

# Selective Outsourcing of IT Functions is the Best Option

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**Citation:** Magableh A.K. (2018) Selective Outsourcing of IT Functions is the Best Option. Open Science Journal 3(1)

**Received:** 3<sup>rd</sup> October 2017

**Accepted:** 20<sup>th</sup> February 2018

**Published:** 22<sup>th</sup> February 2018

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**Funding:** The author(s) received no specific funding for this work

**Competing Interests:** The author have declared that no competing interests exist.

## Abstract:

The current research indicates that selective outsourcing is still the norm, however, outsourcing are becoming more complex. There are many perceived and hidden benefits and risks of outsourcing. The current research covers Full In-sourcing, Selective Outsourcing and Full outsourcing. This article provides an overview of Selective outsourcing of IT Functions, further, it traces the evolution of outsourcing and discusses the enabling role of information technology in outsourcing. Additionally, the research talks about process, management, and benefits of selective outsourcing.

**Keywords:** Outsourcing

## Introduction to Outsourcing

Project team requires resources and resources should be acquired externally from sellers such as external vendors, suppliers or manufacturers. Primarily, the projects scope can be broken into number of steps and sub-projects and some can be sub-contracted to another company. Outsourcing is the term often used in place of sub-contracting. Further, outsourcing can be called as Procurement Management. Outsourcing can be used for the complete organization or may be used for any particular project. Moreover, outsourcing is a strategic approach to take advantage of cheap labor leading to reduction of cost, speed up delivery and high skilled staff. In outsourcing the client organization and the supplier/vendor enter into a contractual agreement that defines the transferred services. The supplier delivers the require product within budget and time to the client and the client agrees to procure the services from the supplier for the term of the contract.

According to Aalders (2001), Outsourcing is handing over of a fundamental corporate process to any external company.

According to Phillip, et al (2004), transferring IT applications to servers that are physically located in a vendors' facility – where the vendor is responsible for the up-time, connectivity and maintenance of both hardware and software with service level agreements for performance – is an example of outsourcing an explicit selective IT function. The basic reason for outsourcing should be cost reduction, shared risk or access to enhanced capability while defining limitations or boundaries.

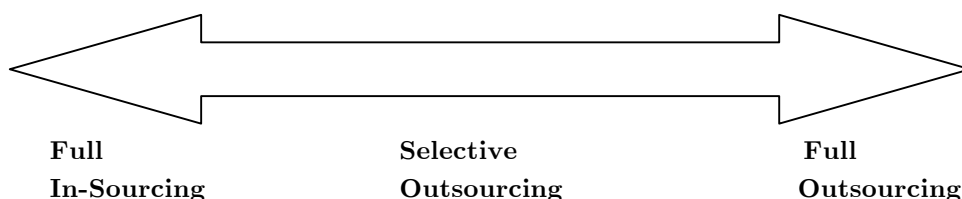
While the promise of quality services at cheaper prices lure organizations offshore, they should be mindful of several challenges posed by the cultural differences and geographical separation organizations face in offshore outsourcing. Only through thorough planning and watchful execution of the outsourced project will an organization be able to achieve the benefits from offshore outsourcing.

## IT Outsourcing Motivation and History

The background of IT outsourcing can be traced back to 1960s and 1970 and it gradually developed phase wise (Jae-Nam 2003). It originated from the professional services and facility management, from high cost and in-accessible main-frame to highly available low-cost PC's. In recent times Outsourcing of IT functions is perceived to better leverage the resources and focus on core applications to increase IT's value to corporate mission.

## Different types of Outsourcing

Marchewka (2006) describes the following three types of outsourcing which an organization or a project follows and further he illustrates continuum of outsourcing relationship.



**Figure 1.0** Outsourcing Model  
[Source : Marchewka (2006, p.304)]

### *Full In-sourcing*

According to Mary, et al (1996), full In-sourcing retains the management of software development internally after evaluating the IT service market. Included in our definition of in-sourcing is the buying-in of vendor resources to meet a

temporary need, such as programmers in the latter stages of a new development project or management consultants to facilitate a strategic planning process.

### *Selective Outsourcing*

Marchewka (2006) defines that Selective outsourcing provides greater flexibility and the facility to select the project process deliverables to outsource. Mary et al further describes that selective outsourcing locates selected IT functions with external providers and the vendor becomes responsible for delivering the result of the selectively outsourced IT activities, while the company remains responsible for delivering the result of the in-sourced IT activities.

Selective outsourcing of IT functions are the need of the hour because the companies are always looking out for what is best for them which leads them to practice selective outsourcing. Vendors have their specialized skill and this provides one factor which companies would like to take advantage of when outsourcing. According to Oberby (2006) selective outsourcing of IT functions is highly recommended to stay on top and concentrate on core business values. Further, he argues for labour arbitrage, cutting costs, availability of labour forces, their education, relevant experience, their skill and 'cost-versus risk equation'.

