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OUTSOURCING AND ITS PROFITABILITY FOR THE SWISS FINANCIAL SECTOR

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Phil Moser

International Business Abstract
Author Phil Moser Year 2024
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Supervisors Simona Chilba

Outsourcing is a global trend that has become increasingly important due to the forces of globalization and technological developments. The practice of outsourcing specific business activities to achieve cost savings or other advantages and remain competitive is a phenomenon that transcends geographical and economic borders. This includes the Swiss financial market, which is well known for its profitability and stability.

The objective of this thesis is to identify the implications of this trend for the profitability of Swiss financial service providers. Furthermore, it aims to provide a generic strategy that financial institutions in Switzerland can follow to leverage the benefits of outsourcing.

In order to provide a more comprehensive understanding of the subject matter, the concept of outsourcing is initially discussed, followed by an examination of the associated theories and concepts, the various types of outsourcing, and the theoretical effects on profitability.

To corroborate the findings, interviews were conducted with Swiss financial institutions and peer-reviewed studies were consulted. The results demonstrate that outsourcing has a beneficial impact on the already high profitability of Swiss banks. Moreover, the effects are more pronounced in the case of smaller banks, while they are weaker in the case of larger banks.

Information technology outsourcing (ITO) can be regarded as an industry standard. This strategy has been demonstrated to enhance the profitability of most financial institutions that have been interviewed and thus represents a generic solution for many banks.

Keywords Outsourcing, Profitability, Financial Service Provider, Swiss Financial Industry
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1 Introduction

Being successful as a company means remaining flexible and being able to adapt to changes in the environment. Globalization is leading to tougher competition for many companies in various sectors, and it is also affecting the Swiss financial industry (Nasreen et al., 2020, p. 10). The trend of connecting parts of the world to each other has drastically changed the business landscape for many companies, including financial service providers, by intensifying competition and forcing organizations to change their strategy. In order to remain competitive in a global market like this, companies are forced to focus on what they do best, their so-called core competencies. Furthermore, to keep up with the competition, it is essential for a company to reduce its own costs as much as possible. To achieve this, that is, to focus on core activities while simultaneously reducing costs, many companies transfer non-value-adding functions or processes to third parties (Mirzaei et al., 2021). This phenomenon is known as outsourcing and is particularly interesting to observe among financial service providers, as it is the services and not the production of components or products that are being outsourced.

1.1 Thesis Objectives

But what does outsourcing actually mean? What types of outsourcing and outsourcing strategies are there? What are the advantages and disadvantages from the company's point of view? How does outsourcing affect a company's profitability? All these are questions that drive this research in this area. In addition, the theoretical framework of the thesis attempts to find answers to these issues. The aforementioned questions also serve to define the research path and are further specified in the main research question and its relevant sub-questions.

Once these fundamental problems have been clarified, the next step is to examine the development of outsourcing, particularly in the light of globalization. The Swiss financial market is known for its reliability and stability, but as already mentioned, globalization - and particularly the trend of outsourcing - is also having an impact on it (Swiss Banking, 2024). Based on this market and its players, various outsourcing strategies are examined in this paper. From this, it can be concluded whether there is a blueprint strategy and whether it makes sense for Swiss financial service providers to jump on the outsourcing bandwagon from a profitability perspective.

This study serves to shed light on the phenomenon of outsourcing, its current trends, and its impact on the Swiss financial market. Due to digitalization, the world is becoming more interconnected by the day, further supporting globalization and the need for knowledge on this topic. There is a lack of current literature in this particular area, which proves the importance of this research and underpins the purpose of the thesis.

1.2 Research Question

As can be seen from the above paragraph, this paper aims to answer the following question:

"How does outsourcing affect the profitability of Swiss financial service providers and is there a specific strategy for companies considering outsourcing?"

In order to answer this question to the greatest extent possible, fundamental aspects of outsourcing, such as its theory, the advantages, disadvantages, and risks from a company's perspective, and various outsourcing strategies, are explained in more detail.

A quantitative research approach is used to gather information on the general theory of outsourcing, the strategies, the advantages and disadvantages, as well as the risks of such business activities. In order to gain more specific insights, i.e., from Swiss financial service providers, on profitability and the points mentioned above, a qualitative research approach is also pursued.

1.3 Limitations

The financial sector is dynamic due to various factors, including regulations, innovations, and digitalization. This means that trends, such as outsourcing discussed in this paper, can change rapidly. Therefore, the relevance of the findings in this paper may also change in the future.

In addition to the limitation already mentioned, the time limit is another hurdle. This thesis is written within a period of three months; a longer timeframe would allow a more precise analysis and observation of trends. Nevertheless, enough information and observations can be made during this period to achieve a representative result.

One of this paper's goals is to determine whether an outsourcing strategy is generally effective and, if so, to explain it. Even though businesses in the same industry might experience many of the same difficulties, it is still vital to consider the unique circumstances of each player. A generalization of the results is therefore likely to be challenging.

Another limiting factor is the response rate to the interview requests, which at just 4.5% makes it difficult to draw conclusions that are transferable to the Swiss financial market as a whole. As described in the methodology, five banks in Switzerland were interviewed.

2 Theoretical Framework

This chapter examines outsourcing by exploring various definitions in the current literature. It highlights economic theories, such as the transaction cost theory, and popular outcomes of famous economists and researchers. Additionally, this section delves into the historic evolution of outsourcing and highlights key events that contributed to its emergence.

There is a plethora of jargon associated with outsourcing. The second part of this chapter deals with its definitions and explains the considerations behind these concepts. This will provide a better understanding of outsourcing before diving into a more practical approach in the third chapter.

A theoretical approach towards the impact of outsourcing on the profitability of companies is presented at the end of this section. This provides an overview of how outsourcing business activities can affect a company's financial situation and how profitability considerations can influence outsourcing decision-making. The concepts discussed in this chapter will later be applied to the Swiss financial market and its players.

2.1 Outsourcing

The main objective of most companies is to generate profit (Hurth et al., 2022), which is achieved when revenues exceed costs. Therefore, there are two ways to turn a profit: increasing revenue or reducing costs. The latter is often the easier and faster way to achieve the above-mentioned goal. The question therefore arises as to how a company can reduce its costs, and this is where outsourcing comes into play. This chapter explains outsourcing and the associated theories.

There is ambiguity among academics and business people regarding the exact definition of outsourcing. According to Harland et al. (2005), the broad definition of outsourcing is the transfer of activities that a company has the knowledge and resources to perform to an external entity.

By this definition, outsourcing is an important part or result of a company's decision whether to manufacture products, services, or parts thereof itself or to source them from outside the company.

The trend towards "lean production", i.e., using as few "unnecessary" resources as possible in the production of goods and/or services, also plays an important role in outsourcing (Jasti & Kodali, 2014). Companies that outsource superfluous activities can concentrate on their strengths, or so-called core competencies.

Ishizaka et al. (2019) examined a number of definitions in the body of literature on this subject and provided a more thorough definition in a recently published paper: “Outsourcing is a business agreement, either domestic and/or international (known as offshoring), and strategic management initiative for gaining a competitive advantage of a firm by contracting out their existing internal and/or external non-value-added functions, and/or value-added functions, and/or core competencies to competent supplier(s) to produce products and/or services efficiently and effectively for the outsourcing firm”.

While most other definitions describe outsourcing as an activity, the explanation given by Ishizaka et al. (2019) also includes the purpose of outsourcing. The authors state that outsourcing is a business arrangement, which means that it involves a legally binding contract between companies. The purpose of outsourcing is to produce products or services more effectively and efficiently, with the aim of gaining a competitive advantage. This is achieved by outsourcing certain external or internal functions, or even core competencies (Pang et al., 2021).

In the latter definition, the term "offshoring" is used, it is important to distinguish this from outsourcing. While offshoring always implies outsourcing, the opposite is not the case. Upon taking a closer look at the origin of the word, the meaning becomes evident. "Offshoring" is a word made up of the adverb "offshore", which is derived from the preposition "off" (from, away) and the noun "shore" (the coast). It refers to the outsourcing of business activities and/or processes to another country, far away from one's own country and neighboring countries (more on offshoring in the following sub-chapters) (Radło, 2016).

2.1.1 Theories

In order to supplement the definitions and better understand the emergence of outsourcing, the relevant theories and how they build on each other are first described in more detail.

Outsourcing itself is not a new concept in economics and can be traced back to the famous economist Adam Smith. The Absolute Advantage Theory introduced by Smith focuses on the labor productivity aspect of trade, which happens to be one of the benefits of outsourcing. The economist believed that mutual trade between two countries is beneficial for both parties due to the absolute advantage each has. Furthermore, in his work, Smith mentioned “the invisible hand” that drives the economy. That is, the actions of self-interested individuals bring a free market to equilibrium. In the case of outsourcing, it can be referred to as the price set by an outside supplier or vendor who specializes in a product or service that is sold at a lower price than if produced internally (in-house) (Mederos, 2021, p. 2).

