The Worlds of Academic Research, Media, Politics and Practice on IS Outsourcing: Musings of a Casual Observer

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I have always had a fascination for the general topic of IS outsourcing. The issue for me, as an academic researcher, has always been about the tensions created by IS phenomena. In the case of outsourcing, the economic benefits from leveraging capabilities of service providers are manifest, particularly if their scale, scope, and expertise advantages cannot be matched in-house. The counter-case is however is based in the inability of the firm to predict and control resources and outcomes. This gets more fascinating when the resources involve information with its plasticity that cannot be naturally separated from the outsourcing firm. Hence we see the tension. This is reflected in most academic work that looks to applying theories like resource based theory, agency theory or transaction cost economics to understand this tension.

Beyond the academic world, there are other places where outsourcing is tension is prevalent. The popular press, covering the recently concluded presidential election in the US would often broach the topic of outsourcing. The tension there of course paralleled the presidential camps – as each side pushed its own perspective on outsourcing and its impact on the US economy. While the outsourcing discussed was broader than IS outsourcing, the rhetoric in many ways was narrower.

Finally, in my opportunities to engage with business on issues of outsourcing, I am noticing a different kind of tension there. This tension is largely manifest in the nature of the relationship firms should have with their providers. On one hand an arms-length transactional relationship seems appropriate and clean – but tougher in cases where the provider is a strategic or innovative partner.

In June 2012, I was honored to participate as the keynote Speaker for the 10th Annual International Smart Sourcing Conference at Daejeon, South Korea. Delegates to this conference represented a diverse group of vendors, scholars, clients and government officials. In that speech, I articulated the tensions described above – in what I refer to as the "three worlds of outsourcing." Below, I elaborate on these perspectives and intersperse my comments with some of the slides from my presentation.

The Academic World

If we trace academic research in outsourcing, we can quickly come to the conclusion that it is not new – and its evolution was largely driven by cost. When hardware was a scarce resource in the 1960s, time sharing on mainframe computing was quite prevalent. The 1970s and 80s hardware costs dropped enough to justify customer control and ownership of IT assets. In the 1990s, the increasing costs of software, global IT skills shortage forced economies of packaged solutions. Companies were also changing their processes and radically slashing costs to improve. ERP solutions were being adopted, and some trailblazing companies like Kodak went for complete outsourcing of their IT services. With the Internet, the shift in economies led to more selective "net-sourcing" of business processes.

Research has followed this evolution. Early research focused on describing benefits and problems for business. Benefits include competiveness, competencies, economics, technologies, etc. and problems are concerned with risk, flexibility, control, jobs, contracts, security, etc. Typically, the script for explanatory IS outsourcing research has been fairly consistent. The typical paper starts with an interesting outsourcing problem or gap, often pertaining to the outsourcing decision or contract. Then a theoretical perspective (e.g., transaction cost economics) is adopted to frame the problem. The theoretical arguments are adapted to the phenomena and a mid-level model is build. This includes hypotheses with predictions for the decision or the nature of the contract. The model is then tested using survey data (or cases), and in some cases extended with moderating variables in subsequent studies.

Most of the work on IS outsourcing has pertained to the buyer's decision making process, while some focuses on contract management, partnership quality and outsourcing performance. Tiwana and Bush (2007)[1] describe some typically used theoretical perspectives and hypotheses that epitomize the script described above.. They use three theoretical perspectives that characterize the nature of IS outsourcing research and are briefly described below.

First, from the perspective of Knowledge-Based Theory, firms are regarded as repositories of tacit and explicit resources. Sustaining competitive advantage will only be possible if firms can create valuable, rare, and immobile knowledge through "blending." Based on this perspective, logical theoretical predictions suggest that projects that increase the chances of exploiting the service provider's knowledge-base, will be more likely to be outsourced. The authors argue that a client's (technical) knowledge would be inversely related to outsourcing, while specifiability of requirements would be positively related to outsourcing.

Second, from a Transaction Cost Theory perspective, inter-firm exchanges generally incur transaction costs such as negotiation, monitoring, contract enforcement, etc. costs. High

[1] Tiwana, A and Bush, A., "A Comparison of Transaction Cost, Agency, and Knowledge-based Predictors of IT Outsourcing Decisions: A US-Japan Cross-Cultural Field Study," Journal of Management Information Systems (JMIS), 24(1), 2007, 263-305.

transaction costs make firm over market a more economical governance structure. From this logic, the authors propose the threat of opportunism or lower trust in the relationship would decrease outsourcing. More complex projects would decrease outsourcing, while generic technologies would be more readily outsourced.

