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Business risk perspectives on information systems outsourcing

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Abstract

Information systems (IS) outsourcing research has continued to evolve over the past decade to reflect changes in its practice and a deeper understanding of its business impact. Typically, the drivers of outsourcing decisions are both internal and external to the outsourcing organization and have been the basis for such studies. Since IS essentially represents an organization's implementation of its business processes, this paper approaches IS outsourcing by explicitly integrating issues related to business process outsourcing. The resulting business risk management framework provides a basis for effective IS outsourcing. The framework is further discussed within the context of outsourcing in e-business. By adopting a risk management perspective, this paper provides a strategic direction to further the field of IS outsourcing research.

Keywords: Business risk perspective; Information systems outsourcing; Four-S outsourcing model; Reengineering-outsourcing decision matrix

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1. Introduction

Lehman Brothers and Goldman Sachs expect business process outsourcing to grow to $500 Billion by 2004 (Spagat, 2001). In a March 2001 report, Goldman Sachs called business process outsourcing "the next big wave" in information technology services (Spagat, 2001). Companies that focus on providing business process outsourcing services include the likes of International Business Machines (IBM), Electronic Data Systems, Computer Sciences Corporation, and a fledgling unit of PricewaterhouseCoopers, that is the smallest but fastest growing of that firm's six business lines[3] (Spagat, 2001). The projected growth and "blue-blood" corporate involvement in business process outsourcing, therefore, are indicative of the high relevance of the issue in the current economic environment.

Despite the recent focus on business process outsourcing in the popular press, identifying the most compatible fit between Information Systems (IS) functions and organizational goals has been a critical IS management issue since the mid-1980s (Brancheau and Wetherbe, 1987; Dixon and John, 1989; Niederman et al., 1991; Watson and Brancheau, 1991; Brown and Magill, 1994). Research interest in IS outsourcing as one of the elements in the larger quest for IS and organizational alignment can be traced back to 1989. That year marked Kodak's landmark shifting of its responsibility for a significant portion of its IS to IBM and other vendors (Smith et al., 1998). Kodak's new paradigm for IS and organizational alignment also ushered in a body of research that continues to explore the organizational implications of the outsourcing of erstwhile intraorganizational IS functions.

Prior studies on IS outsourcing have examined managers' and investors' perceptions of outsourcing, what companies typically choose to outsource, and what constitutes good outsourcing practice (Smith et al., 1998; Arnett and Jones, 1994; Lacity and Hirschheim, 1993; McFarlan and Nolan, 1995). Some studies have analyzed specific IS outsourcing cases (Cross, 1995; Huber, 1993), while others have used publicly available data, such as IS outsourcing announcements in the *Wall Street Journal* or financial data from the *Center for Research in Securities Pricing* (*CRSP*) and *Compustat* (Smith et al., 1998). Some work has indicated that the IS outsourcing decision is motivated more by internal influence (or imitative behavior) than by external influence (Loh and Venkatraman, 1992a,b), while others have pointed to a mixture of internal and external influences (Saunders et al., 1997).

Prior research suggests several reasons for firms outsourcing their IS. These key drivers include financial reasons such as reducing costs, generating cash, and replacing capital outlays with periodic payments. Firms also outsource their IS in order to simplify their management agenda and to renew focus on their core competencies in the organizational value chain. Technical reasons for outsourcing, such as improving the quality of IS, gaining access to new talent and technology, and the easy availability of vendors with expertise and economies of scale have also been proposed. Political reasons for outsourcing include dissatisfaction with the IS department, dissatisfaction with the chief information officer,

[3] PWC Consulting is now a division of IBM.