

## Chapter 2

# Offshoring Activities Impact a Company's Business Model: The Case of BBVA and Banco Santander

Carmen Paz-Aparicio and Joan E. Ricart

**Abstract** There is an agreement in the literature that an effective business model is a competitive weapon for multinationals. We extend this strategic framework to the offshoring arena by analyzing a change in the business model as a means for coping with the inefficiency trap and reducing complexity management. Most companies start by offshoring simpler tasks and achieve great savings. But, as they become more involved in offshoring, complexity increases and savings decrease. We analyze this by studying two Spanish banks, BBVA and Banco Santander. Findings suggest that the reason and the limit to complexity can be found in the need to change the business model. Results may stimulate future research in other industries and companies from other countries.

**Keywords** Offshoring · Business model · Effectiveness · Inefficiency trap · Complexity management · Case study

## 2.1 Introduction

For a long time, the topic of *business models* has dominated management literature and business jargon. However, there is no widely accepted definition of this term's meaning. Practitioners often talk about business models as “the way the firm operates” (Casadesus-Masanell and Ricart 2009). Although this notion seems to be

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C. Paz-Aparicio (✉)  
Business Management Division, Universidad Carlos III de Madrid, c. Madrid 126, 28903  
Getafe, Madrid, Spain  
e-mail: carmen.paz@uc3m.es

J. E. Ricart  
IESE Business School, University of Navarra, Avda. Pearson 21, 08034 Barcelona, Spain  
e-mail: JERicart@iese.edu

similar to that of strategy, Casadesus-Masanell and Ricart (2010) argue that a *business model* is a reflection of the firm's realized strategy. It refers to the firm's logic, the way it operates and how it creates value for its stakeholders. The same authors define *strategy* as the contingent choice of business model through which the firm will compete in the marketplace.

The chapter seeks to extend this strategic framework to the offshoring arena as a way of dealing with the inefficiency trap. We use this term to refer to the observed phenomenon in which many experienced firms start to fail in the efficiency goals they pursue as they extend offshoring to more complex activities.

There is essentially no consideration of the impact of offshoring activities on the firm's business model. It seems that the factors usually considered are those related exclusively to the individual activity to be offshored, not the impact on the business model as a whole. We address the question of how to avoid the inefficiency trap by understanding the implicit impact on business models. As the strategic management literature has shown, when business models are effective, companies tend to perform better.

There are potential benefits in extending this framework to the offshoring arena. First, it can provide a new, conceptually grounded way of understanding the reasons for deciding to offshore. Second, it can be used to incorporate a contingency view of offshoring according to which another reason for offshoring will revolve around the expected impact of the integration of offshored activities on the business model and how companies can deal with the inefficiency trap. Finally, extending this approach has benefits from a practical perspective. A key challenge for practitioners in multinationals incorporating offshoring is to make the most appropriate decisions to remain competitive within the industry.

The chapter is structured as follows: The Sect. 2.2 explains in detail what a business model is, or what we understand it to be, what the difference is between business model and strategy, and what we mean by an effective business model. In Sect. 2.3, we review the topic of offshoring, analyze its most important drivers for companies and review the activities that are most commonly offshored. We also introduce the concept of inefficiency trap. Section 2.4 discusses *two different ways of integrating offshoring activities with a business model*, radically changing it or not, by describing the cases of two real companies, BBVA and Banco Santander. Section 2.5 provides a summary of *key findings and best practices* learned from the specific cases in the finance industry. To close the chapter, we suggest some recommendations for companies incorporating offshoring and discuss managerial implications and aspects for future research.

## 2.2 Business Model and Strategy

We all agree that the term business model is more widely used nowadays than almost any other concept in strategy. "When people are asked *what is strategy?* most give an answer that includes the words *business model*", (Baden-Fullen and

Morgan 2010). And this shows that “the terms *business model* and *strategy* are among the most sloppily used in business” (Magretta 2002). In order to have a clear understanding of what the difference is, we provide a concrete definition for each one.