Selective outsourcing of IT functions is the most recommended option because the control on the project remains with the company. The company have the know-how of all the project and they are very much aware of the outsourced project regarding their cost and expected delivery time. Further, it is confined to an specific function rather the entire project. The risk is minimized because the in-house staff has an ability to assess and resolve the issue in the least time. Moreover, vendors are also specialized for specific level of competency.



**Figure 3.0** Three-tier Outsourcing Model

[Source: Phillip et al (2004, p.22)]

Figure 3.0 depicts a recommended distribution of outsourced work in which IT organisation holds 10% of the work in-house, 20% effort occur could occur on site and remaining 70% of the project goes off site under the vendors control. Dibbern, et al (2004) asserts that the decision of selective outsourcing of IT functions should be in a ratio of 10:90. 10% of the budget should be kept in-house where as 90% may be outsourced and this strategy may include single or multiple vendors.

Advocating in favour of selective outsourcing Miller (2006) asserts that cost is not the key business driver for them; rather its skill set that they can't replicate internally there due to time constraint and they need an outsourcer to assist them. Further, he added that exit strategy, time to respond issues, quality metrics and fees are considered while selecting the outsourcer.

### ***Full Outsourcing***

Total outsourcing transfers IT assets, leases staff and management responsibility for delivery of IT services from internal IT functions to third-party vendors. Full Outsourcing approach involves if an organization or project acquires all the products and services from external supplier or vendor. Research shows that companies engaging in total outsourcing experienced significant difficulties a few years into their contracts. Increased IT costs and poor service levels due to ill-defined contracts were the two major issues (Mary et al, 1996).

Clark-Dickson asserts that in Selective Outsourcing the company has to transfer technology and skill to the service provider but must retain a degree of in-house expertise and skills to supervise people and process (Clarke-Dickson 1998 p. 89) .

## **Process of Selective Outsourcing**

According to Marachewka (2006), the process of selective outsourcing generally encompasses four stages:

- 1) Strategic thinking to develop the organization's philosophy about the role of outsourcing in its activities;
- 2) Evaluation and selection, to decide on the appropriate outsourcing projects and potential locations for the work to be done and service providers to do it;
- 3) Contract development, to work out the legal, pricing and service level agreement (SLA) terms; and
- 4) Outsourcing management or governance, to refine the ongoing working relationship between the client and outsourcing service providers.

Outsourcing success primarily depends on three factors: executive-level support in the client organization for the outsourcing mission; ample communication to affected employees; and the client's ability to manage its service providers. The professionals responsible for outsourcing the work need a combination of skills such areas as negotiation, communication, project management, the ability to understand the terms and conditions of the contracts

and service level agreements (SLAs), and, above all, the willingness to be flexible as business needs change. Following are the stages of outsourcing:

**Deciding to outsource:** The decision to outsource is taken at strategic level by higher management to transfer the knowledge sharing with the service provider. The work breakdown of IT project is done and finally the management decides the selected project to outsource.

**Supplier shortlist:** Consequently, a list of potential service provider is compiled that are market leaders in the field of IT and delivering specified products.

**Supplier proposals:** A Request for Proposal (RFP) is issued to the shortlist service providers requesting a proposal and a price.

**Supplier competition:** The best proposal and service provider credibility is considered before selecting the service provider.

**Negotiations:** The negotiations include RFP and the supplier proposals and finally conversion of these two into the contractual agreement leading into the final pricing structure between the Client and the Supplier.

**Contract finalization:** Contract finalization is a legally binding document and is core to the governance of the relationship. It defines all the terms and conditions and service level agreements for the outsourced project.

**Transition:** The transition will begin from the effective date and normally run until four months after service commencement date.

**Ongoing service delivery:** This is the execution of the agreement and lasts for the term of the contract.

**Termination or renewal:** Termination or renewal of contract is considered before the end of the contract term and a decision is made to terminate or renew the contract. Generally, termination involves in-source or transfer of services to another supplier.

### ***Reasons for Outsourcing***

- **Cost Savings:** The prime objective of Selective outsourcing is cost-effectiveness of the module to be outsourced.
- **Cost Restructuring:** Fixed cost and variable cost is analyzed before outsourcing the project
- **Improve Quality:** The quality of the deliverable is enhanced by the service provider as their core business is IT business.
- **Knowledge:** IT Service providers have more IT knowledge than companies with different business activities.
- **Contract.** It will define and describe a legally binding contract with financial penalties and legal issues.