In 1817, the British economist David Ricardo explained that countries do not need to have an absolute advantage over other countries in order to benefit from trade. This explanation transformed absolute advantage into comparative advantage. If a country focuses on what it does best and produces a good or service at a lower cost than another country, it can successfully engage in trade. In other words, a country that is in competition or trade with another more powerful nation should focus on the areas in which the stronger country has a disadvantage. Evidence of this can be found in today’s trade practices in India that supply higher-cost countries such as the US or Switzerland with information technology (Mederos, 2021, p. 3).

In the year 1932, Ronald H. Coase began his transaction cost research, which later played a big role in outsourcing decision-making. Coase referred to the previously mentioned theories and established the concept of “make-or-buy” decisions companies are faced with. By highlighting the costs that arise from the transaction itself, his work helped to assess whether it makes sense to produce a product or service in-house instead of contracting out. The costs associated with the transaction are known as transaction costs; these are expenses that occur when negotiating the contract with the supplier, for example (Mederos, 2021, p. 3).

Oliver E. Williamson, a student of Coase, was inspired by his work and formalized the research into a testable Transactional Cost Economies (TCE) theory in 1971. By applying various factors, such as human and environmental aspects, Williamson was able to provide a framework for assessing organizational failure. He brought more clarity to transaction cost considerations by highlighting entry barriers, associated risks, and the processing of information, which would have an influence on the decision of whether to make or buy (Mederos, 2021, p. 4).

Finally, Michael E. Porter and his works played a significant role in the history of outsourcing and the associated theories. In 1979, Porter developed the tool “Porter’s Five Forces" which helps companies evaluate the attractiveness of doing business in a particular industry or sector while focusing on five aspects, namely the bargaining power of suppliers, the bargaining power of buyers, the threat of new entrants into the industry, the industry rivalry, and the threat of substitutes (Isabelle et al., 2020). Furthermore, the American economist published the book “Competitive Advantage: Creating and Sustaining Superior Performance" in 1985, where the main focus lies on value chain analysis. Porter sheds light on the importance of customers in assessing where costs and value are realized within the creation of products or services. In 1990, Michael Porter published another book called “The Competitive Advantage of Nations" which is referred to as a modern version of Smith’s revolutionary book, that includes the Absolute Advantage Theory. This book contains the “Diamond Model” which is part of the same theory that served as the foundation for outsourcing. The model by Porter helps organizations analyze internal and external competitive factors when doing business in an international environment. In summary, the tools developed and provided by the economist aid companies in formulating their strategy, which also includes the decision whether to outsource (Mederos, 2021, p. 5).

2.1.2 Historical Development

Tracing back to the exact moment when outsourcing was “invented” or practiced is impossible. Whenever an individual possessed a skill that others did not possess and then traded that or the output thereof, it is considered a form of outsourcing. According to some studies, the earliest form of outsourcing happened in Rome for tax collection (Pang et al., 2021, p. 2).

Despite being still rare during that time, outsourcing began to become more prevalent in the 1830s. This is due to ground-breaking innovations, such as the telegraph or innovations on railway networks. These changes in the environment reduced the exchange time for both services and products and, as a result, promoted outsourcing activities. Additionally, the manufacturing industry saw developments that made it possible for companies to lower their production costs and benefit from economies of scale. Further key events in the history of outsourcing happened in the post-war period. Companies during that time favored conducting horizontal and vertical acquisitions. The main reason for this was the companies' desire to have more control over production and an increased market share. However, in the 1970s and 1980s, when academics discovered that conglomerates were underperforming, the trend saw a decline again. This finding can be backed by Williamson's TCE theory. A conglomerate merger is when two or more companies construct a contract with one another to closely work together. This will reduce production costs, but as stated in the theory of Williamson, a company should not only consider production but also transaction costs. Operating in a conglomerate comes with huge transaction costs, as a contract has to be negotiated and work has to be coordinated for a smooth run of operations (Pang et al., 2021, p. 2).

During that time, the UK set a good example for outsourcing because the governments used outsourcing and privatization to reform the public sector. These efforts and their results motivated private firms to contract out certain business functions (Pang et al., 2021, p. 3).

Ghodeswar and Vaidyanathan (2008) provide insight into the emergence and evolution of modern outsourcing. They describe how in the 1980s, companies started to move production to regions with lower labor costs, cheaper land, lower tax costs, or a more skilled workforce. In order to reduce costs, increase savings, and more easily penetrate foreign markets, global companies began to outsource not only manufacturing operations, but also other functions such as customer service and back office functions (Ghodeswar & Vaidyanathan, 2008, p. 25).

In the 1990s, organizations began seeking partners, particularly IT firms and specialists, to develop new server systems. This period is also known as transitional outsourcing. As outsourcing providers developed knowledge and expertise in various fields, such as data centers or other standardized IT areas, they began to focus and specialize in specific, skill-intensive functions. This trend gave birth to business process outsourcing (BPO), which is explained in the next chapter (Ghodeswar & Vaidyanathan, 2008, p. 25).

Later, companies began delegating non-core activities to regional suppliers who offered lower costs and specialized knowledge. This practice evolved into offshoring, which is the outsourcing of work to foreign countries, as companies saw it as a way to reap the benefits of outsourcing while avoiding its drawbacks (Ghodeswar & Vaidyanathan, 2008, p. 25).

2.2 Key concepts

The literature on outsourcing often uses a variety of technical terms that can be difficult to understand. By clarifying these terms, this chapter aims to improve understanding and enable a more informed assessment of the topic.

2.2.1 Levels of Outsourcing

According to the literature, outsourcing can be classified into three levels: strategic, tactical, and transformational outsourcing. This classification is based on different motivations and underlying reasons for outsourcing (Ghodeswar & Vaidyanathan, 2008, p. 25).

The objective of strategic outsourcing is to eliminate non-core business functions, enabling management to concentrate on key aspects of the business. Therefore, the focus is on maintaining or further strengthening the company's competitive advantage. Firms that outsource at this level value working with fewer outsourcing partners and building valuable long-term relationships (Ghodeswar & Vaidyanathan, 2008, p. 25).

Tactical outsourcing is a traditional form of outsourcing based on the make-or-buy decision and cost comparisons. It is mainly used when companies seek solutions to specific problems, such as a lack of managerial competence or financial resources for future projects. The resulting effects are quickly felt and often take the form of cost savings, solutions to human resource issues, or other specific solutions to problems. Furthermore, large established companies often use tactical outsourcing to gain industry-specific capabilities and eliminate repetitive tasks, particularly in departments such as HR, payroll, and procurement (Ghodeswar & Vaidyanathan, 2008, pp. 25–26).

At the transformational level, as the name implies, companies use outsourcing to transform and redesign their business to maintain or gain a leadership position in the market, establish a sustainable competitive advantage, or generate the highest value. Firms that outsource view vendors as an essential force in changing certain business activities to increase their value for both the firm and its customers (Ghodeswar & Vaidyanathan, 2008, p. 26).

2.2.2 Outsourcing vs Insourcing

As described above, outsourcing is the process of transferring certain business operations or competencies to an outside firm with the goal of increasing the efficiency and effectiveness of the production of goods or services to ultimately gain a competitive advantage over competitors (Ishizaka et al., 2019). In other words, outsourcing involves third parties to help complete specific business tasks.

The literature suggests that there are two approaches to the definition of insourcing. The first one says that insourcing is about reversing the effects of outsourcing, meaning to bring back activities that have been previously outsourced to be completed in-house. The second approach is more comprehensive and describes insourcing as "…the inclusion of processes performed outside the organization without the requirement of their prior implementation in the organization." (Grela & Hofman, 2021). This definition not only explains insourcing as the reversal of outsourcing but also establishes that it occurs in situations where business activities have never been carried out in the company but rather by third parties (Grela & Hofman, 2021).

2.2.3 Types of "Shoring"

Offshoring

At the beginning of this chapter, offshoring was defined as contracting out particular business activities and/or processes to a foreign country, far away from one's own and the neighboring countries. Another simpler definition is that outsourcing is sending work from one country to another (PWC, 2013). Both of these definitions imply relocating some business tasks to another country or firm in another country.

Companies engage in offshore outsourcing for various reasons. The study from Alam and Butt (2018, p. 8) differentiates the motives leading to a delegation of business activities to a foreign country into four distinct categories.

The first motive includes entering and gaining market share in a foreign country. Companies that are driven by this goal try to supply and penetrate a new market. Offshoring aids the company as it enables the firm to get accustomed to differences in culture and gather information and knowledge about the market conditions in the desired country without exposing themselves to too much risk (Alam & Butt, 2018, p. 13).

Motives that fall into the second category are concerned with the resource aspect of offshoring. By contracting with third parties in foreign countries, the outsourcing company seeks to obtain resources at a lower price than would otherwise be possible in the domestic country or tries to be closer to the source of the required resources to gain an advantage over the competition (Alam & Butt, 2018, p. 13).

Another driver to delegate to firms located in foreign countries is the desire to be more efficient. Offshoring enables a company to take advantage of different factor endowments and, as a result, become more cost-efficient. Companies that have this motive tend to offshore to countries that give them a cost advantage (Alam & Butt, 2018, p. 13).