Some academicians think of a business model as “a well-specified system of interdependent structures, activities, and processes that serves as a firm’s organizing logic for value creation, for its customers, and for value appropriation, for itself and its partners” (Sorescu et al. 2011), while others define it as “a system of interdependent activities that transcends the focal firm and spans its boundaries” or as “the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities, and a template of how a firm conducts business, how it delivers value to stakeholders and how it links factor and product markets” (Zott and Amit 2010). The same authors think that business model design is a key decision for a new entrepreneur and a crucial and perhaps more difficult task for managers charged with rethinking an old model to prepare their firm for the future (Zott and Amit 2010).

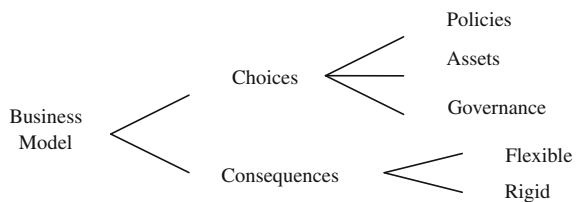
To summarize, the concept of *business model* has been used in the strategy literature to refer to the firm’s logic or how the company operates and creates value for its stakeholders (Casadesus-Masanell and Ricart 2010). A business model is a reflection of the firm’s realized strategy (Casadesus-Masanell and Ricart 2010), and this is the definition that we will adopt.

Going deeper into the topic, a business model consists of a set of *choices* management makes for how the organization will operate and the set of management *consequences* derived from these choices (Casadesus-Masanell and Ricart 2009). For example, decisions such as where to locate facilities or the extent of vertical integration are considered choices. If we think of pricing policies, as they have implications for sales volume, they are considered a consequence. Because these consequences describe the way the firm operates, they are part of the definition of a business model. Figure 2.1 shows the elements of a business model.

Furthermore, Casadesus-Masanell and Ricart (2009) distinguish between different types of choices (policies, assets, and governance of assets and policies) and consequences (flexible or rigid).

*Policies* refer to the courses of action the firm adopts for its operation. Locating plants in rural areas or making employees fly economy class in order to reduce costs are two examples. *Assets* refer to tangible resources such as manufacturing facilities. *Governance of assets and policies* refers to the structure of contractual

**Fig. 2.1** Elements of a business model *Source* Casadesus-Masanell and Ricart (2009)



arrangements that confer decision rights for policies or assets. As an example, a business model may contain as a choice the use of certain assets such as computers. The company may decide to own or lease those computers.

A consequence is *flexible* if it is sensitive to the choices that generate it. For example, “high volume” is a consequence of a policy of low prices. If the policy changes to high prices, volume is likely to fall rapidly. On the other hand, a *rigid* consequence is one that does not change rapidly with the choices that generate it. As an example, corporate culture is a consequence that is very difficult to change.

In most businesses, there are multiple choices and consequences (Casadesus-Masanell and Ricart 2009), which implies that every organization has a business model (Teece 2010). This is because every company makes some choices, and these choices have some consequences. Of course, this does not mean that every business model is satisfactory or even viable in the long run. Different designs have different specific logics of operation and create different value for their stakeholders. So, how can we tell a good business model from a bad one?

The success or failure of a company’s business model depends largely on how it interacts with the models of other players in the industry (Casadesus-Masanell and Ricart 2011). However, a preliminary appraisal of a business model’s effectiveness can be obtained in isolation by checking the business model’s alignment with the organization’s goals, the mutual reinforcement or fit among different parts of the business model, the virtuousness or degree of positive feedback generated by the business model and the business model’s robustness or ability to face threats to its sustainability (Casadesus-Masanell and Ricart 2011). Then, once in interaction, companies can compete through business models in different ways. For instance, they can strengthen their own virtuous cycles, block or destroy rivals’ cycles or build complementarities with them, transforming substitutes into complements (Casadesus-Masanell and Ricart 2011).

