

MANAGING THE RISK OF OUTSOURCING THE IT FUNCTION AT COMPANIES

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Abstract

The main objective for this secondary research is to determine whether the risk of outsourcing the IT function can be managed. Driven by political and economic dynamic changes, facilities management was borne to enable reacting to change. Doing business in today's global economy requires exceptional skills from management in order to be competitive and to have a specific competitive advantage over competitors are getting even more demanding. One of the widest used methods of facilities management deployed by organisations is that of outsourcing in various forms (i.e. I.T., H.R., Distribution, Warehousing, etc.) for various different reasons (i.e. reduce costs, improve quality, focus on core business, etc.). In order for outsourcing to be successful, it needs to add benefits to profits, efficiency or effectiveness ethic. Outsourcing assists management to gain a competitive advantage over competitors within their specific industries as part of their organizational strategies and developing or strengthening core competencies at the same time. Global outsourcing on the other hand leads to controversy inasmuch as it reduces home-country economic activity and employment. The consulted secondary resources confirm that if outsourcing delivers managers can take calculated decisions to use it in their businesses. The future of outsourcing is promising as non-core functions of businesses may rather be outsourced to save on costs. A broad set of new and alternative IT delivery models are already main stream. These models receive attention because of benign economic market conditions.

Keywords: Risk of Outsourcing, IT Function, Competitive Advantage, Outsourcing Relationships

1. BACKGROUND

The main factors surrounding outsourcing is managing outsourcing relationships as observed by Seidl (2007). It seems that in order to gain maximum value from these outsourcing arrangements requires a partnership approach from both the service recipient and providers. Think180 (2008a), suggests that employees, who have the day-to-day job of managing and integrating the work done by vendors and partners, are called delivery managers, and the success of outsourcing starts with them. Vertical and horizontal factors of outsourcing management depend on the size of the outsourced project as the delivery managers are responsible for the project's delivery and integration. Delivery managers of the horizontal process are most likely to be involved in the decision making process to outsource. Therefore are they responsible for defining the work scope. They also often select and engage through daily negotiations with vendors and managing the delivery and completion of the project. The role of the delivery managers of the vertical component is to implement and manage the ongoing program. In the late 1980's the growing trend amongst large companies was that of transferring their information systems to external providers (Greaver, 2012). An outsourcing company called Dimension Data, comments on their website that they perform one or more outsourced functions to 75% of the Global Fortune 100 and 54% of the Global Fortune 500

companies (Dimension Data, 2009). Business optimization in a global economy depends on organization's abilities to access and effective usage of world class information systems (IS). Acquiring this technology is very expensive and skill sets are scarce, almost forcing organizations to outsource this critical function to the specialists in the field of IS. As the main objective for this secondary research is to determine whether the risk of outsourcing the IT function can be managed the following conceptual literature review was done. The study was essentially textual as numerous secondary literatures were consulted. They were carefully selected with the aim to add value to the study. It was then systematically and logically analyzed to ensure an acceptable structure for this relevant research article.

2. LITERATURE REVIEW

2.1. Outsourcing management

The main objective for this secondary research is to determine whether the risk of outsourcing the IT function can be managed. Various secondary research articles were consulted such as the following. Readings from Think180 (2008c), suggests that employees, who have the day-to-day job of managing and integrating the work done by vendors and partners, are called Delivery Managers, and the success of outsourcing starts with them. The

vertical and horizontal factors of outsourcing management, depending on the size of the outsourced project, the Delivery Managers are responsible for the project's delivery and integration and may be responsible for all the processes, or for only some of them.

Delivery Managers of the horizontal process are most likely to be involved in the decision making process to outsource or not and are therefore responsible for defining the work (scope), selecting and engaging through day-to-day negotiations with the vendors, and managing the delivery and completion of the project.

The role of the Delivery Managers of the vertical component is to implement and manage the ongoing program and part of this is to interpret the agreement, and identification of areas not covered by the agreement. According to Corbett (2004) the Delivery Managers should be equipped with the following eight skills:

1. Developing a global business process outsourcing strategy
2. Optimizing the opportunities
3. Creating and leading successful project teams
4. Engaging the marketplace
5. Developing the financial case
6. Pricing, contracting, and negotiating
7. Managing people and change
8. Managing the transition and the outside relationship

At some level, each of these disciplines plays itself across the entire process of outsourcing in one way or another.