Finally, the last motive has to do with a strategic reaction to the behavior of competitors or customers. That means, companies may offshore to follow competitors or customers to other markets in order to remain competitive or increase their competitiveness (Alam & Butt, 2018, p. 13).

Offshoring provides numerous benefits to companies that decide to engage with and pursue this strategy. The most prominent, as with most forms of outsourcing, is cost reduction. Companies can drastically reduce costs and improve their competitiveness because of that. The biggest cost driver for many companies is the cost of producing goods or services. By offshoring parts of those processes to a low-cost country a firm can reduce not only its personnel expenses but also cut down its investments and costs related to manufacturing plants and equipment, as they might no longer be required (Alam & Butt, 2018, p. 13).

Further advantages can be found in the increased quality of the firm’s core products or services. By offshoring standard or non-value-added tasks, a company is able to better focus and allocate resources to their core competencies, which leads to an improvement in quality. Literature also shows that firms that engage in offshoring or outsourcing activities display greater ability to be flexible and adapt to changes in the environment. In addition, these firms tend to be more innovative than companies that do not pursue offshoring or outsourcing strategies (Alam & Butt, 2018, p. 13).

Offshoring not only benefits companies; research on that topic shows that there are multiple disadvantages or risks associated with it. An often-debated drawback of contracting with foreign countries is the loss of market performance. Despite mentioning increased innovation as an advantage, the opposite could also be true. Especially when offshoring R&D tasks to low-cost countries, ideas, or innovations from the own workforce might not be considered anymore. When relying too much on offshoring or outsourcing, a firm might find it challenging to stay up-to-date with the knowledge and skills required in the industry or market (Alam & Butt, 2018, p. 14).

As mentioned before, many firms outsource for financial reasons in the hope of reducing costs. While this desire can be satisfied with offshoring, as cost reduction is one of the main advantages, it could lead to an increase in costs. Regular overseas transactions can accumulate high costs (transaction costs) that were not considered prior to the offshoring decision. Furthermore, another factor that could lead to higher costs than anticipated are exchange rate fluctuations or the wage level in the host country (Alam & Butt, 2018, pp. 14-15). A rather old study from Bettis et al. (1992) conducted on offshoring states that firms pursuing offshoring strategies might find themselves trapped in an offshoring spiral. That is due to the fact that the overhead costs have to be reallocated to the products and services that stay in the domestic country, which in turn degrades their financial performance and forces companies to further offshore or outsource.

Nearshoring

Nearshoring is a business strategy in which a company outsources certain activities or processes to another country, similar to offshoring. The main difference between nearshoring and offshoring is that the country to which certain business activities are relocated is not far away and is usually in the same region or close to the company's home country, as indicated by the prefix "near" (Slepniov et al., 2013).

In addition, a second meaning of this term is that it is a form of reshoring/backshoring (this is bringing back parts of the business from own foreign locations or suppliers to the company), namely bringing back certain business tasks to countries that are closer to the company’s domestic country. Nearshoring provides similar benefits to offshoring, such as lower production costs. However, unlike outsourcing to distant countries, nearshoring ensures faster delivery due to the shorter distance and fewer cultural differences between the home country and the outsourcing country (Piatanesi & Arauzo-Carod, 2019, p. 807).

Nearshoring, as described in the definition, refers to bringing particular business tasks back to countries closer to the company’s home country while still benefiting from the advantages of offshoring. There are various reasons why companies decide to reverse offshoring decisions. One of the most prominent drivers of nearshoring is the increase in production costs in countries that previously attracted offshore firms. The increase in costs can have multiple causes, such as an increased salary level or new regulations (Piatanesi & Arauzo-Carod, 2019, p. 813).

Another motivating factor is when the home or neighboring countries improve in terms of competitiveness compared to the nation, which attracted offshore firms. This can be due to developments that reduce production in those countries, increase quality, improve education, and, as a result, generate more skilled labor, etc. (Piatanesi & Arauzo-Carod, 2019, p. 813).

In addition, a frequently mentioned motive in literature is the aim of reducing the distance between a plant and its market. This enables greater flexibility, as the reaction time to changes in the market is shorter. Additionally, being closer to the supplied market can reduce costs, such as transportation costs (Piatanesi & Arauzo-Carod, 2019, p. 813).

With nearshoring, a company can benefit from the advantages of offshoring while also having additional benefits. One advantage is the improved coordination. A closer proximity to the home country means fewer cultural differences and a lower probability of a time difference, which both positively contribute to better and easier coordination of business tasks. Furthermore, it enables a company to react faster to market changes or changes in consumers' preferences and thereby remain competitive (Piatanesi & Arauzo-Carod, 2019, p. 813).

The downside of nearshoring is the loss of the opportunity to work with a large number of potential partners (Piatanesi & Arauzo-Carod, 2019, p. 814). Other disadvantages are comparable to those of offshoring, as it also implies the relocation of specific tasks or functions to a foreign country.

Onshoring

Onshoring differs from offshoring and nearshoring in that activities are outsourced to different regions in the same country (Chen & Shen, 2021, p. 264). Other literature suggests that onshoring refers to the relocation of production closer to market demand. This implies that this type of outsourcing can also be regarded as some sort of reshoring/backshoring, meaning bringing back production to the domestic market. But it can also be a form of offshoring, when a company relocates to a different country to be closer to market demand (Bolter, n.d., p. 4) or to source or produce work in the same location where the output is consumed (PWC, 2013).

Costs and their reduction are one of the decisive factors for companies to make the strategic move to onshore. Not only the production costs but also costs related to taxes can be lowered and optimized when moving parts of the business to another city in the same country, for example (Xometry, 2023).

Another factor to consider is the proximity to the target market. Being closer to the customer can result in shorter lead times, lower shipping costs, and better responsiveness to customer demand. These factors can lead to lower transaction costs due to the ease of coordinating the product or service on the market (Xometry, 2023).

Other drivers can be found in the customers and their preferences. If the target group prefers domestically produced goods or services, a firm might decide to onshore its production facilities. Furthermore, to reduce cultural differences between the company and the customers and hence increase customer satisfaction, companies might consider onshore activities such as customer support (Xometry, 2023).

More reasons for companies to relocate their operations onshore include aligning their business activities with sustainability goals. By bringing production back from abroad or moving it closer to market demand, a company can significantly reduce its emissions by eliminating long transportation routes (Xometry, 2023).

The decision to bring operations back to the home country is often motivated by the goal of establishing a more resilient supply chain. This is accomplished by reducing the involvement of foreign parties and decreasing dependence on other firms. Additionally, onshoring reduces a company's international exposure and the associated risks (Xometry, 2023).

Financial reasons are not only one of the main drivers for a decision to pursue an onshore strategy but also one of the advantages. As described above, companies that relocate particular business activities onshore benefit from lower operational expenses because of shorter transportation routes. In addition, some governments offer tax breaks or other financial incentives to companies that engage in onshore activities (Xometry, 2023).

Further advantages can be found in the outsourcing service providers and their knowledge of the target market. Because of their closer proximity to the customers, they have a better understanding of the market and its future trends as compared to offshore companies that offer outsourcing services. This may aid companies in tailoring products and services to their target group, enhancing customer satisfaction, and ultimately increasing revenue (Xometry, 2023).

Moving production or specific business activities closer to market demand or relocating within the home country can simplify the supply chain and improve its resilience, making it less prone to collapse due to international events. During a crisis, a company with a stable connection to its suppliers can benefit, as customers may choose them over their competitors, enhancing their competitiveness (Xometry, 2023).

Another advantage of onshoring is the familiarity of the outsourcing service providers with legal requirements, making it easier to adhere to standards and guidelines, thus protecting companies from potential additional costs (Xometry, 2023).

The transportation costs are a notable advantage of this form of shoring. However, the production costs for goods or services are likely to be higher compared to their offshore alternatives. This not only has a financial impact but can also affect the competitiveness of the company, especially if it operates internationally, as the additional production costs drive up the prices that customers have to pay for the goods or services (Xometry, 2023).

As previously mentioned, onshoring can enhance a company's supply chain resilience. However, it can also have the opposite effect by increasing a company's vulnerability to supply chain disruptions that occur in or near its home country. In other words, companies that engage in onshoring practices reduce their exposure to international risk but become more dependent on economic or legal conditions in their home or neighboring country (Xometry, 2023).

Another potential drawback of outsourcing is limited access to skilled workers. When a company outsources within the same country or adjacent countries, they are limited to hiring workers from that area. This means that a company that onshores has a significantly smaller pool of potential workers compared to one that follows offshore strategies. As a result, companies may not be able to access specialized knowledge or may have to incur higher labor costs due to the lack of skilled workers in the local and nearby labor markets (Xometry, 2023).

Moving business operations closer to market demand can be beneficial, as discussed earlier in this chapter. However, withdrawing certain business functions from other markets may result in a decrease in global market presence and missed opportunities for global growth.

Companies that onshore can still cater to different markets, but it is important to consider additional costs such as tariffs that may be imposed when exporting goods or services (Xometry, 2023).