Thus, every organization has a business model, but not every organization has a strategy. A competitive strategy explains how you will do better than your rivals, and doing better means being different (Magretta 2002; Porter 1996). When a new model changes the economics of an industry and is difficult to replicate, it can by itself create a strong competitive advantage (Magretta 2002).

“*Strategy* refers to the choice of business model through which the firm will compete in the marketplace” (Casadesus-Masanell and Ricart 2010). It is an action plan for the different contingencies that may arise.<sup>1</sup> Thus, “*strategy* refers to the *contingent plan* as to what business model to use. Choosing a particular business model means choosing a particular way to compete, a particular logic of the firm and a particular way to operate and create value for the firm’s stakeholders. Business models are reflections of the realized strategy” (Casadesus-Masanell and Ricart 2010). Potentially disparate business models may be consistent with a given

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<sup>1</sup> The same authors talk about another concept: tactics. This refers to the residual choices that are open to a firm by virtue of the business model it chooses to employ and are crucial in determining the firm’s value creation and capture (Casadesus-Masanell and Ricart 2010).

strategy, just as many different paths may lead to the same destination (Sorescu et al. 2011).

Accordingly, the substantive difference between strategy and business model arises when the firm's action plan calls for modifications to the business model when particular contingencies take place (Casadesus-Masanell and Ricart 2010). An analyst outside the company will not observe the incumbent contingent strategy. He will only observe the organization's business model as the reflection of its *realized* strategy. Furthermore, as has been discussed previously, while every organization has some business model, not every organization has a strategy or action plan for the different contingencies that may arise (Casadesus-Masanell and Ricart 2010).

### 2.3 Offshoring Activities and the Business Model

There is some confusion between the terms outsourcing and offshoring as they are not always used appropriately. For clarification, the reader can see Appendix A. Furthermore, we can also distinguish between two main types of offshoring (Ricart et al. 2010):

- The transfer of blue-collar work (i.e., production), which has been very common for many years as an alternative strategy to reduce costs.
- The transfer of white-collar work (i.e., services), which began much more recently, includes activities with greater added value. This new type of offshoring emerged in the 90s as companies started to move administrative and technical functions (IT, call centers, product development, etc.) abroad to save labor costs and tap into new sources of talented and highly skilled employees (Lewin and Peeters 2006). The offshoring of white-collar functions represents a new type of internationalization. In this chapter, we will focus on this type of offshoring.

Thus, the offshoring of services is becoming “the” critical international economic development issue. In contrast to the relocation of manufacturing jobs overseas, where the affected employees are mainly blue-collar workers, in service offshoring, it is the white-collar workers who are to be displaced (Dossani and Kenney 2007).

An examination of outsourcing and offshoring would suggest cost reduction as a main driver. However, especially in recent years, two other strategy motivators have gained significance: the knowledge-accessing motive and to better understand and exploit foreign markets (Contractor et al. 2010). It is also clear that companies' motives for engaging in offshore outsourcing change over time (Lewin and Couto 2007).

Consistent with these views, the 2009 Offshoring Research Network (ORN) report shows that in the early days of offshoring, much of the growth came from the huge volume of administrative transactions (back-office activities such as

finance, human resources, procurement). These functions have often been sourced from specialized service providers who can perform the task more efficiently and at a lower cost. The report states that more recently, companies have started to look for global sourcing for their innovation services (product design, research and development and engineering services). This is surprising as these services were once viewed as critical competencies that had to be kept in-house. In the same 2009 survey conducted by the ORN, 32 % of the surveyed companies indicated that they offshore at least one administrative activity. This report also shows an interesting difference. When making a decision to offshore administrative services, companies are clearly looking for “cost savings” and “business process redesign”. The offshoring of innovation services, however, is driven more by concerns about the need to “enhance capacity for innovation” and increase “organizational flexibility” and “speed to market”.

