Chapter II

IT Outsourcing

Given the potential headaches of managing IT, it is tempting to hand the job over to someone else. Indeed, outsourcing once appeared to be a simple solution to management frustrations, and senior management teams at many companies negotiated contracts with large service providers to run their entire IT functions. At a minimum, these providers were often able to provide IT capabilities for a lower cost and with fewer hassles than the companies had been able to themselves. But many of these outsourcing arrangements resulted in dissatisfaction, particularly as a company’s business needs changed. Service providers, with their standard offerings and detailed contracts, provided IT capabilities that were not flexible enough to meet changing requirements, and they often seemed slow to respond to problems. Furthermore, a relationship with a supplier often required substantial investments of money and time, which entrenched that supplier in the company’s strategic planning and business processes. The company then became particularly vulnerable if the supplier failed to meet its contractual obligations (Ross & Weill, 2002).

Problems arose because senior managers, in choosing to outsource the IT function, were also outsourcing responsibility for one or more of the crucial decisions they should have been making themselves. Companies often hired outside providers because they were dissatisfied with the performance of their own IT departments—but that dissatisfaction was primarily the result of their own lack of involvement. In light of this track record, most larger companies, at least, are deciding to keep their main IT capabilities in-house. But many engage in selective outsourcing. Good candidates for this are commodity services, such as telecommunications, in which there are several competing suppliers and specifications are easy to set, and services involving technologies with which the company lacks expertise. Unlike decisions to outsource the entire IT function, selective outsourcing decisions are usually best left to the IT unit, assuming that senior management has taken responsibility for overall strategy.
Beaumont and Costa (2002) studied IT outsourcing in Australia. They found that almost 40% of Australian organizations outsource one or more IT applications. Large organizations tended to outsource more than small ones. The three most important reasons for outsourcing were access to skills, improved quality and focus on core business. Four factors contributed to successful outsourcing: a tight contract, a partnership, a change process, and the IT manager’s role changing from managing projects and operations to acquiring and managing the internal and external resources required to do the organization’s IT work.

Successful IT outsourcing relationships enable participants to achieve organizational objectives and to build a competitive advantage that each organization could not easily attain by itself. Outsourcing success can be viewed as the level of fitness between the customer’s requirements and the outsourcing outcomes. Outsourcing success can be measured in terms of both business and user perspectives. From a business perspective, outsourcing is motivated by the promise of strategic, economic, and technological benefits. The success of outsourcing, then, should be assessed in terms of attainment of these benefits. From a user perspective, outsourcing success is the quality level of services offered. A decision to outsource on the basis of saving costs without analysis of the quality of services frequently leads to higher costs and lower user satisfaction. Therefore, it is imperative to conduct a proper analysis of the service quality before building a relationship with a service provider for a successful outsourcing arrangement (Lee & Kim, 1999).

Transformational Outsourcing

The traditional way of thinking in IT outsourcing is to move the current IT function out of the organization and let another organization handle it. There is no strategic thinking behind it, except the idea of solving a problem, saving some money or improving a function by means of some undefined solutions. The new way of thinking is to make IT outsourcing part of a strategic transformation of the IT function, where new tasks and roles are implemented to replace old tasks and roles. A classic example of this new way of thinking is the transformation of the IT function at British Petroleum (BP) in the 1990s. The IT function went through a fundamental transformation consisting of the following changes (Cross, Earl, & Sampler, 1997):

• **From systems provider to infrastructure planner.** The mission of the IT function shifted from developing systems to overseeing technical integrity and pursuing value creation and cost-reduction opportunities through information sharing.

• **From monopoly supplier to mixed sourcing.** In 1991, outsourcing of operations, telecommunications, systems development, and IT maintenance began, as BP recognized that it was not essential that these were carried out in-house. Some local sites already had experience in facilities management, and as contracts came up for renewal, lessons were recorded and a worldwide outsourcing program was implemented.
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