The risk of losing global market presence is compounded by the potential loss of competitiveness in the international marketplace. This is due to the fact that onshoring activities may result in higher production costs for goods or services compared to offshoring alternatives. In an effort to reduce costs and mitigate this risk, many companies are implementing automation (Xometry, 2023).

Outsourcing always comes with relocating costs and risks; onshoring is no exception. When delegating business activities, potential disruptions to operations may occur due to the relocation of equipment or the testing of new software. It is also important to consider the different regulations and laws that need to be followed when onshoring. Modifications might result in increased costs and time expenses, especially if they are necessary to ensure compliance. In addition, there are often further costs to the company associated with relocating or hiring new employees (Xometry, 2023).

Reshoring

Unlike the other forms of outsourcing, this one entails the reversal of earlier decisions about offshoring. To put it another way, reshoring refers to moving production, for example, from overseas to the country of origin (Bolter, n.d., pp. 4–5).

In the discussion of the motives for onshoring, most of the reasons for companies to reshore have already been presented. This is because onshoring, by definition, can be seen as a form of reshoring. The main drivers can be distinguished into different categories: global dynamics, host country conditions, home country conditions, supply chain, and firm-specific motivators (Wiesmann et al., 2017, p. 12).

Outsourcing to a host country may become less profitable for a firm due to increased costs caused by global dynamics. This, in turn, would lead to reduced competitiveness in an international context, therefore promoting the decision to reshore. These dynamics include the worldwide economic cycle, political risks affecting trade flows, exchange rate instability, increased competition, and eroding comparative advantages (Wiesmann et al., 2017, p. 12).

If companies face limited growth opportunities, they may consider reshoring to centralize operations and reduce transaction costs. Other drivers specific to the host country include concerns about quality, increased risk of intellectual property theft due to weak patent enforcement, and potential damage to a company's reputation resulting from outsourcing service providers' operations (Wiesmann et al., 2017, p. 13).

Incentives for firms to relocate their operations to their home country also include political benefits such as tax breaks. Additionally, access to skilled employees may also be a factor. The redundancy of labor costs due to increased automation may be a potential motivation to reshore. Moreover, factors such as higher productivity, increased awareness of sustainability, and brand robustness are other motives associated with the home country to reshore (Wiesmann et al., 2017, pp. 13-14).

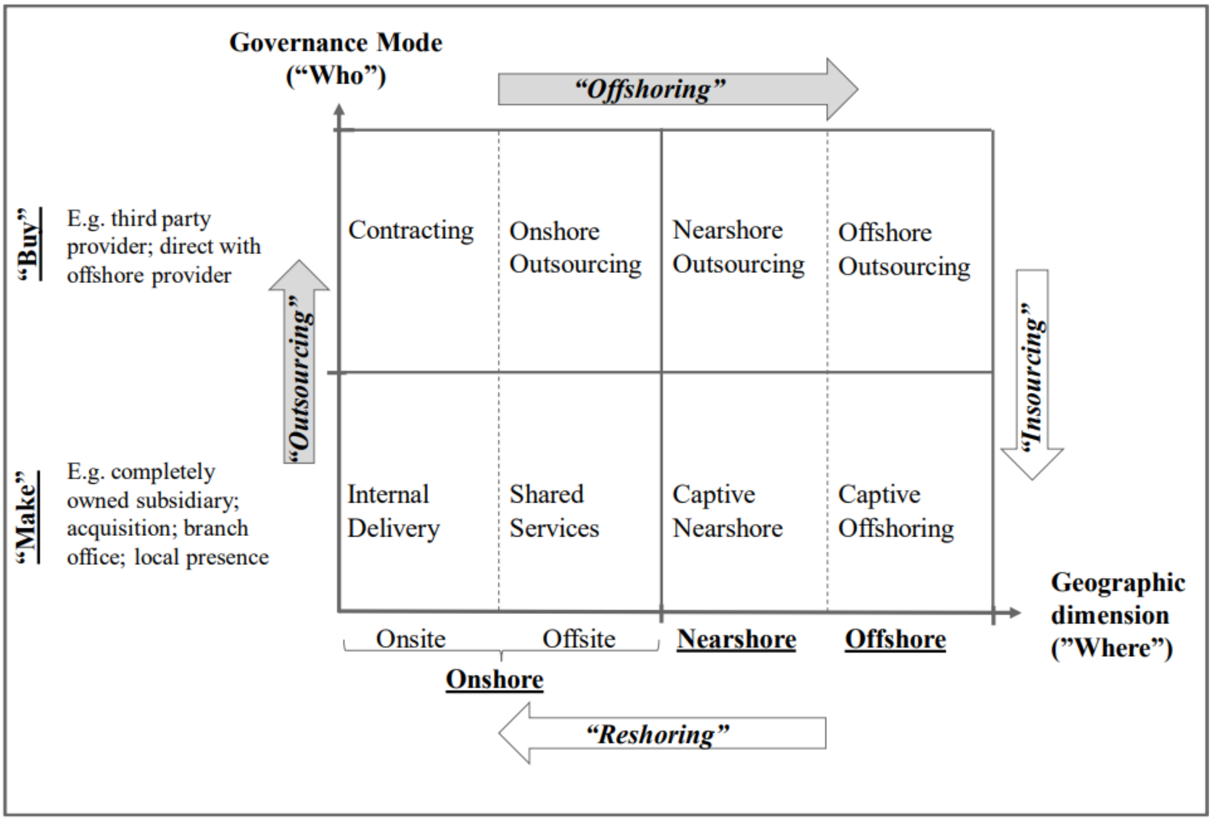
Another cause for companies to bring their operations back to the domestic market is due to supply chain considerations, which are the same as those for onshoring (Wiesmann et al., 2017, p. 14).

Misjudging the decision to offshore poses another motive for a company to consider reshoring. This means that if a company did not take into consideration or falsely evaluate factors such as the benefits and risks associated with offshoring, conditions in the host country, and potential cost implications, it may be beneficial to reverse the decision and move production or certain business activities back home (Wiesmann et al., 2017, p. 14).

Right-shoring

Right-shoring is a term frequently used in literature to describe a strategy or system that involves the appropriate mixture of offshoring, nearshoring, and onshoring. The aim is to achieve the optimal balance between these outsourcing options (Joubioux & Vanpoucke, 2016, p. 118). The following figure 1, depicts a summary of the different “shoring” options:

Figure 1: The right-shoring decision options, adapted from (Tate & Bals, 2017)



One should consider a hypothetical company that is confronted with the decision of how to produce a specific good or provide a service. The figure above shows that the company has a choice between different options that can be categorized along governance and geographic dimensions. Right-shoring means that the company finds the perfect mix between in-house production of products or services and sourcing from third parties and also decides where the company's products or services should be produced (Tate & Bals, 2017).

2.2.4 Types of Outsourcing

Depending on the industry and the company, there are a variety of outsourcing options that can be considered. The most common types, especially for service providers, are discussed below.

Business Process Outsourcing (BPO)

In order to understand what business process outsourcing is, the term business process needs to be defined first. A business process, or BP for short, is a combination of different tasks and activities that, after being carried out in a structured way by a person or a machine, produce a result that contributes to the company's objectives. Specific examples of business processes include customer service, accounting, or sales processes (Bititci et al., 1997; Aguilar-Savén, 2004).

The outsourcing of these kinds of tasks is known as business process outsourcing, or BPO. More specifically, the literature on this topic defines the term as follows: “Business Process Outsourcing (BPO) relates to the process by which firms delegate the production of goods and services to an external vendor” (Suresh & Ravichandran, 2021, p. 677).

Due to the diversity of business processes, BPO can be divided into several broad categories. Mehta et al. (2006) divide BPO into four different classifications in their paper. First, it can be divided into vertical specializations, such as fraud detection or prevention in banking, and horizontal process areas, such as finance or human resources.

Secondly, a distinction can be made between onshore and offshore BPO. Onshore, in this context, means the outsourcing of BPO to a domestic or nearby provider, while offshore BPO refers to the outsourcing of processes to a company in another country (Mehta et al., 2006, p. 326).

Thirdly, a further distinction can be made between discrete, comprehensive, and multi-domain BPO. If the company being outsourced to is only responsible for a single process, such as data entry, it is referred to as discrete BPO. Outsourcing multiple business processes in the same support area, such as HR, to another company is called comprehensive BPO. Multi-dimensional BPO is more complex, i.e., several business processes from different support areas, such as HR and finance, are outsourced to another firm (Mehta et al., 2006, p. 326).

Fourthly, another categorization can be made according to the nature of the outsourced process, namely Front Office BPO, Middle Office BPO, and Back Office BPO. The first category includes processes that involve direct customer contact, such as customer service. Middle office processes are those that connect the front office with the back office, for example, risk management processes in a financial institution. Back office BPO, as the name suggests, supports back office processes and departments such as HR or finance (Mehta et al., 2006, p. 326).

A paper by Paschek et al. (2017) suggests that a distinction is only made between BPO for primary processes such as production/service provision, R&D, as well as sales and marketing, and secondary processes such as HR, accounting, and customer support.

