departments could offer. Unlike internal departments, external service providers do have profit objectives. The respondents indicated that outsourcing of late does not appear to be the best way to cut cost. It is actually costing banks more in terms of revenue loss due to poor quality services.

4.6.1 Future Direction in Process Outsourcing

The study sought to find out what direction the commercial banks planned to take concerning business process outsourcing. All the respondents indicated that they would continue to outsource. Reasons given for this future direction included lower costs of information and communication technologies which are expected to come down in the future, following the developments in the ICT sector in Kenya. Other factors included the learning and expertise that vendors are acquiring in business process outsourcing thus giving better quality service as they become experienced. All the respondents projected that the volumes of outsourced business processes would increase as their firms expanded their operations.

4.6.2 Key Pitfalls in Business Process Outsourcing

Respondents were required to indicate key pitfalls in outsourcing. Findings indicated that the key pitfalls in business process outsourcing that were mentioned by the respondents were inability of vendors to cope with huge contracts, inability to create lasting relationships and failure to adhere to service level agreements. According to the responses, it was established that other challenges included poor vendor staff training, long processes and bureaucracy in addressing complaints, loss of information privacy. Other responses also indicated that outsourcing creates monotony and boredom since the general staff will only be working in their area of specialty hence not able to know what is going on in other departments.

CHAPTER FIVE: SUMMARY, DISCUSSIONS AND CONCLUSIONS

5.1 Introduction

In this chapter, the researcher presents the summary, discussions and conclusions based on the findings and interpretations of the research. The researcher also presents the limitations that were identified when carrying out this research. Further, the researcher provides suggestions for further research on the area and closes the chapter with providing implications for policy and practice that can emanate from the findings provided by the research.

5.2 Summary

The study addressed three research objectives and in this section, the results for them are summarized, discussed and conclusions drawn. From the analysis and data collected the following the researcher made conclusions and recommendations which were made based on the objectives of the study. The respondents comprised of 35 senior executives of commercial banks in Kenya.

The objectives of the survey were to establish the competitive advantage derived from business process outsourcing by the banks, establish the processes that commercial banks outsource in Kenya and find out the challenges involved in Business Process Outsourcing. On the first objective, the researcher established that commercial banks in Kenya derive various competitive advantages from outsourcing their non-core business processes. The most common competitive advantages arising from outsourcing non-core business processes in the commercial banking sector are the ability to focus on core business and flexibility. Business process outsourcing releases staff and other resources to pursue other core banking operations and therefore less time is wasted on supervision and its also a means of letting the experts do the their job best. In order to achieve these competitive advantages, the outsourcing company should take some measures and precautions to ensure effectiveness of the process. Some of the considerations include skills and level of experience of the vendor, setting key performance indicators and ensuring that the terms and conditions of the contract are well understood by both parties. These findings agree with the findings from a study by Brown and Wilson (2005) which found that the most monitored service delivery factors were adherence to SLAs, cost and quality of the outsourced business process. These findings also corroborate with findings from a study by Brown and Wilson (2005) which found that a big percentage of outsourcers required their vendors to have a certain level of skills and knowledge that would make them effective in delivering the service in question. This study also concurs with a study by Kakabadse and Kakabadse (2003) which surveyed IT companies in Malaysia and found that outsourcing non-core processes is aimed at reducing costs and building competitive advantage and therefore the most critical considerations in an outsourcing contract are service delivery as per the contract and the cost of the outsourced process.

Business process outsourcing have enabled commercial banks to remain competitive by giving them access to extensive world-class resources that are provided by specialized vendors, partnering with vendors with world-class capabilities which offers access to new technology, tools and techniques and providing the organization with more structured methodologies, procedures and documentation and expanded skills. These findings relate to the ones in a study by Udo (2000) which concluded that although business process outsourcing is related to improving a firm's competitive position in today's business environment, the amount of business processes outsourced by a company is not linearly related to competitiveness. This disagrees with a study conducted by Graf and Mudambi (2005) which concluded that manufacturing firms were used to outsourcing entire manufacturing operations, business services and even entire business lines. This can be attributed to the level of development in the Kenyan Business process outsourcing industry which is still in its infancy. However, findings from this study corroborates with the findings from the study by Lacity and Rottman (2008) on manufacturing companies in Malaysia. Their study concluded that business processes such as information technology (IT), payroll, logistics and human resources (HR) management are among the common ones regularly outsourced in most of the industries. The findings from this study on the strategic advantages of BPO corroborate with the findings from a study on auditing companies in the US by Lacity, Feeny and Willcocks (2004) which identified the major competitive advantages that arose from business process outsourcing. They found that global outsourcing of back office services produced competitive advantages ranging from improvements in back office efficiency, access to supplier resources and capabilities, and increased flexibility by ramping staff up and down to match fluctuating demand.

