OVERVIEW ON RISKS & RISK MANAGEMENT IN BPO INDUSTRY IN INDIA

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Abstract

The business process outsourcing (BPO) industry in India has witnessed phenomenal growth by providing significant cost savings to its customers worldwide.While Business Process outsourcing is associated with several important benefits, for both the Service Provider and the Customer, it also entails risk. The main purpose of this study is to understand the risks prevalent inBPO industry and how Indian BPO service providers are geared up to manage the risks. The researchers have used secondary research methodology. This Article provides an overview of the "Risks" with reference to Outsourcing of Business Process Services (also popularly known as "BPO") in India and how the service providers manage the risks.

Key words: BPO, Business Process Outsourcing, Risk, Offshoring, Data Security, Risk Mitigation, Risk Management

Importance of "Risk Management" in BPO Industry

BPO industry has grown significantly over the last decade in India and has India is the preferred destination for the English speaking countries across the globe. Though, the benefits accrue on account of Business Process Outsourcing are significant for both the outsourcer and the service provider, there are quite few risks associated with this. In addition to the risks that are applicable to BPO industry in general, there are specific risks relating to BPO work relating to industries such as Banking, Insurance, Telecom, Life Sciences etc. There are unique risks relating to certain type of processes like Finance & Accounting, Human Resource Management, Credit Card Processing, etc. With the new regulatory requirements across different domains, the risk management of BPO is becoming more complex. Adoption of Risk Mitigation practices and good Risk Management is critical to service BPO customers.

Understanding the term "Risk"

The Term "Risk" and "Risk management" have been analysed in many domains, such as Banking, Insurance, Economics, Outsourcing, Medicine, Engineering, etc.Each domain addresses risk in a fashion relevant to its domain.There has been a good amount of literature on Information Technology Outsourcing covering risk in Outsourcing. BPO is a relatively new outsourcing arrangement (Hirschheim and Dibbern, 2002)[1], to date hardly covered in scientific literature and on the practical side still comparatively infant but with large growth expectations (Lukacs et al. 2002)[2]. The term“Risk” has been defined as the “measurable probability of the negative deviation of a target value from a reference value” (Jorion and Khoury (1996)[3]. To evaluate risk exposure, it is essential to identify the array of potential undesirable outcomes that could occur with respect to an outsourcing arrangement, as well as the probability of occurrence of such outcomes.[4]Robbie T. Nakatsu, Charalambos L. Iacovou (2009) have analysed the risk factors of outsourced software development and created empirically generated lists of risk factors for both domestically and offshore-outsourced projects. They have also studied how do the risk factors change and which ones aremost important in each[5].

The term “Operational risk” is the risk of loss resulting from inadequate or failed processes, people and systems or from external events [The Basel II Committee]. With respect to Financial Services, the following lists the official Basel II defined event types with some examples for each category:

1. Internal Fraud - misappropriation of assets, tax evasion, intentional mismarking of positions, bribery
2. External Fraud- theft of information, hacking damage, third-party theft and forgery
3. Employment Practices and Workplace Safety - discrimination, workers compensation, employee health and safety
4. Clients, Products, & Business Practice- market manipulation, antitrust, improper trade, product defects, fiduciary breaches, account churning
5. Damage to Physical Assets - natural disasters, terrorism, vandalism
6. Business Disruption & Systems Failures - utility disruptions, software failures, hardware failures
7. Execution, Delivery, & Process Management - data entry errors, accounting errors, failed mandatory reporting, negligent loss of client assets.

Heiko Gewald and Daniel Hinz (2004) have introduced a framework to classify operational risk in outsourcing in a way that generates quantifiable output for measurement purposes. The authors developed a matrix system that deploys a catalogue of sources of risk and a mutually exclusive yet exhaustive system of measurable impact areas.[6]

Heiko Gewald and Jochen Franke(2005) have done a comparison of risk in IT Outsourcing and Business Process Outsourcing and found the following risks are higher in case of Business Process Outsourcing: (1) Inexperienced Customer/Vendor (2) Failing interfaces (human interaction) (3) Misuse of Trust and (4) Loss of Strategic business flexibility and (5) Loss of competencies[7].The earlier research studies on Offshoring of Information Technology services have pointed out“added risks” when the same are outsourced to an offshore location like India. Most of these risks are applicable to Business

Process Outsourcing as well. Relatively poor telecommunicationsin India, cultural differences, accents and language ability coupled with time-zonedifferences all of which accentuate communication difficulties, lack knowledge of a client's business application etc. have cited as the risks relating to offshoring to India. (Sahay et al, 2003; Sarkar and Sahay, 2004, Nicholson et al, 2006)[8-10]

Types of Risks faced by a BPO Industry

Risks faced on account of outsourcing of Business Processes have been classified in different ways by different authorities. The Technical Guide issued by Institute of Chartered Accountant on Internal Audit of BPO Industry (2010) classifies risks faced by BPO Industry as follows:

(i) Business risk; (ii)Price risk; (iii) Political risk; (iv)Process risk; (v) Human capital risk; (vi) Brand/ Reputation risk; (vii) Systemic risk; (viii) Accessibility risk, Business continuity, Security risks and (ix) Technology risk.Business risk relates to change in scope or change in volume or legal environment, early termination of contract or M&A activities. "Pricing risk" relates to cost control and providing commercial reasonable resolutions for both parties. Government control on tariff, riot change of policies, etc. relates to "Political risk". "Process risk" refers to the possibility of a major change in the delivery of service. Attrition and deployment of right resources relates to "Human Capital risk". "Reputation risk" relates to maintenance customer's reputation, especially when the service provided by a BPO service provider involves some interaction with customer's business stakeholders. Concentration of process management in the hands of a small number of service providers could pose "systemic risks" in the form of anti-trust or anti-competitive conduct, the risk of massive losses due to a single loss incident affecting multiple enterprise customers. "Security risk" relates to protection of confidential information of customers. Business Continuity is a critical when the business processes are handled in a location far away from the customer location. "Technology risk" refers to the risk that an entity faces due to change in technology or obsolescence of existing technology.

Deloitte identifies four risks in outsourcing of IT Services (2010): Operational and Transactional Risk, Risks to the confidentiality of information, Risks to business continuity, Compliance risk.[11]

"Risk Management" in BPO Industry

The risks associated with outsourcing have been a limitation on the growth of business process outsourcing, especially cross-border outsourcing. From the Outsourcer's stand point,in addition to technological improvements in risk management, it is possible to reduce the risk of opportunistic behaviour faced by the outsourcer by redesigning work flows and dividing work among multiple service providers, increasing the range of tasks that are now appropriate candidates for outsourcing[12].

Data security is one of the major risks in Business Process Outsourcing industry. KPMG and Data Security Council of India (2010) jointly conducted a survey in association with CERT-In, to assess current state of data security and privacy practices being adopted by the Indian BPO industry and to gain insights into how the Indian BPO industry is addressing security and privacy related concerns. The organizations have initiated focus on data privacy to address rising concerns of clients' end customers' data, which is also related to organizations being concerned of their brand image and they want to avoid any bad publicity in media. The study indicates that organizations are maturing to understand and distinguish security related operational tasks from strategic security tasks; thus optimizing Chief Information Security Officer's time for strategic activities. Further, organizations are bridging gaps in the security skills by availing services of external consultants for the specialized security tasks. There is an increase in adoption of 'Third Party Risk Assessment Framework' along with conducting Vendor Risk Management exercise by organizations for their service providers to mitigate third party related risks. The study further reveals that organizations continue to consider regulatory requirements as a primary driver for their investments. Although Indian BPO organizations are taking steps to stay updated on new threats, there is a need to have more collaboration within the industry (with peers) to stay ahead of these threats.[13]

Secondary research on leading BPO Service providers in India reveals a structured approach adopted by them to manage risk and ensure that they have a Risk Management Framework aligned to the global standards. For example, Infosys-BPO has aligned its control environment to the best in class standards that include e-SCM, TR 19/BS 25999, ISO 27001, ISO 9001, ISO 14001:2004, OSHAS 18001-1999, COPC, PCMM, AML, FISAP, SAS 70 etc.[14]

Besides the above, these Service Providers adopt the best practices like Failure Mode Effects Analysis (FMEA) to assess and mitigate the risk. Using this framework, risks to be focussed can be prioritized by arriving at "Risk Priority Number" for each potential failure as given below:

RPN = Probability of failure * Detectability of failure *Severityof failure.

The Service Providers take up risks with high RPN on a priority basis to mitigate.[15]

Role of Data Security Council of India

Data Security Council of India (DSCI) is a focal body on data protection in India, setup as an independent Self-Regulatory Organization (SRO) by NASSCOM, to promote data protection, develop security and privacy best practices & standards and encourage the Indian industries to implement the same.DSCI is engaged with the Indian IT/BPO industry, their clients worldwide, Banking and Telecom sectors, industry associations, data protection authorities and other government agencies in different countries. It conducts industry wide surveys and publishes reports, organizes data protection awareness seminars, workshops, projects, interactions and other necessary initiatives for outreach and public advocacy. DSCI has compiled and published the best practices and maturity criteria for each discipline relating to Securitybesides providing the framework[16].

Conclusion

Managing risks in BPO companies is of paramount importance as any major failure could lead to serious implications, not only damaging the service provider's reputation but also the image of the Indian BPO industry. The task of managing risk is only just creating a framework, but continuous rigour and review is needed on constant basis. Changing regulatory environment and new threats add to the complexities in managing risk.

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