The differences in the categorization of various business processes are not the focus of this paper, which is why this issue is not discussed in more detail.

Although BPO is classified differently in the literature, the rationale behind it as well as the advantages and disadvantages of the concept remain the same.

In his study, Gewald (2010) identifies three main factors that drive the decision to use BPO. The first element is economic, i.e., the desire to reduce costs in various aspects of the business. When achieved, this translates into increased competitiveness. Strategic reasons make up the second category of motives for choosing BPO and include the desire to be more flexible. That is, the ability to scale the output of business operations in times of fluctuating customer demand. The final level of motivation is technological, meaning that companies use BPO to gain access to new technology or skilled labor while outsourcing certain business activities.

As with most forms of outsourcing, one of the advantages is the possibility of cost reduction. External vendors might be able to offer and create products or services at a lower price due to specialization, economies of scale and/or scope, or a lower wage level. Therefore, by contracting out non-core business processes, a firm can significantly reduce operational expenses (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

Another advantage that comes with BPO is the ability to focus on core competencies. Delegating non-core processes to outside vendors enables a company to focus and allocate their resources on their core competencies, which in turn aids in the process of becoming more efficient and productive (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

An additional upside of BPO is access to specialized resources. BPO service providers offer various solutions to their customers. Therefore, they develop specialized skills and have expert knowledge in handling the outsourced processes. The company that contracts out particular processes may tap into that knowledge without having to incur additional expenses for training its workforce. The BPO service providers may also benefit from economies of scale, which further contributes to reducing costs even more for the outsourcing firm. Delegating certain business processes to outsourcing service providers with expert knowledge can actively contribute to improving quality. This improvement in quality is often directly correlated with customer satisfaction, thus increasing it as well (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

BPO arrangements offer flexibility and scalability, enabling companies to easily adjust the level of service based on current market conditions. This is especially beneficial for companies that operate in industries with seasonal or unpredictable demand (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

BPO poses different risks and disadvantages to a company that decides to engage in it. Due to transaction costs, the actual costs of outsourcing might be significantly higher than anticipated. Close coordination between the BPO service provider and the company is required to guarantee a smooth completion of the outsourced processes; therefore, changes to programs or processes may be necessary for the outsourcing company. This not only has financial implications but also costs time, as information systems might need to undergo significant changes to adopt new programs (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

Despite the previously mentioned advantage of expert knowledge and expertise, BPO service providers may not deliver the expected level of quality. Reasons for this could be the inability to provide resources, a lack of BPO service providers' capabilities, a lack of experience, or declining service levels over time. A loss in quality may not only damage a firm's reputation but might also incur legal consequences (Gewald & Dibbern, 2009, pp. 250-251; Paschek et al., 2017).

Another potential disadvantage that may occur due to the decision to outsource particular processes is the risk of losing resources or capabilities necessary to stay competitive. The delegated business processes (and the resources and capabilities that are associated with them) are crucial to the company even though they have been outsourced, as they act as a backbone to the company's core competencies. Losing these can have a serious impact on the competitiveness and existence of the company. Critical resources or capabilities include the cross-functional skills or technological know-how to foster innovation (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

In addition, the above-mentioned effects on flexibility could be reversed. Due to their dependence on BPO service providers, companies may not be able to react to internal or external changes in a timely manner (Gewald & Dibbern, 2009, p. 251; Paschek et al., 2017).

Knowledge Process Outsourcing (KPO)

Knowledge Process Outsourcing (KPO) is a subset of BPO. Understanding KPO requires first defining knowledge processes (KP). A KP is a crucial process in a company that significantly contributes to value creation and competitiveness. It involves tasks that require a high level of analytical and specialized knowledge and skills. Examples of such processes in companies include research and development, market research, and legal processes. The practice of outsourcing tasks like this is commonly referred to as Knowledge Process Outsourcing (KPO) (Edvardsson & Durst, 2014, pp. 795–796).

The reason why companies outsource significant parts is not far-fetched. According to Edvardsson and Durst (2014), companies hope that this strategy will give them access to a larger pool of highly qualified employees. This is primarily made possible by the digitalization and advances in IT mentioned in the introduction. In addition, costs can be saved on training employees who are only needed for a special, one-off project or exceptional tasks, as the employees do not have to be trained internally. However, companies do not outsource KPs solely to save costs but rather to maintain their competitiveness.

The benefits of this approach include increased flexibility, not only in the hiring and firing of employees but also in time management. Additionally, KPO allows companies to better adapt to changes in the business environment while also reducing costs (Mierau, 2007, pp. 4-5).

By outsourcing knowledge processes, companies can more easily and cost-effectively adjust their staffing levels to economic conditions than they can internally. Companies are able to lay off some KPO staffing during a downturn to reduce costs and increase their KPO staff during an upturn to boost sales and profits. In addition, firms may take advantage of different time zones between their home and host countries to enhance their market position by enabling knowledge processes to take place around the clock (Mierau, 2007, p. 5).

Flexibility in staffing, combined with the opportunity for continuous work and development due to different time zones, allows companies to better adapt to changes in the industry or business environment. For example, if there is a breakthrough in the more efficient production of a particular good, a firm may choose to outsource knowledge processes to an external company in order to adapt to this change faster than its competitors (Mierau, 2007, p. 5).

Companies can achieve cost savings of up to 50% by outsourcing knowledge processes to countries with lower wage levels. Current trends increase the potential for cost savings as more countries set themselves up to offer high-end services at low prices, thus increasing competition for outsourcing service providers and ultimately leading to even lower prices for KPO (Mierau, 2007, p. 4).

The drawbacks of this form of outsourcing can range from security and quality concerns to disadvantages arising from cultural differences and lower morale among the workforce (Mierau, 2007, pp. 5–6).

As previously established, KPO entails delegating processes that are vital to the company and its operations. By keeping everything in house, a firm can better control and secure essential information. Outsourcing these key tasks can significantly impact a company's existence if the outsourced company is negligent with the knowledge and information gained, copies it, sells it to competitors, or loses it (Mierau, 2007, p. 5).

Other downsides to KPO can be found in the quality of work. The completion of the outsourced activities is done at the discretion of the outsourcing service provider. This may result in a reduction in quality or even the non-completion of certain tasks (Mierau, 2007, p. 5).

Outsourcing processes to a country with a different culture and language can lead to serious issues, such as communication difficulties or differences in work ethics. This divergence may cause inefficiencies and friction within the company, ultimately reducing overall productivity and increasing costs (Mierau, 2007, p. 6).

Additionally, the current workforce may have a negative attitude towards KPO, perceiving their jobs as being at risk. This can have negative consequences for work morale, leading to lower output levels or reduced innovation (Mierau, 2007, pp. 5–6).

Information Technology Outsourcing (ITO)

Information technology outsourcing (ITO) refers to the outsourcing of IT services to external providers. In contrast to business process outsourcing, where entire business functions and processes, including IT services, are outsourced, ITO only involves transferring the information technology aspect to a third party (Rouse, 2008). Firms typically outsource IT services such as application and network management or IT helpdesk.

ITO offers similar benefits to the company as the previously mentioned business process outsourcing and knowledge process outsourcing. By outsourcing IT and related tasks, a company reduces its need for professionals and technology in the related departments; therefore, staffing costs can be reduced because fewer salaries need to be paid as a result of a reduced headcount, and training and purchasing the latest technology become less of an issue (González et al., 2010, pp. 4–7).

Due to the continuous developments and improvements in IT, a firm that engages in ITO can remain flexible rather easily, as they do not need to update or own the necessary hardware or software. By redesigning the outsourcing contracts, the company can meet their information needs at any given time. Furthermore, scalability is a major advantage; the ITO service providers deal with fluctuations in the workload, enabling the outsourcing firm to easily adjust to business-level volatility (González et al., 2010, pp. 4–7).

Delegating IT processes and tasks enables the company to be able to tap into expert knowledge and benefit from state-of-the-art technology. Because ITO service providers are specialized in IT tasks, they offer specialized experience in that field and are up-to-date when it comes to technology. A company may therefore benefit from skilled staff and top technology, which would not have been possible if the IT tasks were not outsourced. Combining these factors ultimately leads to an increase in quality (González et al., 2010, pp. 4–7).

Information technology outsourcing comes with various disadvantages or risks for the outsourcing firm.

Although access to expert knowledge and experience is cited as an advantage, it is often the case that the company outsourcing IT tasks is supported by the same personnel as before, as this staff has been transferred from the company to the ITO service provider. Many companies feel that they have lost business expertise and knowledge due to ITO because, after establishing the business agreement between the client and the vendor, the ITO service provider uses its most skilled workers to attract other companies in the industry (González et al., 2010, pp. 7–11).

As with the other forms of outsourcing, security and quality concerns are disadvantages of ITO. The outsourced tasks are performed at the discretion of the ITO service provider, meaning that the delegating company has no influence on the end product but remains responsible for it. Poor execution or errors by contractors can result in reduced quality and additional costs. Furthermore, there is a risk of trade secrets being disclosed to the public or competitors (González et al., 2010, pp. 7–11).

