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Outsourcing, Governance Mechanisms and Customer Satisfaction in E-commerce

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ABSTRACT

Delivery services play a critical role in online retailing environment. This study examines how different governance mechanisms influence the effects of outsourcing on customer satisfaction. We present propositions which should help academicians and practitioners alike in making desirable changes to the relevant processes while outsourcing their delivery services.

KEYWORDS: Outsourcing, E-commerce, Satisfaction, Control and Service

INTRODUCTION

The new market space of e-commerce is encouraging firms to adopt efficient business models for better profitability. The new and developing ecommerce environment is bringing many players to work together in tandem. It is removing various intermediate levels (resulting in reduction of costs), and at the same time also increasing the significance of intermediaries like the third party logistics firms. But outsourcing of delivery services can have some unforeseen fallouts for client especially when the intermediary fails to deliver on expectations. Such failures from the intermediary can adversely affect customer satisfaction. Hence it is imperative for the client firms to consider the factors that can influence the effects of outsourcing of delivery services on customer satisfaction.

Delivery services play an important role in processes like order fulfillment in the e-businesses. According to Frohlich & Westbrook (2002) and Klein & Rai (2009), there is a growing propensity among firms marketing products and services on the internet about external sharing of the market demand information for enhancing order fulfillment services.

Intermediaries are increasingly playing important part in the ecommerce space. Emergence of intermediaries can result in cost reduction in coordination activities, can alleviate limitation of asset specificity and can promote standardization (Malone et al, 1987). According to Brousseau (2002) economic theorists are proposing the rise of new business model opportunities due to “electronic” intermediaries. Due to the increasing role of supply chain management in the digital economy (Swaminathan & Tayur, 2003), electronic intermediaries have the potential of fundamentally changing the structure of supply chains and uniting disparate processes (Klein, Wareham & Cousins, 2011). Thus it is critical for client firms to ensure that the promised service levels and customer satisfaction levels are maintained. The firms will further have to observe how effect of outsourcing on customer satisfaction, is getting influenced by different factors.
This study considers factors like governance mechanisms and examines how they influence outsourcing effects on customer satisfaction. The paper has the following sections. The next section presents theoretical background discussing different concepts of outsourcing, customer satisfaction, their significance and control mechanisms. The subsequent section deals with propositions formulation and is followed by the section on discussion and managerial implications. The final section presents conclusion and discusses scope for future research.

THEORETICAL BACKGROUND

For e-commerce business besides the online ordering done by customer, other functionalities related to order fulfillment and distribution services, can also be very critical. For selling products the method of distribution could be as crucial as the decision of product development itself (Tsay & Agarwal, 2004).

Outsourcing of Delivery Services

Outsourcing is one of the options used by firms to reduce the transaction costs (Ang & Straub, 1998; Bolumole Frankel & Dag, 2007; Goldsby & Eckert, 2003). Firms are continuously trying to reduce their overall cost. Outsourcing is often undertaken with considerations like the cost savings. According to Poppo & Zenger (1998) and Williamson (1975), keeping Transaction Cost Economics as basis, it is economical for firms to contract out resources having low asset specificity, involving rarely used skills or not fully utilizing the available human capital. Jayaraman, Narayanan, Luo, & Swaminathan (2013) discuss that the transaction cost perspective suggests the consideration of costs and resources required for effective coordination with in the firm and with external party for mitigating the risks inherent in the outsourcing engagement.

Customer Satisfaction and its Significance

While defining satisfaction, Tse & Wilton (1988) mention that it is the consumer’s response to the evaluation of the perceived discrepancy between prior expectations and the actual performance of the product as perceived after its consumption. Giese & Cote (2000) describe customer satisfaction as a summary of affective responses of varying intensity, with a time specific point of determination and limited duration, directed towards focal aspects of product acquisition and/or consumption. Caruana (2002) has used this definition to develop a context relevant definition with respect to retail banking.

Earlier research has indicated that with increase in length of relationship customers can be more forgiving of service failures at transaction level (Anderson & Weitz, 1989; Bitner & Hubbert, 1994). A related point is, in the classic Howard-Sheth model of buyer behavior customer confidence was included as a key determinant of purchase behavior (Howard & Sheth, 1969).

Outsourcing of delivery services may impact service levels and customer satisfaction levels can increase (or decrease) due to improvement (or reduction) in service levels. Further, in the era of intense competition customer retention which can be direct fallout of customer satisfaction may prove to be an important factor in the long term success of an e-commerce firm.

Control Mechanisms
Many firms are accessing external resources for better productivity and performance. Enhancement in overall productivity of client can result due to the access to external high quality resources, lowering of production costs, and release of internal resources for better use (Bardhan, Mithas & Lin, 2007; Dibbern, Winkler & Heinzi, 2008; Levina & Vaast 2008, Luo, Zheng & Jayaraman, 2010; Metters & Verma 2008; Stratman, 2008). Governance mechanisms which a firm applies for ensuring delivery of better services from the service provider can be very critical in such scenarios.

