Successful Outsourcing Strategies: What and How?

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Agenda

1. Introduction
2. Part I
   2.1 Dimensions of OS Strategy
   2.2 Patterns of OS Strategy
3. Part II
   3.1 Fit between OS and Org. Strategies
   3.2 Patterns between them
4. Results
5. Conclusion
**Introduction: Outsourcing Background**

**External Factor**
- Low Growth Rate and Economy
- High Global Competition
- Rapid Change of IT
- Increased Firm's Specialty & Capa.

**Internal Factor**
- Profit Reduction
- Cost Increase
- Severe Fixed Costs
- Ineffective Management

**Organization Environment**
- Limitation of self-capability
- Finding a way to survive
- Pursuing org’al differentiation

**Necessity of Outsourcing**
- Cost Reduction
- Personnel Reduction

**Introduction: Outsourcing Objectives**

**Competitive Advantage**
- Enhance economies of scale in human resource
- Enhance economies of scale in technological resources
- Increase control of IT expenses

**Strategic Benefit**
- (17% Quality Increase)
  - Being able to refocus on core business
  - Enhance the IT competence

**Technological Benefit**
- (16% IT capability increase)
  - Reduce the risk of technological obsolescence
  - Increased access to key IT

**Economic Benefit**
- (9% Cost reduction)
  - Enhance the IT competence

**Company Value**

**Core Competency**

**Customer Value**

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Introduction: Evolution of Outsourcing

- Make or Buy
- Motivation
- Scope
- Performance
- Insourcing or Outsourcing
- Contracts
- Partnership
- Offshore

Business Outsourcing (60% of overall outsourcing)
IT Outsourcing (40% of overall outsourcing)

26% increase of outsourcing activities

Introduction: A Process Model of Outsourcing

Outsourcing Decision

Yes

Strategy Selection
Vendor Evaluation
Vendor Selection
Contract Negotiation
Implementation
Contract Mgt.

Insourcing?

Yes

Yes

Vendor Evaluation
Vendor Selection
Contract Negotiation
Performance Feedback

Change Strategy?

Yes

Yes

Vendor Selection

Change Vendor?

Yes

Yes

Recontract?

No

No

No

No

Yes (Lee and Kim, 1997)
Introduction: Lack of Guidelines (1)

- Most of managers reported an unsatisfactory outcome in real outsourcing cases. Why?
  - The complexity of outsourcing transactions because outsourcing decision involve many factors (Lacity and Hirschheim, 1993)
    - Balancing the needs of different organizational functions
    - Establishing and managing a relationship
    - Making a decision with incomplete information, etc.
  - The limited selection of models to help managers analyze outsourcing decisions and how to choose a set of outsourcing strategies (Ngwenyama and Bryson, 1999)

Introduction: Lack of Guidelines (2)

- While some firms have achieved varying degrees of outsourcing success with any of outsourcing strategies, many have encountered significant difficulties
- How do managers design an effective outsourcing strategy that is the most appropriate for their firms?
- An incorrect outsourcing decision with insufficient thought as to strategy can result in loss of competencies and capabilities, exposure to unexpected risks, and even business failures

  ➢ However, adequate guidelines for organizing effective outsourcing strategies do not exist.
Introduction: Concept and Definition (1)

- **Organizational Strategy** (Miles and Snow, 1978)
  - Determination of the basic long-term goals and objectives of an enterprise, and adoption of courses of action and the allocation of resources necessary for carrying out these goals (Chandler, 1963)

  - **Prospector Strategy**: to frequently add to and change its products and services to be the first in the market. An organization with such a strategy attempts to have innovation and flexibility to respond rapidly to changing market environment.
  - **Analyzer Strategy**: attempts to maintain a relatively stable and limited line of products and services, while selectively moving into carefully selected new areas with demonstrated promise. Organizations in this category tend to be a follower rather than a leader in the market with making the balance between cost and efficiency.
  - **Defender Strategy**: attempts to locate and maintain defined markets in a relatively stable products and services. Often this organization is not at the forefront of developments in the industry. It focuses on tight control and emphasizes operating efficiencies to lower costs.
  - **Reactor Strategy**: An organization with this strategy tends to respond in only those areas where it is forced to by environmental pressures rather than to be aggressive in maintaining existing products and markets because it essentially lacks a consistent strategy.