Third, from an Agency Theory perspective, inter and intra firm relationships can be characterized as agents that work for principals. They have goal conflict due to information asymmetry which is costly. The theory focuses on how principals (clients) can reduce information asymmetry and design proper compensation schemes (rewards or incentives) in order to motivate performance of agents (service providers). Theoretical predictions indicate that projects that reduce information asymmetry will be more likely to be outsourced. Therefore, in cases where outcomes or behaviors are measurable, outsourcing will go up, and the nature of the contract (assessment mechanism) will be different in each case.

While the number and types of outsourcing studies far exceed the few illustrations above, most of this work seems to focus largely on tensions between commodity and non-commodity outsourcing and far less on innovation and co-creation of value. However, there are studies emerging outside the outsourcing stream that examine co-creation of value. Research that focuses on examining how to integrate diverse IT resources across companies to equitably partake in joint creation of value can move the frontier of outsourcing research to platforms, partnerships and innovation – characterizing the evolving state of practice[2].

The World of Politics and Media

In following political discourse in the US, it is apparent that outsourcing has been bandied around with incomplete and biased information that suites a particular political persuasion. On one side of the aisle, we hear quotes like:

> "Plants close, workers lose jobs, take jobs with lower pay, (outsourcing) lowers standard of living (can't buy a home, save for retirement, pay for child's education…)"
>
> "Outsourcing reduces know how as fewer young people go into technical fields if they see these jobs moving overseas"
>
> "Outsourcing increases the trade deficit and increases the deficit"
>
> "Separating innovation and production is inefficient…easier to control inventories and product quality when production is closer to home. Let's bring jobs home"
>
> "Let us create incentives to keep jobs in USA (Help us sponsor a Federal bill that reduces federal money to companies that ship jobs overseas)."

[2] Kohli, R., Grover, V., "Business Value of IT: An Essay on Expanding Research Directions to Keep up with the Times," Journal of the Association for Information Systems, 9(1), 2008, pp.23-39.

On the other side, there are people who believe that economics is on their side. For instance, "if one country is better at making wine and the other at bread, then both can succeed and benefit in a global economy" as the pie expands. Figure 1 (below) highlights the political arguments often made against global outsourcing. It suggests that jobs will be replaced by low income jobs in another part of the globe and warns constituents about "greedy" corporations that are replacing jobs to save money. This case largely describes job displacement as a negative manifestation of outsourcing that ultimately reduces global demand and hurts the local economy. In contrast, the broader economic arguments for global outsourcing (i.e., the counter-case) are less frequently articulated, particularly when economic conditions are poor. See Figure 2, for the counter-case.