Further, according to the literature, influence of the governance mechanisms (structural, relational, and administrative) on performance can be context specific (e.g., Liu, Luo & Liu, 2009; Luo 2000; Zhou, Poppo & Yang, 2008).

According to Govindarajan (1988) and Klein, Crawford & Alchian (1978), firm can be enabled to reduce transaction costs in relationship and achieve higher performance both through inter-organizational and intra-organizational governance control mechanisms. Benton & Maloni (2005) and Paulraj, Lado & Chen (2008) discuss that inter-organizational control mechanisms can facilitate achieving of results which meet mutual expectations in the client-vendor relationships.

Considering the aforementioned scenarios, it can be observed that the e-commerce firms will have to ensure that outsourcing of delivery services does not affect order fulfillment process in a negative manner and customer satisfaction is retained. Application of different control mechanisms can result in different service levels, further affecting customer satisfaction. One may try to intuitively assume that applying all the control mechanisms i.e. structural, administrative and relational can result in better performance but the uncertainties of situations and scarce resources may not allow this all the times.

The effects of outsourcing on customer satisfaction can depend on the degree of control the firm is having on the intermediary and the service delivered by the intermediary. The degree of control can be discussed in terms of the different governance mechanism which a firm can apply and the service delivery will depend on the experience of the service provider. Hence, the study addresses the below mentioned gaps:

How do different governance mechanisms influence the effect of outsourcing on customer satisfaction in e-commerce?

**PROPOSITION FORMULATION**

**Control-Related**

Customer satisfaction is influenced by the service levels provided by the online retail organization through intermediary. Higher are the expertise levels of service provider for managing given situation, lesser can be the dependence on other members of the supply chain. Further, with increase in customer facing operations, uncertainty tends to increase. Rising levels of customer contact result in considerable degree of uncertainty, is what is suggested by service operations literature (Larsson & Bowen, 1989).

With a high degree of uncertainty coupled with high level of expertise, an experienced service provider may desire more freedom and independence for better delivery of services. But the increased uncertainty will require the client firm to exercise more control on the service provider. Managing interdependencies and coordination improves performance (Gittell, 2002). Well
coordinated interactions between the client and service provider can improve coordination. The point of better coordination resulting in better outcomes has already been well discussed in literature, like research and development (Tushman, 1979) and new product development (Clark & Fujimoto, 1991; Iansiti and Clark, 1994). Further, the level of customer satisfaction, attitudes and repurchase intention are affected by the customer service and physical distribution, where physical distribution service items offered by the firm are being rated as some of the most important attributes by customers (Innis & La Londe, 1994). Thus the better performance of the experienced intermediary can positively influence customer satisfaction and repurchase behavior.

Similarly, an inexperienced intermediary will look more sharing and understanding in the given situation. Donnellon, Gray & Bougon (1986) indicate the establishment of shared understanding through communication by the team members when they encounter new circumstances. For an inexperienced service provider while working in business team (considering service provider and client as one single team), encountering newer business situations will require for increased communication and understanding between the team members. Thus, increased control by the client firm in this case can facilitate better understanding of client’s requirements and can also improve knowledge transfer for ensuring service levels. The resultant improved performance of the intermediary can positively affect the satisfaction and repurchase behavior of the customer. Hence the following propositions:

P1: While outsourcing delivery services in e-commerce, exercising lower control over experienced service provider and higher control over inexperienced service provider will be associated with higher customer satisfaction.

Customer dissatisfaction levels will be affected by the service levels provided. In the context of airlines, Fisk & Young (1985) observed that waiting time and pricing overcharges both caused higher levels of dissatisfaction. Likewise, service levels offered by online retailer in the delivery of items purchased can affect customer satisfaction levels. Hence the decision of outsourcing its delivery services can have an impact on the service levels experienced by the end customer. Esper, Jensen, Turnipseed & Burton (2003) and Heim & Field (2007) find that companies using reliable carriers for delivery had better patronage from customers.

Of the different control mechanisms, structural control mechanisms in particular seem to be derived from the considerations of minimizing costs and opportunism in the vendor-client interaction. According to Transaction Cost Economics, structural control mechanisms are derived from economic rationale and they also restrict opportunism using incentives and penalties (Jayaraman et al, 2013). According to Heide & John (1992) and Liu et al (2009) cooperation building and restricting opportunism can be facilitated using relational mechanism. Administrative control mechanisms deal with explicit set of rules and processes delineating individual responsibilities lending structure to activities in firm (Jayaraman et al, 2013).