2.2. Outsourcing matrix

Outsourcing is a complex decision and brings along a whole new set of management, legal and operational issues with it that needs to be addressed. These must be understood and handled correctly for the outsourcing process to work effectively. Outsourcing agreements can consist of many different forms with a variety of components with different deliverables.

Endeavour Business Learning, now Think180 (2008a), developed an outsourcing matrix that can be a useful guide and starting point to overcome the very important strategic priorities that need to be followed to ensure success.

Think180 (2008a) argues that outsourcing can be designated in four different forms, Team Partner, Delivery Partner, Delivery Vendor, Facility Vendor; whom are dependent on two key differentiators, Integration with the Business and Recipients of Service.

These differentiators make up the two axes on the Matrix and the resulting matrix creates the four forms of outsourcing, characteristics of each with examples, what key value is provided, the top two priorities of each and the actions essential to achieve the best results.

Jim Everett from Think180 (2008a) describes the dimensions of outsourcing, management priorities and the outsourcing forms in the following manner in relation to the Outsourcing Matrix:

The two key differentiators make up the two axes and consist of the following:

- Integration with the Business - the extent to which the function, activity or project is integrated with organization's operations, and whether the

vendor participates in the meetings and decisions of the business.

- Recipients of the service - who receives the results of the function, activity or project. This may be employees or internal company functions, or customers, partners, channel members, or other outside stakeholders of the organization.

The four forms of outsourcing consist of the following:

- Team Partner - contract expertise is brought in to work internally as part of a team or within a function. This is the most integrated form of the four with the organization's functions and decision-making.

- Delivery Partner - external third parties provide integrated solutions or deliver strategic information on the organization's products to customers, as part of the overall marketing and product definition.

- Delivery Vendor - the delivery of a service or product to the customer is contracted out and completely handled by an external party.

- Facility Vendor - an internal service or function is contracted to an external party. This is the least integrated with organization's functions and decision-making of the four forms used.

It is quite clear from the Matrix that each of these forms has a particular value that is added through the outsourcing approach and each has particular issues that must be addressed. There is however issues that applies to more than one of these forms (e.g., proficiency, ethical practice); however, each form has strategic priorities that relate to the business objectives for the task.

2.3. Types of contractual arrangements in outsourcing

There are three main types of contractual arrangements through which outsourcing can be managed: Managing Agent; Managing Contractor; Total Facilities Manager.

In order to have a better understanding of the three types of contractual arrangements just a brief discussion follows:

Managing Agent: The organization wishes to retain a function in-house and retain its employees, but the employees lack the necessary skills or expertise and therefore brings in an external organization to manage the facilities.

Managing Contractor: The organization appoints a managing contractor to undertake the fulfilment of the outsourced function who in return appoints sub-contractors to assist in the fulfilment of his obligations under the contract entered into.

Total Facilities Manager: The organization gives full responsibility for managing the outsourced function to a single organization due to his expertise in offering a more complete and competitive solution to the organization's needs than that of a managing agent or managing contractor.

2.4. Outsourcing lifecycle

One of the main factors surrounding outsourcing is managing outsourcing relationships. In order to gain maximum value from these outsourcing arrangements requires a partnership approach from both the service recipient and providers. This can only be achieved if a structured approach is adopted

and is often called the Outsourcing Lifecycle or the Outsourcing Relationship Model. Next, a brief explanation of the different phases as adapted from Think180 (2008), Atos Origin (2014) and Seidl, R. (2007)'s models and theories.

2.5. Outsourcing phases

The outsourcing lifecycle comprises five stages forming the basis for any outsourcing and encumbers six phases consisting of the following:

2.5.1. Strategy phase

The decision to outsource must have a sourcing strategy, which is embedded in the outsourced process's or activity's strategy, which is the starting point of the first phase. It is important that the sourcing strategy correctly reflects the recipient's views on the outsourcing i.e. is the enterprise willing to outsource, what goals do they want to achieve, who are the possible candidates to supply the service, what are the selection criteria, what is the vendor policy?. This type of decision normally originates from senior management level of the organization and needs to be reviewed and evaluated critically for successful execution (De Loof, 2007).