Introduction: Concept and Definition (2)

- **IT Outsourcing**
  - Act of subcontracting a part or all of an organization’s IS work to external vendors (Altinkemer et al., 1994)
  - Managing a firm’s IT infrastructure through … governance mechanisms with other firms (Loh and Venkatraman, 1992)

- **IT Outsourcing Strategy**
  - The logic visible in a firm’s portfolio of IT outsourcing decision (Lee et al., 2004):
  - *Not a single decision that is consciously made, but rather the manifestation of multiple decisions*
OS Strategy: Key Dimensions

- Degree of Outsourcing (total or selective)
- Period of Outsourcing (short- or long-term)
- Relationship Type (contractual or partnership)
- Number of Vendors (single or multi vendor)

Part I

OS Strategy: Degree of Outsourcing

- What are the possible candidates and suitable amount of outsourcing for our organizations?
  - Operations perspective (Ang and Straub, 1998)
  - Functional perspective (Grover, Cheon and Teng, 1996)
  - Budget perspective (Lacity, Willcock and Feeny, 1996)
  - Type of Outsourcing (Loh and Venkatraman, 1991, 1992)
Part I

**OS Strategy: Relationship Type**

- What kind of outsourcing relationship is appropriate for our organization?
  - Buy-in contract (Lacity and Willcocks, 1998)
  - Fee-for-service contract (Saunders, Gebelt and Ha, 1997)
  - Partnership (Klepper, 1994; McFarlan and Nolan, 1995)

Part I

**OS Strategy: Period of Outsourcing**

- Which one is better, long- or short-term outsourcing, for our organization?
  - A long-term contract (Klepper, 1994; McFarlan and Nolan, 1995)
    - Improves financial predictability
    - Reduces the risk and uncertainties
  - A short-term contract allows companies to (Lacity and Willcocks, 1998)
    - Adequately analyze the cost implications of outsourcing decision
    - Motivate vendor performance
    - Recover faster from mistakes
OS Strategy: Number of Vendor

Which way should we adopt, a single vendor or multi-vendor approach?

- A multi-vendor strategy (Applegate and Nomtealegre, 1991)
  - high vendor performance,
  - Low switching cost and increased bargaining power
- A single vendor strategy (Ngwenyama and Bryson, 1999)
  - Develop a strong relationship with one vendor
  - Reduce the cost for communication and coordination activities

OS Strategy: A Fit Model

- Relationship Type
  - Buy-in Contract
  - Fee-for-service
  - Partnership
- Period of Outsourcing
  - Short-term
  - Mid-term
  - Long-term
- Degree of Outsourcing
  - Total Insourcing (Minimal OS)
  - Selective Outsourcing
  - Total Outsourcing
- Number of Vendors
  - Single Vendor
  - Multiple Vendor

Outsourcing Success

The degree of achieving the strategic, economic, and technological benefits of outsourcing

# of Possible approaches

\[3 \times 3 \times 3 \times 2 = 54\]
### Part I

**Results:** Frequency of OS Patterns

<table>
<thead>
<tr>
<th>Strategy Dimension</th>
<th>All Patterns of Outsourcing Strategies (Mean; SD); n=311</th>
<th>Minor Patterns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1st Pattern (Independent)</td>
<td></td>
</tr>
<tr>
<td>Degree of Outsourcing</td>
<td>Total insourcing (8.13; 3.32)</td>
<td></td>
</tr>
<tr>
<td>Relationship Type</td>
<td>Buy-in contract</td>
<td></td>
</tr>
<tr>
<td>Period of Outsourcing</td>
<td>Short-term (1.91; 0.85)</td>
<td></td>
</tr>
<tr>
<td>Number of Vendors</td>
<td>Single (1.00; 0.00)</td>
<td></td>
</tr>
</tbody>
</table>

|                    | 2nd Pattern (Transition)                      |               |
| Degree of Outsourcing | Selective Outsourcing (45.14; 14.25)          |               |
| Relationship Type  | Fee-for-Service                               |               |
| Period of Outsourcing | Medium-term (4.44; 0.84)                     |               |
| Number of Vendors  | Single (1.00; 0.00)                            |               |

