

# Theoretical Framework for CRM Outsourcing

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## INTRODUCTION

Customer service is emerging as a key differentiator among competitors as the explosive growth of e-commerce is changing the nature of competition among companies. This has changed the customer-related business requirements for all types of companies. With firms increasing their online operations, customers now have the ability to contact organizations through a variety of interactive and noninteractive means (such as e-mail, fax, call centers, FAQs, online chats, newsletters, snail mail, retail stores, and Web-based forums). This has led companies to consider customer relationship management (CRM) as an important part of their competitive strategy. As the focus is shifting to retention rather than acquisition of customers, companies are looking for ways to identify and engage their most profitable customers.

CRM is generally stated as a strategy that companies use to identify, manage, and improve relationships with their customers. Thompson (2001) defined CRM as a company's activities related to developing and retaining customers through increased satisfaction and loyalty. *eCRM* is a term generally used when a company's customer service operations are online. According to Cahners In-Stat Group (2001), worldwide revenues from CRM software application will increase from \$9.4 billion in 2001 to approximately \$30.6 billion in 2005.

CRM initiatives have high costs of implementation, typically \$1 million, as well as high failure rates, estimated to be in the 55–75% range (Ericson, 2001). For large-scale CRM implementations at very large businesses, reported spending on CRM software, hardware, services, internal labor, and training have been as high as \$30–90 million (Young, 2001).

For effective CRM, companies must generally adopt a customer-centric philosophy to achieve goals, such as increases in sales, customer loyalty, customer service and support, and better and effective distribution of products. CRM can produce additional profits for firms through cross selling, up selling, reduced product marginal costs, and lower customer acquisition costs (Winer, 2001). CRM applications must be designed to integrate all the customer communication points across various functional

areas of a company. CRM products are generally classified into three categories (Karimi, Somers, & Gupta, 2001). These are as follows:

1. *Operational*: For improving sales, marketing, and customer service efficiency through marketing campaign management, service request management, and automation that integrate with existing processes and infrastructure.
2. *Analytical*: For collecting better customer data that contain customer buying histories and demographics data, mining this data to generate customer profiles and anticipate their needs, and thus formulating more effective customer-centric strategies.
3. *Collaborative*: For integrating communications across various channels to improve information sharing across the organization to build an integrated view of the customer, ensuring consistency of message to customer; for eCRM, one-to-one personalized Web marketing, customized product and services offerings for individual customers, etc.

Despite the rise in popularity of CRM outsourcing, there is little literature in information system (IS) outsourcing specific to CRM functions. This article presents an integrated framework of resource dependence, transaction cost economics, and social exchange theory. This framework is used to study CRM outsourcing partnerships and is an extension of the work of Grover, Cheon, and Teng (1996) and Lee and Kim (1999). This framework could be used to evaluate how these companies select a CRM vendor, how they adopt and integrate CRM technologies into their existing infrastructures, and what factors affect CRM outsourcing success.

## OUTSOURCING OVERVIEW

Outsourcing is more a reflection of the strategic partnerships in the digital economy. While there are many definitions of IS outsourcing in the literature, there are three common components to these definitions, as stated in Yang and Huang (2000): "first an external provider takes

over part or all of an organization IS functions; second, external provider should take the responsibility; and third, customers transfer IS functions to external provider as well as employee and part of computer facilities” (p. 227).

The nature and extent of IS outsourcing have evolved over the past few decades. IS functions of increasingly high asset specificity involving responsibilities for not just the technology but also for the business processes are being outsourced (Grover, Cheon, & Teng, 1994; Grover et al., 1996; Gurbaxani, 1996; Nam, Rajagopalan, Rao, & Chaudhury, 1996; Lee, Huynh, Chi-wai, & Pi, 2000). The reasons cited for widespread use of IT-enabled outsourcing by large U.S. companies are: slowing domestic economic growth, need to conserve costs, ability to focus on core capabilities and providing bottom-line benefits (Banking on Outsourcing, 2003).