On the challenges arising from business process outsourcing, the researcher found that the commercial banking sector faces some major challenges when engaging in business process outsourcing. These major challenges include poor knowledge retention by suppliers which leads to slow learning, hidden costs which become evident after the contract has commenced, information security and privacy issues and high transaction costs which even surpass the costs of providing the costs in-house. Challenges which are not rampant in the Kenyan commercial banking sector are; declining rate of innovation in the bank after removing some processes from the business and misalignment of business process outsourcing strategy and business strategy. These findings concur with findings from other studies performed by other researchers like Gartner Group (2004) which found the strategic risks arising from BPO as loss of organizational learning, Farrell (2004) who established the strategic risk of information security and privacy problems in business process outsourcing arrangements, Mouhalis (2006) who found the risk of declining rate of innovation, Aron and Singh (2005) who established the risk of motivation loss of remaining employees, low-performance rates and, Willcocks and Feeny (2006) who established the risk of high-transaction costs, and other hidden costs that may significantly exceed initial capital estimates. The research study also established the key pitfalls to business process outsourcing as inability of vendors to cope with huge contracts, inability to create lasting relationships and failure to adhere to service level agreements. It was established that other challenges included poor vendor staff training, long processes and bureaucracy in addressing complaints and loss of information privacy on the part of the outsourcing company. Outsourcing also creates monotony and boredom since the general staff will only be working in their area of specialty hence not able to know what is going on in other areas.

5.3 Conclusions

The study concludes that the commercial banking sector has adopted business process outsourcing albeit on a low level. There have been various competitive advantages arising from this practice but the key is to systematically engage in the process with a good strategy and finding a vendor who will leverage technology effectively and asking for visibility into the vendor's processes and platforms. The service level agreements should be clearly and conclusively drafted to ensure that there are not important factors which have been overlooked. BPO has helped many commercial banks improve their strategic competitiveness by helping them focus on core competencies and improving their flexibility.

5.4 Limitations of the Study

The researcher faced a number of limitations in the carrying out of this survey. First there was the limitation of earlier studies on this field. This affected the study in that there lacked a precedence and there were no models on how to design research instruments. The researcher however used journals and magazines extensively to help her get information that helped in designing research instruments that were both reliable and valid. The researcher also used these secondary sources to build a theoretical framework on which to base the study.

Another limitation came when collecting the data. The respondents were supposed to be CEOs of the commercial banks in Kenya. These are senior employees who generally have very busy schedules. This made it difficult for the researcher to get the questionnaires to be filled in time and which finally resulted in some questionnaires not being returned regardless of the fact that the number of respondents was small. The researcher however made several visits and communicated through e-mail to contact persons in the said companies to get favourable responses. Most of the questionnaires were filled by other senior personnel in the commercial banks but not the earlier targeted subjects who were the CEOs. However, these respondents were also competent on the subject which was not expected to affect reliability or validity of collected data.

5.5 Suggestions for Further Research

The practice of business process outsourcing in Kenya is not much developed. This means that the regulatory frameworks and best practices are in their infancy. Most industries have not been able to utilize this practice to leverage their competitiveness.

Further studies therefore will be required in this field to establish the competitiveness factors required in a vendor for the vendor to be considered effective by the outsourcing companies. Such study also should investigate the regulatory and policy frameworks required to make this practice more viable in the country.

Another study also can be carried out in other sectors such as the small and medium enterprises to establish whether they are adopting business process outsourcing and find out what factors they consider important in any business process outsourcing decision. The small and medium enterprises are the driving force of Kenya's economy and hence their development would mean advancement of the country. Other studies like this one can also be carried out in other industries such as insurance and education. This is because their practices may vary due to their nature of business. Service sectors have differing practices from those observed in commodity industries and therefore business process outsourcing may be viewed differently in such industries, differing from what has been established in this study. Such further studies should also utilize different methods of data collection such as interviews to have a deeper insight on the practice.

5.6 Implications for Policy and Practice

These findings from this research have some implications for policy and also for the practice of business process outsourcing in Kenya. Business process outsourcing vendors can be required by their clients to eventually look like application service providers, offering open interfaces and process transparency. Other industries like insurance and medicine which values high information privacy and security can require them to look like black boxes providing only limited inputs and outputs. From the findings on the competitive advantages, clients require BPO vendors to actually deliver innovation and optimize outsourced processes, but not just running existing processes at a lower cost.

The industry also requires some policy and regulations to streamline it since it is in its infancy. However, BPO vendors will have to use business rules to expose the key decision-points within their processes whether or not they provide transparency in a more general case. Companies simply have their own way of doing business and even in a standard process there will be variation in decision-making that needs to be imposed by the client on the outsourcer. The industry can also adopt the use of business rules management systems which would allow the outsourcer to expose these decisions to each of their clients while still running a standard, and black-box, process. BPO Best Practices should include choosing a vendor that's leveraging technology effectively and asking for visibility into the vendor's processes and platforms.

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APPENDICES

Appendix I: Questionnaire for Bank CEOs

Section A: General Information

1. Name of the Organisation: ____
2. Year of Inception of the bank: _____________________________________
3. Number of Employees in the Bank __________________________________
4. Have your company ever practiced Business Process Outsourcing?

   Yes [ ] No [ ]

5. If your answer in 4 (above) is No, Please explain…………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

……….