The decision to offshore an activity is complicated. In choosing which processes to relocate, often the most routinized activities are offshored first because of the lower risks of failure (Dossani and Kenney 2007). The disaggregation of the value chain enables companies to make finer allocation choices, for each slice of their value chain. But disaggregation and dispersion of the firm, beyond an optimal degree, also entail more complexity and more costs in terms of added management and communication efforts (Contractor et al. 2010). Moreover, the new wave of offshoring and outsourcing not only includes standardized activities driven by cost savings and involving lower-skilled labor but, as highlighted in many studies (Baden-Fuller et al. 2000; Lewin and Cuoto 2007), also includes more sophisticated and advanced activities such as research, design, engineering and product development (Contractor et al. 2010).

### ***2.3.1 The Offshoring Inefficiency Trap***

While cost savings have been discussed by academicians and practitioners, efficiency in offshoring has taken on greater significance in the current worldwide economic crisis. Companies participating in the 2007–2008 ORN survey identified two main factors for enhancing efficiencies. The first involves increased emphasis on business process redesign. The second involves enhancing existing organizational capabilities for managing outsourcing/offshoring strategies. Their findings reveal that in response to the current financial crisis, a significant number of respondent companies plan, or have already taken steps, to increase efficiency by improving coordination and integration of their offshoring processes (Lewin et al. 2009, 2011). This rising concern about efficiency reflects firms’ attempts to develop capabilities to overcome the *inefficiency trap*, a common trend among companies conducting offshoring.

The *inefficiency trap* describes a phenomenon in which the first offshoring implementations result in major cost savings, as a result of which the scale and scope of the functions and processes outsourced or offshored are increased.

This growth in offshoring activities is followed by a steady decline in average savings (across all offshored activities). After early successes boost efficiency and add value, more functions are offshored, and various hidden costs become more evident. But few leading companies have been able to back out and escape such a trap. The results of the survey show that as the scale and scope of offshoring increases, low-experience companies discover a need to reflect on the internal capabilities and global competencies needed to manage the coordination and complexity of globally dispersed internal processes, integrating captive and third-party delivery models and functions (Lewin et al. 2011).

Most companies participating in the ORN survey during 2005–2009 are not getting the savings they could possibly achieve. Specifically, in the finance sector, only 5 % of the companies participating in the survey achieved the expected savings in spite of further development of its offshoring activities (ORN Presentation. 2nd Financial Services Roundtable Briefing 2009). This means that all but 5 % of the respondents with sufficient experience in offshoring seem to be caught in the inefficiency trap.

Furthermore, as the scope of offshoring grows and the number of service providers and offshore locations increases, the management of provider selection and oversight becomes much more complicated, forcing companies to acquire and develop the organizational competencies needed to manage and globally coordinate dispersed organizational units (Lewin et al. 2011).

The increased cost of managing and coordinating interdependent activities is denoted as the “hidden” or “invisible” costs of offshoring and stems from the increased need for coordination through the specification of tasks and interfaces among dispersed activities. These costs can be, if not avoided, at least substantially reduced through the selection of proper task interdependence and interface design. The more standardized the interfaces between activities, the less the coordination is needed. These costs are related to the complexity that follows from separating activities and spreading them around the globe (Andersson and Pedersen 2010).

The mechanisms for minimizing hidden costs can be divided into three basic areas: minimization of the use of supervision and management resources, minimization of the need for interunit communication and implementation of high-tech communication solutions (Andersson and Pedersen 2010). Moreover, while coordination of interdependent tasks can be challenging in collocated groups, it is even more so in the case of onshore–offshore teams because of differences in language, culture, institutions, work practices and skills (Cramton 2001 and Mannix et al. 2002 in Sidhu and Volverda 2011).

The ORN data also suggest a growing interest among senior management in offshoring initiatives and developing a corporate-wide strategy for guiding outsourcing–offshoring decisions. The importance of a corporate-wide strategy is further supported by the analysis comparing cost savings achieved before and after implementation of a corporate-wide offshoring strategy. Companies that have adopted offshoring strategies report significantly more savings across all functions (Lewin et al. 2009, 2011).