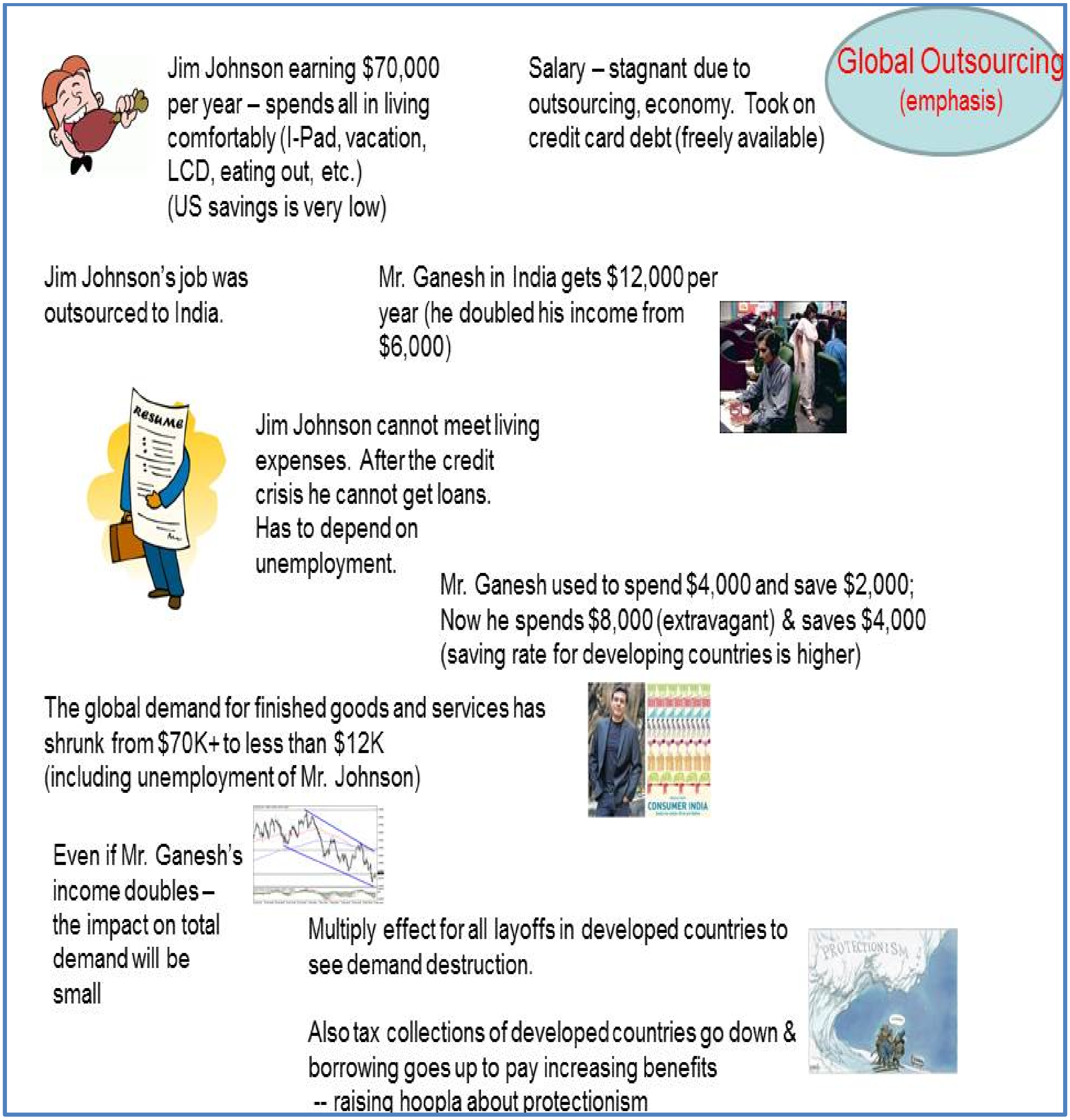

Figure 1: Political Case against Outsourcing

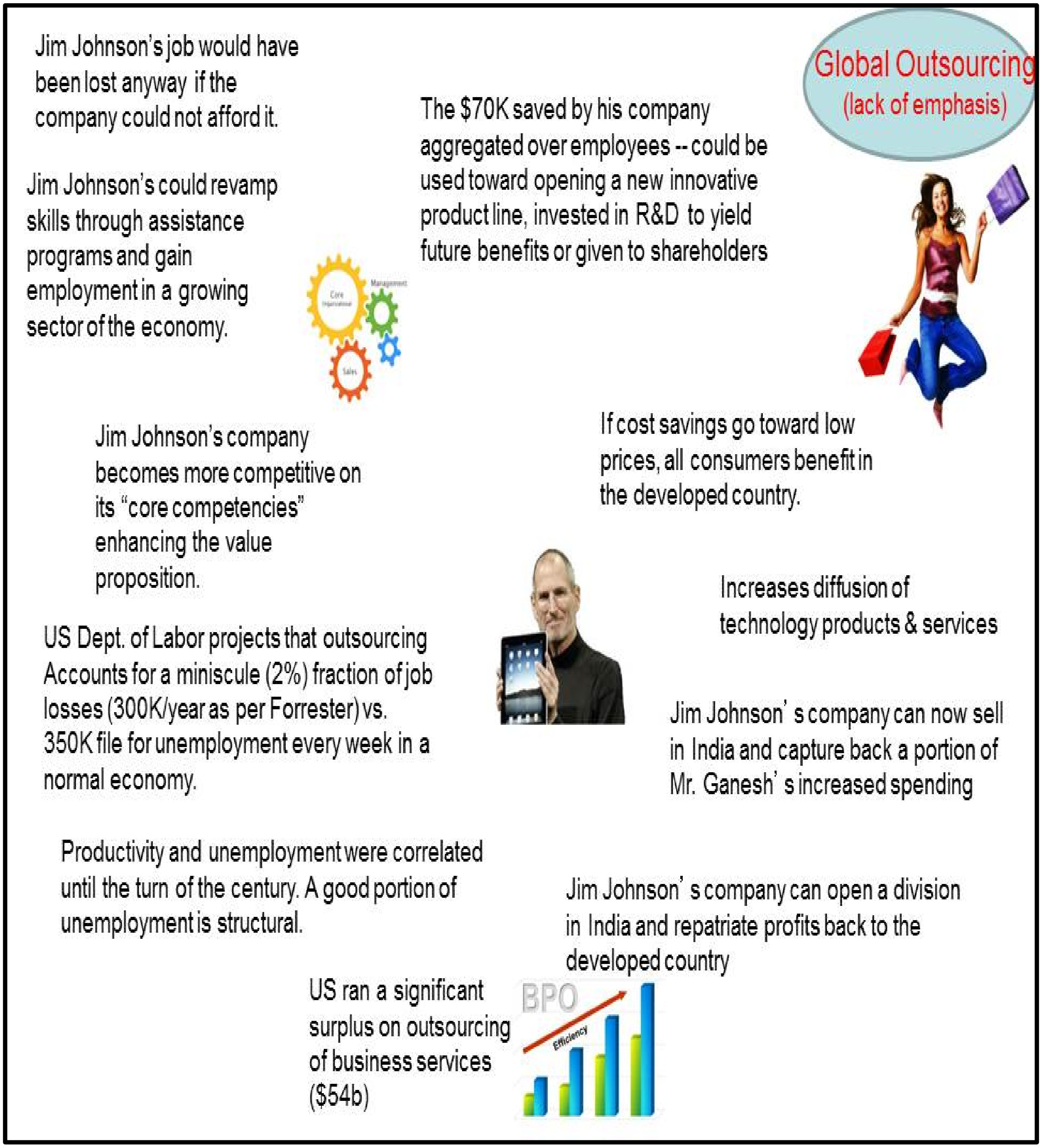

Figure 2: The Counter-Case

In sum, it seems like there is a lot of emphasis in the political debate on wage arbitrage rather than a broader (and arguably more balanced view) of the economic proposition.

The World of Practice

My observations of the world of practice indicate that firms are continually managing evolving outsourcing relationships. Cloud computing for instance is here to stay, and there is increasing readiness to trusting third party providers for critical infrastructural needs. A 2012 Global Outsourcing Survey by Deloitte provides some interesting results regarding the status of outsourcing in practice, as perceived by executives.

- Information Technology, Finance and Human Resources continue to lead other business processes in outsourcing, though all business processes are expecting to see increases in the use of outsourcing and offshoring in the near future

- The ability to partner and clearly communicate expectations are the most important success factors to respondents

- Vendor management organizations, while highly competent at "day-to-day" activities, find themselves underutilized when it comes to driving strategic value

- A significant number of respondents have terminated contracts with their vendors in the past, primarily due to concerns with the quality of services.

- More clients are contemplating insourcing functions due to vendor non-performance or changes in business strategy

- The average length of the outsourcing transaction from strategy to contract signature ranges from 23 to 46 weeks in duration. Contracts are becoming shorter.

- Increasing trend in cloud computing. Privacy/security top concerns.

Therefore, observing outsourcing practice it seems that more diverse relationships with service providers are on the cards, along with greater accountability. The tension seems to be in determining the appropriate relationship (from strategic to tactical) while maintaining accountability amidst continually evolving technologies.