Similar to the disadvantage of BPO, ITO also carries the risk of the company losing knowledge and understanding of the outsourced process or skills over time. Although the ITO service provider may offer innovative services, most of the required knowledge remains with the provider and is not transferable to the company that contracts out. In addition, an organization may lose its ability to keep up with the latest technology, which can have a significant impact on its ability to innovate, as innovation requires significant technical resources (González et al., 2010, pp. 7–11).

One common disadvantage of IT outsourcing is the presence of hidden costs. The transaction costs of the ITO may be higher than expected, resulting in increased expenses and potential financial loss. These transaction costs include not only the expenses incurred during the term of the business agreement but also after its termination, when the company moves its IT activities back in-house or searches for new providers (González et al., 2010, pp. 7–11).

Outsourcing information technology can pose a risk for a company due to potential workforce rejection. Concerns about job security may arise when activities are outsourced to an external company. This can lead to low morale and anxiety, which in turn cause lower production levels and ultimately negative financial effects (González et al., 2010, pp. 7–11).

2.2.5 Implications on Profitability

The decision to outsource is driven by many different factors, such as resource maximization, a more strategic use of the workforce, the optimization of services or products, etc. However, the most prominent reason for this decision is the ability to reduce costs and therefore become more profitable (Adu, 2015). This section examines the impact of outsourcing on profitability. The financial impact varies from company to company and from industry to industry; the focus of this research is on Swiss financial service providers; therefore, the impact on service companies is examined in more detail.

When evaluating the impacts of outsourcing on a company’s profitability, the most obvious metric is the cost of creating or producing services and goods. In this case, delegating business processes to third parties virtually addresses the famous make-or-buy decision firms are often faced with (Adu, 2015, pp. 27).

The make-or-buy decision includes two possible outcomes: the first is making the products and services in-house, as opposed to the second, where a company procures them from outside suppliers (outsourcing). A firm chooses the first option if the cost of producing a good or service within the organization is lower than buying it from third parties. In other words, if the cost of outsourcing is lower than the cost of in-house production, a company would prefer to buy rather than make. However, it is essential to not only consider the prices of the bought products but also the transaction costs, as they increase the price of outsourcing and therefore potentially make it less profitable (Adu, 2015, p. 27).

A study by Görzig and Stephan (2002) found that companies that engage in materials outsourcing, that is, manufacturers, see a benefit in terms of increased returns per employee, while service providers experience a negative effect on the same returns. The authors discovered that the lack of transparency in the pricing of outsourced services is the reason for this phenomenon. Their study was published in 2002 and used a sample of large German companies; therefore, the results may not be applicable to other countries. Additionally, the service sector and services in general have become more important since the publication of this paper; hence, their conclusion might be inaccurate nowadays. Despite those limitations, the results show the importance of analyzing the costs carefully before determining whether to make or buy (Adu, 2015, p. 28).

Regardless of the type of firm, manufacturer or service provider, the profitability of outsourcing is determined by the bargaining power of the two involved parties, the competition in the market, as well as the number of potential partners in the industry. Outsourcing is considered beneficial for a company if there is a great number and thus high competition among subcontractors, or when the final good producers have more bargaining power. Firms with a higher bargaining power are able to benefit more from outsourcing as they can influence the costs of purchasing specific goods or services from the other party. Recent literature has found that the size of the firm plays a similarly important role in the profitability of outsourcing. Larger firms may find it easier to establish a high level of bargaining power over their suppliers. In addition, the transaction costs, or specific search costs for a supplier, may be lower for large companies because they are established in the market and have greater knowledge of the suppliers and competitors (Adu, 2015, p. 28).

Another positive effect of outsourcing on a company’s profitability is the opportunity to utilize and establish economies of scale, which are described as cost advantages due to higher production. Costs can be saved by delegating business activities to specialized third parties. In addition, when outsourcing non-core activities, companies can focus their efforts and resources on what they do best and, as a result, increase productivity and efficiency in those areas (Adu, 2015, p. 28).

Firms that outsource may profit from expert knowledge and technical experience of the supplier. This is especially attractive for small and young firms, as they often do not possess the required knowledge and experience in their field. A direct source of valuable industry information might lead to a better overall position in the market, which ultimately results in an increase in revenue. Those kinds of firms often seek suppliers to cope with sudden changes in demand, as they might be unable to manage sudden fluctuations in demand themselves (Adu, 2015, p. 28).

While the above-mentioned factors contribute positively to a firm's profitability, outsourcing can have the opposite effect. The decision to outsource indicates the loss of power over how a good or service is created, produced, or delivered. The abundance of said power can lead to a loss of profitability if the perceived quality is reduced, as customer retention may decrease. Unlike manufacturers, who can easily assess the quality of the products or components they purchase, service providers are challenged to assess the quality of their offerings as they are intangible (Adu, 2015, p. 28).

3 Methodology

Research Design and Method

The purpose of this paper is to apply the theories and concepts of outsourcing introduced in the first chapter to the Swiss financial sector and its players. The nature of the data required suggested the use of a descriptive research design. That is, the thesis attempts to explain and describe outsourcing and related topics. Due to the extensive studies already conducted on outsourcing in general, a lot of data is readily available. Furthermore, this approach was used because the author is trying to better understand the phenomenon of outsourcing, become more familiar with the different types of this business strategy, and identify trends that occur in this specific area.

The chosen research design has implications for the research methods. A mixture of quantitative and qualitative research was used in order to get a broad picture of this economic phenomenon and to gather as much information as possible.

The first was mainly employed in the theoretical framework to understand the concept of outsourcing and related issues. In doing so, the author used a variety of different peer-reviewed studies that have been conducted on the topic. Due to the dynamic nature of outsourcing and constant new developments and findings, it was essential to use current research whenever possible when selecting studies. To gather information related to the Swiss financial sector and the related sourcing market, this research approach was used.

The latter qualitative research method was used in the second part of this paper when assessing the impact of outsourcing on the profitability of Swiss financial service providers. By conducting semi-structured interviews with a number of renowned Swiss banks, a great deal of insight was gained. Furthermore, pursuing this research method allowed the author to guarantee the quality of the information.

The survey was divided into four different categories and consisted of 15 open-ended questions. The first part dealt with outsourcing in the context of the Swiss financial market and tried to find out the extent to which financial institutions are involved in outsourcing and their attitude towards this trend. The second part of the interview was focused on outsourcing practices within the organization of the interviewee. This enabled the author to assess different outsourcing strategies and identify patterns in the delegation of business activities to others. The impact on profitability was the core of the third category. Finally, expectations about the future development of outsourcing were the main topic of the fourth section.

Through a mixture of quantitative and qualitative research, the thesis writer improved the evaluation of the data by ensuring that the limitations of one method are balanced by the strengths of the other.

Interview Partners

Due to time constraints and a total research period of three months, it was important to carefully select the interviewees. In order to shed light on possible differences in outsourcing practices between banks of different sizes, the interviewees consisted of financial institutions ranging from small to large Swiss financial service providers.

A total of 110 financial institutions in Switzerland were contacted and asked to participate in an interview. Of these, only five banks agreed to take part in a discussion, which corresponds to a response rate of 4.5%. While this is a limitation, as a higher number of responses would enable a more accurate evaluation, the results of this thesis are representative, as additional studies were consulted. Due to the disparate locations of the thesis writer and the Swiss banks, all interviews were conducted via telephone or through the use of MS Teams. The interviews were carried out between the 15th and 19th of April 2024.

In order to maintain the anonymity of the interviewees, no company-specific details are disclosed in this paper.

Data Analysis

The data collected through the research, specifically the information from the interviews, was subjected to a comparative analysis with the theoretical framework and subsequently operationalized in order to achieve a meaningful result.

The various outsourcing practices of the interviewed banks were compared with each other and with existing studies, enabling the author to identify patterns that are of fundamental importance in answering the research question.

Ethical Considerations

The research methodology employed in this thesis strictly adhered to ethical standards. All information derived from studies or other sources was accurately cited in accordance with APA 7 guidelines. Prior to the commencement of the interviews, informed consent was obtained from all participants. Once the research had been completed, any audio recordings were deleted, and only the transcripts were retained for a period of one year.

4 Results

This chapter offers a more comprehensive understanding of outsourcing practices and the sourcing market in Switzerland. The results of the interviews with several financial institutions in Switzerland are presented in this chapter, and an answer to the research question is provided.

4.1 Outsourcing and the Swiss financial sector

This section provides information about the degree to which players in the Swiss financial industry currently outsource.

The phenomenon of outsourcing in the Swiss financial sector, and more specifically, Swiss retail banks, is not a novel occurrence. A 2022 study conducted by Blattmann et al. revealed that this particular sourcing market had reached a volume of CHF 2.1 billion (or approximately USD 2.3 billion). Upon comparing this figure to previous years, it becomes evident that the sourcing market for retail banks in Switzerland has undergone considerable growth (Blattmann et al., 2022).