To summarize, most companies start by offshoring simpler tasks and achieve great savings. But as they become more involved in offshoring, complexity increases and savings decrease. In the end, offshoring results worsen instead of improving. Companies fall into the inefficiency trap because managing complexity decreases the labor cost arbitrage.

We claim that the business model perspective introduced in the previous section can help us understand this phenomenon and the ways to approach it. In the most standard evolution of offshoring activities, companies use the incremental perspective, starting with simple tasks and then offshoring increasingly complex activities. Eventually, the changes introduced reach the boundary of the established business model, and further changes start generating inconsistencies, making it more difficult to spin off virtuous cycles. Faced with these tensions in the business model, firms make effort to simplify the organization and develop new organizational capabilities or better information and governance systems. As reported by Andersson and Pedersen (2010), some firms succeed in these efforts. Others, however, cannot adapt the established business model and fail.

Strategy is the art of anticipation. Some firms decide *ex ante* to develop new strategic alternatives by creating innovative business models where offshoring is naturally engrained on them; they develop the necessary organizational capabilities and governance systems in anticipation of entering into offshoring. Thus, they first make a strategy move, and change their business model, and only then move into further offshoring. If well designed, they can avoid the inefficiency trap altogether.

To illustrate both types of move, we use as examples two bank groups from Spain: the BBVA and Banco Santander.

## 2.4 The Case of BBVA and Banco Santander

We begin with the case of BBVA, a Spanish bank. BBVA is a leading multinational financial institution with over 150 years of history. It is currently one of the leaders in the Spanish, Portuguese and Latin American markets. By the end of 2010, it employed 107,000 people, had 7,361 branches in over 37 countries around the world and accounted for 37 million customers. As of December 2009, it had 884,373 shareholders. The BBVA group has five primary business units: Spain and Portugal, Global Services, Mexico, USA and South America.

In 2006, the Operations and Production department received instructions from the top management to reduce expenditure as part of a global strategy to increase bank competitiveness and a new Global Operations Director was named. BBVA's Operations Division employed about 6,000 people, which were providing service mainly to Spain, Mexico, South America and USA. The services were offered locally. The Spanish Division's Operations Department had about 1,000 employees, 90 % working in Madrid and 10 % in Bilbao. This department was the bank's "back office" in Spain and Portugal.



The Global Operations Director created a new operations model, with a Global Operations Division for each region. He wanted not only to reduce costs but also to give autonomy to the different business units, increasing service quality and efficiency.

When deciding to offshore some of its activities, BBVA wanted to keep know-how and process control in-house. For the Spanish business unit, the first regional unit to move into offshoring, the critical activities (30 %) were identified, and for these activities, the bank created a near-shore center in Malaga, wholly owned by BBVA.<sup>2</sup> The other functions, the simpler administrative functions, after the successful move to Malaga, were to be provided by external global partners.

The story of BBVA Spain is therefore quite simple. Starting with “back office” functions, they carry out a process reengineering. This is the most common way of introducing the bank into offshoring. BBVA identified the processes that can be moved onshore and offshore (70 %), and they choose the countries, select a reliable external provider (IBM) and sign a long-term contract. And they are successful in terms of cost reduction, increased efficiency and service quality. Once this is done, they do the same in South America, Mexico and USA. There is no unified system and they work with different providers,<sup>3</sup> but they can share best practices and experiences thanks to the unified dependence of the Global Operations Department.

They also plan to focus on specialization of vendors in order to obtain more synergies, but they need to develop the corresponding capabilities. They have plans to also offshore some of their branch office activities in the short term, but again new learning will be required. Over time, complexity will surely increase. Furthermore, the activities that it is planned to offshore in the near future are very close to the customer and thus very difficult to manage. In order to avoid the trap, the BBVA will need new organizational capabilities and governance structures. At some point, the bank may find it necessary to change its business model and look for other policies, new investments and, most important, new governance modes.<sup>4</sup> If the bank is able to perform these changes, it will avoid the inefficiency trap. If not, BBVA might have to cope with it. We contend that the main sign that the bank is approaching the inefficiency trap is the strain and tensions on the actual business model.