SECTION B: SERVICES OUTSOURCED BY THE BANK

1. Which of the following describes the nature of the process your organisation outsources;

[ ] Call centres

[ ] Research and Development services

[ ] Contact centres

[ ] Software development

[ ] Data transcription services

[ ] Data entry services

[ ] Human Resource

[ ] Benefit Administration

[ ] Logistics and distribution

[ ] payroll and benefit administration

Others, please specify

____

____

____

____

2. Of the services that you outsource, list the ones that give the business the best benefits?

1.___________________________________

2.___________________________________

3.___________________________________

SECTION B: COMPETITIVE ADVANTAGES GAINED FROM BUSINESS PROCESS OUTSOURCING

1. On a scale of 1 - 5 please rate the extent to which you think your bank has gained the following competitive advantages from Business Process Outsourcing

[1]No Extent [2] Little extent [3] Moderate extent [4] Great Extent [5] Very Great Extent

	Please circle one that applies
Focusing on Core processes	[1] [2] [3] [4] [5]
Flexibility	[1] [2] [3] [4] [5]
Having access to wider skills	[1] [2] [3] [4] [5]
Better service and product quality	[1] [2] [3] [4] [5]
Better Consumer relationship management	[1] [2] [3] [4] [5]
Better service Quality than was provide internally	[1] [2] [3] [4] [5]
Other (specify)________________	[1] [2] [3] [4] [5]

____

____

____

2. On a scale of 1 – 5, please rate the extent to which your company considers the following reasons while outsourcing a business process

[1]No Extent [2] Little extent [3] Moderate extent [4] Great Extent [5] Very Great Extent

	Please circle one that applies
Quality	[1] [2] [3] [4] [5]
Experience	[1] [2] [3] [4] [5]
Honesty	[1] [2] [3] [4] [5]
Reliability	[1] [2] [3] [4] [5]
Fairness	[1] [2] [3] [4] [5]
Trust	[1] [2] [3] [4] [5]
Other (specify)___________________	[1] [2] [3] [4] [5]
Other (specify)___________________	[1] [2] [3] [4] [5]

3. Has BPO increased your firm's competitiveness? Yes [ ] No [ ]

If yes, in which ways

____

____

____

____

____

4. Do you foresee the outsourced volumes increasing or decreasing?

Increasing [ ]

Decreasing [ ]

Please give a reason for this?

____

____

____

____

SECTION C: CHALLENGES ARISING FROM BUSINESS PROCESS OUTSOURCING

1. On a scale of 1 - 5 please rate the extent to which the bank has faced the following challenges from Business Process Outsourcing

[1]No Extent [2] Little extent [3] Moderate extent [4] Great Extent [5] Very Great Extent

	Please circle one that applies
Loss of Organization learning	[1] [2] [3] [4] [5]
Information security and privacy issues	[1] [2] [3] [4] [5]
Declining rate of innovation	[1] [2] [3] [4] [5]
Motivation loss of remaining employees	[1] [2] [3] [4] [5]
Low performance rates	[1] [2] [3] [4] [5]
High transaction costs	[1] [2] [3] [4] [5]
Hidden costs	[1] [2] [3] [4] [5]
Misalignment of BPO strategy and Business Strategy	[1] [2] [3] [4] [5]
Misalignment of supplier and client needs	[1] [2] [3] [4] [5]
Poor knowledge retention by Suppliers	[1] [2] [3] [4] [5]

Please indicate any other challenge your bank may have faced from BPO__________

____

____

____

____

2. What are the key pitfalls in outsourcing?

____

____

____

____

Thanks for your input in the survey

Appendix II: List of Commercial banks in Kenya

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd
3. Bank of Baroda (K) Ltd
4. Bank of India
5. Barclays Bank of Kenya Ltd
6. CFC Stanbic Bank Ltd
7. Chase Bank (K) Ltd
8. Charter House bank Ltd (Under Statutory Management)
9. Citibank N.A Kenya
10. Commercial Bank of Africa Ltd
11. Consolidated Bank of Kenya Ltd
12. Co-operative Bank of Kenya Ltd
13. Credit Bank Ltd
14. Development Bank of Kenya Ltd
15. Diamond Trust Bank Kenya Ltd
16. Dubai Bank Kenya Ltd
17. Ecobank Kenya Ltd
18. Equatorial Commercial Bank Ltd
19. Equity Bank Ltd
20. Family Bank Limited
21. Fidelity Commercial Bank Ltd
22. Fina Bank Ltd
23. First community Bank Limited
24. Giro Commercial Bank Ltd
25. Guardian Bank Ltd
26. Gulf African Bank Limited
27. Habib Bank A.G Zurich
28. Habib Bank Ltd
29. Imperial Bank Ltd
30. I & M Bank Ltd
31. Jamii Bora Bank Limited
32. Kenya Commercial Bank Ltd
33. K-Rep Bank Ltd
34. Middle East Bank (K) Ltd

35. National Bank of Kenya Ltd
36. NIC Bank Ltd
37. Oriental Commercial Bank Ltd
38. Paramount Universal Bank Ltd
39. Prime Bank Ltd
40. Standard Chartered Bank Kenya Ltd
41. Trans-National Bank Ltd
42. UBA Kenya Bank Limited
43. Victoria Commercial Bank Ltd