The feasibility study should include but not be limited to the TELOSS: Technical - how we can do it; Economic - is it cost justifiable; Legal - are there legal issues; Operational - does this fit the way we want to do business; Schedule - can we get it done on time; Security - what are the risks. Further to this, the costs and benefits should be considered, taking into account:

- a) Costs are easier to identify than benefits
- b) Include intangible and tangible costs
- c) Business benefits include reduced costs and increased revenue
- d) Include competitive positioning
- e) Consider business focus: low cost, differentiation, focus
- f) Differentiate ongoing from one-time costs
- g) Separate development costs from operating costs.

Costs and benefits should be detailed for each alternative.

2.5.2. Selection phase

In this phase there are three major processes: Defining the work; Sourcing the vendor(s); Selecting the vendor(s).

The scope of the work to be outsourced and the number of service providers need to be clear as well as the process to contract the service has to be detailed i.e. Request for Information (RFI) (long list), Request for Proposal (RFP) (short list), negotiations (exclusive) and contract conclusion with the "best-fit" vendor(s) i.e. price, personal style, cultural fit, etc. Ensure all business and technical arguments have been considered (Think 180, 2008b).

2.5.3. Negotiation phase

This phase comprises two major processes: Negotiating the contracts and associated agreements; Signing the final contract.

It is important during this phase to get business management, IT, Lawyers, Finance, HR, experts involved and to ensure that the "getting to know each other" process with the potential supplier is fully exploited. Making use of independent external advisors by the service recipient can speed up the process. In the selection of the service provider(s), the capability to execute is a key factor in when deciding to finalise the contract (Atos Origin, 2014).

2.5.4. Implementation phase

This phase involves, in essence a tailored project plan, involves the start-up activities of planning the transition and implementation of the outsourced agreement, establishing the administrative functions needed for its management, and the formal launching. The four major processes are: Planning the transition; Engaging the vendor or vendors; Preparing the detailed budgets and forecasts; Launching the program (Think 180, 2008b).

The purpose of the transition period is to secure continuity of the service delivery and implement the changes required to achieve the agreements made.

2.5.5. Management phase

This phase encompasses all ongoing activities required to manage the project, and successfully achieve the contracted results. Here the key aspect is Governance which enables control and is based on contractual agreements and very essential, trust. The seven major processes listed continues for the life of the project: Managing the Customer (or user) relationship; Performing all project financial oversight; Monitoring project and vendor performance; Managing the partnership or vendor relationship; Ensuring Governance through proper demand/supply contracts; Contract management i.e. negotiating changes in the project; Knowledge Management (Think 180, 2008b & Seidl, 2007).

2.5.6. Completion phase

The completion phase covers all completion and close out activities for the outsourced agreement and the major process here is: Completing the contract; Closing out the project. Depending on the initial intend or characteristics of the outsourced contract / project, there could be a renewal of the current contract discussions. The overall outsourcing success should be measurable and obvious in terms of economic, technical, strategic value and overall satisfaction with the contract.

2.6. Outsourcing the information technology function

In the late 1980's the growing trend amongst large companies was that of transferring their information systems to external providers (Greaver, 2012). An outsourcing company called Dimension Data, comments on their website that they perform one or more outsourced functions to 75% of the Global Fortune 100 and 54% of the Global Fortune 500 companies (Dimension Data, 2004). Business optimization in a global economy depends on

organization's abilities to access and effective usage of world class information systems (IS). Acquiring this technology is very expensive and skill sets are scares, almost forcing organizations to outsource this critical function to the specialists in the field of IS.