The process followed by BBVA is similar to that used by other firms. According to a report published by The Conference Board and Duke ORN in 2010, the service delivery model that financial services and insurance (F&I) companies have been using for offshoring has evolved. Prior to 2001, 61 % of F&I companies

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<sup>2</sup> In fact, 10 % of the processes stayed in Madrid and 20 % finally moved near shore to Malaga.

<sup>3</sup> For the case of the Spanish business unit, IBM is responsible for 90 % of the processes, which are performed in Buenos Aires and Mexico DF, while Indra and Everis manage the other 10 %, from a center in Lima.

<sup>4</sup> In the case of an internal governance mode, the firm owns the foreign entity. In the case of an external governance mode, the firm outsources its activities to a local service provider (Hutzschenreuter et al. 2011).

reported that they initiated offshoring through captive operations. By 2006, most of the large institutions had already built significant captive operations. According to the 2009 Duke University survey (Lewin 2009), only 17 % of F&I companies had opened a captive delivery center in the last two years. Respondents from F&I organizations with captive operations rate “part of a larger global strategy” (83 %) as the number one driver that influenced their offshoring decisions. They also prefer a captive model because it is perceived as a hedge against the “loss of managerial control.” But as they become more experienced with offshoring, they tend to diversify their operations and start putting more emphasis on third-party international providers.

Another interesting example of offshoring is the case of Santander Group. Their approach to integrating offshoring activities is completely different from that of BBVA.

Banco Santander started in 1857 as a local financial institution. The bank grew in importance and financial resources over the years. In 1994, it bought Banesto, which reaffirmed the bank’s position as the leading player in the Spanish market. Five years later, it merged with Banco Central Hispano—the first major bank merger under the Euro. Expansion continued with acquisitions in Portugal, Brazil, Mexico and Chile, making it the leading financial franchise in Latin America in the year 2000. Abbey (the sixth largest bank in the UK) was purchased in 2004. This acquisition was followed by the purchase of Banco Real in Brazil (2007), allowing it to double its presence in that market. Alliance & Leicester and Bradford & Bingley, both UK banks, were acquired in 2008, and the financial institution became the third largest bank in the UK by deposits. Finally, in 2009, Banco Santander entered the US retail banking market with the acquisition of Sovereign Bank.

Today, Santander has a well-balanced geographic diversification spanning both developed and developing markets. The Group presently has more than 90 million customers, 13,600 branches and over 169,000 employees. In 2009, it reported a net income of 8,943 million Euros, a market capitalization of 95,043 million Euros and asset management above 1,100 billion.

The Santander Group has differentiated itself from its competitors by designing and implementing a unique technological platform and a successful operational and organizational model capable of absorbing the numerous acquisitions without losing control of operations and, at the same time, reducing costs. Thus, Santander changes its business model completely before embarking on offshoring. It changes its technological platform and governance modes; it creates three companies (Isban, Produban and Geoban)<sup>5</sup> where back-office tasks are centralized. Once everything has been moved into these captive factories, offshoring (and outsourcing) is a natural step in managing decentralized activities. Let us look at this in more detail.

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<sup>5</sup> And other smaller units not included in this document.

Its technological platform consists of three layers (Ricart et al. 2011). The base, called *Partenón*, is a flexible, modular and expandable transactional system shared by the whole group.<sup>6</sup> This allows rational operations and creation of cross-selling opportunities, improving customers' satisfaction and operational performance. The platform uses a single database so all of the customer's relationships with the bank are automatically linked through a single view. Above the transactional system, there is a "middleware" layer which serves as the baseline for the multi-channel services, such as integrating ATMs, Internet banking, offices. Finally, there is a user layer, called *Alhambra*, which performs typical functions for a consumer management system (CMS) platform, customer service, information integration, etc.

