IT Outsourcing:
Asia Pacific Case - Australia

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IT outsourcing market has been significantly growing since Eastman Kodak's landmark decision to outsource IT in 1989. Outsourcing itself is already known as a practical business strategy in the competitive global economy. However, IT outsourcing is far more complex and multidimensional than most other types of outsourcing (Kern and Willcocks, 2002). Lacity *et al* (1996) highlighted some traits that make IT outsourcing distinctive such as IT is a heterogeneous function with complex activities; IT capabilities evolve at a dizzying rate making outsourcing formed with uncertainty; there is no simple basis for measuring the economies of IT activities and outsourcing; and large IT switching costs.

This paper is a critique about Beaumont and Costa's study into IT outsourcing in Australia. Beaumont and Costa's major objectives were to identify IT activities that were outsourced and reasons underlying outsourcing option. They also examined the incidence of outsourcing with costs and benefits, factors associated with successful outsourcing arrangements and possible changes in outsourcing approaches and motivations. Their study indicated that outcomes rest critically on the interlinked successful IT outsourcing arrangement and cultural match between provider and client. The nature of contract was also critical factor of successful outsourcing. However, outsourcing decisions were weakly related with company size but not industry sectors. The size of IT function did not significantly determine successful outsourcing (Lacity and Willcocks, 1998). In general, they contributed comprehensive understanding of IT outsourcing that could be used as practical framework by other Australian firms. They suggested further research especially to address several crucial questions in order to provide a robust understanding of IT outsourcing. In this critique, some limitations of their study had been covered using different author arguments.

Beaumont and Costa (2002) argued that outsourcing was driven more by internal factors. However, Lacity *et al* (1996) argued that outsourcing was forced by cost pressures from the economic recession and competition. The authors also claimed that access to skills, better service quality and focus on business core were three most important factors driving IT outsourcing. They argued that cost saving was the least important reason as it may be hard to ascertain. Conversely, Lacity *et al* (1996) and Earl (1996) argued that cost saving was the key factor of outsourcing. Most managers view IT as a necessary cost to be minimized and want to know how much IT could generate extra profits (Lacity *et al*, 1996). Even expected cost saving achieved could be used as successful outsourcing indicator (Lacity and Willcocks, 1998). On the other side of cost saving, Barthelemy (2001) argued that various hidden costs (vendor search and contracting, transitioning to the vendor, managing the effort and transitioning after outsourcing) often undercut anticipated benefits making many managers criticize IT outsourcing. Cost is clear indicator of effectiveness and business performance (Davies and Lam, 2001) making it crucial factor in examining IT outsourcing.

The authors acknowledged some advantages (reduced IT costs, risk avoidance, cultural problems avoidance and focus on business core) and disadvantages of IT outsourcing (loss of distinctive competencies, changing problem, ascertaining relevant cost and cultural problems). They also identified some motivations for outsourcing (cost savings, focus on core business, change fixed cost basis and access to skills) and not outsourcing (IT management changing; human resources and management changing; complex and risky relationship management with the service providers). Generally, they, like Gill (2002), believe that IT outsourcing has the potential to create benefits that cannot be delivered by insourcing.

Four critical success factors of outsourcing – contracts, partnering, IT management and human resources and change management – were identified by the authors. However,

thesefactors are needed further study as it is very complex and broad issue. The authors claimed that successful outsourcing arrangements were based on tight contracts and strategic partnership in term of good cooperation and communication. Rola (2002) claimed that the secret to a successful relationship with outsourcing partners was treating them like internal part. Kern and Willcocks (2002) provided broad understanding in exploring the relationships in outsourcing. Using the interaction approach, they addressed four neglected management issues. The first issue was the critically of the contract. Secondly, the hidden management cost. Third issue was the importance of the institutionalization of operations and process. Finally, the management structure needed to manage the outsourcing relationship. Although using outsourcing, a firm still has to manage the key assets (Hurley, 2001). Obviously, IT outsourcing strategy is important. It provides a comprehensive framework for both provider and client to fully understand and evaluate the expectations, considerations and implications of IT outsourcing in order to form a successful long-term strategic alliance (Chen, 2002).

Basically, contracts and partnering issues are related to transaction cost view. Four factors that determine the transaction cost are: the extent to which complete contract is possible, the extent to which there is a threat of opportunism, the degree of asset specificity or idiosyncratic investment and the frequency of transactions (Davies and Lam, 2001). Lacity and Willcocks (2002) argued that short-term and detailed fee-for service contracts achieved higher rate of expected cost saving. However, such complete contract is impossible as uncertainty and complexity make it difficult and expensive to specify every term. Human beings also have bounded rationality. Moreover, there is asymmetric information. Each party has different access to information and may be in the form of hidden information which leads to adverse selection or hidden action which leads to moral hazard. Finally, there are difficulties in measuring the performance of each party to a contract.