- Operational Expertise. Operational best practice is difficult or time consuming to develop in-house.
- Staffing Issues. The company can access large number of skilled staffs
- Capacity Management: The vendor covers the risk of providing capacity management of services and technology.
- Catalyst For Change: An organization can use vendor as a catalyst for major step change that can not be achieved alone. The vendor helps in changing the complete process.
- Reduce Time to Market: The time to market can be reduced drastically with help of vendor.
- Risk Management: Risk can be mitigate and shared with the vendor effectively.
- Time Zone. Time zone factor can be use in favor to break sequential task and can be done during normal day shift in different time zones - to make it seamlessly available 24x7.

### *Drawbacks of outsourcing*

#### Public opinion:

Outsourcing is the transfer of a function and that affects jobs and individuals, however, outsourcing brings down prices which provide greater economic benefit to all.

#### Failure to realize business value

The main business criticism of outsourcing is that it fails to deliver the business value that the service provider promised the client.

#### Language skills

Language skills are a major issue in outsourcing the project offshore. This is exacerbated when outsourcing is combined with off-shoring to regions where the first language and culture are different.

#### Social responsibility

Outsourcing of jobs particularly off-shore exploits the lower paid workers and affects the society.

#### Quality of service

Quality of service is measured through a service level agreement (SLA) in the outsourcing contract.

#### Staff turnover

The staff turnover of employee who originally transferred to the vendor is a concern for many companies. Turnover is higher under an vendor and key company skills may be lost with retention outside of the control of the company.

#### Company knowledge

Outsourcing could lead to communication problems with transferred employees. For example before transfer staff have access to broadcast company e-mail informing them of new products, procedures etc.

#### Qualifications of outsourcers

The vendor may replace staff with less qualified people or with people with different non-equivalent qualifications.

#### Security

Security is an special issue because organization is not responsible for the actions of vendors staff and not liable for their actions.

#### Fraud

Fraud is a specific security issue and is more likely when vendors are involved.

## The Value of Selective Outsourcing of IT functions

Unlike other outsourcing - like manufacturing, distribution, advertising, mail-rooms, and cafeterias – IT functions cannot be outsourced and handed to the vendor (Mary, et al 1996). Following are the issues involve with the Selective Outsourcing of IT functions.

1. IT is not homogenous but comprises a wide variety of activities.
2. IT capabilities continue to evolve at a very fast pace; thus predicting IT needs beyond three years is very difficult.
3. There is no simple basis for gauging the economics of IT activities.

According to Mary et al (1996) selective outsourcing meets customers' needs while minimizing the risks associated with total outsourcing approaches.

### *Benefits of Selective Outsourcing:*

According to research done by Kaplan (2008), following are the high level benefits achieved by the company on the process of Selective outsourcing of IT functions.

1. The ability to test satisfaction with the selective IT outsourced functions in a phased approach, expanding the scope of outsourcing increasingly to mitigate risk.
2. Identify corporate objectives and IT requirements and put more realistic performance objectives.
3. It enhances the capability to monitor the vendor's performance, further it provides an ability to identify and resolve potential problems easily and quickly leading to project success.
4. It reduces risks and costs involved while increasing business opportunities and profitability.

## Conclusion

In recent years most of the company had made a strategic decision to keep key applications in-house but want to outsource legacy IT developments. According to research and survey done by Kaplan (2008), the company now tends to terminate the mega-outsourcing deal and selectively outsource the legacy applications to vendor. In particular, they are embracing selectively outsourcing to enhance flexibility while keeping some critical and important IT development in-house. Further, selective outsourcing provides the in-house staff to adapt and learn new technology on line and assimilation. This allows a company to learn new technology with less capital investment. According to Saugatuck (2005) study, Selective outsourcing is an integral part of defining and realising competitive advantage. Rudy & Mary (2000) further asserts that selective outsourcing can achieve scalable resources, to be utilised and paid depending on the need and requirement basis adding value to the IT development.

Research shows that more companies are opting for Selective Outsourcing and are hiring different outsourcing providers for different outsourcing tasks.

The changing trend in outsourcing shows that companies are getting smarter when they plan to outsource any project.

However, in cases where outsourcing fits, proper supervision and careful attention to expectations and details can ensure that it provides a significant business advantage.

Successful experiences with IT outsourcing practices a reasoned, incremental and selective approach to IT outsourcing which is increasingly reflect the market structure.

Finally, it can be concluded that Selective Outsourcing of IT Functions is the best option as it allows a company to hold vital applications and involve key staff on emerging opportunities to learn technology enabling peak quality performance and can be termed as business strategist's best option and friend. Based on the research it can be proved that careful selection of IT functions to outsource, strictly evaluate vendors, effective and binding terms of contract and careful management of the vendor are the key issues for the success of any outsource IT function.

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