The Santander Group is determined to be recognized as the most efficient bank in the world (Ricart et al. 2011). In order to achieve this goal, it has built a strategy aimed at reducing costs, implementing a strong cost discipline and increasing efficiency through unification and standardization of both processes and technology. The efficiency model implemented emphasizes the importance of three clearly defined dimensions—decrease in costs, control of operational risks and continuous improvement in service quality.

These three dimensions encompass all three levels of the technological support system: technological, operational and organizational. As a result, the system is not only a technological advance but has also become an irreplaceable part of the business model as a whole. Known as the "integrated management of efficiency," this entails coordinating work among the different systems, impacting on all three efficiency dimensions. The common technological platform and organizational model allow Banco Santander to benefit from economies of scale as it is able to transfer key technological aspects, information systems and processes to unified and centralized units.

The Santander's organizational model is characterized by each business unit (a bank, for example) having a Manufacturing Manager, responsible for the unit's technology and operations, while also being a member of the executive team in charge of the business's management. The Manufacturing Manager's main objective would thus be to maximize the bank's value while introducing adequate cost optimization, quality improvements and adequate control of operational risk. Moreover, the work at the individual unit has been further consolidated with that of the corporation, as most of the technology and operations are subcontracted to the group's centralized units (factories): Isban (software development), Produban (data centers) and Geoban (back-office activities).<sup>7</sup> This unification and centralization leads to substantial improvements in efficiency as a result of the effective and successful coordination of the relations between the two entities.

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<sup>6</sup> In fact, the actual deployment is not finished yet, but the ultimate objective is the common platform as explained in the text. The same is true for the other layers of the system.

<sup>7</sup> Isban has three global centers in Spain, Brazil and Chile. Produban operates globally from its centers in Spain, Mexico, UK and Brazil. And finally, Geoban provides its back-office activities from centers located in Spain, Portugal, Poland, Mexico, UK, Germany, USA and Argentina.

By means of this technology and operations model, the business units (majority banks) use these centralized factories, with unified policies established at corporate level in the Group, guaranteeing maximum efficiency. This allows the banks to remain in control of their processes, operations and technology, while, at the same time, they can rely on the highly specialized functionality of the centralized units. In essence, the bank outsources execution of these services on a technological level, while, due to the interconnectedness of the central and local units, the process remains within its premises.

The efficiency ratio, used as a principle for measuring operations' efficiency, is the cost-to-income ratio. This measures how much each unit of income costs in operations (the smaller the ratio, the better the efficiency within the unit). However, it is not the only measure that the Group uses to reflect corporate development, as improvements should be achieved by increasing quality without increasing the banking risk. This balance is the key to the bank's future development.

Note that Banco Santander basically decided to change the business model in anticipation of the expected complexities associated with integrating an increasingly large and diverse number of acquisitions. The new business model is designed to benefit from the opportunities provided by its global imprint, including, of course, offshoring/outsourcing.

## **2.5 Offshoring and the Business Model: Key Findings in Finance Companies**

Having described how BBVA and Banco Santander integrate offshoring into their business models, we can summarize by saying that companies may start by offshoring a few simple activities and this is a good way to learn. We saw that while the cost savings from offshoring service work are usually clear, operating at a distance also brings with it certain "invisible costs" (Stringfellow et al. 2008) that managers need to be aware of. Unlike manufacturing, which does not need customer presence during production, some services require customer involvement and the immediate implication for offshoring is how to facilitate this customer involvement in real time and across distance. Furthermore, the most important issue in the service sector is service quality (Stringfellow et al. 2008).

But in the end, complexity will overtake you and complexity costs will increase dramatically. The reason can be found in the need to change the business model. You should anticipate it and prepare yourself. Otherwise, complexity will destroy all arbitrage advantages, unless the organization is mature enough to deal with it. Eventually, the need to adapt the business model requires a change in the strategy and the organization, as well as developing some new capabilities. And the move to a new, innovative business model may require big changes even in the technological platform, as the example of Banco Santander shows.

Essentially, we are describing a process of incremental change that pushes firms to the boundary of their established business models. When increasingly strategic activities are offshored, the overall growth in complexity, with local, onshore and offshore activities, will eventually make it clear that a change in business model is needed. Failure to do so will lead to the inefficiency trap described earlier.