4.1.1 Current Situation

By interviewing various banks and key players in the Swiss financial market, the findings of the previously mentioned study can be underpinned. When asked about the current situation of outsourcing, the respondents were in agreement that the degree of outsourcing is high and is expected to grow in the future due to various reasons discussed later in this paper. As a result of the strong degree of contracting out, some key outsourcing service providers have emerged and were identified as being Swisscom, Avaloq, and SIX. The first company is Switzerland's leading ICT firm and caters to private as well as corporate customers; Avaloq is one of the main providers of core bank applications; and the latter operates the infrastructure for the Swiss financial centers. This has led and is leading to increased standardization among Swiss financial service providers. Furthermore, the great extent of outsourcing is forcing especially smaller banks to contract out particular business activities to remain competitive. However, for smaller to medium-sized banks, it is also an enabler for growth as they can benefit from know-how and sophisticated infrastructures (Personal communication, April 2024).

When queried regarding the perceived nature of the outsourcing trend - as a chance or a potential threat - all participants indicated that the trend is perceived as an opportunity. Although there are some risks associated with it, the benefits clearly exceed the perceived downsides of having an increased dependency on outsourcing service providers. Furthermore, as mentioned above, delegating business activities aids smaller banks in operating without incurring additional costs, such as personnel costs or expenses related to infrastructure, that might not be able to be covered. Moreover, other participants in the Swiss financial market have suggested that the outsourcing trend represents an opportunity for them to provide outsourcing services to third parties (Personal communication, April 2024).

4.1.2 Outsourcing for Swiss banks

The following paragraphs explore the outsourcing practices of Swiss financial service providers.

The responses gathered from interviews indicate that, in addition to ITO, banks in Switzerland pursue the general objective of outsourcing all non-core business activities and those that do not contribute to their differentiation from competitors. For all participants, it is of the utmost importance to maintain the customer contact point within the organization. Consequently, consulting services and the associated processes are regarded as core competencies and not part of outsourcing considerations (Personal communication, April 2024).

Furthermore, it was observed that while some banks engage in business process outsourcing (BPO), the practical implementation of this strategy is challenging. The underlying reason for this difficulty is the internal processes of the bank that is outsourcing. A bank has a multitude of diverse programs and procedures that function in unison, and when an activity is outsourced, these intricate processes must be adapted and realigned, which is a costly and often unprofitable endeavor from a financial perspective (Personal communication, April 2024).

Cloud computing is a new development in the realm of ITO and allows companies to gain on-demand access to scalable IT resources, such as storages, servers, and applications (Sunyaev, 2020). Many respondents communicated their interest in engaging in business agreements with cloud service providers, notably from the USA, to leverage the benefits of this development (Personal communication, April 2024).

Cloud services represent the only rationale for Swiss banks to utilize offshore service providers, a practice that is not commonly observed within the Swiss financial market. In fact, the majority of interviewees initially seek out domestic vendors before considering those based abroad (Personal communication, April 2024).

4.1.3 Motives driving Swiss financial service providers to outsource

The motives behind outsourcing decisions of Swiss banks are the ones presented in the theoretical framework. However, the interviewees highlighted the importance of scalability, access to a specialized pool of workers, better adaptability to industry changes, reduction of costs, and quality as the most important ones (Personal communication, April 2024).

The establishment of synergies within the banking sector allows financial service providers to enhance their scalability. This enables them to adapt to varying volumes of demand and to use and allocate their resources in a more efficient manner. Due to the specialization of outsourcing service providers, banks benefit from expertise, and it is easier for them to adapt to industry changes as the response time to new developments is reduced. The possible reduction in cost is one of the main reasons for some banks to outsource. However, a few respondents indicated that the price of outsourcing is not the decisive factor when considering contracting out. These firms are willing to incur additional expenses for higher quality (Personal communication, April 2024).

4.1.4 Perceived Benefits and Risks

The interviews conducted revealed that the primary benefits of outsourcing are derived from the motivation behind the decision to outsource.

This encompasses the potential for cost reduction through the contracting out of non-core activities as well as the opportunity to scale particular business activities by entering into business agreements with other entities and consolidating functions. Additionally, outsourcing service providers often possess greater expertise and specialization in the offered services, enabling them to handle processes more efficiently. Another advantage that has been identified is the ability to concentrate on the core competencies, which for many banks is the provision of consultancy services to their clients (Personal communication, April 2024).

As mentioned in the theoretical framework, the delegation of business activities is connected to some risks.

One of the risks identified by most of the interviewed banks is the dependency on outsourcing service providers and the threat of potential disruptions to business operations due to IT failure, for example. Another potential disadvantage of outsourcing is the possibility of data loss due to negligence or fraudulent actions on the part of the vendor. Due to contracting out particular functions, one respondent feared the loss of competencies found in these business activities (Personal communication, April 2024).

The potential loss of jobs was not regarded as a risk or negative consequence of outsourcing, unless the bank in question is small or there is a shortage of qualified workers in the labor market (Personal communication, April 2024).

4.1.5 Effects on Quality and Customer Satisfaction

According to the interviewees, delegating business activities to third parties does not have a negative effect on quality, as extensive SLAs are in place to guarantee that the required and expected quality is met. It was mentioned by some of the banks that their customers are unaware of the fact that they outsource (Personal communication, April 2024).

As there is no negative impact on the quality of the service provided and the customer contact point remains with the bank, there is no significant change in customer satisfaction. However, various interviewees mentioned that improvements in the availability of certain banking applications due to outsourcing have the potential to increase customer satisfaction (Personal communication, April 2024).

One respondent described a decline in customers resulting from the implementation of revised general terms and conditions, which were deemed necessary for the effective operation of outsourcing, in particular cloud computing. However, the resulting loss was minimal and of no significant consequence (Personal communication, April 2024).

4.2 Main findings

This work is based on the following question:

- How does outsourcing affect the profitability of Swiss financial service providers and is there a specific strategy for companies considering outsourcing?

This question can be divided into two parts, the first being the impact on profitability: "How does outsourcing affect the profitability of Swiss financial service providers? The second is, "Is there a specific strategy for companies considering outsourcing? The following two sections answer these questions accordingly.

4.2.1 Analysis of profitability effects

The interviews indicate that the majority of respondents exhibit superior cost efficiency, which is reflected in higher profitability. For some of the banks surveyed, this is mainly a result of a reduction in the workforce and correspondingly lower recurring costs. Moreover, the delegation of business activities to third parties has the effect of reducing the costs associated with the processing of these activities (Personal communication, April 2024).

However, as one interviewee observed, the increased profitability resulting from outsourcing is only significant when viewed in the context of specific processes. From the perspective of the bank as a whole, the cost savings associated with outsourcing are relatively minor and do not warrant significant attention. It is noteworthy that this is the observation of a large bank, as it is likely to be different for smaller financial institutions (Personal communication, April 2024).

Another bank, which is a subsidiary of a larger financial service provider, asserts that outsourcing to their parent company has led to a notable increase in profitability. In this case, the parent company does not charge a margin, which naturally translates to significant cost reductions. This financial institution also indicated that profitability and cost considerations were the main motivations behind contracting out (Personal communication, April 2024).

The decision to outsource does not immediately result in an increase in profitability. The majority of respondents estimate that it will take a medium to long time for this strategy to have a positive impact on the bank's financial situation. Initially, it is an investment, as the necessary internal arrangements have to be made and contracts have to be negotiated. Furthermore, it is often the case that there is a parallel operation between programs and processes until the outsourcing is complete, resulting in additional expenses (Personal communication, April 2024).

It was also observed that the outsourcing of services to third parties increases the bank's supervisory and monitoring margin, which results in additional costs and thus partially offsets the positive financial effects of outsourcing. However, this is not the case for all banks involved in the interviews, as some believe that service quality is maintained due to the specific service-level agreements (SLAs) (Personal communication, April 2024).

The increase in profitability appears to be of significant importance in outsourcing decision-making, as the overwhelming majority of the interviewees cited it as a primary factor. One even stated that outsourcing partners are selected based on their cost efficiency. However, this may not be the case for all financial institutions. As the interview results demonstrate, there are some banks that prioritize scalability, quality, or the provision of infrastructure over cost considerations. These findings are in line with the previously cited study conducted by Adu (2015), who suggests that while scalability, a strategic use of the workforce, and the optimization of products and services are important aspects of the outsourcing decision, the most prominent reason is the ability to reduce costs (Personal communication, April 2024).

Financial institutions that identified cost considerations as a significant factor in their decision-making process have opted to outsource activities that would be more expensive to perform in-house. This directly addresses the well-known "make-or-buy" decision, as described by Adu (2015). As previously stated in this paper, transaction costs cannot be overlooked, as they are essential to include in cost considerations. The aforementioned increase in a bank’s supervisory and monitoring activities due to outsourcing represents a transaction cost that must be accounted for prior to the delegation of business activities (Personal communication, April 2024).