|                    | 3rd Pattern (Arm’s-length)                    |               |
| Degree of Outsourcing | Selective Outsourcing (65.21; 13.08)          |               |
| Relationship Type  | Fee-for-Service                               |               |
| Period of Outsourcing | Medium-term (4.98; 0.93)                     |               |
| Number of Vendors  | Multiple (2.50; 0.58)                          |               |

|                    | 4th Pattern (Embedded)                        |               |
| Degree of Outsourcing | Total Outsourcing (83.08; 5.45)              |               |
| Relationship Type  | Partnership                                    |               |
| Period of Outsourcing | Long-term (7.79; 1.95)                      |               |
| Number of Vendors  | Single (1.00; 0.00)                            |               |

|                    | 5th Pattern (Network)                         |               |
| Degree of Outsourcing | Total outsourcing (92.90; 5.77)              |               |
| Relationship Type  | Partnership                                    |               |
| Period of Outsourcing | Long-term (8.39; 1.95)                      |               |
| Number of Vendors  | Multiple (2.57; 0.64)                          |               |

**Others (14 types)**

**Minor Patterns**

<table>
<thead>
<tr>
<th>Variable</th>
<th>1 (n=16)</th>
<th>2 (n=9)</th>
<th>3 (n=3)</th>
<th>4 (n=6)</th>
<th>5 (n=3)</th>
<th>6 (n=1)</th>
<th>7 (n=1)</th>
<th>8 (n=2)</th>
<th>9 (n=1)</th>
<th>10 (n=2)</th>
<th>11 (n=6)</th>
<th>12 (n=4)</th>
<th>13 (n=2)</th>
<th>14 (n=4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree of Outsourcing</td>
<td>Selective outsourcing</td>
<td>Selective outsourcing</td>
<td>Selective outsourcing</td>
<td>Selective outsourcing</td>
<td>Selective outsourcing</td>
<td>Selective outsourcing</td>
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</tr>
<tr>
<td>Relationship Type</td>
<td>Buy-in contract</td>
<td>Buy-in contract</td>
<td>Buy-in contract</td>
<td>Fee-for-service</td>
<td>Partnership</td>
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<td>Partnership</td>
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<td>Fee-for-service</td>
<td>Fee-for-service</td>
<td>Fee-for-service</td>
<td>Fee-for-service</td>
<td>Partnership</td>
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</tr>
<tr>
<td>Number of Vendors</td>
<td>Single vendor</td>
<td>Single vendor</td>
<td>Multiple vendors</td>
<td>Single vendor</td>
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<td>Single vendor</td>
<td>Single vendor</td>
<td>Multiple vendors</td>
<td>Single vendor</td>
<td>Multiple vendors</td>
<td>Single vendor</td>
<td>Multiple vendors</td>
</tr>
</tbody>
</table>
### Results: OS Performance of Each Pattern

#### Variables (Alpha=0.946)

<table>
<thead>
<tr>
<th></th>
<th>All Patterns: Mean (S.D)</th>
<th>Minor Patterns (n=61)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dominant Patterns</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pattern 1 (n=47)</td>
<td>Pattern 2 (n=63)</td>
</tr>
<tr>
<td>OS Success</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Focus on core bus.</td>
<td>4.46 (0.80)</td>
<td>4.73 (0.99)</td>
</tr>
<tr>
<td>IT competence</td>
<td>4.47 (0.86)</td>
<td>4.92 (0.97)</td>
</tr>
<tr>
<td>Skilled personnel</td>
<td>4.40 (0.77)</td>
<td>4.87 (0.94)</td>
</tr>
<tr>
<td>Economies of scale in HR</td>
<td>4.62 (0.79)</td>
<td>4.81 (1.01)</td>
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<tr>
<td>Economies of scale in TR</td>
<td>4.47 (0.72)</td>
<td>5.09 (0.89)</td>
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<tr>
<td>Control of IT expenses</td>
<td>4.42 (0.90)</td>
<td>5.14 (0.84)</td>
</tr>
<tr>
<td>Avoidance of obsolescence risk</td>
<td>4.53 (0.74)</td>
<td>4.84 (0.99)</td>
</tr>
<tr>
<td>Access to key IT</td>
<td>4.55 (0.90)</td>
<td>4.78 (1.02)</td>
</tr>
<tr>
<td>Overall satisfaction</td>
<td>4.47 (0.78)</td>
<td>4.74 (0.98)</td>
</tr>
<tr>
<td>Overall OS Success</td>
<td>4.49 (0.71)</td>
<td>4.88 (0.84)</td>
</tr>
</tbody>
</table>