2.7. Reasons to outsource

From the researcher's various readings, Greaver (2012), Van Weele (2013), IAOP (2009a), Dimension Data (2009), Atos Origin (2014), Think180 (2008c) & Seidl (2007), the following summary of reasons were identified but are not limited to these:

- Focusing in-house resources on more strategic business issues and/or new technology and systems;
- Increased competition, need to improve competitive advantage;
- Globalization of markets;
- Reorganization and streamlining;
- Gaining access to new technologies and skills and innovation;
- Convergence of industries;
- Cost of new technology i.e. total cost of ownership;
- Complexity of solutions and variability of costs;
- Availability of necessary skilled workforce;
- Improving business efficiencies and quality of IT services.

Different organizations will have different needs and in-house skill sets for variation in reasons and methods for outsourcing. Some organizations will also make use of insourcing as opposed to outsourcing for a period of time depending on the requirements and the level of in-house skills.

2.8. Risks attached to IT outsourcing

Arguments against outsourcing are confidentiality and inextricability of business process and IT services. The outsourcing risks do go however wider than this according to Seidl (2007) as illustrated in Table 1.

Most of the risks can be managed, but it is extremely important as per Van Weele (2013:128) to choose the right supplier to be your outsource partner.

2.9. Decision making model

Deciding on the right outsourcing partner is part of the strategic phase of Momme and Hvolby's (2002) outsourcing decision model. It is of critical importance that managers of all levels and from the specific activity or function to be outsourced, labour unions, legal advisors be involved with the decision making process (Taplin, 2008). De Loof (2007) developed a model to assist organizations with the decision making process whether to outsource or not and what to outsource. This model is based on six intermediate variables to base your decision process on.

The model discussed below, is a framework to assist management in deciding whether to outsource or not and under which circumstances they can consider outsourcing.

Table 1. Risks in outsourcing

<i>Outsourcing risks</i>	
<i>Risk</i>	<i>Major concerns</i>
Strategic Risk	<ul style="list-style-type: none"> - The third party may conduct activities on its own behalf which are inconsistent with the overall strategic goals of the regulated entity. - Failure to implement appropriate oversight of the outsource provider. - Inadequate expertise to oversee the service provider
Reputation Risk	<ul style="list-style-type: none"> - Poor service from third party - Customer interaction is not consistent with overall standards of the regulated entity. - Third party practices not in line with stated practices (ethical or otherwise) of regulated entity.
Compliance Risk	<ul style="list-style-type: none"> - Privacy laws are not complied with. - Consumer and prudential laws not adequately complied with. - Outsource provider has inadequate compliance systems and controls.
Operational Risk	<ul style="list-style-type: none"> - Technology failure. - Inadequate financial capacity to fulfil obligations and/or provide remedies. - Fraud or error. - Risks that firms find it difficult/costly to undertake inspections.
Exit Strategy Risk	<ul style="list-style-type: none"> - The risk that appropriate exit strategies are not in place. This could arise from over-reliance on one firm, the loss of relevant skills in the institution itself preventing it bringing the activity back in-house, and contracts which make a speedy exit prohibitively expensive. - Limited ability to return services to home country due to lack of staff or loss of intellectual history.
Counterparty Risk	<ul style="list-style-type: none"> - Inappropriate underwriting or credit assessments. - Quality of receivables may diminish.
Country Risk	<ul style="list-style-type: none"> - Political, social and legal climate may create added risk. - Business continuity planning is more complex.
Contractual Risk	<ul style="list-style-type: none"> - Ability to enforce contract. - For Offshoring, choice of law is important.
Access Risk	<ul style="list-style-type: none"> - Outsourcing arrangement hinders ability of regulated entity to provide timely data and other information to regulators. - Additional layer of difficulty in regulator understanding activities of the outsource provider.
Concentration and Systemic Risk	<ul style="list-style-type: none"> - Overall industry has significant exposure to outsource provider. This concentration risk has a number of facets, including: <ul style="list-style-type: none"> - Lack of control of individual firms over provider and - Systemic risk to industry as a whole.

Source: Adopted from Seidl, 2007

In today's global economy business conditions change overnight and great care needs to be taken in evaluating risks of outsourcing IT and information systems activities of long term significance. The organization should ask themselves questions about business objectives and philosophy before deciding on outsourcing (Cant and Van Scheers, 2012), for example:

- Is the IT strategy and operation in a state which is stable, measurable and suitable for contracting out?
- How will outsourcing fit in with the overall business direction?