Further while selecting the service provider the firm will have to choose from various options available like the provider with more experience and credibility is going to charge more but a new entrant may quote some lesser price for gaining advantage through competitive pricing. Firm may choose to opt for either of the options but for each scenario different control mechanism could be required. In either case the information dependence can play a very critical role in outsourcing of services.
Firms choosing the service provider who is charging less but also has less experience will have to ensure that the client-vendor relationship is structurally strong so to make the inexperienced service provider better aware of the requirements and client expectations. Firm may even be required to do some initial hand holding in such scenarios. Further, the dependence of information exchange will be far higher as the firm will have to ensure that the vendor understands the tasks clearly. This will further require clear delineating of processes, contracts and service level agreements. Hence a structural control mechanism will be required, which can directly improve delivery service levels in turn affecting customer satisfaction. But for an experienced service provider, the processes and skills are already well established, and may not require much guidance or hand holding. Rather than improving structural and administrative requirements, focusing on relational mechanism will not only improve integration but will also give the required freedom to the service provider in this case. So we present the following propositions:

P2: Higher customer satisfaction will be associated with structural governance mechanism being used with inexperienced service providers and relational governance mechanism with experienced service providers of the delivery services.

Increasing competition can force online retail organizations to be more customer focused especially in maintaining service levels. Ensuring the maintenance of desired customer focus by third party service provider may require application of control mechanisms. Also, the administrative mechanisms will have to be applied at the service provider’s place. To ensure such implementation of mechanisms, online retail organization may have to use structural mechanism to enforce the specific administrative mechanisms in the service providers processes. Thus, for improving end customer satisfaction, out of the three control mechanisms (structural, administrative and relational), structural and administrative mechanisms will be more effective. Similar practices are also followed in automobile industries where even the supplier’s supplier has to follow certain practices and protocols if he is responsible for delivering raw material or assembly components.

Hence we present the following propositions:

P3: Structural and administrative mechanisms are associated with improving customer satisfaction more than relational governance control mechanism

**DISCUSSION AND MANAGERIAL IMPLICATIONS**

This study examined areas such as the outsourcing of delivery services in e-commerce, governance mechanism, and their influence on outsourcing effects on end customer satisfaction. For the present business scenario it is important to discuss outsourcing of delivery service in ecommerce firstly because more and more firms are increasing their businesses in to ecommerce space. Also, with delivery of items playing an important role in online buying process and logistics becoming a specialized area, the trend of more and more firms outsourcing their delivery services to a third party are likely to increase. For effective outsourcing of services, controlling the interactions between client firm and the service provider will be required. With increasing digitalization, information dependence discussed in the study will be gaining importance in ecommerce business format. The governance mechanisms discussed in the study considered both the explicit knowledge (using structural mechanisms) and tacit knowledge (using relational mechanisms). With the increase in available online choices to customers, their satisfaction (and resultanty their retention) will be governed not only
by the product but also by its delivery. Hence considering the highly competitive e-commerce space, outsourcing and controlling in this study is discussed in context of how control mechanisms are influencing outsourcing effects on customer satisfaction.

Practice of enforcing suppliers to adopt processes and protocols has been followed in manufacturing sector (where the component suppliers are required to follow certain practices and rules if they are to supply to the known manufacturers). While such enforcement on suppliers is being observed travelling upstream in manufacturing supply chain, this study discussed the same in context of customer facing delivery services which are highly critical to e-commerce customer buying process and also for smooth functioning of overall the e-commerce business. Such procedures can also be observed in the call centers where the operators hired by the service provider are particularly trained in a standard way (like starting the conversation with mentioning ones name and saying proper greetings) so as to ensure service levels and accountability.

Thus contrary to intuitive judgment which may suggest applying of all the control mechanisms in equal measure for improving customer satisfaction, it can be observed that there can be context specific factors like experience of the service provider which can emphasize on the requirement of a particular mechanism. Likewise, information dependency is another area that can affect the choice of control mechanism. It may not be always feasible to capture tacit information through structural mechanism and relational control mechanism may have to be employed in such scenarios.

This can help both industry practitioners and academicians alike. For practitioners the various insights/propositions provided can aid in better evaluating the service providers according to the given limitations of the situation and improve customer satisfaction. For academicians they can also provide a renewed understanding of the way different control mechanisms can be employed and the possible outcomes they can expect.

CONCLUSION AND AREAS OF FUTURE RESEARCH

The study presents a several propositions and the future research will be based on empirically testing the propositions. Further, though the study provides with various discussions emphasizing the role of control mechanisms on outsourcing effects, it is especially relevant for the upcoming business environment of e-commerce where more and more firms are likely to go online with their business. As it may not be always possible for the firms to employ or develop their own delivery services and hence effective and efficient outsourcing of delivery services can be an important area of research in the context of e-commerce.

Future research can consider the scenario of any ecommerce firm which has outsourced its delivery services to various service providers and test the propositions mentioned in this study. A particular product category and geography can be considered so as to avoid complexities of comparing different firms. The end customer can be requested for the feedback about the services. Indirect measures like repurchase behavior can also be observed or longitudinal study can also be undertaken.

REFERENCES


