3 Theoretical Background on Outsourcing

3.1 Definition and Background of Information Systems Outsourcing

The generic notion of outsourcing refers to a decision of an organization whether to make or buy certain products, services or parts thereof (Loh/Venkatraman 1992a, 9, 1992b, 336). The business practice of making arrangements with an external entity for the provision of goods or services to supplement or replace internal efforts has been around for centuries (Dibbern et al. 2004). In the course of establishing a trend towards “lean production” (Womack/Jones/Roos 1991), organizations more and more focused on their core competencies in order to leverage the organization’s unique potential and comparative advantages over their competitors (Wintergerst/Welker 2007). Consequently, companies assigned commodity or non-specific assets (i.e., processes, products, or services) to external entities. By reducing the level of in-house production and the degree of the company’s vertical integration, companies also shifted those components away from a “hierarchical” mode toward a “market” mode of governance (Loh/Venkatraman 1992a, 8; Malone/Yates/Benjamin 1987; Wintergerst/Welker 2007, 938pp.).

A large body of research examines the outsourcing of various business functions such as human resources, payroll, logistics, or facility management. In its generic form it has been studied in several settings and industries such as “the manufacturing of parts in the automotive industry, the sales function in the electronic industry, the procurement of components or services in the naval shipbuilding industry, and the distribution of equipment, components, and supplies across a broad set of industrial firms” (Loh/Venkatraman 1992a, 9, 1992b, 336).

In the field of information systems, the outsourcing of information technology began to evolve in 1963 when Electronic Data Systems (EDS) as a service provider signed a contract with Blue Cross of Pennsylvania for the management of its data processing services. This was the first time that a large business had turned over its entire data processing department to an external vendor. The arrangement was also different from other EDS service providing contracts since EDS also took over the responsibility for Blue Cross’s IS people (Dibbern et al. 2004). Despite the pioneering role of this outsourcing case, information systems outsourcing experienced a real boost not until 1989, when Eastman Kodak announced its well-publicized decision that it was outsourcing its information technology function to IBM, DEC and Businessland (Wilder 1989, 1990). Never before had such a large and well-known organization, where IS was considered to be a strategic asset, turned its IT over to external service providers (Applegate/Montealegre 1991). Kodak’s US $1 billion outsourcing deal led to a widespread interest in outsourcing and legitimized for both large and small companies to transfer their IT assets, processes, and staff to outsourcing service providers (Arnett/Jones 1994), leading to what some authors have labeled “the Kodak effect” (Loh/Venkatraman 1992b; Caldwell 1994).

Trying to replicate the success of the Kodak deal, other large US companies promptly followed, e.g., Delta Airlines, Continental Bank, Xerox, Chevron, Dupont, JP Morgan, and Bell South (Dibbern et al. 2004). But the trend is not an exclusive US phenomenon. Deals by Luft Hansa, Commerzbank, Deutsche Bank, and Bundeswehr (Herkules) in Germany, Inland Rev-
enue, BP, British Aerospace, and BBC in the United Kingdom (Lacity/Willcocks 2000b; Kumar 2006), the South Australia government, Telestra, LendLease, and the Commonwealth Bank of Australia in Australia (Beaumont/Costa 2003), Swiss Bank, Credit Suisse in Switzerland, and Telecom Italia, Banca di Roma in Italy document the rise of the outsourcing phenomenon worldwide (Dibbern et al. 2004, 8).

The growth of the worldwide IS outsourcing market can be attributed to two primary phenomena (Lacity/Willcocks 2001). First, the increased interest in IS outsourcing is mainly a consequence of a shift in business strategy. As elaborated on in the introductory section on outsourcing above many companies have abandoned their diversification strategies to focus on core competencies that the organization does better than its competitors. As a result of this focus strategy, information systems came under scrutiny. Company executives often consider the IS function as a non-core activity with the underlying belief that IT providers have economies of scale and technical expertise to provide IS services more efficiently than internal IS departments. Second, the increase in outsourcing is a consequence of the lack of clarity around the value delivered by IS. In many companies, IS is regarded as an overhead and (essential) cost factor. Thus, the refocus to core competencies and the perception of IS as a cost burden prompt many companies to engage in a variety of outsourcing arrangements (Dibbern et al. 2004).

3.1.1 Specific Characteristics of Information Systems Outsourcing

Even though the term outsourcing is not specific to information systems (Nagengast 1997), in this thesis the term outsourcing is solely focused on the IS domain. Senior executives often argue that information systems outsourcing does not warrant attention, since it is no different from the outsourcing of other non-core business functions, such as legal, administrative, or custodial services of a firm (Lacity/Hirschheim 1995b, 217). What renews interest in IS outsourcing and deserves attention especially with regard to information systems is the dramatic change in scope (Lacity/Hirschheim 1993a, 3). Some authors even call IS outsourcing an “administrative innovation”, i.e., “significant changes in the routines (or behavioral repertoires) used by the organization to deal with its tasks of internal arrangements and external alignments” (Venkatraman/Loh/Koh 1992), because of three distinct features (Loh/Venkatraman 1992b, 337).

First, it represents a significant shift in the mode of governance from the traditional locus of control and coordination within the hierarchy (combined with relatively standardized market transactions with vendors) towards newer modes that could be characterized as hybrids or partnerships. Second, it leads to significant changes in the internal processes of the user organization. And third, it constitutes a significant change in the organizational routines used to deal with the external environment. This includes specifically a shift away from an arms-length approach for dealing with the “IT marketplace” towards a mutual relationship mode (with longer-term alliances involving a few selected partners) where increased mutual understanding, enhanced goal compatibility and recognition of complementary skills and requirements is required (Loh/Venkatraman 1992b, 337pp.).