Increasingly, the nature of the client–vendor relationship has shifted from just a contractual relationship to a tightly integrated partnership relationship for mutual benefit between the vendor and the outsourcing firm, as firms consider outsourcing a key strategic choice (Grover et al., 1996; Lee & Kim, 1999; Lee et al., 2000).

CRM implementations require far more coordination among functionally disparate organizational units, including IT and senior management involvement in IT planning, organization, control, and integration (Karimi et al., 2001). Because CRM initiatives are not confined to a particular function but rather cut across various functions of an organization, the process of CRM implementation through outsourcing becomes complicated. Because of the complex technologies involved in CRM, companies are choosing to outsource to vendors that specialize in CRM. IDC research shows that the worldwide CRM services market will increase from \$19.4 billion in 2001 to \$45.5 billion in 2006 (Morphy, 2002).

Outsourcing offers various strategic, technological, and economic advantages to a firm (Grover et al., 1996; Smith, Mitra, & Narsimhan, 1998; Lankford & Parsa, 1999; Ngwenyama & Bryson, 1999; King & Malhotra, 2000; Lee et al., 2000; Yang & Huang, 2000). These are as follows:

- *Strategic benefits* by allowing a firm to focus on its core competencies by outsourcing routine IT functions, being able to acquire state-of-the-art knowledge that the firm otherwise would not have the resources to acquire and improve IS service quality.
- *Technological benefits* through acquisition of complex technologies through an external vendor that otherwise would have high internal acquisition and coordination costs, high obsolescence risks, and longer time-to-market.
- *Economic benefits* through reduced costs and improved efficiencies in the long term by utilizing

external vendors’ expertise and economies of scale, and through favorable allocation of fixed costs.

Cost reductions through outsourcing to external vendors result through two primary approaches. One approach is adversarial, involving bidding among competing vendors to drive down prices. The other approach is through collaboration between the vendor and firm to lower transactional costs (Canon & Homburg, 2001). Outsourcing strategies involve contracting with either a single vendor or multiple vendors, though developing a relationship with a single vendor is more cost effective and leads to better outsourcing performance over the long term (Ngwenyama & Bryson, 1999).

Notwithstanding the advantages, outsourcing IS functions may fail due to complexities involved in managing long-term relationships with its vendor, resulting in loss of control of organizational assets, loss of firms’ internal IS expertise and capacity to learn new skills and technologies, threat of opportunism from vendor, uncertainties and lack of decision models in choosing outsourcing vendor, and loss of morale and performance among firm’s employees (Rao, Nam, & Chaudhury, 1996; Ngwenyama & Bryson, 1999; King & Malhotra, 2000). High-asset-specific IS outsourcing may also result in competitive threat from the vendor, and in addition, a firm may lose out on future business opportunities if the skills and competencies being outsourced appreciate in value (King & Malhotra, 2000).

## CRM OUTSOURCING FRAMEWORK

While there are a number of studies for evaluating outsourcing of IS functions (Grover et al., 1996; Lee & Kim, 1999; Maltz & Ellram, 1999; King & Malhotra, 2000; Kini, 2000; Lee et al., 2000; Yang & Huang, 2000), there is very little literature specific to the outsourcing of CRM functions. This framework contributes to the IS field by studying CRM outsourcing partnerships through an integrated framework of resource dependence, transaction cost economics, and social exchange theories.

Resource-dependency theory refers to outsourcing to external vendors to fill resource gaps within the firm for the purpose of providing the firm with strategic competitive advantage (Lee et al., 2000).

Transaction cost theory provides an economic viewpoint to outsourcing via a set of principles for analyzing buyer–supplier (outsourcer–vendor) transactions and determining the most efficient mode of structuring and managing them (Nam et al., 1996; Ngwenyama & Bryson, 1999; Lee et al., 2000). Yang and Huang (2000) considered five factors—management, strategy, technology, eco-

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