- What benefits are being sought? Are these realistic?

- Might security be compromised?
- How will success be measured?
- Where will innovation, whether technical or in information systems, originate?

According to Van Weele (2013), all parties involved in outsourcing should consider several key activities:

- Defining the reasons for outsourcing;
- Evaluating outsourcing business processes versus functions;
- Recognizing seller and buyer roles;
- Preparing for the risks;
- Planning the change.

3. DISCUSSION

The literature clearly stresses the importance of what steps need to be taken and which aspects need to be considered before making a decision whether or not to outsource the IT function.

3.1. IT outsourcing relationship model

According to Seidl (2007) placing all the risks on the vendor is impractical, and therefore a partnership approach of risk sharing and reward may be more effective in bringing client and the vendor to successful project outcomes (Baca, 2009). He further comments that Bragg (2013) stated that "the use of outsourcing is becoming more sophisticated; more organizations are outsourcing responsibility for processes". The Kern Model of Outsourcing Relationship, also known as the "gestalt" model observes the key exchanges and the context between the two parties.

The relationship between the client and the service provider will be handled in a formal (contractual) and more informal (normative) way of monitoring, measuring (working context) on all levels of the business and people interactions. There must be clear action plans and points of interaction with specific goals to be achieved with time lines. According to Atos Origin (2004) the importance of trust between the partners cannot be stressed enough and trust enables the solving of issues and supports the co-operation between them. This becomes even more important if there is a transfer of staff between the parties, as the service provider has a duty of care to their new employees.

4. CONCLUSION AND RECOMMENDATIONS

Greaver, Dimension Data, Atos Origin, Seidl, Van Weele, etc., are all of the opinion that Outsourcing is one of the most critical management tools available to management in today's business world to optimise technological advances and expertise for the organizations in order to be competitive and ensure sustainability. They are all of the opinion that outsourcing will only grow and will become more and more prominent in order to compete globally.

In an article published in *Computing.co.uk* written by Phil Muncaster he addresses the issue of Chief Information Officers (CIOs) failing to measure outsourcing value. According to the article, less than half of CIOs know the financial value of outsourcing to their business. The study by Warwick Business

School, on behalf of global IT services firm Cognizant, interviewed 263 CIOs and finance directors across Europe, and found that the majority lack the tools to effectively measure the return on investment (RoI) from such projects, despite spending millions each year on outsourcing". Just 43% said they have attempted to calculate the financial impact on the bottom line, while a third said they do not even try to measure RoI at all and a further fifth said they do not know if they have tried. Julia Kotlarsky, associate professor of information systems at Warwick Business School, said the following "A combination of proven methodology, industry expertise and tight integration of business' strategy into outsourcing objectives to effectively measure, improve and communicate outsourcing's true impact, is required to ensure outsourcing delivers on its promises" (Muncaster, 2009:1).

An article published by Fortune 500 (2013) describes the 10 Outsourcing Trends to Watch in 2014 to both suppliers and outsourcing customers:

- Optimization is the new transformation
- Renegotiation of contracts for rates, ensuring optimum value
- Re-evaluation and restructuring of relationships regarding multi-sourcing
- Look for more captive center divestitures with low number of new captives being set up
- Consolidation at firms and mergers / acquisitions
- Offshoring to America due to lower dollar and sluggish employment
- Cost pressure will drive decline in Mega-Deals, more core processes
- Increased outsourcing in local and state government
- Slow return of discretionary spend i.e. application development, maintenance and consulting services
- Semi-outsourcing alternatives i.e. Cloud computing and software-as-a-service.

The main objective for this secondary research was to determine whether the risk of outsourcing the IT function can be managed. The consulted secondary resources confirm that the although the risk of outsourcing is high but if outsourcing delivers on its promises it can be consider by more businesses. The researcher is of the opinion that outsourcing in the IT Industry will continue to grow. During the next five to seven years, a broad set of new and alternative IT delivery models - already in use by aggressive early technology adopter organizations - will become main stream. Since these models have been gaining attention from enterprises in recent years in relatively benign economic market conditions, they are likely to become of far greater interest to buyers as economic conditions worsen through 2016".

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