Looking Forward

To my eye as a casual observer of outsourcing, it seems that the three worlds are quite disparate, but are replete with different kinds of tensions. In research, we seem to straddle the line on what should be outsourced – and are just beginning to look at broader questions of co-creating value. In the world of media and politics, issues of wage arbitrage are highlighted for political expediency over truly emphasizing effects of outsourcing on a global economy. Finally, the world of practice is struggling to figure out appropriate balance between relationships and accountability, while leveraging capabilities of the parties involved.

In moving forward, it seems that the issue of value appropriation is going to become increasingly important in all three worlds' – and will arguably be the concepts that bring these worlds together. Outsourcing is certainly going to continue well into the future. However, its nature will continue to evolve along the issue of value. Therefore, there are opportunities for all three worlds to study and promote richer knowledge sharing partnerships and technology platforms that can spawn new products, services and capabilities. So, along with the non-essential services being outsourced, we will also see new structures that promote and incentivize innovative behaviors with contracts based increasingly on relational norms. Further, shorter-term renewable strategic contracts might be more prevalent than the mega deals of the past. Smaller companies that drive much of the economic activity are increasingly going to get a handle on outsourcing – and work with independent (smaller) contractors in a global market. And, finally, newer deals in emerging technologies like cloud computing, business analytics and social media are going to grow. Hopefully, the political world will not be so fractioned as to inhibit development of sound policies that facilitate outsourcing that can balance the tension between local and global economic expansion.