In contrast to the prevailing view that outsourcing is beneficial for a company if there is a high level of rivalry among outsourcing service providers, as this drives down the prices of these kinds of services (Adu, 2015), the author of this thesis found that this does not necessarily hold true for the Swiss financial sector. When considering supply and demand, it is evident that prices are forced down if there is a high level of competition. However, this is not a pivotal factor for companies to be able to profit from cost reductions due to outsourcing. The Swiss financial market is characterized by a high degree of concentration in the outsourcing service sector, with a limited number of key vendors. Despite this, the potential for cost savings is significant, largely due to the specialization and standardization of processes observed at these outsourcing service providers. (personal communication, April 2024).

The ability to focus on the core business (consultancy services to customers), benefit from expert knowledge, and use infrastructure are identified to be positively correlated with the profitability of outsourcing, as they lead to a boost in efficiency and quality. This finding can be corroborated by the author's interviews with financial institutions, which indicated that these factors have positive indirect effects on the firm’s profitability (Personal communication, April 2024).

4.2.2 Blueprint outsourcing strategy

The objective of this paper is to present a generic outsourcing strategy for players in the Swiss financial industry that aligns with the most prominent goals associated with outsourcing, as previously discussed in the thesis.

After conducting interviews and consulting studies, the author found that the most popular outsourcing strategy among Swiss financial service providers is information technology outsourcing (ITO). This has several reasons, such as the often-discussed possibility of scaling IT, the lack of internal knowledge regarding information technology, or the lack of financial means to carry IT infrastructure in-house. Factors such as the difficulty of implementing BPO due to the complex network of internal processes or the lack of incentive to outsource other parts of business due to an already high degree of profitability further contribute to this. None of the respondents in the financial sector reported outsourcing knowledge processes. This can be explained by the bank's desire to outsource only non-core activities that do not contribute to differentiation from competitors (Personal communication, April 2024).

Although it is difficult to develop a generic outsourcing strategy for Swiss financial service providers, as the impact of this depends on many factors such as bank size, business model, or capabilities, the author believes that ITO is a potential industry standard and outsourcing strategy that can be of great benefit to most financial institutions. In terms of current trends in cloud computing, some respondents indicated that information technology outsourcing is likely to become more important in the future (Personal communication, April 2024).

The financial service providers should carefully evaluate the potential risks and costs associated with the outsourcing decision and weigh them against the perceived benefits and gains before embarking on such a strategy. A miscalculation not only has negative financial implications but also a potential reputational risk for the firm, which ultimately affects the bank's profitability.

4.3 Future of Outsourcing in the Swiss financial market

This section deals with future trends of outsourcing in the Swiss financial sector and helps in gauging the importance of this research for the coming years.

The sourcing market in Switzerland is expected to grow by 5% over the next three years, while IT costs are projected to increase by 3% due to digital transformation. A closer look at these two growth rates suggests that the share of IT costs accounted for by in-house services is declining (Blattmann et al., 2022, p. 39). The authors' findings from the interviews support this prediction, as all respondents expect the sourcing market to grow and have additional outsourcing considerations in mind (especially related to cloud computing) (Personal communication, April 2024).

Cloud computing will continue to increase the popularity of ITO as it allows companies to reduce time to market while increasing their ability to innovate. Many respondents emphasized their desire to move to cloud computing and mentioned ongoing negotiations with cloud service providers (Blattmann et al., 2022, p. 39; Personal communication, April 2024).

Business process outsourcing is likely to remain at the status quo because, as mentioned earlier, there is less incentive to outsource these activities due to the already high level of profitability in this area. In addition to this explanation, many financial institutions consider their business processes, such as mortgage operations, to be core competencies and are reluctant to outsource these tasks (Blattmann et al., 2022, p. 39; Personal communication, April 2024).

5 Conclusion

Outsourcing, which is the delegation of business activities to third parties, has a long history and can be linked to various theories of renowned economists. The earliest and arguably most notable of these is Adam Smith. Over the years, outsourcing has gained greater significance, not only because of globalization and digitalization but also because of the trend towards "lean production" and the desire of companies to reduce costs and focus on their core competencies. Initially, outsourcing was primarily concentrated in the secondary industry, where companies contracted out their manufacturing processes to lower-wage countries. Over time, this practice expanded to encompass services. Currently, outsourcing is nearly indispensable for any enterprise, regardless of whether it manufactures goods or provides services.

There are various types of outsourcing, which are classified at different levels. From the perspective of where the outsourced process takes place, a distinction is made between offshoring, nearshoring, and onshoring. Offshoring encompasses the delegation of business activities abroad, far away from the home country. Nearshoring, on the other hand, not only describes the relocation of business activities back to the country of origin but also the relocation of tasks to be closer to the home country or neighboring countries. Onshoring encompasses the outsourcing of activities within the home country as well as moving production closer to market demand.

From the perspective of outsourcing activities, there are a plethora of different types. The most well-known and crucial for service companies are business process outsourcing (BPO), information technology outsourcing (ITO), and knowledge process outsourcing (KPO). BPO is the delegation of an entire process to a third-party provider. Information technology outsourcing, as the name suggests, involves the outsourcing of IT systems. KPO, on the other hand, describes the delegation of processes where skilled workers are required.

The primary motives driving outsourcing decisions for the majority of firms are cost considerations, scalability, enhanced adaptability to market changes, increased innovation, access to expertise and skilled workers, and the ability to focus on core competencies. These drivers frequently result in increased profitability, which is also a significant factor in the outsourcing decision.

To gain insight into the outsourcing phenomenon and its implications for Swiss financial service providers, interviews were conducted and studies consulted.

It was discovered that the players in the Swiss financial market currently outsource to a significant extent. The most prevalent type of outsourcing is ITO, which is primarily due to the simplicity of implementing this strategy in comparison to the complexity and required changes to existing processes and programs associated with BPO. The knowledge processes within Swiss banks are often regarded as core competencies and, thus, are not subject to outsourcing considerations.

The motives for Swiss financial institutes align with those found in the literature, with a specific emphasis on scalability, access to expertise, better adaptability to industry changes, and reduction in costs.

The author's findings indicate that outsourcing has a positive impact on profitability. However, the observed effects do not occur immediately after the outsourcing of business activities but rather in the medium to long term. In the short term, outsourcing is generally perceived as an investment, as costs are incurred for the adaptation of internal processes and contract negotiations. The extent to which outsourcing has a positive impact on profitability also depends on the size of the bank. For larger companies, the potential for significant cost savings through such a strategy is considerable. However, these savings are almost insignificant in the context of the bank's overall financial position. This is less the case for smaller banks. Other indirect positive effects of outsourcing on the profitability of a financial institution include the ability to focus on the core business, benefit from expert knowledge, and use sophisticated infrastructures.

Information technology outsourcing (ITO) is regarded as an industry standard in the Swiss financial sector due to its high popularity among financial institutions. As mentioned earlier, business process outsourcing is less common within this particular industry, as it is challenging to implement because of the complex network of existing processes and programs within a bank.

Although it is difficult to develop a generic outsourcing strategy, as the effects are dependent on numerous different factors, the author believes that ITO can be of significant benefit to most Swiss banks. It is likely that information technology outsourcing will become increasingly popular in the near future as a result of the current trend towards cloud computing.

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Appendix 1. Interview Questions

Outsourcing in the Swiss financial sector

1. How does outsourcing affect the way of doing business in the financial sector?
2. Is outsourcing viewed as an opportunity or threat by your organization?
3. If you have any additional insights on the topic of outsourcing in the context of the Swiss financial market as a whole and are convinced that these could add value to my research work, please let me know.

Outsourcing in your organization

4. Do you use outsourcing as a business strategy and what are the reasons behind this decision?
5. What outsourcing strategy does your company pursue and what role does profitability play in the selection of this strategy?
6. What are the perceived benefits and risks associated with your decision to outsource?
7. What impact does outsourcing have on the services you offer, for example in terms of quality?
8. What impact does outsourcing have on your customers, for example in terms of customer satisfaction?
9. How does outsourcing influence your internal processes?

Profitability

10. What is the expected impact of outsourcing on your organization's profitability?
11. Did the expected effects materialize? Please specify how.
12. What direct impact do your outsourcing practices have on your company's profitability?
13. What indirect impact do your outsourcing practices have on your company's profitability?
14. How long did it take after your decision to outsource for these impacts to become apparent?

Future

15. Please describe your perspective on the future of outsourcing for Swiss financial service providers.
16. How will outsourcing considerations change within your organization in the future?
17. How will customer perception of outsourcing develop in the future and what impact will this have on your future outsourcing decisions?

Appendix 2. Thesis Data Management Plan

Management and Storage of Research Data

The data utilized in this thesis includes the results of five interviews as well as a plethora of academic papers. The interviews were recorded, then stored locally on the mobile phone of the thesis author, with access restricted to this individual. After transcription, the recordings were deleted, and the transcriptions (excluding sensitive data, such as company names) were saved to the OneDrive account of the thesis author, where they will remain for a period of at least one year. The studies that are cited were also saved using the cloud service of Microsoft. The studies were cited in accordance with HAMK’s citation guidelines in order to ensure compliance with the terms of use of the data.

Ownership of thesis data

The exclusive proprietor of the data and thesis results is the author, Phil Moser. Any data that has been collected from studies or internet research belongs to the cited person/s or organization.