#### Summary: A Contingency Model

**Part I**

**Strategic Economic Technological**

- **Arm's-length** (Transaction Cost)
  - M(EC)=5.18; M(SC)=5.10; M(TK)=5.00

- **Transition**
  - M(EC)=5.02; M(SC)=4.84; M(TK)=4.81

- **Independent** (Resource-dependency)
  - M(EC)=4.50; M(SC)=4.45; M(TK)=4.54

- **Network** (Social Networks/ Resource-based)
  - M(EC)=5.08; M(SC)=5.19; M(TK)=5.12

- **Embedded** (Social Networks)
  - M(EC)=5.06; M(SC)=5.10; M(TK)=5.04
Part II

OS & Org. Strategies: A Fit Model

Outsourcing Strategy

Organization Strategy

Independent
Arms-length
Embedded
Extended

Defender
Prospector
Analyzer
Reactor

Fit

Organization Performance

# of Possible approaches
= 4*4 = 16

The amount of sales growth between 2002 and 2003

Part II

Results: Cross-tabulation

<table>
<thead>
<tr>
<th>Organization Strategy</th>
<th>Outsourcing Strategies (Number; Percent); n=150</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Independent (1)</td>
</tr>
<tr>
<td>Defender (1)</td>
<td>28 (18.7%)</td>
</tr>
<tr>
<td>Prospector (2)</td>
<td>18 (12%)</td>
</tr>
<tr>
<td>Analyzer (3)</td>
<td>12 (8.0%)</td>
</tr>
<tr>
<td>Reactor (4)</td>
<td>4 (2.7%)</td>
</tr>
<tr>
<td>Total</td>
<td>62 (41.3%)</td>
</tr>
</tbody>
</table>
Part II

Results: Sales Growth of Each Pattern

<table>
<thead>
<tr>
<th>Organization Strategy</th>
<th>Outsourcing Strategies (Million Won)</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Independent (1)</td>
<td></td>
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<tr>
<td>Defender (1)</td>
<td>14,369</td>
<td>9,445</td>
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<tr>
<td></td>
<td>Arm’s-length (2)</td>
<td>21,964</td>
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<td></td>
<td>Embedded (3)</td>
<td>-14,010</td>
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<td></td>
<td>Network (4)</td>
<td>15,457</td>
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<tr>
<td></td>
<td>Mean</td>
<td>15,483</td>
</tr>
<tr>
<td></td>
<td>Top Best Five:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Top Worst Five:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Prospector (2)</td>
<td>30,855</td>
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<tr>
<td></td>
<td>30,762</td>
<td>50,138</td>
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<td>107,246</td>
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<td></td>
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<td>126,910</td>
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<tr>
<td></td>
<td>Mean</td>
<td>15,483</td>
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</tbody>
</table>

Summary: A Contingency Model

- Economic Control
  - Low: Transition
  - High: Arm’s-length

- Strategic Competency and Technical Knowledge
  - Low: Prospector
  - High: Network

- Transition
  - Defender / Prospector
  - Defender / Prospector
  - Independent (Resource-dependency)
  - Embedded (Social Networks)
Conclusion: Discussions

- Pattern five in OS strategy exhibits the highest achievement?
  - Total outsourcing, partnership, long-term and multi-vendors
  - Inconsistent with a recent study (Lacity and Willcocks, 1998)
    - Selective, short-term, and fee-for-service contract decisions achieved expected cost saving than other types of outsourcing strategies
  - The divergent result in findings may be caused by different perspective

- However, it depends on organizational strategy
  - Defender: arm’s length, network strategies
  - Prospector: embedded, independent strategies
  - Analyzer: embedded strategy
  - Reactor: arm’s length strategy

Conclusion: Implications

- Organizations should adopt an integrated outsourcing approach with their basic organizational directions to have the distinctive outcomes
- The results provide meaningful guidelines or directions for organizations that are considering outsourcing as an effective outsourcing strategic decision model
- Effective combinations between outsourcing strategy and organizational strategy provide organizations with a benchmark against which they can compare their own combinations
Thank You!

Question & Answer