Alternatively, firms can start by radically redefining their business model to adapt it to the arbitrage, scale and learning opportunities associated with the multiple locations of business activities. This has been the risky road taken, for example, by the Santander Group. However, by redesigning the business model beforehand, it has avoided complexities *ex post*. Or, in other words, complexity has moved to a corporate office where it can be dealt with better than at the operational level.

Not surprisingly, a study conducted by IBM Corporation, based on conversations with 1,500 chief executive officers worldwide, states that CEOs consistently say that coping with change is their most pressing challenge. In 2010, their conversations identified complexity as a primary challenge. But how can CEOs capitalize on complexity? The increasing complexity calls on CEOs and their teams to lead with creativity, connecting with their customers in imaginative ways and designing their operations for speed and flexibility to position their organizations for success. Previously, CEOs only had to recognize the need for business model innovation, but today, they are struggling to find the requisite creative leadership to produce such innovation. To capitalize on complexity, CEOs embody creative leadership, reinvent customer relationships and build operating dexterity (IBM report 2010).

It is our belief that most multinationals have already accumulated some experience in offshoring and outsourcing. They have learned and developed some basic capabilities. As we move forward, we expect most of them to act proactively and develop innovative, novel business models where they can get the full advantage of offshoring and outsourcing as they locate multiple and diverse activities around the globe.

## 2.6 Conclusion

Offshoring value-chain activities to organizational sites located in other countries has materialized as a business phenomenon of tremendous social and economic significance (Sidhu and Volverda 2011), and it is expected to continue to grow for at least the next two or three years, according to the 2009 ORN survey results (Lewin et al. 2011). Specifically, 57 % of financial services companies, in spite of the economic downturn, indicate that they plan to expand their offshore operations in the next 18–36 months. This is why understanding the offshoring phenomenon and the factors that contribute to increasing effectiveness can help companies make better decisions in the design and location portfolio of their offshored work (Stringfellow et al. 2008). “Companies will discover that offshoring is not so much

about taking costs as it is about enabling them to experiment with radically new ways of doing business” (Lewin and Peeters 2006).

By analyzing the cases of BBVA and Banco Santander, we are able to find some best practices that we hope will help practitioners in the financial services industry. As companies become more involved in offshoring, complexity increases and leads them to the inefficiency trap because managing complexity decreases the labor cost arbitrage. We think that the limit to this complexity is at the business model level and suggest that companies should make effort to simplify the organization and develop new organizational capabilities and governance systems. The key issue here is the need to define and adapt the business model. Moreover, companies will benefit if they are able to predict this potential complexity and ensure that their business model is aligned and consistent (Larsen et al. 2011) before integrating offshoring. And Banco Santander perfectly illustrates this situation. As a result, we see how complexity will increase at the corporate level, requiring substantially more leadership skills and creativity from CEOs and upper-level managers. But is not that better than facing complexity at the operational level? We definitely think so.

The recommendations given in this chapter have limitations. It will be interesting to do the same analysis for companies in other industries and also from different countries (BBVA and Banco Santander are both originally from Spain).

“Transformational outsourcing”, which is the new buzzword of the twenty-first century, aims at creating new radical business models that can generate competitive edge for firms and change the rules of the game in their industries (Engardio 2006 in Hätonen and Eriksson 2009). The essence of transformational outsourcing is that where “traditional outsourcing” focuses on sweating assets harder, “strategic outsourcing” aims at acquiring capabilities that the firm is lacking, and “transformational outsourcing” is about changing the paradigm, that is, targeting a new adaptive enterprise (Linder 2004; Linder et al. 2002 and Mazzawi 2002 in Hätonen and Eriksson 2009). So, could not we also talk about “Transformational offshoring” if, as we have said, we need to change (radically or not) our business model if we wish to remain competitive and avoid the inefficiency trap when incorporating offshoring activities?

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