Successful outsourcing arrangements were also determined by firms approach to encounter the changing IT and human resource management (Beaumont and Costa, 2002). Adopting IT outsourcing will lead to make job security issue more sensitive (Leung, 2003).

However, Earl (1996) and Hirschheim and Lacity (2000) emphasized the need of insourcing. Earl (1996) addressed potential threats of outsourcing. These were possibility of weak management, inexperienced staff, business uncertainty, outdated technology skills, endemic uncertainty, hidden costs, lack of organizational learning, loss of innovative capacity, dangers of an eternal triangle, technology indivisibility and fuzzy focus. Although these risks do not occur in every outsourcing decision and some can be avoided or minimized, Earl believes that outsourcing is very complex and uncertain. Earl argued that, in practice, these risks could not be simply outweighed by the outsourcing objectives.

Hirschheim and Lacity (2000) claimed that insourcing was not only the practice of evaluating IT outsourcing but also confirming that it could achieve the same objectives as outsourcing. Firms that invited both internal and external bids achieved higher rate of expected cost saving (Lacity and Willcocks, 1998). Insourcing must be completely explored to give complete understanding in making the best IT sourcing decision (Earl 1996; Hirschheim and Lacity, 2000). They argued four alternative approaches for insourcing. Firstly, senior executives enable internal IT managers to cut costs by replicating a vendor's cost reduction strategy. Secondly, IT managers terminate failing outsourcing contracts due to poor negotiated contracts, increasing IT cost and falling service level. Thirdly, IT managers defend insourcing by justifying that insourcing is a better option than outsourcing. Finally, senior executives confirm the value of IT as part of their business strategies.

An interesting point underlying arguments against outsourcing trend was addressed by Shaw (2003) who claimed that outsourcing trend had forced IT managers become strategists. As a result, IT managers have to play strategic role in IT sourcing that gives a far better chance to transform and add value to firms. It can be seen that IT role has been emerging into

mature phase of the business organization itself, leading to selective sourcing trend. Beaumont and Costa (2002) claimed that Australian firms had outsourced IT functions through selective sourcing. Most Australian firms outsourced IT functions that were not associated with business core. IT functions most closely related to business knowledge and sustaining competitive advantage cannot be effectively outsourced (Lacity et al, 1996; Lacity and Willcocks, 1998). They believe that Australian firms perform important IT functions for their business in-house avoiding become dependent on service providers. Moreover, security and confidentiality issues have to be well covered in outsourcing approach (Anthes, 2003).

Furthermore, Lacity et al (1996) developed a framework to clarify sourcing options. They offered selective sourcing instead of either outsourcing or insourcing. They claimed that outsourcing often failed to bring expected benefits as managers did not carefully select which IT functions to outsource. Therefore, selective sourcing could reduce the problem and deliver potential benefits from other sourcing options. Higher rate of expected cost saving was achieved through selective sourcing instead of other sourcing options (Lacity and Willcocks, 1998). They also provided selective sourcing framework focusing on its critical success factor. IT sourcing modes were characterized by two dimensions, purchasing style (transaction or relationship) and purchasing focus (resource or result). As a result, four distinct contracts emerge. These were buy-in, contract-out, preferred supplier and preferred contractor. A firm should choose the best framework resulting to an effective business strategy. Other considerations determine the value of selective sourcing were business (selecting which IT functions to outsource), economic (comparing vendor offerings with insouring capabilities) and technical (selecting an appropriate contract).

However, I believe that there will be increasing needs of IT use in the competitive global economy. In addition, the knowledge-driven economy has been extensively forcing firms to be knowledge-based organizations (Allard, 2002). IT will be a primary basis of competition where IT role is critical to differentiate a firm from its competitors in products and services as well as performance. From resource-based view, there will be greater disadvantages not considering IT as part of business strategy such as loss of valuable knowledge and competitive capacity (Zack, 1999). Consequently, this will force firm to adopt insourcing approach. Similarly, Raynor (2003) concerned about the importance of "outsourcing IT but not the value" based on value-chain view.

In addition, the multiple contingencies view can be used to better explain different IT sourcing modes. Firms are subject to impact of some contingency forces by strengthening, weakening, or overriding their mutual effects on the IT sourcing mode. By analyzing these contingency forces and their complex interactions, a firm implements particular IT sourcing mode in order to effectively respond its internal (strengths and weakness) and external factor (opportunities and threats). The theory offers three different characteristics –reinforcing, conflicting and dominating contingencies– in examining overall influences of these contingency forces (Sambamurthy and Zmud, 1999). Both reinforcing and dominating contingencies will force firms to adopt either outsourcing or insourcing. On the other hand, conflicting contingencies will obviously force enterprises to adopt selective sourcing.

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